LANNETT CO INC
Form 10-Q
November 09, 2012
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2012

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM TO .

Commission File No. 001-31298

LANNETT COMPANY, INC.

(Exact Name of Registrant as Specified in its Charter)

State of Delaware	**23-0787699**
(State of Incorporation)	(I.R.S. Employer I.D. No.)

9000 State Road

Philadelphia, PA 19136

(215) 333-9000

(Address of principal executive offices and telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12B-12 of the Exchange Act). Yes x No o

Indicate the number of shares outstanding of each class of the registrant s common stock, as of the latest practical date.

Class	**Outstanding as of October 31, 2012**
Common stock, par value $0.001 per share	28,353,317 shares

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

LANNETT COMPANY, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

(In thousands, except share and per share data)		(Unaudited) September 30, 2012		June 30, 2012
ASSETS				
Current Assets				
Cash and cash equivalents	$	26,361	$	22,562
Investment securities		5,010		6,667
Trade accounts receivable (net of allowance of $173 and $124, respectively)		42,057		42,212
Inventories, net		27,606		27,064
Income taxes receivable				2,120
Deferred tax assets		4,914		4,833
Other current assets		2,083		1,023
Total Current Assets		108,031		106,481
Property, plant and equipment, net		36,811		37,068
Intangible assets, net		3,958		4,429
Deferred tax assets		8,853		9,069
Other assets		1,167		1,171
TOTAL ASSETS	$	158,820	$	158,218
LIABILITIES				
Current Liabilities				
Accounts payable	$	12,640	$	17,989
Accrued expenses		1,899		1,518
Accrued payroll and payroll related		2,338		3,198
Income taxes payable		1,679		
Current portion of long-term debt		651		648
Rebates, chargebacks and returns payable		18,313		17,039
Total Current Liabilities		37,520		40,392
Long-term debt, less current portion		6,385		6,513
TOTAL LIABILITIES		43,905		46,905
Commitment and Contingencies, See notes 13 and 14				
SHAREHOLDERS EQUITY				
Common stock - authorized 50,000,000 shares, par value $0.001; issued 28,707,574 and 28,594,437 shares, respectively; outstanding, 28,297,233 and 28,252,192 shares, respectively		29		29
Additional paid-in capital		100,467		99,515
Retained earnings		16,162		13,236
Accumulated other comprehensive (loss)		(22)		(63)

Treasury stock at cost 410,341 and 342,245 shares, respectively		(1,928)		(1,594)
Total Shareholders Equity Attributable to Lannett Company, Inc.		114,708		111,123
Noncontrolling Interest		207		190
TOTAL SHAREHOLDERS EQUITY		114,915		111,313
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$	158,820	$	158,218

The accompanying notes to the consolidated financial statements are an integral part of these statements.

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LANNETT COMPANY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS

(UNAUDITED)

(In thousands, except share and per share data)	**Three months ended September 30, 2012**	**2011**
Net sales	$ 35,294	$ 28,878
Cost of sales	21,164	19,742
Amortization of intangible assets	471	468
Product royalties	33	52
Gross Profit	13,626	8,616
Research and development expenses	3,764	2,426
Selling, general, and administrative expenses	6,171	4,745
Operating Income	3,691	1,445
Other income (expense):		
Foreign currency gain	3	5
Gain on sale of assets	70	7
Realized loss on investments	(36)	(173)
Unrealized gain (loss) on investments	270	(826)
Litigation settlement	1,250	
Interest and dividend income	35	53
Interest expense	(63)	(77)
	1,529	(1,011)
Income before income tax expense	5,220	434
Income tax expense	2,277	212
Net Income	2,943	222
Less net income attributable to noncontrolling interest	(17)	(16)
Net Income attributable to Lannett Company, Inc.	$ 2,926	$ 206
Basic earnings per common share - Lannett Company, Inc.	$ 0.10	$ 0.01
Diluted earnings per common share - Lannett Company, Inc.	$ 0.10	$ 0.01
Basic weighted average number of shares outstanding	28,278,514	28,431,733
Diluted weighted average number of shares outstanding	28,469,224	28,686,644

The accompanying notes to the consolidated financial statements are an integral part of these statements.

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LANNETT COMPANY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(UNAUDITED)

(In thousands)	**Three months ended September 30, 2012**	**2011**
Net Income	$ 2,943	$ 222
Foreign currency translation adjustments	41	(3)
Unrealized holding loss on securities		(1)
Tax effect		1
Total Other Comprehensive Income (Loss), net of tax	41	(3)
Comprehensive Income	2,984	219
Less: Total Comprehensive Income attributable to noncontrolling interest	(17)	(16)
Comprehensive Income attributable to Lannett Company Inc.	$ 2,967	$ 203

The accompanying notes to the consolidated financial statements are an integral part of these statements.

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LANNETT COMPANY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY

(UNAUDITED)

	Shareholders Equity Attributable to Lannett Company, Inc.								
	Common Stock								
(In thousands)	**Shares Issued**	**Amount**	**Additional Paid-In Capital**	**Retained Earnings**	**Accumulated Other Comprehensive Loss**	**Treasury Stock**	**Shareholders Equity Attributable to Lannett Co., Inc.**	**Noncontrolling Interest**	**Total Shareholders Equity**
Balance, July 1, 2012	28,594	$ 29	$ 99,515	$ 13,236	$ (63)	$ (1,594)	$ 111,123	$ 190	$ 111,313
Shares issued in connection with share-based compensation plans	114		296				296		296
Share-based compensation			656				656		656
Purchase of treasury stock						(334)	(334)		(334)
Other comprehensive income, net of income tax					41		41		41
Net income				2,926			2,926	17	2,943
Balance, September 30, 2012	28,708	$ 29	$ 100,467	$ 16,162	$ (22)	$ (1,928)	$ 114,708	$ 207	$ 114,915

The accompanying notes to the consolidated financial statements are an integral part of these statements.

