

LANNETT CO INC  
Form 10-K  
August 29, 2014  
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# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## FORM 10-K

(Mark One)

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended June 30, 2014

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES 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)

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**State of Delaware**  
State of Incorporation

**23-0787699**  
I.R.S. Employer I.D. No.

**9000 State Road**

**Philadelphia, Pennsylvania 19136**

**Registrant's telephone number, including area code: (215) 333-9000**

(Address of principal executive offices and telephone number)

Securities registered under Section 12(b) of the Exchange Act:

**Common Stock, \$.001 Par Value**

(Title of class)

Securities registered under Section 12(g) of the Exchange Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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  No

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

Aggregate market value of common stock held by non-affiliates of the registrant, as of December 31, 2013 was \$960,641,606 based on the closing price of the stock on the NYSE.

As of July 31, 2014, there were 35,684,367 shares of the registrant's common stock, \$.001 par value, outstanding.

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**CAUTIONARY STATEMENT FOR PURPOSES OF THE SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995.**

This Annual Report on Form 10-K contains forward-looking statements in Item 1A Risk Factors, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations and in other statements throughout the report. Any statements made in this Annual Report that are not statements of historical fact or that refer to estimated or anticipated future events are forward-looking statements. We have based our forward-looking statements on our management's beliefs and assumptions based on information available to them at this time. Such forward-looking statements reflect our current perspective of our business, future performance, existing trends and information as of the date of this filing. These include, but are not limited to, our beliefs about future revenue and expense levels, growth rates, prospects related to our strategic initiatives and business strategies, express or implied assumptions about government regulatory action or inaction, anticipated product approvals and launches, business initiatives and product development activities, assessments related to clinical trial results, product performance and competitive environment, and anticipated financial performance. Without limiting the generality of the foregoing, words such as may, will, expect, believe, anticipate, intend, could, would, estimate, continue, or pursue, or the negative other variations thereof or comparable terminology, are intended to identify forward-looking statements. The statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. We caution the reader that certain important factors may affect our actual operating results and could cause such results to differ materially from those expressed or implied by forward-looking statements. We believe the risks and uncertainties discussed under the Item 1A - Risk Factors and other risks and uncertainties detailed herein and from time to time in our SEC filings, may affect our actual results.

We disclaim any obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise. We also may make additional disclosures in our Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and in other filings that we may make from time to time with the SEC. Other factors besides those listed here could also adversely affect us. This discussion is provided as permitted by the Private Securities Litigation Reform Act of 1995, as amended.

**PART I**

**ITEM 1. DESCRIPTION OF BUSINESS**

**Business Overview**

Lannett Company, Inc. and subsidiaries (the Company, Lannett, we, or us) was incorporated in 1942 under the laws of the Commonwealth of Pennsylvania, and reincorporated in 1991 as a Delaware corporation. We develop, manufacture, market and distribute generic versions of brand pharmaceutical products. We report financial information on a quarterly and fiscal year basis with the most recent being the fiscal year ended June 30, 2014. All references herein to a fiscal year or Fiscal refer to the applicable fiscal year ended June 30.

The Company has experienced net sales growth at a compounded annual growth rate in excess of 22% over the past twelve years. In that time period net sales went from \$25.1 million in fiscal year 2002 to \$273.8 million in fiscal year 2014. This growth has been achieved through favorable product pricing environments, strategic partnerships, and launches of additional manufactured drugs, as well as opportunities resulting from our strong historical record of regulatory compliance.

All products that we currently manufacture and/or distribute are prescription products. Of the products listed in the table entitled "Current Products" below, our top five products in each year collectively accounted for 74% of our net sales in fiscal year 2014 and 69% of our net sales in fiscal years 2013 and 2012.

### **Competitive Strengths**

*Vertically Integrated Manufacturer, Supplier and Distributor of Narcotics and Controlled Drugs.* In July 2008, the U.S. Drug Enforcement Administration (DEA) granted Cody Laboratories, Inc. (Cody Labs) a license to directly import concentrated poppy straw for conversion into opioid-based active pharmaceutical ingredients (APIs) for use in various dosage forms for pain management. This license, along with Cody Labs' expertise in API development and manufacture allows the Company to perform in a market with high barriers to entry, no foreign competition, and limited domestic competition. Because of this vertical integration, the Company has direct control of its supply and can avoid increased costs associated with buying APIs from third-party manufacturers, thereby achieving higher margins.

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*Proven Ability to Develop Successful Products and Achieve Scale in Production.* We believe that our ability to select viable products for development, efficiently develop such products, including obtaining any applicable regulatory approvals, vertically integrate into certain markets and achieve economies of scale in production are critical to our success in the generic pharmaceutical industry. We intend to focus on long-term profitability driven in part by securing market positions with less competition.

*Efficient Development Systems and Manufacturing Expertise for New Products.* We believe that our manufacturing expertise, low overhead expenses, efficient product development, and marketing capabilities can help us remain competitive in the generic pharmaceutical market. We intend to dedicate significant capital toward developing new products because we believe our success is linked to our ability to continually introduce new generic products into the marketplace. Competition from new and other market participants for the manufacture and distribution of certain products would likely affect our market share with respect to such products as well as force us to reduce our selling price for such products due to their increased availability. As a result, we believe that our success depends on our ability to properly assess the competitive market for new products, including market share, the number of competitors and the generic unit price erosion. We intend to reduce our exposure to competitive influences that may negatively affect our sales and profits, including the potential saturation of the market for certain products, by continuing to emphasize maintenance of a strong research and development ( R&D ) pipeline.

