AKORN INC
Form 10-Q
November 09, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE QUARTERLY PERIOD ENDED September 30, 2006

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER: 0-13976

AKORN, INC.
(Exact Name of Registrant as Specified in its Charter)

LOUISIANA (State or Other Jurisdiction of Incorporation or Organization)	72-0717400 (I.R.S. Employer Identification No.)
2500 MILLBROOK DRIVE BUFFALO GROVE, ILLINOIS (Address of Principal Executive Offices)	60089 (Zip Code)

(847) 279-6100
(Registrant s 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 Securities Exchange Act of 1934 during the preceding 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 þ No o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Exchange Act Rule 12b-2).

Large accelerated filer o **Accelerated filer** o **Non-accelerated filer** þ

Indicate by check mark whether the Registrant is a shell company (as defined in Exchange Act Rule 12b-2).

Yes o No þ

At October 31, 2006 there were 81,064,895 shares of common stock, no par value, outstanding.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

AKORN, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
IN THOUSANDS, EXCEPT SHARE DATA

	SEPTEMBER 30, 2006 (UNAUDITED)	DECEMBER 31, 2005 (AUDITED)
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 19,523	$ 791
Trade accounts receivable (less allowance for doubtful accounts of $1 and $13, respectively)	6,939	3,222
Inventories	10,421	10,279
Prepaid expenses and other current assets	1,206	1,402
TOTAL CURRENT ASSETS	38,089	15,694
PROPERTY, PLANT AND EQUIPMENT, NET	33,244	31,071
OTHER LONG-TERM ASSETS		
Intangibles, net	9,164	10,210
Other	98	120
TOTAL OTHER LONG-TERM ASSETS	9,262	10,330
TOTAL ASSETS	$ 80,595	$ 57,095
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES		
Current installments of debt	$ 387	$ 7,044
Trade accounts payable	2,039	3,046
Accrued compensation	1,674	1,519
Customer accrued liabilities	538	135
Accrued interest payable		2,514
Accrued expenses and other liabilities	1,126	1,202
TOTAL CURRENT LIABILITIES	5,764	15,460
LONG-TERM LIABILITIES		
Long-term debt, less current installments	309	602
Product warranty	1,131	
TOTAL LONG-TERM LIABILITIES	1,440	602
TOTAL LIABILITIES	7,204	16,062
SHAREHOLDERS EQUITY		
Common stock, no par value 150,000,000 shares authorized; 81,000,130 and 27,618,745 shares issued and outstanding at September 30, 2006 and	136,863	67,339

December 31, 2005, respectively				
Series A Preferred Stock, $1.00 par value, 257,172 shares authorized and issued, 241,122 shares outstanding at December 31, 2005				27,232
Series B Preferred Stock, $1.00 par value, 170,000 shares authorized, 141,000 shares issued, 74,195 outstanding at September 30, 2006 and 106,600 outstanding at December 31, 2005		7,854		10,758
Warrants to acquire common stock		7,312		13,696
Accumulated deficit		(78,638)		(77,992)
TOTAL SHAREHOLDERS EQUITY		73,391		41,033
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$	80,595	$	57,095

See notes to condensed consolidated financial statements.

AKORN, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
IN THOUSANDS, EXCEPT PER SHARE DATA
(UNAUDITED)

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2006	**2005**	**2006**	**2005**
Revenues	$ 14,490	$ 10,985	$ 56,695	$ 33,744
Cost of sales	8,539	7,317	34,056	21,881
GROSS PROFIT	5,951	3,668	22,639	11,863
Selling, general and administrative expenses	4,226	3,894	13,379	10,961
Amortization and write-down of intangibles	345	353	1,046	1,157
Research and development expenses	2,649	1,438	6,815	4,203
TOTAL OPERATING EXPENSES	7,220	5,685	21,240	16,321
OPERATING INCOME (LOSS)	(1,269)	(2,017)	1,399	(4,458)
Interest income/(expense) net	230	(595)	(855)	(1,705)
Debt Retirement Gain/(Expense)			(391)	1,212
Other Expense	(28)		(57)	
INCOME/(LOSS) BEFORE INCOME TAXES	(1,067)	(2,612)	96	(4,951)
Income tax provision		2		17
NET INCOME/(LOSS)	(1,067)	(2,614)	96	(4,968)
Preferred stock dividends and adjustments	(182)	(1,015)	(742)	(2,991)
NET LOSS AVAILABLE TO COMMON STOCKHOLDERS	$ (1,249)	$ (3,629)	$ (646)	$ (7,959)
NET LOSS PER SHARE:				
BASIC	$ (0.02)	$ (0.14)	$ (0.01)	$ (0.31)
DILUTED	$ (0.02)	$ (0.14)	$ (0.01)	$ (0.31)
SHARES USED IN COMPUTING NET INCOME/(LOSS) PER SHARE:				
BASIC	76,420	26,203	71,050	25,804
DILUTED	76,420	26,203	71,050	25,804

See notes to condensed consolidated financial statements.

AKORN, INC.
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006 AND 2005
UNAUDITED
(In Thousands)

Nine Months Ended September 30, 2006	Common Stock		Series A Preferred Stock	Series B Preferred Stock	Warrants to acquire Common Stock	Retained Earnings (Accumulated Deficit)	Total
	Shares	Amount					
BALANCES AT DECEMBER 31, 2005	27,619	$ 67,339	$ 27,232	$ 10,758	$ 13,696	$ (77,992)	$ 41,033
Net income						96	96
Preferred stock dividends earned			55	435		(490)	
Intrinsic value of beneficial conversion features in convertible preferred stock		252				(252)	
Conversion of preferred stock into common stock	38,123	30,626	(27,287)	(3,339)			
Exercise of warrants into common stock	5,682	9,418			(8,205)		1,213
Conversion of convertible notes into common stock	3,540	7,298					7,298
Net proceeds from issuance of common stock and warrants	5,312	19,800			1,821		21,621
Stock issuance under stock option and stock purchase plans	724	606					606
Amortization of deferred compensation related to restricted stock awards		498					498
FAS123R share based payment expense		1,026					1,026
BALANCES AT SEPTEMBER 30, 2006	81,000	$ 136,863	$	$ 7,854	$ 7,312	$ (78,638)	$ 73,391

Nine Months Ended September 30, 2005	Common Stock		Series A Preferred Stock	Series B Preferred Stock	Warrants to acquire Common Stock	Retained Earnings (Accumulated Deficit)	Total
	Shares	Amount					
BALANCES AT DECEMBER 31, 2004	25,133	$ 59,571	$ 25,787	$ 13,109	$ 14,160	$ (65,301)	$ 47,326
Net loss						(4,968)	(4,968)
Preferred stock dividends earned			1,155	597		(1,752)	
Intrinsic value of beneficial conversion features in convertible preferred stock		1,239				(1,239)	
Conversion of preferred stock into common stock	682	1,708		(1,708)			
Exercise of warrants into common stock	200	405			(255)		150
Intrinsic value of beneficial conversion features in convertible interest		204					204

Stock issuance under stock option and stock purchase plans	441	734					734
Amortization of deferred compensation related to restricted stock awards		273					273
BALANCES AT SEPTEMBER 30, 2005	26,456	$ 64,134	$ 26,942	$ 11,998	$ 13,905	$ (73,260)	$ 43,719

See notes to the condensed consolidated financial statements.

AKORN, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
IN THOUSANDS
(UNAUDITED)
See notes to condensed consolidated financial statements.