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LANNETT COMPANY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

(UNAUDITED)

(In thousands)	**Three months ended September 30, 2012**	**2011**
OPERATING ACTIVITIES:		
Net income	$ 2,943	$ 222
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,549	1,418
Deferred tax expense	135	315
Share-based compensation expense	656	671
Gain on sale of assets	(70)	(7)
Realized loss on investments	36	173
Unrealized (gain) loss on investments	(270)	826
Gain on litigation settlement	(1,250)	
Proceeds from litigation settlement	450	
Other noncash expenses	3	4
Changes in assets and liabilities which provided (used) cash:		
Trade accounts receivable	155	(1,172)
Inventories	(542)	428
Income taxes receivable / payable	3,799	(103)
Prepaid expenses and other assets	(260)	(712)
Accounts payable	(5,349)	(3,040)
Accrued expenses	381	(227)
Rebates, chargebacks and returns payable	1,274	786
Accrued payroll and payroll related	(860)	270
Net cash provided by (used in) operating activities	2,780	(148)
INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(821)	(726)
Proceeds from sale of property, plant and equipment	70	7
Proceeds from sale of investment securities	4,808	15,802
Purchase of investment securities	(2,916)	(4,284)
Net cash provided by investing activities	1,141	10,799
FINANCING ACTIVITIES:		
Repayments of debt	(125)	(123)
Proceeds from issuance of stock	296	54
Purchase of treasury stock	(334)	(337)
Proceeds from line of credit		2,000
Net cash provided by (used in) financing activities	(163)	1,594
Effect of foreign currency rates on cash and cash equivalents	41	(3)
NET INCREASE IN CASH AND CASH EQUIVALENTS	3,799	12,242
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	22,562	5,277

CASH AND CASH EQUIVALENTS, END OF PERIOD	$	26,361	$	17,519
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION -				
Interest paid	$	76	$	77
Income taxes paid (refunded)	$	(1,657)	$	

The accompanying notes to the consolidated financial statements are an integral part of these statements.

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LANNETT COMPANY, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED

(In thousands, unless otherwise noted and per share data)

Note 1. Interim Financial Information

The accompanying unaudited financial statements have been prepared in accordance with U.S. generally accepted accounting principles for presentation of interim financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, the unaudited financial statements do not include all the information and footnotes necessary for a comprehensive presentation of the financial position, results of operations, and cash flows for the periods presented. In the opinion of management, the unaudited financial statements include all the normal recurring adjustments that are necessary for a fair presentation of the financial position, results of operations, and cash flows for the periods presented. Operating results for the three months ended September 30, 2012 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2013. You should read these unaudited financial statements in combination with the other Notes in this section; Management s Discussion and Analysis of Financial Condition and Results of Operations appearing in Item 2; and the Financial Statements, including the Notes to the Financial Statements, included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2012.

Note 2. Summary of Significant Accounting Policies

Lannett Company, Inc., a Delaware corporation, and subsidiaries (the Company or Lannett), develop, manufacture, package, market, and distribute finished dosage forms of drugs as well as manufacture active pharmaceutical ingredients. The Company manufactures solid oral dosage forms, including tablets and capsules, topical and oral solutions, and is pursuing partnerships and research contracts for the development and production of other dosage forms, including ophthalmic, nasal and injectable products.

The Company is engaged in an industry which is subject to considerable government regulation related to the development, manufacturing and marketing of pharmaceutical products. In the normal course of business, the Company periodically responds to inquiries or engages in administrative and judicial proceedings involving regulatory authorities, particularly the Food and Drug Administration (FDA) and the Drug Enforcement Agency (DEA).

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Principles of Consolidation - The consolidated financial statements include the accounts of the operating parent company, Lannett Company, Inc., and its wholly owned subsidiaries, as well as the consolidation of Cody LCI Realty, LLC, a variable interest entity. See Note 12 regarding the consolidation of this variable interest entity. All intercompany accounts and transactions have been eliminated.

Foreign Currency Translation - The local currency is the functional currency of the Company s foreign subsidiary. Assets and liabilities of the foreign subsidiary are translated into U.S. dollars at the period-end currency exchange rate and revenues and expenses are translated at an average currency exchange rate for the period. The resulting translation adjustment is recorded in a separate component of shareholders equity and changes to such are included in comprehensive income. Exchange adjustments resulting from transactions denominated in foreign currencies are recognized in the consolidated statements of operations.

Reclassifications Certain prior year amounts have been reclassified to conform to the current year financial statement presentation.

Revenue Recognition - The Company recognizes revenue when its products are shipped. At this point, title and risk of loss have transferred to the customer and provisions for estimates, including rebates, promotional adjustments, price adjustments, returns, chargebacks, and other potential adjustments are reasonably determinable. Accruals for these provisions are presented in the consolidated financial statements as rebates, chargebacks and returns payable and reductions to net sales. The change in the reserves for various sales adjustments may not be proportionally equal to the change in sales because of changes in both the product and the customer mix. Increased sales to wholesalers will generally require additional accruals as they are the primary recipient of chargebacks and rebates. Incentives offered to secure sales vary from product to product. Provisions for estimated rebates and promotional credits are estimated based upon contractual terms. Provisions for other customer credits, such as price adjustments, returns, and chargebacks, require management to make subjective judgments on customer mix. Unlike branded innovator drug companies, Lannett does not use information about product levels in distribution channels from third-party sources, such as IMS and

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Wolters Kluwer, in estimating future returns and other credits. Lannett calculates a chargeback/rebate rate based on contractual terms with its customers and applies this rate to customer sales. The only variable is customer mix, and this assumption is based on historical data and sales expectations.

Chargebacks The provision for chargebacks is the most significant and complex estimate used in the recognition of revenue. The Company sells its products directly to wholesale distributors, generic distributors, retail pharmacy chains, and mail-order pharmacies. The Company also sells its products indirectly to independent pharmacies, managed care organizations, hospitals, nursing homes, and group purchasing organizations, collectively referred to as indirect customers. Lannett enters into agreements with its indirect customers to establish pricing for certain products. The indirect customers then independently select a wholesaler from which to actually purchase the products at these agreed-upon prices. Lannett will provide credit to the wholesaler for the difference between the agreed-upon price with the indirect customer and the wholesaler s invoice price if the price sold to the indirect customer is lower than the direct price to the wholesaler. This credit is called a chargeback. The provision for chargebacks is based on expected sell-through levels by the Company s wholesale customers to the indirect customers and estimated wholesaler inventory levels. As sales to the large wholesale customers, such as Cardinal Health, AmerisourceBergen, and McKesson increase, the reserve for chargebacks will also generally increase. However, the size of the increase depends on the product mix and the amount of those sales that end up at indirect customers with which the Company has specific chargeback agreements. The Company continually monitors the reserve for chargebacks and makes adjustments when management believes that expected chargebacks on actual sales may differ from actual chargeback reserves.