*Mutually Beneficial Supply and Distribution Arrangements.* In 2004, we entered into an exclusive ten-year distribution agreement (the JSP Distribution Agreement ) with Jerome Stevens Pharmaceuticals ( JSP ) covering four different product lines. On August 19, 2013, the Company entered into an agreement with JSP to extend its initial contract to continue as the exclusive distributor in the United States of three JSP products: Butalbital, Aspirin, Caffeine with Codeine Phosphate Capsules USP; Digoxin Tablets USP; Levothyroxine Sodium Tablets USP. The amendment to the original agreement extends the initial contract, which was due to expire on March 22, 2014, for five years. In connection with the amendment, the Company issued 1.5 million shares of the Company s common stock to JSP and its designees. In accordance with its policy related to renewal and extension costs for recognized intangible assets, the Company recorded a \$20.1 million expense in cost of sales, which represented the fair value of the shares on August 19, 2013. If the parties agree to a second five year extension from March 23, 2019 to March 23, 2024, the Company is required to issue to JSP or its designees an additional 1.5 million shares of the Company s common stock. Both Lannett and JSP have the right to terminate the contract if one of the parties does not cure a material breach of the contract within thirty (30) days of notice from the non-breaching party. Levothyroxine Sodium and Digoxin, collectively accounted for 57% of our net sales in fiscal year 2014 and both products have experienced significant growth in sales over the past few years.

During the term of the agreement and related amendment, the Company is required to use commercially reasonable efforts to purchase minimum dollar quantities of JSP products. The Company has met the minimum purchase requirement for the first ten years of the contract, but there is no guarantee that the Company will be able to continue to do so in fiscal year 2015 and in the future. If the Company does not meet the minimum purchase requirements, JSP s sole remedy is to terminate the agreement.

*Dependable Supplier to our Customers.* We believe we are viewed within the generic pharmaceutical industry as a strong, dependable supplier. We have cultivated strong and dependable customer relationships by maintaining adequate inventory levels, employing a responsive order filling system and prioritizing timely fulfillment of those orders. A majority of our orders are filled and shipped either on the day that we receive the order or the following day.

*Strong Track Record of Obtaining Regulatory Approvals for New Products.* During the past three fiscal years, we have received eleven approved Abbreviated New Drug Applications (each, an ANDA )/ANDA supplements from the Food and Drug Administration (the FDA ). Although the timing of ANDA approvals by the FDA is uncertain, we currently expect to receive several more during Fiscal 2015. These regulatory approvals will enable us to manufacture and supply a broader portfolio of generic pharmaceutical products.

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*Reputation for Regulatory Compliance.* We have a strong track record of regulatory compliance. We believe that we have strong effective regulatory compliance capabilities and practices which result from the hiring of qualified individuals and the implementation of strong current Good Manufacturing Practices ( cGMP ). Our agility in responding quickly to market events and a reputation for regulatory compliance position us to avail ourselves of market opportunities as they are presented to us.

In addition, narcotics which are classified by the DEA as controlled drugs are subject to a rigorous regulatory compliance regimen. We are one of seven companies in the U.S. that have been granted a license from the DEA to import raw concentrated poppy straw for conversion into APIs. Such licenses are renewed annually, and non-compliance could result in a license not being renewed. As a result, we believe that our strong reputation for regulatory compliance allows us to have a competitive edge in managing the production and distribution of controlled drugs.



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**Business Strategies**

*Continue to Broaden our Product Lines Through Internal Development and Strategic Partnerships.* We are focused on increasing our market share in the generic pharmaceutical industry while concentrating additional resources on the development of new products, with an emphasis on controlled substance products. We continue to improve our financial performance by expanding our line of generic products, increasing unit sales to current customers, creating manufacturing efficiencies, and managing our overhead and administrative costs.

We have targeted four strategies for expanding our product offerings: (1) deploying our experienced R&D staff to develop products in-house, (2) entering into product development agreements or strategic partnerships with third-party product developers and formulators, (3) purchasing ANDAs from other generic manufacturers and (4) marketing drugs under brand names. We expect that each method will facilitate our identification, selection and development of additional generic pharmaceutical products that we may distribute through our existing network of customers.

We have several existing supply and development agreements with both international and domestic companies, and are currently in negotiations on similar agreements with additional companies, through which we can market and distribute future products. We intend to capitalize on our strong customer relationships to build our market share for such products.

*Improve our Operating Profile in Certain Targeted Specialty Markets.* In certain situations, we may increase our focus on particular specialty markets within the generic pharmaceutical industry. By narrowing our focus to specialty markets, we can provide product alternatives in categories with relatively fewer market participants. We plan to strengthen our relationships with strategic partners, including providers of product development research, raw materials, APIs and finished products. We believe that mutually beneficial strategic relationships in such areas, including potential financing arrangements, partnerships, joint ventures or acquisitions, could enhance our competitive advantages in the generic pharmaceutical market.

*Leverage Ability to Vertically Integrate as a Manufacturer, Supplier and Distributor of Controlled Substance Products.* One initiative that is at the core of the Company's strategy is to continue leveraging the asset we acquired in 2007, Cody Labs. In July 2008, the DEA granted Cody Labs a license to directly import concentrated poppy straw for conversion into opioid-based APIs for use in various dosage forms for pain management. The value of this license comes from the fact that, to date, only six other companies in the U.S. have been granted this license. This license, along with Cody Labs' expertise in API development and manufacture, allows the Company to perform in a market with high barriers to entry, no foreign competition, and limited domestic competition. Because of this vertical integration, the Company has direct control of its supply and can avoid increased costs associated with buying APIs from third-party manufacturers, thereby achieving higher margins. The Company can also leverage this vertical integration not only for direct supply of opioid-based APIs, but also for the manufacture non-opioid-based APIs.

The Company believes that the demand for controlled substance, pain management drugs will continue to grow as the Baby Boomer generation ages. By concentrating additional resources in the development of opioid-based APIs and dosage forms, the Company is well-positioned to take advantage of this opportunity. The Company is currently vertically integrated on two products with several others in various stages of development.