	NINE MONTHS ENDED SEPTEMBER 30	
	2006	**2005**
OPERATING ACTIVITIES		
Net income (loss)	$ 96	$ (4,968)
Adjustments to reconcile net income/(loss) to net cash provided by operating activities:		
Depreciation and amortization	2,444	4,927
Amortization of deferred financing costs		72
Amortization of debt discounts	1,059	876
Advances to Strides Arcolab Limited		(1,500)
Gain on Retirement of Debt		(1,212)
Non-cash stock compensation expense	1,524	273
Changes in operating assets and liabilities:		
Trade accounts receivable	(3,717)	4,761
Inventories	(142)	(330)
Prepaid expenses and other current assets	218	480
Trade accounts payable	(1,007)	(3,279)
Product warranty	1,131	
Accrued customer liability	403	
Accrued expenses and other liabilities	(137)	502
NET CASH PROVIDED BY OPERATING ACTIVITIES	1,872	602
INVESTING ACTIVITIES		
Purchases of property, plant and equipment	(3,571)	(744)
Purchase of intangible assets		(75)
NET CASH USED IN INVESTING ACTIVITIES	(3,571)	(819)
FINANCING ACTIVITIES (See Note 1 below)		
Repayment of long-term debt	(3,009)	(253)
Repayment of NeoPharm Debt		(2,500)
Net borrowings under lines of credit		
Proceeds from common stock and warrant offering	21,621	
Proceeds from warrants exercised	1,213	150
Proceeds under stock option and stock purchase plans	606	734
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	20,431	(1,869)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	18,732	(2,086)
Cash and cash equivalents at beginning of period	791	4,110
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 19,523	$ 2,024

Amount paid for interest	$ 577	$ 397
Amount paid for income taxes	$ 2	$ 72

Note 1: In March 2006, $7,298 in principal and interest related to convertible notes was retired by conversion to the common stock of Akorn, Inc. (See Note H Financing Arrangements)

AKORN, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE A BUSINESS AND BASIS OF PRESENTATION

Business: Akorn, Inc. and its wholly owned subsidiary, Akorn (New Jersey), Inc. (collectively, the Company) manufacture and market diagnostic and therapeutic pharmaceuticals in specialty areas such as ophthalmology, rheumatology, anesthesia and antidotes, among others. Customers, including physicians, optometrists, wholesalers, group purchasing organizations and other pharmaceutical companies, are served primarily from three operating facilities in the United States. In September 2004, the Company, along with a venture partner, Strides Arcolab Limited (Strides) formed a mutually owned limited liability company, Akorn-Strides, LLC (the Joint Venture Company). The accompanying unaudited condensed consolidated financial statements include the accounts of Akorn, Inc. and Akorn (New Jersey) Inc. as well as the accounts and results of the Joint Venture Company. Intercompany transactions and balances have been eliminated in consolidation.

Basis of Presentation: These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and accordingly do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included in these financial statements. Operating results for the nine-month period ended September 30, 2006 are not necessarily indicative of the results that may be expected for a full year. For further information, refer to the consolidated financial statements and footnotes for the year ended December 31, 2005, included in the Company s Annual Report on Form 10-K.

NOTE B SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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 and 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 materially from those estimates. Significant estimates and assumptions for the Company relate to the allowance for doubtful accounts, the allowance for chargebacks, the allowance for rebates, the reserve for slow-moving and obsolete inventory, the allowance for product returns, the carrying value of intangible assets and the carrying value of deferred income tax assets.

Chargebacks: The Company enters into contractual agreements with certain third parties such as hospitals and group-purchasing organizations to sell certain products at predetermined prices. The parties have elected to have these contracts administered through wholesalers that buy the product from the Company and subsequently sell it to those third parties. When a wholesaler sells products to one of these third parties that are subject to a contractual price agreement, the difference between the price paid to the Company by the wholesaler and the price under the specific contract is charged back to the Company by the wholesaler. The Company tracks sales and submitted chargebacks by product number and contract for each wholesaler. Utilizing this information, the Company estimates a chargeback percentage for each product. The Company reduces gross sales and increases the chargeback allowance by the estimated chargeback amount for each product sold to a wholesaler. The Company reduces the chargeback allowance when it processes a request for a chargeback from a wholesaler. Actual chargebacks processed by the Company can vary materially from period to period based upon actual sales volume through the wholesalers. However, the Company s provision for chargebacks is fully reserved for at the time when sales revenues are recognized.

Management obtains certain wholesaler inventory reports to aid in analyzing the reasonableness of the chargeback allowance that will be paid out in the future. The Company assesses the reasonableness of its chargeback allowance by applying the product chargeback percentage based on historical activity to the quantities of inventory on hand per the wholesaler inventory reports and an estimate of in-transit inventory that is not reported on the wholesaler inventory reports at the end of each reporting period. In accordance with its accounting policy, the Company s estimate of the percentage amount of wholesaler inventory that will ultimately be sold to a third party that is subject to a contractual price agreement is based on a six-quarter trend of such sales through wholesalers. The Company uses this percentage

estimate (90% in 2006) until historical trends indicate that a revision should be made.

On an ongoing basis, the Company evaluates its actual chargeback rate experience and new trends are factored into its estimates each quarter as market conditions change.

Sales Returns: Certain of the Company s products are sold with the customer having the right to return the product within specified periods and guidelines for a variety of reasons, including but not limited to, pending expiration dates. Provisions are made at the time of sale based upon tracked historical experience, by customer in some cases. The Company estimates its sales returns reserve based on a historical percentage of returns to sales utilizing a twelve month look back period. One-time historical factors or pending new developments that would impact the expected level of returns are taken into account to determine the appropriate reserve estimate at each balance sheet date.

As part of the evaluation of the balance required, the Company considers actual returns to date that are in process, the expected impact of any product recalls and the wholesaler s inventory information to assess the magnitude of unconsumed product that may result in a sales return to the Company in the future. The sales returns level can be impacted by factors such as overall market demand and market competition and availability for substitute products which can increase or decrease the end-user pull through for sales of the Company s products and ultimately impact the level of sales returns. Actual returns experience and trends are factored into the Company s estimates each quarter as market conditions change.

NOTE C STOCK BASED COMPENSATION

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share Based Payment (SFAS 123(R)), applying the modified prospective method. Prior to the adoption of SFAS 123(R), the Company applied the provisions of APB Opinion No. 25, Accounting for Stock Issued to Employees, in accounting for its stock-based awards, and accordingly, recognized no compensation cost for its stock plans other than for its restricted stock awards.

Under the modified prospective method, SFAS 123(R) applies to new awards and to awards that were outstanding as of December 31, 2005 that are subsequently vested, modified, repurchased or cancelled. Compensation expense recognized during the first nine months of 2006 includes the portion vesting during the period for (1) all share-based payments granted prior to, but not yet vested as of December 31, 2005, based on the grant date fair value estimated in accordance with the original provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS 123) and (2) all share-based payments granted subsequent to December 31, 2005, based on the grant-date fair value estimated using the Black-Scholes option-pricing model.

Stock option compensation expense of $325,000 and $1,026,000 was recognized during the three and nine month periods ended September 30, 2006. As a result of the Company s decision to adopt the modified prospective method, prior period results have not been restated. For awards issued prior to January 1, 2006, the Company used the multiple award method for allocating the compensation cost to each period. For awards issued on or after January 1, 2006, concurrent with the adoption of SFAS 123(R), the Company has elected to use the single-award method for allocating the compensation cost to each period.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123 for the three and nine months ended September 30, 2005 (in thousands, except for per share data).