Rebates Rebates are offered to the Company s key chain drug store, distributor and wholesaler customers to promote customer loyalty and increase product sales. These rebate programs provide customers with rebate credits upon attainment of pre-established volumes or attainment of net sales milestones for a specified period. Other promotional programs are incentive programs offered to the customers. As a result of the Patient Protection and Affordable Care Act (PPACA) enacted in the U.S. in March 2010, the Company participates in a new cost sharing program for certain Medicare Part D beneficiaries designed primarily for the sale of brand drugs and certain generic drugs if their FDA approval was granted under a New Drug Application (NDA) or 505(b) NDA versus an Abbreviated New Drug Application (ANDA). Because our drugs used for the treatment of thyroid deficiency and our Morphine Sulfate Oral Solution product were approved by the FDA as a 505(b)(2) NDA, they are considered branded drugs for purposes of the PPACA. Drugs purchased under this program during Medicare Part D coverage gap (commonly referred to as the donut hole) result in additional rebates. At the time of shipment, the Company estimates reserves for rebates and other promotional credit programs based on the specific terms in each agreement. The reserve for rebates increases as sales to certain wholesale and retail customers increase. However, since these rebate programs are not identical for all customers, the size of the reserve will depend on the mix of customers that are eligible to receive rebates.

Returns Consistent with industry practice, the Company has a product returns policy that allows customers to return product within a specified period prior to and subsequent to the product s lot expiration date in exchange for a credit to be applied to future purchases. The Company s policy requires that the customer obtain pre-approval from the Company for any qualifying return. The Company estimates its provision for returns based on historical experience, changes to business practices, and credit terms. While such experience has allowed for reasonable estimations in the past, history may not always be an accurate indicator of future returns. The Company continually monitors the provisions for returns and makes adjustments when management believes that actual product returns may differ from established reserves. Generally, the reserve for returns increases as net sales increase. The reserve for returns is included in the rebates, chargebacks and returns payable account on the balance sheet.

Other Adjustments Other adjustments consist primarily of price adjustments, also known as shelf stock adjustments, which are credits issued to reflect decreases in the selling prices of the Company s products that customers have remaining in their inventories at the time of the price reduction. Decreases in selling prices are discretionary decisions made by management to reflect competitive market conditions. Amounts recorded for estimated shelf stock adjustments are based upon specified terms with direct customers, estimated declines in market prices, and estimates of inventory held by customers. The Company regularly monitors these and other factors and evaluates the reserve as additional information becomes available. Other adjustments are included in the rebates, chargebacks and returns payable account on the balance sheet.

The following tables identify the reserves for each major category of revenue allowance and a summary of the activity for the three months ended September 30, 2012 and 2011:

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For the three months ended September 30, 2012

(In thousands) Reserve Category	Chargebacks	Rebates	Returns	Other	Total
Reserve Balance as of July 1, 2012	$ 7,063	$ 4,436	$ 5,540	$	$ 17,039
Actual credits issued related to sales recorded in prior fiscal years	(6,504)	(3,743)	(875)	(55)	(11,177)
Reserves or (reversals) charged during Fiscal 2013 related to sales in prior fiscal years	(372)	105		55	(212)
Reserves charged to net sales during Fiscal 2013 related to sales recorded in Fiscal 2013	19,350	5,675	1,405	139	26,569
Actual credits issued related to sales recorded in Fiscal 2013	(11,490)	(2,277)		(139)	(13,906)
Reserve Balance as of September 30, 2012	$ 8,047	$ 4,196	$ 6,070	$	$ 18,313

For the three months ended September 30, 2011

(In thousands) Reserve Category	Chargebacks	Rebates	Returns	Other	Total
Reserve Balance as of July 1, 2011	$ 5,497	$ 2,925	$ 5,142	$	$ 13,564
Actual credits issued related to sales recorded in prior fiscal years	(5,262)	(2,686)	(1,412)	(92)	(9,452)
Reserves or (reversals) charged during Fiscal 2012 related to sales in prior fiscal years	(36)	72		92	128
Reserves charged to net sales during Fiscal 2012 related to sales recorded in Fiscal 2012	17,477	4,358	1,337	202	23,374
Actual credits issued related to sales recorded in Fiscal 2012	(11,119)	(1,943)		(202)	(13,264)
Reserve Balance as of September 30, 2011	$ 6,557	$ 2,726	$ 5,067	$	$ 14,350

Reserve Activity September 30, 2012 vs. June 30, 2012

The following tables compare the reserve balances at September 30, 2012 and June 30, 2012:

(In thousands)	September 30, 2012	%	June 30, 2012	%
Chargeback reserve	$ 8,047	44%	$ 7,063	41%
Rebate reserve	4,196	23%	4,436	26%
Return reserve	6,070	33%	5,540	33%
Other reserve		%		%
	$ 18,313	100%	$ 17,039	100%

The total reserve for chargebacks, rebates, returns and other adjustments increased from $17,039 at June 30, 2012 to $18,313 at September 30, 2012. The increase in chargeback reserves is due primarily to an increase in inventory levels at wholesale distribution

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centers as a result of increased gross sales during the first three months of Fiscal 2013 as compared to Fiscal 2012. The activity in the Other category for the quarter ended September 30, 2012 includes shelf-stock, shipping and other sales adjustments.

The Company ships its products to the warehouses of its wholesale and retail chain customers. When the Company and a customer enter into an agreement for the supply of a product, the customer will generally continue to purchase the product, stock its warehouse (s), and resell the product to its own customers. The Company s customer will reorder the product as its warehouse is depleted. The Company generally has no minimum size orders for its customers. Additionally, most warehousing customers prefer not to stock excess inventory levels due to the additional carrying costs and inefficiencies created by holding excess inventory. As such, the Company s customers continually reorder the Company s products. It is common for the Company s customers to order the same products on a monthly basis. For generic pharmaceutical manufacturers, it is critical to ensure that customers warehouses are adequately stocked with its products. This is important due to the fact that multiple generic competitors may compete for the consumer demand for a given product. Availability of inventory ensures that a manufacturer s product is considered. Otherwise, retail prescriptions would be filled with competitors products. For this reason, the Company periodically offers incentives to its customers to purchase its products. These incentives are generally up-front discounts off its standard prices at the beginning of a generic campaign launch for a newly-approved or newly-introduced product, or when a customer purchases a Lannett product for the first time. Customers generally inform the Company that such purchases represent an estimate of expected resale for a period of time. This period of time is generally up to three months. The Company records this revenue, net of any discounts offered and accepted by its customers at the time of shipment. The Company s products generally have either 24 months or 36 months of shelf-life at the time of manufacture. The Company monitors its customers purchasing trends to attempt to identify any significant lapses in purchasing activity. If the Company observes a lack of recent activity, inquiries will be made to such customer regarding the success of the customer s resale efforts. The Company attempts to minimize any potential return (or shelf life issues) by maintaining an active dialogue with the customers.