**Key Products**

Levothyroxine Sodium tablets are produced and marketed with 12 varying potencies. Levothyroxine Sodium tablets are manufactured by JSP. Levothyroxine Sodium tablets remain one of the most prescribed drugs in the U.S. and are used by patients of various ages and demographic backgrounds for the treatment of thyroid deficiency. Net sales of Levothyroxine Sodium tablets totaled \$102.2 million in fiscal year 2014. In our distribution of these products, we compete with two brand Levothyroxine Sodium products AbbVie's Synthroid® and Pfizer's Levoxyl® as well as generic products from Mylan and Sandoz.

Digoxin tablets are produced and marketed with two different potencies. This product is manufactured by JSP and we distribute it under the JSP Distribution Agreement. Digoxin tablets are used to treat congestive heart failure in patients of various ages and demographics. Net sales of this product totaled \$54.7 million in fiscal year 2014. In our distribution of these products, we compete with a generic product from Impax and expect to compete against West-Ward, Caraco and the brand Lanoxin from Covis.

We distribute three products containing Butalbital. We have manufactured and sold Butalbital with Aspirin and Caffeine capsules for more than 20 years. Butalbital with Aspirin, Caffeine and Codeine Phosphate capsules is manufactured by JSP and distributed under the JSP Distribution Agreement. Additionally, in September 2012 the Company was approved to sell Butalbital, Acetaminophen and Caffeine Tablets. Butalbital products, which are orally administered capsule or tablet dosage forms, are prescribed to treat migraines and tension headaches caused by contractions of the muscles in the neck and shoulder area. The drug is prescribed primarily for adults of various demographics. Migraines are an increasingly prevalent condition in the United States and we believe the demand for effective medical treatments will continue to increase.

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Although new innovator drugs to treat migraines have been introduced by brand name drug companies, we believe that there is still a loyal following of doctors and consumers who prefer to use Butalbital products for treatment.

Cocaine Topical® Solution ( C-Topical® ) is produced and marketed under a preliminary new drug application ( PIND ) in two different strengths and two different size containers. Sales of C-Topical® were 8% of Lannett's net sales during fiscal year 2014. This drug is utilized primarily for the anesthetization of the patient during ear, nose or throat surgery.

Morphine Sulfate Oral Solution is produced and marketed in three different size containers. We manufacture this product at Cody Labs and are currently finishing the manufacturing methods and capabilities to make the API. This drug is prescribed primarily for the management of pain in adults where other products or delivery methods are not tolerable.

Oxycodone HCl Oral Solution ( Oxycodone ) was produced until August 20, 2012 and marketed until October 4, 2012 in two different size containers, at which point, as a result of FDA enforcement actions against all market participants, the Company voluntarily exited the market. Prior to the enforcement actions the Company had submitted an ANDA to the FDA. The Company was granted expedited review for this application. The Company expects to receive approval and resume selling Oxycodone in the near future. Once approval is granted, we will resume manufacture of these solution dosage forms at Cody Labs.

**Validated Pharmaceutical Capabilities**

Our 31,000 square foot manufacturing facility sits on 3.5 acres of Company owned land. In addition, we own a 63,000 square foot building residing on 3.0 acres of Company owned land. This facility is located within one mile of our manufacturing facility. The facility houses packaging and research and development, and has capacity for additional manufacturing space, if needed. We also own a 66,000 square foot building on 7.3 acres of land, which is used for certain administrative functions, warehouse space and shipping. It also has capacity for additional manufacturing space, if needed. All three of these buildings are located in Philadelphia, Pennsylvania.

The manufacturing facility of our wholly-owned subsidiary, Cody Labs, consists of an approximately 73,000 square foot facility located on approximately 15.0 acres of land in Cody, Wyoming. Cody Labs leases the facility from Cody LCI Realty, LLC ( Realty ), which is 50% owned by Lannett and 50% by a former officer of Cody Labs. Cody Labs' manufacturing facility currently has capacity for further expansion, both inside and outside the existing structure.

We have adopted many new processes in support of regulations relating to cGMPs in the last several years, and we believe we are operating our facilities in substantial compliance with the FDA's cGMP regulations. In designing our facilities, full attention was given to material flow, equipment and automation, quality control and inspection. A granulator, an automatic film coating machine, high-speed tablet presses, blenders, encapsulators, fluid bed dryers, high shear mixers, and high-speed bottle filling and high potency or specialized manufacturing suites are a few examples of the sophisticated product development, manufacturing and packaging equipment used in the production process. In addition, our Quality Control laboratory facilities are equipped with high precision instruments, such as automated liquid chromatographs (HPLC and UPLC), gas chromatographs, and laser particle size analyzers.

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We continue to pursue the Quality by Design concept for improving and maintaining quality control and quality assurance programs in our pharmaceutical development and manufacturing facilities, which is outlined in the FDA report titled, *Pharmaceutical Quality for the 21st Century: A Risk-Based Approach*. The FDA periodically inspects our production facilities to determine our compliance with the FDA's manufacturing standards. Typically, after completing its inspection, the FDA will issue a report, entitled a Form 483, containing observations arising from an inspection. The FDA's observations may be minor or severe in nature and the degree of severity is generally determined by the time necessary to remediate the cGMP violation, any consequences to the consumer of the products, and whether the observation is subject to a Warning Letter from the FDA. By strictly complying with cGMPs and the various FDA guidelines, Good Laboratory Practices (GLPs), as well as adherence to our Standard Operating Procedures, we have never received a cGMP Warning Letter in more than 70 years of business.

### **Research and Development Process**

Over the past several years, we have invested heavily in R&D projects. The costs of these R&D efforts are expensed during the periods incurred. We believe that such costs may be recovered in future years when we receive approval from the FDA to distribute such products. We have embarked on a plan to grow in future years, which includes organic growth to be achieved through our R&D efforts. We expect that our growing list of generic products under development will drive future growth. Over the past several years, we have hired additional personnel in product development, production, and formulation. The following steps outline the numerous stages in the generic drug development process:

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1.) *Formulation and Analytical Method Development.* After a drug candidate is selected for future sale, product development scientists perform various experiments on the incorporation of active ingredients into a dosage form. These experiments will result in the creation of a number of product formulations to determine which formula will be most suitable for our subsequent development process. Various formulations are tested in the laboratory to measure results against the innovator drug. During this time, we may use reverse engineering methods on samples of the innovator drug to determine the type and quantity of inactive ingredients. During the formulation phase, our R&D chemists begin to develop an analytical, laboratory testing method. The successful development of this test method will allow us to test developmental and commercial batches of the product in the future. All of the information used in the final formulation, including the analytical test methods adopted for the generic drug candidate, will be included as part of the Chemistry, Manufacturing and Controls section of the ANDA submitted to the FDA.