	THREE MONTHS ENDED SEPTEMBER 30, 2005	NINE MONTHS ENDED SEPTEMBER 30, 2005
Net income (loss) as reported	$ (2,614)	$ (4,968)
Add: stock-based employee compensation expense included in reported net income	123	273
Deduct: total stock-based employee compensation expense determined under fair-value-based method for all awards	(270)	(1,080)

Pro forma net income (loss)	(2,761)	(5,775)
Deduct: preferred stock dividends and adjustments	(1,015)	(2,991)
Pro forma net loss available for common stockholders	$ (3,776)	$ (8,766)
Basic and diluted loss per share of common stock		
Shares used in Computing Net Loss Per Share	26,203	25,804
As reported	$ (0.14)	$ (0.31)
Pro forma	$ (0.14)	$ (0.34)

The weighted-average assumptions used in estimating the fair value of the stock options granted during the period, along with the weighted-average grant date fair values, were as follows:

	THREE MONTHS ENDED SEPTEMBER 30, 2006 (SFAS 123(R))	THREE MONTHS ENDED SEPTEMBER 30, 2005 (SFAS 123 Pro Forma)
Expected Volatility	52%	59%
Expected Life (in years)	3.5	5.0
Risk-free interest rate	4.8%	4.0%
Dividend yield		
Fair value per stock option	$1.60	$ 1.63

A summary of stock based compensation activity within the Company s stock-based compensation plans for the nine months ended September 30, 2006 is as follows:

	Number of Shares (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2006	3,706	$ 2.54		
Granted	1,002	$ 4.73		
Exercised	(745)	$ 2.38		
Forfeited	(237)	$ 4.01		
Outstanding at September 30, 2006	3,726	$ 2.97	2.86	$ 3,524
Exercisable at September 30, 2006	2,604	$ 2.43	2.33	$ 3,367

The aggregate intrinsic value for stock options outstanding and exercisable is defined as the difference between the market value of the Company s common stock as of the end of the period and the exercise price of the stock options. The total intrinsic value of stock options exercised during the three and nine months ended September 30, 2006 was $66,000 and $1,573,000, respectively. As a result of the stock options exercised, the Company recorded cash received and additional paid-in-capital of $260,000 and $783,000 during the three and nine months ended September 30, 2006. The following is a summary of nonvested stock option activity:

	Number of Shares (in thousands)	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2005	842	$ 1.94

Granted	1,002	$ 1.89
Vested	(596)	$ 1.79
Canceled	(126)	$ 1.63
Nonvested at September 30, 2006	1,122	$ 2.02

At September 30, 2006, there was $1,532,000 of total unrecognized compensation cost related to nonvested stock options. This cost will be recognized over 3 years.

The Company also grants restricted stock awards to certain employees. Restricted stock awards are valued at the closing market value of the Company s common stock on the day of grant, and the total value of the award is recognized as expense ratably over the vesting period of the employees receiving the grants. The Company did not grant restricted stock awards during the third quarter of 2006. As of September 30, 2006, the total amount of unrecognized compensation expense related to nonvested restricted stock awards was $1,399,000. The Company recognized compensation expense of $221,000 and $498,000 during the three and nine-month periods ended September 30, 2006, respectively, related to outstanding restricted stock awards.
The following is a summary of nonvested restricted stock activity:

	Number of Shares (in thousands)	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2005	208	$ 2.61
Granted	350	$ 5.05
Vested	(206)	$ 2.61
Canceled	(2)	$ 2.61
Nonvested at September 30, 2006	350	$ 5.05

NOTE D REVENUE RECOGNITION

The Company recognizes product sales for its ophthalmic and hospital drugs & injectables business segments upon the shipment of goods or upon the delivery of goods, depending on the sales terms. Revenue is recognized when all obligations of the Company have been fulfilled and collection of the related receivable is probable.

The contract services segment, which produces products for third party customers based upon their specifications and at pre-determined prices, also recognizes sales upon the shipment of goods or upon delivery of the product or service as appropriate. Revenue is recognized when all obligations of the Company have been fulfilled and collection of the related receivable is probable.

Provision for estimated doubtful accounts, chargebacks, rebates, discounts and product returns is made at the time of sale and is analyzed and adjusted, if necessary, at each balance sheet date.

NOTE E ACCOUNTS RECEIVABLE ALLOWANCES & CUSTOMER ACCRUED LIABILITIES

The nature of the Company s business inherently involves, in the ordinary course, significant amounts and substantial volumes of transactions and estimates relating to allowances for doubtful accounts, product returns, chargebacks, rebates and discounts given to customers. This is a natural circumstance of the pharmaceutical industry and not specific to the Company and inherently lengthens the collection process. Depending on the product, the end-user customer, the specific terms of national supply contracts and the particular arrangements with the Company s wholesaler customers, certain rebates, chargebacks and other credits are deducted from the Company s accounts receivable. The process of claiming these deductions depends on wholesalers reporting to the Company the amount of deductions that were earned under the respective terms with end-user customers (which in turn depends on which end-user customer, with different pricing arrangements might be entitled to a particular deduction). This process can lead to partial payments against outstanding invoices as the wholesalers take the claimed deductions at the time of payment.

The provisions for the following customer reserves are reflected in the accompanying financial statements as reductions of revenues in the income statement with the exception of the allowance for doubtful accounts which is reflected as part of selling, general and administrative expense. The ending reserve amounts are included in the net trade accounts receivable and customer accrued liabilities in the balance sheet.

Net trade accounts receivable consists of the following (in thousands):

	SEPTEMBER 30, 2006	DECEMBER 31, 2005
Gross Accounts Receivable	$ 17,956	$ 12,642
Less:		
Allowance for Doubtful Accounts	(1)	(13)
Returns Reserve	(2,172)	(1,529)
Discount and Allowances Reserve	(361)	(244)
Chargeback and Rebates Reserves	(8,483)	(7,634)
Net Trade Accounts Receivable	$ 6,939	$ 3,222

For the three-month periods ended September 30, 2006 and 2005, the Company recorded chargeback and rebate expense of $7,898,000 and $5,391,000, respectively. For the nine month periods ended September 30, 2006 and 2005, the Company recorded chargeback and rebate expense of $19,641,000 and $17,417,000, respectively. This increase was primarily due to increased sales to wholesalers.

For the three-month periods ended September 30, 2006 and 2005, the Company recorded a provision for product returns of $1,335,000 and $1,265,000, respectively. For the nine-month periods ended September 30, 2006 and 2005, the Company recorded a provision for product returns of $2,942,000 and $2,322,000, respectively. The increase in the provision was to recognize unfavorable customer returns experience in the period.

For the three-month periods ended September 30, 2006 and 2005, the Company recorded a net benefit for doubtful accounts of $9,000 and a provision of $188,000, respectively. For the nine-month periods ended September 30, 2006 and 2005, the Company recorded a net benefit for doubtful accounts of $97,000 and a provision of $71,000, respectively.

For the three-month periods ended September 30, 2006 and 2005, the Company recorded a provision for cash discounts of $380,000 and $241,000, respectively. For the nine-month periods ended September 30, 2006 and 2005, the Company recorded a provision for cash discounts of $1,332,000 and $717,000, respectively. This increase primarily related to a cash discount for a large sale of the Company s antidote products (see Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations).

NOTE F INVENTORIES

The components of inventories are as follows (in thousands):

	SEPTEMBER 30, 2006	DECEMBER 31, 2005
Finished goods	$ 3,086	$ 4,914
Work in process	2,042	1,702
Raw materials and supplies	5,293	3,663
	$ 10,421	$ 10,279

Inventory at September 30, 2006 and December 31, 2005 is reported net of reserves for slow-moving, unsalable and obsolete items of $847,000 and $916,000, respectively, primarily related to finished goods. For the three-month periods ended September 30, 2006 and 2005, the Company recorded a provision of $190,000 and $149,000, respectively. For the nine-month periods ended September 30, 2006 and 2005, the Company recorded a provision of $390,000 and $353,000, respectively.