The products that the Company sells are generic versions of brand named drugs. The consumer markets for such drugs are well-established markets with many years of historically-confirmed consumer demand. Such consumer demand may be affected by several factors, including alternative treatments and costs, etc. However, the effects of changes in such consumer demand for the Company s products, like generic products manufactured by other generic companies, are gradual in nature. Any overall decrease in consumer demand for generic products generally occurs over an extended period of time. This is because there are thousands of doctors, prescribers, third-party payers, institutional formularies and other buyers of drugs that must change prescribing habits and medicinal practices before such a decrease would affect a generic drug market. If the historical data the Company uses and the assumptions management makes to calculate its estimates of future returns, chargebacks, and other credits do not accurately approximate future activity, its net sales, gross profit, net income and earnings per share could change. However, management believes that these estimates are reasonable based upon historical experience and current conditions.

Cash and cash equivalents The Company considers all highly liquid securities purchased with original maturities of 90 days or less to be cash equivalents. Cash equivalents are stated at cost, which approximates market value, and consist of certificates of deposit that are readily converted to cash. The Company maintains cash and cash equivalents with several major financial institutions.

Accounts Receivable - The Company performs ongoing credit evaluations of its customers and adjusts credit limits based upon payment history and the customer s current credit worthiness, as determined by a review of current credit information. The Company continuously monitors collections and payments from its customers and maintains a provision for estimated credit losses based upon historical experience and any specific customer collection issues that have been identified. While such credit losses have historically been within both the Company s expectations and the provisions established, the Company cannot guarantee that it will continue to experience the same credit loss rates that it has in the past.

Inventories - The Company values its inventory at the lower of cost (determined by the first-in, first-out method) or market, regularly reviews inventory quantities on hand, and records a provision for excess and obsolete inventory based primarily on estimated forecasts of product demand and production requirements. The Company s estimates of future product demand may fluctuate, in which case estimated required reserves for excess and obsolete inventory may increase or decrease. If the Company s inventory is determined to be overvalued, the Company reduces the inventory value and recognizes such costs in cost of goods sold at the time of such determination. Likewise, if inventory is determined to be undervalued, the Company may have recognized excess cost of goods sold in previous periods and would recognize such additional operating income at the time of sale.

Property, Plant and Equipment - Property, plant and equipment are stated at cost. Depreciation is provided for by the straight-line method for financial reporting purposes over the estimated useful lives of the assets. Depreciation expense for the three months ended September 30, 2012 and 2011 was $1,078 and $950, respectively.

Investment Securities The Company s investment securities consist of equity securities. The Company s equity securities are classified as trading. Investment securities are recorded at fair value based on quoted market prices. For trading investments, unrealized holding gains and losses are recorded on the consolidated statements of operations. No gains or losses on investment

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securities are realized until they are sold or a decline in fair value is determined to be other-than-temporary. The Company reviews its investment securities and determines whether the investments are other-than-temporarily impaired. If the investments are deemed to be other-than-temporarily impaired, the investments are written down to their then current fair market value with a new cost basis being established. There were no securities determined by management to be other-than-temporarily impaired during the three months ended September 30, 2012 or the fiscal year ended June 30, 2012.

Shipping and Handling Costs The cost of shipping products to customers is recognized at the time the products are shipped, and is included in cost of sales.

Research and Development Research and development costs are charged to expense as incurred.

Intangible Assets Indefinite-lived intangible assets are tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. Definite-lived intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. Definite-lived intangible assets are amortized over the estimated useful lives, generally for periods ranging from 10 to 15 years. The Company continually evaluates the reasonableness of the useful lives of these assets.

Impairments An impairment loss is measured as the excess of the asset s carrying value over its fair value, calculated using a discounted future cash flow method. Our discounted cash flow models are highly reliant on various assumptions which are considered level 3 inputs, including estimates of future cash flow (including long-term growth rates), discount rate, and expectations about variations in the amount and timing of cash flows and the probability of achieving the estimated cash flows.

Advertising Costs - The Company charges advertising costs to operations as incurred. Advertising expense for the three months ended September 30, 2012 and 2011 was $2 and $15, respectively.

Income Taxes - The Company uses the liability method to account for income taxes. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities as measured by the enacted tax rates which will be in effect when these differences reverse. Deferred tax expense/(benefit) is the result of changes in deferred tax assets and liabilities. The Company may recognize the tax benefit from an uncertain tax position claimed on a tax return only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The authoritative standards issued by the FASB also provide guidance on de-recognition, classification, interest and penalties on income taxes, accounting in interim periods and requires increased disclosures. The factors used to assess the likelihood of realization are the Company s forecast of future taxable income and available tax planning strategies that could be implemented to realize the net deferred tax assets. Failure to achieve forecasted taxable income in applicable tax jurisdictions could affect the ultimate realization of deferred tax assets and could result in an increase in the Company s effective tax rate on future earnings.

Segment Information The Company operates one business segment - generic pharmaceuticals; accordingly the Company has one reporting segment. The Company aggregates its financial information for all products and reports as one operating segment. The following table identifies the Company s approximate net product sales by medical indication for the three months ended September 30, 2012 and 2011:

(In thousands)	**For the Three Months Ended September 30,**	
Medical Indication	**2012**	**2011**
Migraine Headache	$ 1,249	$ 1,612
Glaucoma	1,373	1,032
Gallstone Prevention	1,578	1,300
Cardiovascular	7,100	2,510
Thyroid Deficiency	13,637	13,034
Antibiotic	1,689	1,679
Pain Management	5,532	5,310
Obesity	1,310	547
Other	1,826	1,854
Total	$ 35,294	$ 28,878

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Concentration of Market and Credit Risk The following table identifies certain of the Company s products, defined as generics containing the same active ingredient or combination of ingredients, which accounted for greater than 10% of net sales in either of the three month periods ended September 30, 2012 and 2011, respectively.

	2012	2011
Product 1	39%	45%
Product 2	10%	9%
Product 3	10%	
Product 4	8%	12%

The following table identifies certain of the Company s customers which accounted for greater than 10% of net sales in either of the three month periods ended September 30, 2012 and 2011, respectively.