2.) *Scale-up and Tech Transfer.* After product development scientists and the R&D chemists agree on a final formulation for use in moving the drug candidate forward in the developmental process, we then attempt to increase the batch size of the product. The batch size represents the standard magnitude to be used in manufacturing a batch of the product. The determination of batch size affects the amount of raw material that is used in the manufacturing process and the number of expected dosages to be created during the production cycle. We attempt to determine batch size based on the amount of active ingredient in each dosage, the available production equipment and unit sales projections. The scaled-up batch is then generally produced in our commercial manufacturing facilities. During this manufacturing process, we document the equipment used, the amount of time in each major processing step and any other steps needed to consistently produce a batch of that product. This information, generally referred to as the validated manufacturing process, is included in the ANDA.

3.) *Bioequivalency and Clinical testing.* After a successful scale-up of the generic drug batch, we schedule and perform bioequivalency testing on the product, and in some cases clinical testing if required by the FDA. These procedures, which are generally outsourced to third parties, include testing the absorption of the generic product in the human bloodstream compared to the absorption of the innovator drug. The results of this testing are then documented and reported to us to determine the success of the generic drug product. Success, in this context, means that we are able to demonstrate that our product is comparable to the innovator product in dosage form, strength, route of administration, quality, performance characteristics and intended use.

Bioequivalence (meaning that the product performs in the same manner and in the same amount of time as the innovator drug) and a stable formula are the primary requirements for a generic drug approval (assuming the manufacturing plant is in compliance with the FDA's cGMP regulations). With the exception of 505(b)(2) NDA filings, lengthy and costly clinical trials proving safety and efficacy, which are required by the FDA for innovator drug approvals, are typically unnecessary for generic companies. If the results are successful, we will continue the collection of information and documentation for assembly of the drug application.

4.) *Submission of the ANDA for FDA review and approval.* The ANDA process became formalized under The Drug Price Competition and Patent Term Restoration Act of 1984, also known as the Hatch-Waxman Act ( Hatch-Waxman Act ). The Hatch-Waxman Act amended the Federal Food, Drug and Cosmetic Act ( FDCA ) to permit the FDA to review and approve an ANDA for a generic equivalent of a new drug product, which previously received FDA approval through its new drug approval process, without having the generic drug company conduct costly clinical trials. An ANDA is a comprehensive submission that contains, among other things, data and information pertaining to the active pharmaceutical ingredient, drug product formulation, specifications and stability of the generic drug, as well as analytical methods, manufacturing process validation data, and quality control procedures.

ANDAs and NDAs submitted for our products may not receive FDA approval on a timely basis, or at all. The current FDA median review time for ANDAs is 31 months. While we have received approval for some of our ANDAs in as little as 14 months, we have also waited longer than 36 months before receiving approval. The FDA has advised that electronic submissions of applications may shorten the approval process. We

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currently file our ANDAs and NDAs electronically. On July 9, 2012, the Food and Drug Administration Safety and Innovation Act was enacted, which included the Generic Drug User Fee Amendments of 2012 ( GDUFA ). Under these Amendments the FDA committed to reviewing 90% of complete electronic generic applications within 10 months after the date of submission. Applications filed after October 2014 will be reviewed under this process.

When a generic drug company files an ANDA with the FDA, it must certify either (i) that no patent was filed for the listed drug (a paragraph I certification), (ii) that the patent has expired (a paragraph II certification), (iii) that the patent will expire on a specified date and the ANDA filer will not market the drug until that date (a paragraph III certification), or (iv) that the patent is invalid or would not be infringed by the manufacture, use, or sale of the new drug (a paragraph IV certification). A paragraph IV certification must be provided to each owner of the patent that is the subject of the certification and to the holder of the approved NDA to which the ANDA refers. A paragraph IV certification can trigger an automatic 30 month stay of the ANDA if the innovator company files a claim which would delay the approval of the generic company s ANDA.

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To date, we have filed four paragraph IV certifications. In response to our paragraph IV certification with respect to the Zomig® nasal spray product, AstraZeneca AB, AstraZeneca UK Limited and Impax Laboratories, Inc. filed two patent infringement complaints against the Company in July 2014.

**Sales and Customer Relationships**

We sell our pharmaceutical products to generic pharmaceutical distributors, drug wholesalers, chain drug retailers, private label distributors, mail-order pharmacies, other pharmaceutical manufacturers, managed care organizations, hospital buying groups, governmental entities and health maintenance organizations. We promote our products through direct sales, trade shows, and bids. Our practice of maintaining adequate inventory levels, employing a responsive order filling system and prioritizing timely fulfillment of those orders have contributed to a strong reputation among our customers as a dependable supplier of high quality generic pharmaceuticals.

**Management**

We have been focused on enhancing the quality of our management team in anticipation of continuing growth. We have hired experienced personnel from large, established, brand pharmaceutical companies as well as competing generic companies to complement the skills and knowledge of the existing management team. As we continue to grow, additional personnel may need to be added to our management team. We intend to hire the best people available to expand the knowledge base and expertise within our personnel ranks.