NOTE G PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consists of the following (in thousands):

	SEPTEMBER30, 2006	DECEMBER 31, 2005
Land	$ 396	$ 396
Buildings and leasehold improvements	9,478	9,393
Furniture and equipment	29,008	27,866
Automobiles	55	55
Sub-total	38,937	37,710
Accumulated depreciation	(28,277)	(26,879)
	10,660	10,831
Construction in progress	22,584	20,240
Property, Plant, & Equipment, net	$ 33,244	$ 31,071

Construction in progress primarily represents capital expenditures related to the Company s Lyophilization project. The Company anticipates completing its lyophilization facility validation and having a pre-approval inspection (PAI) by the U.S. Food and Drug Administration (FDA) in the first quarter of 2007. Future costs are estimated to be approximately $300,000. The Company can make no assurances that it will be able to complete this project within its estimated timeframe, or at all, or that material impairment charges will not be required if such completion does not occur as anticipated. The commissioning of the lyophilization facility is contingent upon a successful PAI to be conducted by the FDA.

NOTE H FINANCING ARRANGEMENTS

The Company s long-term debt consists of (in thousands):

	SEPTEMBER 30, 2006	DECEMBER 31, 2005
2003 Subordinated Notes	$	$ 2,767
Convertible subordinated debentures		5,000
Mortgages payable	696	938
	696	8,705
Less unamortized discount on debt		(1,059)
Less current installments of debt	(387)	(7,044)
Long-term debt	$ 309	$ 602

On September 30, 2005, the Company renewed its credit agreement (the Credit Facility) with LaSalle Bank National Association (LaSalle Bank). The renewal extended the existing Credit Facility until September 30, 2008 and increased the Revolving Commitment amount (the Revolver) from $5,000,000 to $10,000,000, as well as made modifications of prior existing covenants and the addition of a tangible net worth financial covenant. The borrowing rate was reduced to the LaSalle Bank prime rate (8.25% at September 30, 2006) plus 0.5% from the previous rate of LaSalle prime plus 1.5%. On September 30, 2006, the Company had $9,925,000 of undrawn availability under the Credit Facility which is based on its level of accounts receivable and inventory and certain equipment as of

September 30, 2006. There was no borrowing against the Revolver at September 30, 2006.

On October 7, 2003, the Company issued subordinated promissory notes in the aggregate principal amount of $2,767,000 (the 2003 Subordinated Notes) along with warrants to purchase 276,714 shares of common stock at an exercise price of $1.10 per share to the John N. Kapoor Trust dated 9/20/89 (the Kapoor Trust), Arjun C. Waney and Argent Fund Management, Ltd. The 2003 Subordinated Notes were to mature on April 7, 2006 and bore interest at prime plus 1.75%, but interest payments were prohibited under the terms of the Company s subordination agreement. With the consent of LaSalle Bank, the Company retired the 2003 Subordinated Notes with cash payments totaling $3,288,000 on March 20, 2006. The unamortized debt discount related to the 2003 Subordinated Notes was $113,000 at December 31, 2005. Related debt discount amortization was zero and $138,000 for the three months ended September 30, 2006 and 2005, respectively. Related debt discount amortization was $113,000 and $347,000 for the nine months ended September 30, 2006 and 2005, respectively.

In 2001, the Company entered into a $5,000,000 convertible subordinated debt agreement, which included a $3,000,000 Tranche A note (Tranche A Note) and a $2,000,000 Tranche B note (Tranche B Note), with the Kapoor Trust (collectively, the Convertible Note Agreement). Under the terms of the Convertible Note Agreement, both the Tranche A Note and the Tranche B Note, which

were due December 20, 2006, bore interest at prime plus 3% and were issued with detachable warrants (the Tranche A Warrants and the Tranche B Warrants) to purchase shares of common stock.

Interest payments for the Tranche A Note and the Tranche B Note were prohibited under the terms of a subordination arrangement. The convertible feature of the Convertible Note Agreement, as amended, allowed for conversion of the subordinated debt plus interest into the Company s common stock, at a price of $2.28 per share of common stock for the Tranche A Note and $1.80 per share of common stock for the Tranche B Note. The convertible feature on the accrued interest could generate separately recordable beneficial conversion amounts when the price of the Company s common stock was higher than the conversion rate when the interest was accrued. The beneficial conversion amount related to interest was zero for the three month periods ended September 30, 2006 and 2005, respectively. The beneficial conversion amount related to interest was zero and $204,000 for the nine month periods ended September 30, 2006 and 2005, respectively.

The Company negotiated an early settlement of the Tranche A Note and the Tranche B Note in March 2006. The associated principal and accumulated interest of approximately $7,298,000 was retired by conversion into 3,540,281 shares of the Company s common stock on March 31, 2006. A debt retirement fee of approximately $391,000 was paid as an inducement to retire these notes prior to the original maturity date of December 20, 2006.

Unamortized debt discount related to the Tranche A Note and the Tranche B Note was $428,000 at December 31, 2005. Related debt discount amortization was zero and $186,000 for the three months ended September 30, 2006 and 2005, respectively. Related debt discount amortization was $428,000 and $529,000 for the nine months ended September 30, 2006 and 2005, respectively.

In June 1998, the Company entered into a $3,000,000 mortgage agreement with Standard Mortgage Investors, LLC of which there were outstanding borrowings of $696,000 and $938,000 at September 30, 2006 and December 31, 2005, respectively. The principal balance is payable over 10 years, with the final payment due in June 2008. The mortgage note bears a fixed interest rate of 7.375% and is secured by the real property located in Decatur, Illinois.

NOTE I COMMON STOCK ISSUANCE

On March 8, 2006 the Company issued 4,311,669 shares of its common stock in a private placement with various investors at a price of $4.50 per share which included warrants to purchase 1,509,088 additional shares of common stock. The warrants are exercisable for a five year period at an exercise price of $5.40 per share and may be exercised by cash payment of the exercise price or by means of a cashless exercise. The aggregate offering price of the private placement was approximately $19,402,000 and the net proceeds to the Company, after payment of approximately $1,324,000 of commissions and expenses, was approximately $18,078,000. The net proceeds were allocated based on the relative fair market values of the common stock and warrants with $16,257,000 allocated to the common stock and $1,821,000 allocated to the warrants.

Also, in September 2006, the Company issued 1,000,000 shares of its common stock in a private placement with Serum Institute of India, Ltd. at a price of $3.56 per share. The offering price was $3,560,000 and the net proceeds to the Company, after payment of approximately $17,000 in expenses, was approximately $3,543,000.

NOTE J EARNINGS PER COMMON SHARE

Basic net income (loss) per common share is based upon weighted average common shares outstanding. Diluted net income (loss) per common share is based upon the weighted average number of common shares outstanding, including the dilutive effect of stock options, warrants and convertible debt using the treasury stock and if converted methods. However, for the three and nine-month periods ended September 30, 2006 and 2005, the assumed exercise or conversion of any of these securities would be anti-dilutive; and, accordingly, diluted loss per share equals basic loss per share for each period.

The number of such shares as of September 30, 2006 and September 30, 2005 subject to warrants, convertible debt, and convertible preferred stock was 7,060,000 and 55,961,000, respectively. The number of such shares as of September 30, 2006 and September 30, 2005 subject to stock options was 3,726,000 and 4,034,000, respectively.

NOTE K INDUSTRY SEGMENT INFORMATION

The Company classifies its operations into three business segments, ophthalmic, hospital drugs & injectables and contract services. The ophthalmic segment manufactures, markets and distributes diagnostic and therapeutic pharmaceuticals. The hospital drugs & injectables segment manufactures, markets and distributes drugs and injectable pharmaceuticals, primarily in niche markets. This segment was previously classified as the injectable segment; however, the Company recently changed the classification to reflect that an increasing amount of pharmaceuticals delivered by the Company to hospitals are drugs other than injectable pharmaceuticals. The new classification reflects that the segment includes both hospital drugs and injectable pharmaceuticals. The contract services segment manufactures products for third party pharmaceutical and biotechnology customers based on their specifications. Selected financial information by industry segment is presented below (in thousands).