	2012	2011
Customer A	17%	21%
Customer B	11%	12%
Customer C	10%	9%
Customer D	10%	11%

At September 30, 2012 and 2011, four customers accounted for 67% and 71% of the Company s accounts receivable balances, respectively. Credit terms are offered to customers based on evaluations of the customers financial condition. Generally, collateral is not required from customers. Accounts receivable payment terms vary and are stated in the financial statements at amounts due from customers net of an allowance for doubtful accounts. Accounts remaining outstanding longer than the payment terms are considered past due. The Company determines its allowance by considering a number of factors, including the length of time trade accounts receivable are past due, the Company s previous loss history, the customer s current ability to pay its obligation to the Company, and the condition of the general economy and the industry as a whole. The Company writes-off accounts receivable when they are determined to have become uncollectible.

Share-based Compensation - Share-based compensation costs are recognized over the vesting period based on the fair value of the instrument on the date of grant less an estimate for forfeitures. The Company uses the Black-Scholes valuation model to determine the fair value of stock options and the share price on the grant date to value restricted stock. The fair value model includes various assumptions, including the expected volatility, expected life of the awards, and risk-free interest rates. These assumptions involve inherent uncertainties based on market conditions which are generally outside the Company s control. Changes in these assumptions could have a material impact on share-based compensation costs recognized in the financial statements.

Note 3. New Accounting Standards

In June 2011, the FASB issued authoritative guidance which allows an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both options, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. This guidance eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders equity. This guidance does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. This authoritative guidance must be applied retrospectively, and is effective for fiscal years and interim periods within those years, beginning after December 15, 2011. In December 2011, the FASB issued an update deferring the effective date for amendments to the presentation of reclassifications of items out of accumulated other comprehensive income. The adoption of this guidance by the Company on July 1, 2012 did not have a significant impact on the Company s consolidated financial statements as it only requires a change in the format of the presentation.

In July 2012, the FASB issued authoritative guidance which allows an entity the option to first assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that an indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. An entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. An entity will be able to resume performing the qualitative assessment in any subsequent period. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012.

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Early adoption is permitted, including for annual and interim impairment tests performed as of a date before July 27, 2012, if a public entity s financial statements for the most recent annual or interim period have not yet been issued or, for nonpublic entities, have not yet been made available for issuance. The Company adopted this guidance effective July 1, 2012. The adoption of this guidance by the Company did not have a significant impact on the Company s consolidated financial statements.

Note 4. Inventories

Inventories at September 30, 2012 and June 30, 2012 consist of the following:

(In thousands)	September 30, 2012	June 30, 2012
Raw Materials	$ 11,648	$ 11,351
Work-in-process	6,336	4,805
Finished Goods	7,875	9,130
Packaging Supplies	1,747	1,778
	$ 27,606	$ 27,064

The preceding amounts are net of excess and obsolete inventory reserves of $1,564 and $1,472 at September 30, 2012 and June 30, 2012, respectively.

Recently, the FDA increased its efforts to force companies to file and seek FDA approval for GRASE or Grandfathered products. GRASE products are those old drugs that do not require prior approval from FDA in order to be marketed because they are generally recognized as safe and effective based on published scientific literature. Similarly, Grandfathered products are those which entered the market before the passage of the 1906 Act, the 1938 Act or the 1962 amendments to the Act. Efforts have included issuing notices to discontinue marketing certain products to companies currently producing these products. Lannett currently manufactures and markets several products that are considered GRASE or Grandfathered products, including C-Topical Solution and Oxycodone HCl Oral Solution. The FDA is currently undertaking activities to force all companies who manufacture such products to file applications and seek approval for these types of products or remove them from the market. The Company had approximately $942 and $1,703 of net inventory value of other Grandfathered products at September 30, 2012 and June 30, 2012, respectively.

Note 5. Property, Plant and Equipment

Property, plant and equipment at September 30, 2012 and June 30, 2012 consist of the following:

(In thousands)	Useful Lives	September 30, 2012	June 30, 2012
Land		$ 1,350	$ 1,350
Building and improvements	10 - 39 years	28,686	28,420

Machinery and equipment	5 - 10 years	32,741	32,322
Furniture and fixtures	5 - 7 years	1,261	1,247
Construction in progress		2,199	2,159
		66,237	65,498
Less accumulated depreciation		(29,426)	(28,430)
Property, plant and equipment, net		$ 36,811	$ 37,068

At September 30, 2012 and June 30, 2012, Property, plant and equipment, net included amounts held in foreign countries in the amount of $1,156 and $1,239, respectively.

Note 6. Fair Value Measures

The Company follows the authoritative guidance which clarifies the definition of fair value, establishes a framework for measuring fair value, and expands the disclosures on fair value measurements. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The authoritative guidance also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Three levels of inputs were established that may be used to measure fair value:

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Level 1 Quoted prices in active markets for identical assets or liabilities. The fair value of the Company s equity securities classified as trading securities in Note 7 below are derived solely from Level 1 inputs.

Level 2 Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices for identical or similar instruments in markets that are not active; or model-derived valuations whose inputs are observable or whose significant value drivers are observable. The Company s Level 2 assets and liabilities primarily include debt securities with quoted prices that are traded less frequently than exchange-traded instruments, corporate bonds, U.S. government and agency securities and certain mortgage-backed and asset-backed securities whose values are determined using pricing models with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. The Company did not have any Level 2 assets or liabilities as of September 30, 2012 or June 30, 2012.

Level 3 Unobservable inputs that are supported by little or no market activity and that are financial instruments whose values are determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant judgment or estimation. The Company did not have any Level 3 assets or liabilities as of September 30, 2012 or June 30, 2012.

If the inputs used to measure the financial assets and liabilities fall within more than one level described above, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument.

The carrying value of certain financial instruments, primarily cash and cash equivalents, accounts receivable, accounts payable, and accrued expenses approximate their estimated fair values based upon the short-term nature of these instruments. The carrying amount of the Company s debt obligations approximates fair value based on current rates available to the Company on similar debt obligations.

Note 7. Investment Securities

The amortized cost, gross unrealized gains and losses, and fair value of the Company s investment securities as of September 30, 2012 and June 30, 2012:

September 30, 2012

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Trading				
Equity securities	$ 4,947	$ 195	$ (132)	$ 5,010

June 30, 2012

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Trading				
Equity securities	$ 6,874	$ 157	$ (364)	$ 6,667

The Company uses the specific identification method to determine the cost of securities sold. For the three months ended September 30, 2012 the Company had gains on investments of $234, of which $36 were realized losses and $270 were unrealized gains. For the three months ended September 30, 2011, the Company had losses on investments of $999, of which $173 were realized losses and $826 were unrealized losses.