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As of the date of this filing, we manufactured and/or distributed the following products:

| <b>Name of Product</b>   | <b>Medical Indication</b> | <b>Equivalent Brand</b> |
|--|---------------------------|-------------------------|
| 1 Acetazolamide Tablets  | Glaucoma                  | Diamox®                 |
| 2 Butalbital, Acetaminophen and Caffeine Tablets                 | Migraine                  | Fioricet®               |
| 3 Butalbital, Aspirin and Caffeine Capsules                      | Migraine                  | Fiorinal®               |
| 4 Butalbital, Aspirin, Caffeine with Codeine Phosphate Capsules* | Migraine                  | Fiorinal w/ Codeine #3® |
| 5 Clindamycin HCl Capsules                                       | Antibiotic                | Cleocin®                |
| 6 Codeine Sulfate Tablets  | Pain Management           | N/A                     |
| 7 C-Topical ® Solution   | Anesthetic                | N/A                     |
| 8 Danazol Capsules   | Endometriosis             | Danocrine®              |
| 9 Diazepam Oral Solution   | Anxiety                   | Valium®                 |
| 10 Dicyclomine Tablets   | Irritable Bowel Syndrome  | Bentyl®                 |
| 11 Dicyclomine Capsules  | Irritable Bowel Syndrome  | Bentyl®                 |
| 12 Diethylpropion HCl IR and ER Tablets                          | Obesity                   | Tenuate® and Dospan®    |
| 13 Digoxin Tablets*  | Congestive Heart Failure  | Lanoxin®                |
| 14 Doxycycline Monohydrate Tablets                               | Antibiotic                | Adoxa®                  |
| 15 Doxycycline Hyclate Tablets                                   | Antibiotic                | Periostat®              |
| 16 Fluphenazine Tablets  | Antipsychotic             | Prolixin®               |
| 17 Hydromorphone HCl Tablets                                     | Pain Management           | Dilaudid®               |
| 18 Isoniazid Tablets   | Tuberculosis              | Niazid®                 |
| 19 Levothyroxine Sodium Tablets*                                 | Thyroid Deficiency        | Levoxyl®/ Synthroid®    |
| 20 Loxapine Succinate Capsules                                   | Antipsychotic             | Loxitane®               |
| 21 Morphine Sulfate Oral Solution                                | Pain Management           | N/A                     |
| 22 Phentermine HCl Tablets                                       | Obesity                   | Adipex-P®               |
| 23 Phentermine HCl Capsules                                      | Obesity                   | Fastin®                 |
| 24 Pilocarpine HCl Tablets                                       | Dryness of the Mouth      | Salagen®                |
| 25 Primidone Tablets   | Epilepsy                  | Mysoline®               |
| 26 Probenecid Tablets  | Gout                      | Benemid®                |
| 27 Rifampin Capsules   | Antibiotic                | Rifadin®                |
| 28 Sodium Chloride Tablets                                       | Low Sodium                | N/A                     |
| 29 Terbutaline Sulfate Tablets                                   | Bronchospasms             | Brethine®               |
| 30 Triamterene w/Hydrochlorothiazide Capsules                    | Hypertension              | Dyazide®                |
| 31 Ursodiol Capsules   | Gallstone                 | Actigall ®              |
| 32 Zidovudine Tablets  | HIV                       | Retrovir ®              |

\*Distributed under the JSP Distribution Agreement

Unlike the brand, innovator companies, we do not develop new molecules. However, we have filed and received two patents for APIs at our Cody, Wyoming manufacturing facility, with additional patents in process.



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In fiscal years 2014, 2013 and 2012, we received a total of eleven ANDA/ANDA supplement approvals from the FDA. The following summary contains more specific details regarding our latest ANDA approvals. Market data was obtained from Wolters Kluwer and IMS.

In April 2014, we received a letter from the FDA with approval to market and launch Diazepam Oral Solution (Concentrate), 5 mg/mL, a Schedule C-IV controlled drug. Diazepam Oral Solution (Concentrate), 5 mg/mL, is therapeutically equivalent to the reference listed drug, Diazepam Intensol Oral Solution (Concentrate), 5 mg/mL, of Roxane Laboratories, Inc.

In June 2014, we received a letter from the FDA with approval to market and launch Codeine Sulfate Tablets USP, a schedule II controlled substance, 15 mg, 30 mg and 60 mg, the therapeutic equivalent to the reference listed drug, Codeine Sulfate Tablets USP 15 mg, 30 mg and 60 mg, of Roxane Laboratories, Inc. According to IMS, for the year ended April 2014 total sales of Codeine Sulfate Tablets USP 15 mg, 30 mg and 60 mg at Average Wholesale Price (AWP) were \$4.3 million.

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In July 2014, we received a letter from the FDA with approval to market and launch Oxycodone Hydrochloride Capsules, 5mg, the therapeutic equivalent to the reference listed drug, Oxycodone Hydrochloride Capsules, 5mg, of Lehigh Valley Technologies, Inc. According to IMS, for the year ended June 2014 total sales of Oxycodone Hydrochloride Capsules, 5mg, at Average Wholesale Price (AWP) were \$7.1 million.

We have additional products currently under development which are orally administered solid oral-dosage products (i.e. tablet/capsule) or oral solutions, nasal, topicals or parenterals, as well as other dosage forms designed to be generic equivalents to brand named innovator drugs. Our developmental drug products are intended to treat a diverse range of indications. The products under development are at various stages in the development cycle formulation, scale-up, clinical testing and FDA review.

The cost associated with each product that we are currently developing is dependent on numerous factors, including but not limited to, the complexity of the active ingredient's chemical characteristics, the price of the raw materials and the FDA-mandated requirement of bioequivalence studies (depending on the FDA's Orange Book classification). The cost to develop a new generic product varies but could total several million dollars.

In addition, we currently own several ANDAs that are dormant for products which we currently do not manufacture and market. Occasionally, we review such ANDAs to determine if the market potential for any of these older drugs has recently changed to make it attractive for us to reconsider manufacturing and selling. If we decide to introduce one of these products into the consumer market, we must review the original ANDA and related documentation to ensure that the approved product specifications, formulation and other factors meet current FDA requirements for the marketing of the applicable drug. Generally, in these situations, we file a supplement to the FDA for the applicable ANDA, informing the FDA of any significant changes in the manufacturing process, the formulation, the raw material supplier or another major feature of the previously approved ANDA. We would then redevelop the product and submit it to the FDA for supplemental approval. The FDA's approval process for an ANDA supplement is similar to that of a new ANDA.