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2006	2005	2006	2005
REVENUES				
Ophthalmic	$ 6,139	$ 5,779	$ 15,649	$ 17,102
Hospital Drugs & Injectables	6,028	3,152	35,029	10,415
Contract Services	2,323	2,054	6,017	6,227
Total revenues	$ 14,490	$ 10,985	$ 56,695	$ 33,744
GROSS PROFIT				
Ophthalmic	$ 2,198	$ 2,261	$ 5,483	$ 6,453
Hospital Drugs & Injectables	3,070	1,255	15,437	4,630
Contract Services	683	152	1,719	780
Total gross profit	5,951	3,668	22,639	11,863
Operating expenses	7,220	5,685	21,240	16,321
Operating income (loss)	(1,269)	(2,017)	1,399	(4,458)
Interest & Other income (expense)	202	(595)	(912)	(1,705)
Debt Retirement gain/(expense)			(391)	1,212
Income/(Loss) before income taxes	$ (1,067)	$ (2,612)	$ 96	$ (4,951)

The Company manages its business segments to the gross profit level and manages its operating and other costs on a company-wide basis. Intersegment activity at the gross profit level is minimal. The Company does not identify assets by segment for internal purposes, as certain manufacturing and warehouse facilities support more than one segment.

NOTE L COMMITMENTS AND CONTINGENCIES

(i) The FDA issued the Company a warning letter (Warning Letter) in October 2000 following a routine inspection of its Decatur manufacturing facility. An FDA warning letter is intended to provide notice to a company of violations of the laws administered by the FDA and to elicit voluntary corrective action. The Warning Letter cited violations of regulatory requirements identified during the 2000 inspection and requested that the Company take corrective actions. Under the terms of the Warning Letter, the Company was unable to obtain any approvals to market new products and government agencies were notified of its non-compliant status. Additional FDA inspections in 2002, 2003 and 2004 identified additional and recurring violations resulting in continuance of the Warning Letter. During this time, the FDA initiated no enforcement action.

Since 2000, and in response to the violations cited by the FDA, the Company has implemented a comprehensive systematic corrective action plan at its Decatur manufacturing facility. The Company maintained regular communications with the FDA and provided periodic progress reports.

On December 13, 2005, the FDA notified the Company that it had satisfactorily implemented corrective actions and the FDA had determined that the Decatur manufacturing facility was in substantial compliance with current Good Manufacturing Practices regulations. Consequently, the restrictions of the Warning Letter were removed and the Company became eligible for new product approvals for products manufactured at its Decatur manufacturing facility.

While under the Warning Letter restrictions from 2000 to 2005, the Company s inability to fully utilize the capabilities of the Decatur manufacturing facility had a material adverse effect on its business, financial condition and results of operations.

(ii) The Company anticipates completing its lyophilization facility validation and having a PAI by the FDA in the first quarter of 2007. However, the commissioning of the lyophilization facility is contingent upon a successful PAI to be conducted by the FDA.

(iii) In the quarter ended March 31, 2006, the Company recorded product warranty expense of approximately $1,121,000 and recognized the corresponding long-term liability for its obligation pertaining to the sale of two injectable antidotes to the United States Department of Health and Human Services (HHS). This obligation provides that the Company will guarantee the stability of the injectable antidotes to HHS for a period of ten years from the shipment date. In the event either of these two products does not retain its stability during this ten year period, the Company is obligated to replace the product at no cost to HHS.

Accordingly, the Company recognized a contingent liability equal to approximately $1,121,000 for the replacement cost of the injectable antidotes associated with the ten year stability guarantee to HHS in the quarter ended March 31, 2006, when product revenues were recognized for this customer order. In the quarter ending September 30, 2006, the Company recorded an additional $10,000 liability for the replacement cost of injectable antidote products sold to the U.S. Department of Veterans Affairs. Because these obligations represent a long-term liability for the Company, they were recorded under a new line item titled Product warranty .

(iv) The Company is a party in legal proceedings and potential claims arising in the ordinary course of its business. The amount, if any, of ultimate liability with respect to such matters cannot be determined. Despite the inherent uncertainties of litigation, management of the Company at this time does not believe that such proceedings will have a material adverse impact on the financial condition, results of operations, or cash flows of the Company.

NOTE M CUSTOMER AND SUPPLIER CONCENTRATION

The Company s major customer for the nine month period ended September 30, 2006 was HHS, which purchased $21,962,000 of the Company s injectable antidote products during the first quarter of 2006. The Company did not sell to HHS in 2005. AmerisourceBergen Health Corporation (Amerisource), Cardinal Health, Inc. (Cardinal) and McKesson Drug Company (McKesson) are all distributors of the Company s products, as well as suppliers of a broad range of health care products. These three customers accounted for 71% and 61% of the Company s gross revenues and 58% and 46% of net revenues for the three months ended September 30, 2006 and 2005, respectively. They accounted for approximately 78% and 61% of the gross accounts receivable balances as of September 30, 2006 and 2005, respectively. These three customers accounted for 49% and 60% of the Company s gross revenues and 32% and 45% of net revenues for the nine months ended September 30, 2006 and 2005, respectively. No other customers accounted for more than 10% of gross sales, net revenues or gross trade receivables for the indicated dates and periods.

If sales to any of Amerisource, Cardinal or McKesson were to diminish or cease, the Company believes that the end users of its products would find little difficulty obtaining the Company s products either directly from the Company or from another distributor.

No supplier of products accounted for more than 10% of the Company s purchases in the three months ended September 30, 2006 and 2005, respectively. For the nine months ended September 30, 2006, Hameln Pharmaceuticals GmbH accounted for 15% of the Company s purchases. For the nine months ended September 30, 2005, Cardinal Health PTS, LLC accounted for 21% of the Company s purchases.

The Company requires a supply of quality raw materials and components to manufacture and package pharmaceutical products for its own use and for third parties with which it has contracted. The principal components of the Company s products are active and inactive pharmaceutical ingredients and certain packaging materials. Certain of these ingredients and components are available from only a single source and, in the case of certain of the Company s Abbreviated New Drug Applications (ANDAs) and New Drug Applications (NDAs), only one supplier of raw materials has been identified. Because FDA approval of drugs requires manufacturers to specify their proposed suppliers of active ingredients and certain packaging materials in their applications, FDA approval of any new supplier would be required if active ingredients or such packaging materials were no longer available from the

specified supplier. The qualification of a new supplier could delay the Company s development and marketing efforts. If for any reason the Company is unable to obtain sufficient quantities of any of the raw materials or components required to produce and package its products, it may not be able to manufacture its products as planned, which could have a material adverse effect on the Company s business, financial condition and results of operations.

Item 2.

AKORN, INC.
MANAGEMENT S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS AND FACTORS AFFECTING FUTURE RESULTS

Certain statements in this Form 10-Q constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act. When used in this document, the words anticipate, believe, estimate and expect a similar expressions are generally intended to identify forward-looking statements. Any forward-looking statements, including statements regarding the intent, belief or expectations of Akorn or its management are not guarantees of future performance. These statements involve risks and uncertainties and actual results may differ materially from those in the forward-looking statements as a result of various factors, including but not limited to:

Our ability to comply with all of the requirements of the FDA, including current Good Manufacturing Practices regulations;

Our ability to obtain regulatory approvals of, commence operations at and obtain business for our new lyophilization facility;

Our ability to generate cash from operations sufficient to meet our working capital requirements;

The effects of federal, state and other governmental regulation on our business;

Our success in developing, manufacturing, acquiring and marketing new products;

The success of our strategic partnerships for the development and marketing of new products;

Our ability to bring new products to market and the effects of sales of such products on our financial results;

The effects of competition from generic pharmaceuticals and from other pharmaceutical companies;

Availability of raw materials needed to produce our products; and

Other factors referred to in this Form 10-Q, our Form 10-K and our other Securities and Exchange Commission (SEC) filings.