As of September 30, 2012 and June 30, 2012, there were no securities held from a single issuer that represented more than 10% of shareholders equity. As of September 30, 2012, securities with an aggregate fair value of $2,294 were in an unrealized loss position totaling $132. As of June 30, 2012, securities with an aggregate fair value of $3,466 were in an unrealized loss position totaling $364. Of those securities in an unrealized loss position at September 30, 2012, $96 were in a continuous unrealized loss position for more than 12 months with a total unrealized loss of $14. No securities were in a continuous unrealized loss position for more than 12 months as of June 30, 2012.

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Note 8. Other Assets

As of July 24, 2010, Lannett stopped manufacturing and distributing Morphine Sulfate Oral Solution (MS). Lannett filed a 505(b) (2) New Drug Application (MS NDA) in February 2010 and received FDA approval on the submission in June 2011. The filing fee related to this application totaled $1,406 and was initially recorded within other current assets on the consolidated balance sheets because part of or the entire fee was thought to be refundable. Lannett met with the FDA in January 2011 to review the status of the application. At that time, the FDA stated that it will need to finalize its Establishment Inspection Report for the February 2011 inspection of Lannett s facilities before it could give final approval on the MS NDA. Additionally, the Company corresponded with the FDA in March 2011 regarding whether any of the fee is refundable. The FDA s response was that the entire filing fee was not refundable. In September 2012, the Company had further communications with the FDA regarding the refundable portion of the filing fee. Based on these communications, the Company continues to believe that a portion of the filing fee is refundable. As of September 30, 2012, the Company has not been refunded any portion of the filing fee, nor has the Company received final determination on whether any of the fee is refundable.

The Company s position is that the value related to the part of the fee that is not refunded is the cost of getting regulatory approval for its MS product and that this value should be properly recorded as an intangible asset based upon approval and amortized over the product s estimated useful life upon shipment of the product. The revenues and gross profit margins attained by the Company from sales of its MS product currently substantiate its value as an intangible asset. As a result of the FDA approval of the MS NDA, an estimate of the nonrefundable amount totaling $398 determined, based upon input from a third party analysis, was reclassified to intangible assets upon shipment of the product which commenced in August 2011. Amortization will be adjusted prospectively once the nonrefundable portion of the fee is finalized with the FDA.

Note 9. Intangible Assets

Intangible assets, net as of September 30, 2012 and June 30, 2012, consist of the following:

(In thousands)	Gross Carrying Amount September 30, 2012	Gross Carrying Amount June 30, 2012	Accumulated Amortization September 30, 2012	Accumulated Amortization June 30, 2012	Intangible Assets, Net September 30, 2012	Intangible Assets, Net June 30, 2012
JSP Marketing and Dist. Rights	$ 16,062	$ 16,062	$ (13,385)	$ (12,939)	$ 2,677	$ 3,123
Cody Labs Import License	582	582	(163)	(154)	419	428
Morphine Sulfate Oral Solution NDA	398	398	(31)	(24)	367	374
Other ANDA Product Rights(A)	600	600	(105)	(96)	495	504
	$ 17,642	$ 17,642	$ (13,684)	$ (13,213)	$ 3,958	$ 4,429

(A) The amounts above include the product line covered by the ANDA s purchased in August 2009 for $149. These ANDA s are not being amortized at this time and will continue to be un-amortized intangible assets until such time as the Company begins shipping these products.

The following table summarizes intangible assets, net activity

(In thousands)		**Intangible assets, net**
Balances at July 1, 2012	$	4,429
Additions		
Amortization		(471)
Impairments		
Balances at September 30, 2012	$	3,958

There were no impairments related to intangible assets during the three months ended September 30, 2012 or the fiscal year ended June 30, 2012.

For the three months ended September 30, 2012 and 2011, the Company incurred amortization expense of approximately $471 and $468, respectively.

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Future annual amortization expense consists of the following as of September 30, 2012:

(In thousands) Fiscal Year Ending June 30,		Annual Amortization Expense
2013	$	1,411
2014		1,435
2015		97
2016		97
2017		97
Thereafter		672
	$	3,809

The amounts above do not include the product line covered by the ANDA s purchased in August 2009 for $149, as amortization will begin when the Company starts shipping these products.

Note 10. Bank Line of Credit

The Company has a $3,000 line of credit from Wells Fargo Bank, N.A. (Wells Fargo) that was scheduled to expire on March 31, 2012. The line of credit was renewed and extended until April 30, 2013 and bears interest of 1-month LIBOR Market Index Rate plus 2.00%. The interest rate at September 30, 2012 and June 30, 2012 was 2.21% and 2.22%. Availability under the line of credit is reduced by outstanding letters of credit. As of September 30, 2012 and June 30, 2012, the Company had $3,000 and $2,995 of availability under the line of credit, respectively. The availability fee on the unused balance of the line of credit is 0.375%. The line of credit is collateralized by the working capital assets of the Company. As of September 30, 2012, the Company was in compliance with the financial covenants under the agreement.

Note 11. Long-Term Debt

Long-term debt consists of the following:

(In thousands)		September 30, 2012		June 30, 2012
Pennsylvania Industrial Development Authority loan	$	757	$	777
Tax-exempt bond loan (PAID)		290		290
Wells Fargo N.A. Townsend Road mortgage		2,767		2,818
PIDA Townsend Road mortgage		1,873		1,899
First National Bank of Cody mortgage		1,349		1,377
Total debt		7,036		7,161
Less current portion		651		648
Long term debt	$	6,385	$	6,513

Current Portion of Long Term Debt

	September 30, 2012	June 30, 2012
Pennsylvania Industrial Development Authority loan	$ 82	$ 81
Tax-exempt bond loan (PAID)	140	140
Wells Fargo N.A. Townsend Road mortgage	204	204
PIDA Townsend Road mortgage	106	105
First National Bank of Cody mortgage	119	118
Total current portion of long term debt	$ 651	$ 648

The Company financed $1,250 through the Pennsylvania Industrial Development Authority (PIDA). The Company is required to make equal payments each month for 180 months starting February 1, 2006 with interest of 2.75% per annum.

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In April 1999, the Company entered into a loan agreement with a governmental authority, the Philadelphia Authority for Industrial Development (the Authority or PAID), to finance future construction and growth projects of the Company. The Authority issued $3,700 in tax-exempt variable rate demand and fixed rate revenue bonds to provide the funds to finance such growth projects pursuant to a trust indenture (the Trust Indenture). A portion of the Company s proceeds from the bonds was used to pay for bond issuance costs of approximately $170. The Trust Indenture requires that the Company repay the Authority loan through installment payments beginning in May 2003 and continuing through May 2014, the year the bonds mature. The bonds bear interest at the floating variable rate determined by the organization responsible for selling the bonds. The interest rate fluctuates on a weekly basis. The effective interest rate at September 30, 2012 and June 30, 2012 was 0.39% and 0.38%, respectively.