In addition to the efforts of our internal product development group, we have contracted with several outside firms for the formulation and development of several new generic drug products. These outsourced R&D products are at various stages in the development cycle formulation, analytical method development, and testing and manufacturing scale-up. These products include orally administered solid dosage products, injectables and nasal delivery products that are intended to treat a diverse range of medical indications. We intend to ultimately transfer the formulation technology and manufacturing process for some of these R&D products to our own commercial manufacturing sites. We initiated these outsourced R&D efforts to complement the progress of our own internal R&D efforts.

The following table summarizes key information related to our R&D products at June 30, 2014. The column headings are defined as follows:

- 1.) Stage of R&D defines the current stage of the R&D product in the development process, as of the date of this Form 10-K.
- 2.) Regulatory Requirement defines whether the R&D product is or is expected to be a new ANDA submission or a New Drug Application ( NDA ).

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3.) **Number of Products** defines the number of products in R&D at the stage noted. In this context, a product means any finished dosage form, including all potencies, containing the same API or combination of APIs and which represents a generic version of the same Reference Listed Drug ( RLD ) or innovator drug, identified in the FDA's Orange Book.

| <b>Stage of R&amp;D</b> | <b>Regulatory Requirement</b> | <b>Number of Products</b> |
|-------------------------|-------------------------------|---------------------------|
| FDA Review              | ANDA                          | 24                        |
| In Development          | ANDA/NDA                      | 45                        |

We recorded R&D expenses of \$27.7 million in fiscal year 2014, \$16.3 million in fiscal year 2013, and \$11.8 million in fiscal year 2012. These amounts included expenses associated with bioequivalence studies, internal development resources as well as outsourced development. While we manage all R&D from our principal executive office in Philadelphia, Pennsylvania, we have also been taking steps to capitalize on favorable development costs in other countries. We have strategic relationships with various companies that either act as contract research organizations or API suppliers as well as dosage form manufacturers. In addition, U.S.-based research organizations have been engaged for product development to enhance our internal development. Fixed payment arrangements are established between Lannett and these research organizations and in some cases include a royalty provision. Development payments are normally scheduled in advance, based on attaining development milestones.

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**Raw Materials and Finished Goods Suppliers**

Our use of raw materials in the production process consists of using pharmaceutical chemicals in various forms that are generally available from several sources. FDA approval is required in connection with the process of using active ingredient suppliers. In addition to the raw materials we purchase for the production process, we purchase certain finished dosage inventories. We sell these finished dosage form products directly to our customers along with the finished dosage form products manufactured in-house. We generally take precautionary measures to avoid a disruption in raw materials and finished goods, such as finding secondary suppliers for certain raw materials or finished goods when available.

The Company's primary finished goods inventory supplier is JSP, in Bohemia, New York. Purchases of finished goods from JSP accounted for 62% of our inventory purchases in fiscal year 2014, 60% in fiscal year 2013 and 64% in fiscal year 2012. On March 23, 2004, the Company entered into an agreement with JSP for the exclusive distribution rights in the United States to the current line of JSP products, in exchange for 4.0 million shares of the Company's common stock. The JSP products covered under the agreement included Butalbital, Aspirin, Caffeine with Codeine Phosphate Capsules; Digoxin Tablets; Levothyroxine Sodium Tablets, sold generically and under the brand name Unithroid®. On August 19, 2013, the Company entered into an agreement with JSP to extend its initial contract to continue as the exclusive distributor in the United States of three JSP products: Butalbital, Aspirin, Caffeine with Codeine Phosphate Capsules USP; Digoxin Tablets USP; Levothyroxine Sodium Tablets USP. The amendment to the original agreement extends the initial contract, which was due to expire on March 22, 2014, for five years through March 2019. In connection with the amendment, the Company issued 1.5 million shares of the Company's common stock to JSP and its designees. The Company recorded a \$20.1 million expense in cost of sales, which represents the fair value of the shares on August 19, 2013. If the parties agree to a second five year extension from March 23, 2019 to March 23, 2024, the Company is required to issue to JSP or its designees an additional 1.5 million shares of the Company's common stock. Both Lannett and JSP have the right to terminate the contract if one of the parties does not cure a material breach of the contract within thirty (30) days of notice from the non-breaching party.

During the term of the agreement and related amendment, the Company is required to use commercially reasonable efforts to purchase minimum dollar quantities of JSP products. The Company has met the minimum purchase requirement for the first ten years of the contract, but there is no guarantee that the Company will be able to continue to do so in fiscal year 2015 and in the future. If the Company does not meet the minimum purchase requirements, JSP's sole remedy is to terminate the agreement.

We have entered into definitive supply and development agreements with international companies, including, Azad Pharma AG, Swiss Caps of Switzerland, Pharma 2B (formerly Pharmaseed), The GC Group of Israel and HEC Pharm Group, as well as domestic companies, including JSP, Cerovene, and Summit Bioscience LLC. We are currently in negotiations on similar agreements with other companies, through which we will market and distribute future products manufactured in-house or by third parties. We intend to capitalize on our strong customer relationships to build market share for such products, and increase future revenues and income.

**Customers and Marketing**

We sell our products primarily to wholesale distributors, generic drug distributors, mail-order pharmacies, group purchasing organizations, chain drug stores and other pharmaceutical companies. The pharmaceutical industry's largest wholesale distributors, Amerisource Bergen, Cardinal Health, and McKesson, accounted for 19%, 9%, and 8%, respectively, of our net sales in fiscal year 2014 and 12%, 10% and 9%, respectively, of our net sales in fiscal year 2013. Our largest chain drug store customer, Walgreens, accounted for 13% and 17% of net sales in fiscal year 2014 and fiscal year 2013, respectively. Due to a strategic partnership between Amerisource Bergen and Walgreens, Amerisource Bergen will begin handling product distribution for Walgreens. As Amerisource Bergen begins purchasing on Walgreens behalf, the Company expects increased sales to Amerisource Bergen with a corresponding decrease in sales to Walgreens. We perform ongoing credit evaluations of our

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customers' financial condition, and have experienced no significant collection problems to date. Generally, we require no collateral from our customers.