RESULTS OF OPERATIONS

THREE MONTHS ENDED SEPTEMBER 30, 2006 COMPARED TO 2005

The following table sets forth, for the periods indicated, revenues by segment, excluding intersegment sales (in thousands):

	THREE MONTHS ENDED SEPTEMBER 30,	
	2006	**2005**
Ophthalmic segment	$ 6,139	$ 5,779
Hospital Drugs & Injectables segment	6,028	3,152
Contract Services segment	2,323	2,054
Total revenues	$ 14,490	$ 10,985

Consolidated revenues increased $3,505,000 or 31.9% in the quarter ended September 30, 2006 compared to the same period in 2005. Ophthalmic segment revenues increased $360,000 or 6.2% due to higher sales of diagnostic ophthalmic products. Hospital Drugs & Injectables segment revenues increased by $2,876,000 or 91.2% reflecting the favorable impact of three product launches.

Our contract services segment revenues increased by $269,000 or 13.1% and includes the impact of product deliveries that were deferred from the second quarter.

Consolidated gross profit was $5,951,000 or 41.1% for the third quarter of 2006 as compared to a gross profit of $3,668,000 or 33.4% in the same period a year ago mainly due to the sales volume variation matters for each segment discussed above. We continue to seek margin enhancement opportunities through our product offerings as well as through cost reductions at our operating facilities.

Selling, general and administrative (SG&A) expenses increased by $332,000 or 8.5%, during the quarter ended September 30, 2006 as compared to the same period in 2005. The key components of this increase in 2006 were management bonus expense of $300,000 and SFAS 123(R) stock option compensation expense of $325,000, partially offset by a reduction in bad debt expense of $197,000 for 2006.

Research and development (R&D) expense increased $1,211,000 or 84.2% in the quarter, to $2,649,000 from $1,438,000 for the same period in 2005, mainly due to continued testing and development of our lyophilization processes ($833,000), increased spending on improvements in regulatory compliance measures ($286,000), and spending on new product development ($654,000) in 2006. This increase in R&D expense was partially offset by a reduction in product development expenses for the Joint Venture Company of approximately $562,000.

Interest income for the third quarter of 2006 was $230,000 versus interest expense of $595,000 for the same period in 2005 as we retired our subordinated and convertible debt instruments in early 2006 and invested our cash proceeds from our operations and the March 2006 common stock and warrant offering.

For the three-month period ended September 30, 2006 the income tax provision was zero due to the quarterly net loss. There was a $2,000 state tax provision for the same period in 2005.

We reported a net loss of $1,067,000 for the three months ended September 30, 2006, versus a net loss of $2,614,000 for the same period in 2005 mainly due to the increased sales volumes partially offset by higher administrative and research expenses discussed above.

NINE MONTHS ENDED SEPTEMBER 30, 2006 COMPARED TO 2005

The following table sets forth, for the periods indicated, revenues by segment, excluding intersegment sales (in thousands):

	NINE MONTHS ENDED SEPTEMBER 30,	
	2006	**2005**
Ophthalmic segment	$ 15,649	$ 17,102
Hospital Drugs & Injectables segment	35,029	10,415
Contract Services segment	6,017	6,227
Total revenues	$ 56,695	$ 33,744

Consolidated revenues increased $22,951,000 or 68.0% for the nine months ended September 30, 2006 compared to the same period in 2005.

Ophthalmic segment revenues decreased $1,453,000 or 8.5% for the nine months ended September 30, 2006 compared to the same period in 2005. This was mainly due to reduced export sales of ophthalmic diagnostic products.

Hospital Drugs & Injectable segment revenues increased $24,614,000 or 236.3% for the nine months ended September 30, 2006 compared to the same period in 2005 mainly due to a $21,962,000 order for antidote products which is discussed below. In addition, we continue to experience volume growth in our other antidote and hospital anesthetic products.

On December 30, 2005, we received a commercial item award from HHS for the procurement of two injectable antidotes. These two products were introduced to our antidote product line under an exclusive license and supply agreement that was executed on November 16, 2004. The commercial item award provided for a combined total of 450,000 units. In addition, the award contains an

option that may be exercised by HHS during a five-year period to purchase an additional one million units. We recognized revenues for this customer order in March 2006.

For the year ended December 31, 2005, we recognized revenues of approximately $44.5 million and for the quarter ended March 31, 2006, we recognized revenues of approximately $29.7 million, including approximately $22 million that was recognized from injectable antidote product shipments to HHS. Our projected outlook statement for 2006 vs. 2005 year-over-year consolidated revenue growth indicated that 2006 revenues will exceed 2005 revenues by approximately 50%. This projected outlook statement for 2006 consolidated revenue growth includes the impact of revenue recognized from the two injectable antidotes that were sold to HHS in the quarter ended March 31, 2006. We do not expect continuing sales of DTPA throughout the remainder of 2006 in the volumes experienced in the first quarter 2006, given the fact that the commercial item award option has a five-year life and there is no assurance when, if ever, the additional volumes will be made, and also that purchases of DTPA from other sources are speculative.

Year-to-date consolidated gross profit was $22,639,000 or 39.9% for 2006 as compared to a gross profit of $11,863,000 or 35.2% for the same period a year ago mainly due to the sales volume variation matters for each segment discussed above. We continue to seek margin enhancement opportunities through our product offerings as well as through cost reductions at our operating facilities.

SG&A expenses increased by $2,418,000 or 22.1%, for the year to date period ended September 30, 2006 as compared to the same period in 2005. The key components of this increase in 2006 were management bonus expense of $1,151,000, increased restricted stock compensation expense of $225,000 and $1,026,000 in SFAS 123(R) stock option compensation expense for 2006.

R&D expense increased $2,612,000 or 62.1% for the nine months ended September 30, 2006, to $6,815,000 from $4,203,000 for the same period in 2005 mainly due to continued testing and development of our lyophilization processes ($2,188,000), increased spending on improvements in regulatory compliance measures ($1,011,000), and spending on new product development ($1,227,000) in 2006. This increase in R&D expense was partially offset by a reduction in product development expenses for the Joint Venture Company of approximately $1,813,000.

Interest expense for the nine month period ended September 30, 2006 was $855,000 versus $1,705,000 for the same period in 2005. The change compared to the same period in the prior year was mainly due to the $1,059,000 of amortization of debt discount in accordance with retiring the convertible debt and subordinated notes in the first quarter of 2006 which was offset by lower interest cost in accordance with retiring that debt and interest earned from investing our cash proceeds from operations and the March 2006 common stock and warrant offering.

For the nine month period ended September 30, 2006 the income tax provision was zero as we are utilizing prior years tax losses to offset the tax liability on income in 2006. For the same period in 2005, there was income tax expense of $17,000 related primarily to prior periods.

We reported net income of $96,000 for the nine months ended September 30, 2006, versus a net loss of $4,968,000 for the same period in 2005 mainly due to the increase in revenues discussed above and the $1,212,000 impact of the 2005 NeoPharm debt retirement gain in 2005. See Item 8. Financial Statements and Supplementary Data, Note G Financing Arrangements in our Form 10-K filed March 30, 2006, for further information regarding the retirement of the NeoPharm debt.