During the third and fourth quarters of Fiscal 2011, the Company negotiated a set of mortgages on its Townsend Road facility with both Wells Fargo and the PIDA. The Wells Fargo portion of the loan is for $3,056, bears a floating interest rate of the 1 Month LIBOR rate plus 2.95%, amortizes over a 15 year term and has an 8 year maturity date. The effective interest rate at September 30, 2012 and June 30, 2012 was 3.16% and 3.20%, respectively. The PIDA portion of the loan is for $2,000, bears an interest rate of 3.75% and matures in 15 years. Both loans closed and were funded in May 2011. As of September 30, 2012 and June 30, 2012, the Company was in compliance with the new financial covenants under the agreements.

The Company has executed Security Agreements with Wells Fargo, PIDA and PIDC in which the Company has agreed to pledge its working capital, some equipment and its Townsend Road property to collateralize the amounts due.

The Company is the primary beneficiary to a variable interest entity (VIE) called Cody LCI Realty, LLC. See Note 12, Consolidation of Variable Interest Entity for additional description. The VIE owns land and a building which is being leased to Cody. A mortgage loan with First National Bank of Cody has been consolidated in the Company s financial statements, along with the related land and building. The mortgage requires monthly principal and interest payments of $15. Effective February 2011, the interest rate was modified from a fixed rate of 7.5% to a floating rate with a floor of 4.5% and a ceiling of 9.0%, with payments to be made through April 2022. As of September 30, 2012 and June 30, 2012, the effective rate was 4.5%. The mortgage is collateralized by the land and building.

Long-term debt amounts due, for the twelve month periods ending September 30 are as follows:

(In thousands)		**Amounts Payable to Institutions**
2013	$	651
2014		673
2015		535
2016		548
2017		562
Thereafter		4,067
	$	7,036

Note 12. Consolidation of Variable Interest Entity

Lannett consolidates any Variable Interest Entity (VIE) of which it is the primary beneficiary. The liabilities recognized as a result of consolidating a VIE do not represent additional claims on the Company s general assets rather, they represent claims against the specific assets of the consolidated VIE. Conversely, assets recognized as a result of consolidating a VIE do not represent additional assets that could be used to satisfy claims against our general assets. Reflected in each of the September 30, 2012 and June 30, 2012 balance sheets are consolidated VIE assets of approximately $1,761 and $1,757, respectively, which are comprised mainly of land and a building. VIE liabilities consist primarily of a mortgage on that property in the amount of $1,349 and $1,377 at September 30, 2012 and June 30, 2012, respectively.

Cody LCI Realty LLC (Realty) is the only VIE that is consolidated. Realty had been consolidated by Cody prior to its acquisition by Lannett. Realty is a 50/50 joint venture with an officer of Cody Labs. Its purpose was to acquire the facility used by Cody. Until the acquisition of Cody in April 2007, Lannett had not consolidated the VIE because Cody had been the primary beneficiary of the VIE. Risk associated with our interests in this VIE is limited to a decline in the value of the land and building as compared to the balance of the mortgage note on that property, up to Lannett s 50% share of the venture. Realty owns the land and building, and Cody leases the building and property from Realty for $20 per month. All intercompany rent expense is eliminated upon consolidation with Cody. The Company is not involved in any other VIE.

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Note 13. Contingencies

In January 2010, the Company initiated an arbitration proceeding against Olive Healthcare (Olive) for damages arising out of Olive s delivery of defective soft-gel prenatal vitamin capsules. The Company sought damages in excess of $3,500. Olive denied liability and filed a counterclaim in February 2010 for breach of contract. Olive also filed a lawsuit against the Company in Daman, India seeking to enjoin the United States arbitration and claiming damages of approximately $6,800 for compensatory damages and an additional approximately $6,800 for loss of business. The Company engaged Indian counsel and actively defended that suit. The parties reached a settlement agreement which was signed and executed on August 13, 2012. The agreement is favorable to Lannett and includes the dismissal with prejudice of all legal proceedings between the Company and Olive in the U.S. and India. As of September 30, 2012, the Company had recorded all amounts related to the agreement.

Note 14. Commitments

Leases

Lannett s subsidiary, Cody leases a 73 square foot facility in Cody, Wyoming. This location houses Cody s manufacturing and production facilities. Cody leases the facility from Cody LCI Realty, LLC, a Wyoming limited liability company which is 50% owned by Lannett. See Note 12.

Rental and lease expense for the three months ended September 30, 2012 and 2011 was approximately $24 and $28, respectively.

Employment Agreements

The Company has entered into employment agreements with Arthur P. Bedrosian, President and Chief Executive Officer, Martin P. Galvan, Vice President of Finance, Chief Financial Officer and Treasurer, Kevin R. Smith, Vice President of Sales and Marketing, William F. Schreck, Chief Operating Officer, Ernest J. Sabo, Vice President of Regulatory Affairs and Chief Compliance Officer and Robert Ehlinger, Vice President of Logistics and Chief Information Officer. Each of the agreements provide for an annual base salary and eligibility to receive a bonus. The salary and bonus amounts of these executives are determined by the review and approval of the Compensation Committee in accordance with the Committee s Charter as approved by the Board of Directors. Additionally, these executives are eligible to receive stock options and restricted stock awards, which are granted at the discretion of the Compensation Committee in accordance with the Committee s Charter as approved by the Board of Directors and in accordance with the Company s policies regarding stock option and restricted stock grants. Under the agreements, these executive employees may be terminated at any time with or without cause, or by reason of death or disability. In certain termination situations, the Company is liable to pay severance compensation to these executives of between 18 months and three years.