Sales to wholesale customers include indirect sales, which represent sales to third-party entities, such as independent pharmacies, managed care organizations, hospitals, nursing homes, and group purchasing organizations, collectively referred to as indirect customers. We enter into definitive agreements with our indirect customers to establish pricing for certain covered products. Under such agreements, the indirect customers independently select a wholesaler from which to purchase the products at these agreed-upon prices. We will provide credit to the wholesaler for the difference between the agreed-upon price with the indirect customer and the wholesaler's invoice price. This credit is called a chargeback. For more information on chargebacks, see the section entitled Critical Accounting Policies in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-K. These indirect sale transactions are recorded on our books as sales to wholesale customers.

We promote our products through direct sales, trade shows and group purchasing organizations' bidding processes. We also market our products through private label arrangements, under which we manufacture our products with a label containing the name and logo of our customer. This practice is commonly referred to as private label business. Private label business allows us to leverage our internal sales efforts by using the marketing services from other well-respected pharmaceutical suppliers. The focus of our sales efforts is the relationships we create with our customer accounts.

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Strong and dependable customer relationships have created a positive platform for us to increase our sales volumes. Historically and in fiscal years 2014, 2013 and 2012, our advertising expenses were immaterial. When our sales representatives make contact with a customer, we will generally offer to supply the customer our products at fixed prices. If accepted, the customer's purchasing department will coordinate the purchase, receipt and distribution of the products throughout its distribution centers and retail outlets. Once a customer accepts our supply of a product, the customer typically expects a high standard of service, including timely receipt of products ordered, availability of convenient, user-friendly and effective customer service functions and maintaining open lines of communication.

We believe that retail-level consumer demand dictates the total volume of sales for various products. In the event that wholesale and retail customers adjust their purchasing volumes, we believe that consumer demand will be fulfilled by other wholesale or retail sources of supply. As a result, we attempt to develop and maintain strong relationships with most of the major retail chains, wholesale distributors and mail-order pharmacies in order to facilitate the supply of our products through whatever channel the consumer prefers. Although we have agreements with customers governing the transaction terms of our sales, generally there are no minimum purchase quantities applicable to these agreements.

**Competition**

The manufacturing and distribution of generic pharmaceutical products is a highly competitive industry. Competition is based primarily on price. In addition to competitive pricing our competitive advantages are our ability to provide strong and dependable customer service by maintaining adequate inventory levels, employing a responsive order filling system and prioritizing timely fulfillment of orders. We ensure that our products are available from national suppliers as well as our own warehouse. The modernization of our facilities, hiring of experienced staff and implementation of inventory and quality control programs have improved our competitive cost position over the past five years.

We compete with other manufacturers and marketers of generic and brand name drugs. Each product manufactured and/or sold by us has a different set of competitors. The list below identifies the companies with which we primarily compete with respect to each of our major products.

| <b>Product</b>  | <b>Primary Competitors</b>                               |
|---|--|
| Butalbital, Acetaminophen and Caffeine Tablets                                    | Mallinckrodt, Mikart, Qualitest, Actavis and West-Ward   |
| Butalbital with Aspirin and Caffeine, with and without Codeine Phosphate Capsules | Actavis and Breckenridge                                 |
| C-Topical® Solution   | Alternative products including Lidocaine and Epinephrine |
| Digoxin Tablets   | Impax, West-Ward, Caraco, and Covis                      |
| Doxycycline Hyclate and Monohydrate Tablets                                       | Par, Mylan, Sandoz and Ranbaxy                           |
| Hydromorphone HCl Tablets   | Mallinckrodt, Roxane and Purdue                          |
| Levothyroxine Sodium Tablets  | AbbVie, Pfizer, Mylan and Sandoz                         |
| Morphine Sulfate Oral Solution  |  |

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|  |   |
|--|---|
|  | Caraco, Paddock, Roxane, Mallinckrodt and Vista |
| Primidone Tablets                          | Actavis, Qualitest and Amneal                   |
| Rifampin Capsules                          | Lupin, Sandoz and Versapharm                    |
| Triamterene w/Hydrochlorothiazide Capsules | Sandoz and Mylan                                |
| Ursodiol Capsules                          | Epic, Mylan and Actavis                         |

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**Government Regulation**

Pharmaceutical manufacturers are subject to extensive regulation by the federal government, principally by the FDA, and, in cases of controlled substance products the DEA, and to a lesser extent by other federal regulatory bodies and state governments. The FDCA, the Controlled Substance Act (the CSA) and other federal statutes and regulations govern or influence the testing, manufacture, safety, labeling, storage, record keeping, approval, pricing, advertising, and promotion of our generic drug products. Noncompliance with applicable regulations can result in fines, product recalls, and seizure of products, total or partial suspension of production, personal and/or corporate prosecution and debarment, and refusal of the government to approve new drug applications. The FDA also has the authority to revoke previously approved drug applications.

Generally, FDA approval is required before a prescription drug can be marketed. A new drug is one not generally recognized by qualified experts as safe and effective for its intended use. New drugs are typically developed and submitted to the FDA by companies expecting to brand the product and sell it. The FDA review process for new drugs is very extensive and requires a substantial investment to research and test the drug candidate. However, less burdensome approval procedures are generally used for generic equivalents. Typically, the investment required to develop a generic drug is less costly than the innovator drug.