FINANCIAL CONDITION AND LIQUIDITY

Overview

During the nine-month period ended September 30, 2006, we generated $1,872,000 in cash provided from operations, primarily due to non-cash expenses of $5,027,000 for the period, offset by a $3,251,000 change in working capital items mainly due to higher receivables levels with wholesalers. Investing activities generated a $3,571,000 reduction in cash flow mainly due to capital expenditures for production equipment, including an early buyout of our Serail Lyophilization equipment operating lease from National City Leasing Corporation for $1,505,000. Financing activities provided $20,431,000 in cash, primarily due to the $18,078,000 net proceeds from the March 2006 common stock and warrants offering and the $3,542,000 net proceeds from the offering to the Serum Institute of India, Ltd. (see Item 1. Financial Statements, Note I Common Stock Issuance), along with proceeds of $1,819,000 from stock option and warrant exercises, offset by $2,767,000 repayment of long-term debt. In addition, on March 31, 2006, $7,298,000 in principal and accrued interest on certain outstanding convertible notes was retired by conversion into

3,540,281 shares of our common stock (see Item 1. Financial Statements, Note H Financing Arrangements).

During the nine month period ended September 30, 2005, we provided $602,000 in cash from operations, primarily due to a $4,761,000 decrease in accounts receivable, offset by the net loss, which was offset by non-cash amortization and depreciation, and a $1,500,000 prepayment to our Joint Venture Company to develop ANDAs and a $3,279,000 reduction in accounts payable. Investing activities during the nine month period ended September 30, 2005, include a $75,000 licensing fee, as well as $744,000 of capital expenditures primarily related to the lyophilized (freeze-dried) pharmaceuticals manufacturing line expansion. Financing activities used $1,869,000 in cash, due to the $2,500,000 repayment of the NeoPharm Note, offset by $884,000 proceeds from stock option and warrant exercises.

As of September 30, 2006, we had $19,523,000 in cash and $9,925,000 of undrawn availability under our Credit Facility with LaSalle Bank which is based on our level of accounts receivable and inventory and certain equipment as of September 30, 2006. There was no borrowing against the Revolver at September 30, 2006.

Facility Expansion

We are in the process of completing an expansion of our Decatur, Illinois manufacturing facility to add capacity to provide lyophilization manufacturing services, a manufacturing capability we currently do not have. As of September 30, 2006, we had spent approximately $22,096,000 on the lyophilization expansion and anticipate the need to spend approximately $300,000 of additional funds to complete the expansion. The majority of the additional spending will be focused on final validation testing of the lyophilization facility as the major capital equipment items are currently in place.

Commissioning of the lyophilization facility in 2007 will be contingent upon a successful pre-approval inspection to be conducted by the FDA. Manufacturing capabilities for lyophilized products are subsequently projected to be in service by the first quarter of 2007.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. A summary of our significant accounting policies is included in Item 1. Financial Statements, Note B Summary of Significant Accounting Policies, which are included in our Annual Report on Form 10-K for the year ended December 31, 2005. Certain of our accounting policies are considered critical, as these policies require significant, difficult or complex judgments by management, often employing the use of estimates about the effects of matters that are inherently uncertain. Such policies are summarized in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations of our Annual Report on Form 10-K for the year ended December 31, 2005. There have been no significant changes in the application of the critical accounting policies since December 31, 2005.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

At December 31, 2005, we were subject to market risk associated with changes in interest rates involving two debt instruments. Debt under the 2003 Subordinated Notes bore interest at prime plus 1.75%. Each of the Tranche A and Tranche B Notes bore interest at prime plus 3.0%. We estimated that a change of 1% in our variable rate debt from interest rates in effect at December 31, 2005 would have resulted in a $105,000 pre-tax change in annual interest expense.

We are no longer affected by changes in market interest rates as our variable interest rate debt has been paid off (See Item 1. Financial Statements, Note H Financing Arrangements). At September 30, 2006, our only outstanding debt is the mortgage on our Decatur property which is set at a fixed rate of 7.375%.

ITEM 4. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Securities Exchange Act of 1934, as amended (Exchange Act), reports is recorded, processed, summarized and reported within the periods specified in the SEC s rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act. Based on

that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this

report, our disclosure controls and procedures are effective in timely communicating to them the material information relating to us required to be included in our periodic SEC filings.

There were no changes to our internal controls over financial reporting that occurred during our most recently completed fiscal quarter that materially affected, or are reasonably likely to materially affect our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are a party in legal proceedings and potential claims arising in the ordinary course of our business. The amount, if any, of ultimate liability with respect to such matters cannot be determined. Despite the inherent uncertainties of litigation, we at this time do not believe that such proceedings will have a material adverse impact on the financial condition, results of operations, or cash flows of us.

ITEM 1A. RISK FACTORS

There have been no material changes from the risk factors disclosed in Part 1, Item 1A, of our Form 10-K filed March 30, 2006.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On August 23, 2005, we filed a Registration Statement on Form S-3 (File No. 333-127794) (the S-3) with the SEC, which was declared effective on September 7, 2005. Pursuant to Rule 429 under the Securities Act of 1933, the prospectus included in the S-3 is a combined prospectus and relates to the previously filed Registration Statement on Form S-1 (File No. 333-119168) (the S-1), as to which the S-3 constitutes Post-Effective Amendment No. 3. Such Post-Effective Amendment became effective concurrently with the effectiveness of the S-3. The S-3 relates to the resale of 64,964,680 shares, no par value per share, of our common stock by the selling stockholders identified in the S-3, which have been issued or reserved for issuance upon the conversion or exercise of presently outstanding shares of our Series A 6.0% Participating Convertible Preferred Stock (Series A Preferred Stock), shares of Series B 6.0% Participating Convertible Preferred Stock (Series B Preferred Stock), warrants and convertible notes, including shares estimated to be issuable in satisfaction of accrued and unpaid dividends and interest on shares of preferred stock and convertible notes, respectively. Of the 64,964,680 shares of our common stock registered under the S-3, 60,953,394 of such shares were registered under the S-1. The shares of common stock registered by the S-3 and the S-1 represent the number of shares that have been issued or are issuable upon the conversion or exercise of the Series A Preferred Stock, Series B Preferred Stock, warrants and convertible notes described in the Registration Statement, including shares estimated to be issuable in satisfaction of dividends accrued and unpaid through December 31, 2007 and interest accrued and unpaid through December 20, 2006 on such securities.

With respect to the S-1, we estimated the aggregate offering price of the amount registered to be $182,246,053, which was derived from the average of the bid and asked prices of our common stock on September 17, 2004, as reported on the OTC Bulletin Board(R). With respect to the S-3, we estimated the aggregate offering price of the amount registered to be $10,870,585, which was derived from the average of the high and low prices of our common stock as reported on the American Stock Exchange on August 18, 2005. Such amounts were estimated solely for the purpose of calculating the amount of the registration fee pursuant to Rule 457(h) under the Securities Act of 1933. As of September 30, 2006, we are aware of the sale of 4,679,943 shares of common stock by selling stockholders under the S-3 or the S-1. We do not know at what price such shares were sold, or how many shares of common stock will be sold in the future or at what price. We have not and will not receive any of the proceeds from the sale of the shares by the selling stockholders. The selling stockholders will receive all of the proceeds from the sale of the shares and will pay all underwriting discounts and selling commissions, if any, applicable to the sale of the shares. We will, in the ordinary course of business, receive proceeds from the issuance of shares upon exercise of the warrants described in the S-3 or the S-1, which we will use for working capital and other general corporate purposes.