Note 15. Accumulated Comprehensive Loss

The Company s Accumulated Comprehensive Loss is comprised of the following components as of September 30, 2012 and 2011:

(In thousands)	September 30, 2012	September 30, 2011
Foreign Currency Translation		
Beginning Balance	$ (63)	$ 22
Net gain (loss) on foreign currency translation (net of tax of $0 and $0)	41	(3)
Reclassifications to net income (net of tax of $0 and $0)		
Other Comprehensive income (loss), net of tax	41	(3)
Ending Balance	(22)	19
Unrealized Holding Gain (Loss)		
Beginning Balance	$	$ 2
Net unrealized holding gain (loss) (net of tax of $0 and $1)		(1)
Reclassifications to net income (net of tax of $0 and $0)		
Other comprehensive income (loss), net of tax		(1)
Ending Balance		1
Total Accumulated Other Comprehensive Loss	$ (22)	$ 20

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Note 16. Earnings Per Common Share

A dual presentation of basic and diluted earnings per common share is required on the face of the Company s consolidated statement of operations as well as a reconciliation of the computation of basic earnings per common share to diluted earnings per common share. Basic earnings per common share excludes the dilutive impact of common stock equivalents and is computed by dividing net income by the weighted-average number of shares of common stock outstanding for the period. Diluted earnings per common share include the effect of potential dilution from the exercise of outstanding common stock equivalents into common stock using the treasury stock method. Dilutive shares have been excluded in the weighted average shares used for the calculation of earnings per share in periods of net loss because the effect of such securities would be anti-dilutive. A reconciliation of the Company s basic and diluted earnings per common share follows:

	For The Three Months Ended September 30,			
(In thousands, except share and per share data)		**2012**		**2011**
Net Income attributable to Lannett common shareholders	$	2,926	$	206
Weighted average common shares outstanding (basic)		28,278,514		28,431,733
Effect of potentially dilutive options and restricted stock awards		190,710		254,911
Weighted average common shares outstanding (diluted)		28,469,224		28,686,644
Basic earnings per common share	$	0.10	$	0.01
Diluted earnings per common share	$	0.10	$	0.01

The number of anti-dilutive shares that have been excluded in the computation of diluted earnings per share for the three months ended September 30, 2012 and 2011 were 2,017 and 1,575, respectively.

Note 17. Share-based Compensation

At September 30, 2012, the Company had four share-based employee compensation plans (the Old Plan, the 2003 Plan, the 2006 Long-term Incentive Plan, or 2006 LTIP and the 2011 Long-Term Incentive Plan or 2011 LTIP).

At September 30, 2012, there were 2,610 options outstanding. Of those, 1,565 were options issued under the 2006 LTIP, 862 were issued under the 2003 Plan, and 183 under the Old Plan. There are no further shares authorized to be issued under the Old Plan. Under the 2003 Plan, 1,125 shares were authorized to be issued, with 60 shares under options having already been exercised under that plan since its inception, leaving a balance of 203 shares in that plan for future issuances. Under the 2006 LTIP, 2,500 shares were authorized to be issued, with 190 shares under options having already been exercised under that plan since its inception. At September 30, 2012, there were 73 nonvested restricted shares outstanding which were issued under the 2006 LTIP, with 635 shares having already vested under that plan since its inception. At September 30, 2012, a balance of 37 shares is available in the 2006 LTIP for future issuances. Under the 2011 LTIP, 1,500 shares were authorized to be issued. As of September 30, 2012, 3 shares of restricted stock have vested under the plan, leaving a balance of 1,497 shares available in the 2011 LTIP for future issuances.

The following tables presents all share-based compensation costs recognized in our statements of income, substantially all of which is reflected in the selling, general and administrative expense line:

(In thousands)	**Three months ended September 30, 2012**		**2011**	
Share-based compensation				
Stock options	$	315	$	389
Employee stock purchase plan	$	27	$	9
Restricted stock	$	314	$	273
Tax benefit at statutory rate	$	23	$	38

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Stock Options

The Company measures share-based compensation cost for options using the Black-Scholes option pricing model. The following table presents the weighted average assumptions used to estimate fair values of the stock options granted during the three months ended September 30 and the estimated annual forfeiture rates used to recognize the associated compensation expense:

	Incentive Stock Options FY 2013	Non-qualified Stock Options FY 2013	Incentive Stock Options FY 2012	Non-qualified Stock Options FY 2012
Risk-free interest rate	%	%	0.3%	0.1%
Expected volatility	%	%	63.6%	63.9%
Expected dividend yield	%	%	%	%
Forfeiture rate	%	%	7.50%	7.50%
Expected term (in years)			5.2 years	5.1 years
Weighted average fair value	$	$	$ 1.99	$ 1.94

Expected volatility is based on the historical volatility of the price of our common shares during the historical period equal to the expected term of the option. We use historical information to estimate expected term within the valuation model. The expected term of awards represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. Compensation cost is recognized using a straight-line method over the vesting or service period and is net of estimated forfeitures.

The forfeiture rate assumption is the estimated annual rate at which unvested awards are expected to be forfeited during the vesting period. This assumption is based on our historical forfeiture rate. Periodically, management will assess whether it is necessary to adjust the estimated rate to reflect changes in actual forfeitures or changes in expectations.

Options outstanding that have vested and are expected to vest as of September 30, 2012 are as follows:

(In thousands, except weighted average price and life data)	**Awards**	**Weighted Average Exercise Price**	**Aggregate Intrinsic Value**	**Weighted Average Remaining Contractual Life (yrs.)**
Options vested	1,872	$ 7.23	$ 768	4.74
Options expected to vest	679	$ 4.55	$ 561	8.44
Total vested and expected to vest	2,551	$ 6.51	$ 1,329	5.73

Options with a fair value of approximately $540 and $206 vested during the three months ended September 30, 2012 and 2011, respectively.

A summary of stock option award activity under the Plans as of September 30, 2012 and 2011 and changes during the three months then ended, is presented below:

	Incentive Stock Options				Nonqualified Stock Options			
(In thousands, except for weighted average price and life data)	**Awards**	**Weighted-Average Exercise Price**	**Aggregate Intrinsic Value**	**Weighted Average Remaining Contractual Life (yrs.)**	**Awards**	**Weighted-Average Exercise Price**	**Aggregate Intrinsic Value**	**Weighted Average Remaining Contractual Life (yrs.)**
Outstanding at July 1, 2012	1,871	$ 5.26	$		877	$ 8.89		
Granted		$				$		
Exercised	(44)	$ 4.06	$ 35			$	$	
Forfeited, expired or repurchased	(73)	$ 6.40			(21)	$ 7.23		
Outstanding at September 30, 2012	1,754	$ 5.24	$ 1,127	6.7	856	$ 8.93	$ 266	4.0
Outstanding at September 30, 2012 and not yet vested	695	$ 4.42	$ 603	8.5	43	$ 5.59	$ 22	7.8
Exercisable at September 30, 2012	1,059	$ 5.78	$ 524	5.5	813	$ 9.11	$ 244	3.8

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	Incentive Stock Options		Nonqualified Stock Options	
		Weighted		Weighted
&nbs				