For the quarter ended September 30, 2006, we issued the following equity securities that have not been previously reported on a Form 8-K: (i) On September 22, 2006, a warrantholder exercised warrants to purchase 297,333 shares of our common stock at an exercise price of $1.00 per share by providing us with notice of election to exercise on a cashless basis. By exercising on a cashless basis the warrantholder authorizes us to withhold from issuance such number of shares of common stock that would otherwise be issuable upon such exercise of the warrant which when

multiplied by the market price of the common stock as of the date of exercise is equal to the

aggregate exercise price. The number of shares of common stock that would otherwise have been issuable upon the exercise of such warrants was reduced by 84,230 shares, an aggregate value of $297,333 as of the exercise date. Accordingly, we issued 213,103 shares of our common stock upon such exercise. (ii) Also on September 22, 2006, a warrantholder exercised warrants to purchase 166,667 shares of our common stock at an exercise price of $1.00 per share by providing us with notice of exercise on a cashless basis. By exercising on a cashless basis, the number of shares of common stock that would otherwise have been issuable upon the exercise of such warrants was reduced by 47,214 shares, an aggregate value of $166,667 as of the exercise date. Accordingly, we issued 119,453 shares of our common stock upon such exercise. (iii) Also on September 22, 2006, a warrantholder exercised warrants to purchase 166,667 shares of our common stock at an exercise price of $1.00 per share by providing us with notice of exercise on a cashless basis. By exercising on a cashless basis, the number of shares of common stock that would otherwise have been acquired upon the exercise of such warrants was reduced by 47,214 shares, an aggregate value of $166,667 as of the exercise date. Accordingly, we issued 119,453 shares of our common stock upon such exercise. (iv) On September 25, 2006, a warrantholder exercised warrants to purchase 233,333 shares of our common stock at an exercise price of $1.00 per share in exchange for cash of $233,333. (v) On September 29, 2006, a warrantholder exercised warrants to purchase 8,333 shares of our common stock at an exercise price of $1.00 per share by providing us with notice of exercise on a cashless basis. By exercising on a cashless basis, the number of shares of common stock that would otherwise have been issuable upon the exercise of such warrants was reduced by 2,308 shares, an aggregate value of $8,333 as of the exercise date. Accordingly, we issued 6,025 shares of our common stock upon such exercise. The issuance of our common stock upon exercise of the warrants described herein was exempt from registration requirements under the Securities Act of 1933, as amended, pursuant to Section 4(2) thereof, because none of the transactions involved a public offering.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Those exhibits marked with an asterisk (*) refer to exhibits filed herewith. The other exhibits are incorporated herein by reference, as indicated in the following list.

Exhibit No.	Description
(3.1)	Restated Articles of Incorporation of Akorn, Inc. dated September 16, 2004, incorporated by reference to Exhibit 3.1 to Akorn, Inc. s Registration Statement on Form S-1 filed on September 21, 2004.
(3.2)	Amended and Restated By-laws of Akorn, Inc. incorporated by reference to Exhibit 3.2 to Akorn, Inc. s Registration Statement on Form S-1 filed on June 14, 2005.
(3.3)	Amendment to By-laws of Akorn, Inc. incorporated by reference to Exhibit 3.1 to the Akorn, Inc. s report on Form 8-K filed on March 31, 2006.
(4.1)	First Amendment dated October 7, 2003 to Registration Rights Agreement dated July 12, 2001 between Akorn, Inc. and The John N. Kapoor Trust dated 9/20/89, incorporated by reference to Exhibit 4.1 to Akorn, Inc. s report on Form 8-K filed on October 24, 2003.
(4.2)	Form of Warrant Certificate, incorporated by reference to Exhibit 4.2 to Akorn, Inc. s report on Form 8-K filed on October 24, 2003.
(4.3)	Form of Warrant Agreement dated October 7, 2003 between Akorn, Inc. and certain investors, incorporated by reference to Exhibit 4.3 to Akorn, Inc. s report on Form 8-K filed on October 24, 2003.
(4.4)	Warrant Agreement dated October 7, 2003 between Akorn, Inc. and The John N. Kapoor Trust dated 9/20/89 issued with respect to New Credit Facility guaranty, incorporated by reference to Exhibit 4.4 to Akorn, Inc. s report on Form 8-K filed on October 24, 2003.
(4.5)	Warrant Agreement dated October 7, 2003 between Akorn, Inc. and Arjun C. Waney issued with respect to New Credit Facility guaranty, incorporated by reference to Exhibit 4.5 to Akorn, Inc. s report on Form 8-K filed on October 24, 2003.
(4.6)	Warrant Agreement dated October 7, 2003 between Akorn, Inc. and The John N. Kapoor Trust dated 9/20/89 issued with respect to the Notes, incorporated by reference to Exhibit 4.6 to Akorn, Inc. s report on Form 8-K filed on October 24, 2003.
(4.7)	Warrant Agreement dated October 7, 2003 between Akorn, Inc. and Arjun C. Waney issued with respect to the Notes, incorporated by reference to Exhibit 4.7 to the Akorn, Inc. s report on Form 8-K filed on October 24, 2003.
(4.8)	Warrant Agreement dated October 7, 2003 between Akorn, Inc. and Argent Fund Management Ltd. issued with respect to the Notes, incorporated by reference to Exhibit 4.8 to Akorn, Inc. s report on Form 8-K filed on October 24, 2003.
(4.9)	Registration Rights Agreement dated October 7, 2003 among Akorn, Inc. and certain investors, incorporated by reference to Exhibit 4.9 to Akorn, Inc. s report on Form 8-K filed on October 24, 2003.
(4.10)	Form of Subscription Agreement between Akorn, Inc. and certain investors, incorporated by reference to Exhibit 4.1 to Akorn, Inc. s report on Form 8-K filed on August 24, 2004.

(4.11) Form of Common Stock Purchase Warrant between Akorn, Inc. and certain investors, incorporated by reference to Exhibit 4.2 to Akorn, Inc. s report on Form 8-K filed on August 24, 2004.

(4.12) Warrant Purchase and Registration Agreement dated June 18, 2003 between Akorn Inc. and AEG Partners LLC, incorporated by reference to Exhibit 4.1 to Akorn, Inc. s report on Form 8-K filed on August 27, 2004.

(4.13) Stock Registration Rights Agreement dated November 15, 1990 between Akorn, Inc. and The John N. Kapoor Trust dated 9/20/89, incorporated by reference to Exhibit 4.12 to Akorn, Inc. s Registration Statement on Form S-1 filed on September 21, 2004.

Exhibit No.	Description
(4.14)	Stock Purchase Agreement dated November 15, 1990 between Akorn, Inc. and The John N. Kapoor Trust dated 9/20/89, incorporated by reference to Exhibit 4.13 to Akorn, Inc. s Registration Statement on Form S-1 filed on September 21, 2004.
(4.15)	Form of Securities Purchase Agreement dated March 1, 2006 between Akorn, Inc. and certain investors, incorporated by reference to Exhibit 4.1 to Akorn Inc. s report on Form 8-K filed March 7, 2006.
(4.16)	Form of Warrant issued in connection with the Securities Purchase Agreement dated March 1, 2006, incorporated by reference to Exhibit 4.2 to Akorn, Inc. s report on Form 8-K filed on March 7, 2006. (All warrants are dated March 8, 2006. Please see Exhibit 99.1 of Akorn, Inc. s report on Form 8-K filed March 14, 2006, which is hereby incorporated by reference, for a schedule setting forth the other material details for each of the warrants.)
(4.17)	Securities Purchase Agreement dated September 13, 2006, between Akorn, Inc. and Serum Institute of India, incorporated by reference to Exhibit 4.1 to Akorn Inc. s report on Form 8-K filed September 14, 2006.
(10.1)	Waiver and Consent to Credit Agreement dated September 13, 2006, among LaSalle Bank National Association, the financial institutions party thereto, Akorn, Inc. and Akorn (New Jersey), Inc. incorporated by reference to Exhibit 10.1 to Akorn Inc. s report on Form 8-K filed September 14, 2006.
(10.2)*	Akorn, Inc. Director Compensation Agreement
(31.1)*	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934
(31.2)*	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934
(32.1)*	Certification of Chief Executive Officer pursuant to 18 U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002
(32.2)*	Certification of Chief Financial Officer pursuant to 18 U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AKORN, INC.

/s/ JEFFREY A. WHITNELL

Jeffrey A. Whitnell
Sr. Vice President, Chief Financial Officer
(Duly Authorized and Principal Financial Officer)

Date: November 9, 2006