There are currently three ways to obtain FDA approval of a drug:

- ***New Drug Applications (NDA)***: Unless one of the two procedures discussed in the following sections is available, a manufacturer must conduct and submit to the FDA complete clinical studies to establish a drug's safety and efficacy. The new drug approval process generally involves:
  - completion of preclinical laboratory and animal testing in compliance with the FDA's GLP regulations;
  - submission to the FDA of an Investigational New Drug (IND) application for human clinical testing, which must become effective before human clinical trials may begin;
  - performance of adequate and well-controlled human clinical trials to establish the safety and efficacy of the proposed drug product for each intended use;
  - satisfactory completion of an FDA pre-approval inspection of the facility or facilities at which the product is produced to assess compliance with the FDA's cGMP regulations; and



- submission to and approval by the FDA of an NDA.

The results of preclinical tests, together with manufacturing information and analytical data, are submitted to the FDA as part of an IND, which must become effective before human clinical trials may begin. Further, each clinical trial must be reviewed and approved by an independent Institutional Review Board. Human clinical trials are typically conducted in three sequential phases that may overlap. These phases generally include:

- Phase I, during which the drug is introduced into healthy human subjects or, on occasion, patients and is tested for safety, stability, dose tolerance, and metabolism;
- Phase II, during which the drug is introduced into a limited patient population to determine the efficacy of the product in specific targeted indications, to determine dosage tolerance and optimal dosage, and to identify possible adverse effects and safety risks; and
- Phase III, during which the clinical trial is expanded to a larger and more diverse patient group at geographically dispersed clinical trial sites to further evaluate clinical efficacy, optimal dosage, and safety.

The drug sponsor, the FDA, or the independent Institutional Review Board at each institution at which a clinical trial is being performed may suspend a clinical trial at any time for various reasons, including a belief that the subjects are being exposed to an unacceptable health risk.

The results of preclinical animal studies and human clinical studies, together with other detailed information, are submitted to the FDA as part of the NDA. The NDA also must contain extensive manufacturing information. The FDA may disapprove the NDA if applicable FDA regulatory criteria are not satisfied or it may require additional clinical data. Once approved, the FDA may withdraw the product approval if compliance with pre- and post-market regulatory standards is not maintained or if problems occur or are identified after the product reaches the marketplace. In addition, the FDA may require post-marketing studies to monitor the effect of approved products and may limit further marketing of the product based on the results of these post-marketing studies.

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The FDA has broad post-market regulatory and enforcement powers, including the ability to levy fines and civil penalties, suspend or delay issuance of approvals, seize or recall products, and withdraw approvals.

Satisfaction of FDA new drug approval requirements typically takes several years, and the actual time required may vary substantially based upon the type, complexity, and novelty of the product or disease. Government regulation may delay or prevent marketing of potential products for a considerable period of time and/or require additional procedures which increase manufacturing costs. Success in early stage clinical trials does not assure success in later stage clinical trials. Data obtained from clinical activities is not always conclusive and may be subject to varying interpretations that could delay, limit, or prevent regulatory approval. Even if a product receives regulatory approval, later discovery of previously unknown problems with a product may result in restrictions on the product or even complete withdrawal of the product from the market.

- **Abbreviated New Drug Applications (ANDA):** An ANDA is similar to an NDA except that the FDA generally waives the requirement of complete clinical studies of safety and efficacy. However, it may require bioavailability and bioequivalence studies. Bioavailability indicates the rate of absorption and levels of concentration of a drug in the bloodstream needed to produce a therapeutic effect. Bioequivalence compares one drug product with another and indicates if the rate of absorption and the levels of concentration of a generic drug in the body are within prescribed statistical limits to those of a previously approved drug. Under the Hatch-Waxman Act, an ANDA may be submitted for a drug on the basis that it is the equivalent of an approved drug regardless of when such other drug was approved. The FDA will approve the generic product as suitable for an ANDA application if it finds that the generic product does not raise new questions of safety and effectiveness as compared to the innovator product. A product is not eligible for ANDA approval if the FDA determines that it is not equivalent to the referenced innovator drug, if it is intended for a different use, or if it is not subject to an approved Suitability Petition. However, such a product might be approved under an NDA, with supportive data from clinical trials.

In addition to establishing a new ANDA procedure, the Hatch-Waxman Act created statutory protections for approved brand name drugs. Under the Hatch-Waxman Act, an ANDA for a generic drug may not be made effective until all relevant product and use patents for the brand name drug have expired or have been determined to be invalid. Prior to this act, the FDA gave no consideration to the patent status of a previously approved drug. Upon NDA approval, the FDA lists in its Orange Book the approved drug product and any patents identified by the NDA applicant that relate to the drug product. Any applicant who files an ANDA seeking approval of a generic equivalent version of a drug listed in the FDA's Orange Book before expiration of the referenced patent(s), must certify to the FDA that (1) no patent information on the drug product that is the subject of the ANDA has been submitted to the FDA; (2) such patent has expired; (3) the date on which such patent expires; or (4) such patent is invalid or will not be infringed upon by the manufacture, use, or sale of the drug product for which the ANDA is submitted. This last certification is known as a Paragraph IV certification. A notice of the Paragraph IV certification must be provided to each owner of the patent that is the subject of the certification and to the holder of the approved NDA to which the ANDA refers. Before the enactment of the Medicare Prescription Drug Improvement and Modernization Act of 2003 (the MMA), which amended the Hatch-Waxman Act, if the NDA holder or patent owner(s) asserted a patent challenge within 45 days of its receipt of the certification notice, the FDA was prevented from approving that ANDA until the earlier of 30 months from the receipt of the notice of the paragraph IV certification, the expiration of the patent, when the infringement case concerning each such patent was favorably decided in an ANDA applicant's favor, or such shorter or longer period as may be ordered by a court. This prohibition is generally referred to as the 30-month stay. In some cases, NDA owners and patent holders have obtained additional patents for their products after an ANDA had been filed but before that ANDA received final marketing approval, and then initiated a new patent challenge, which resulted in more than one 30-month stay. The MMA amended the Hatch-Waxman Act to eliminate certain unfair advantages of patent holders in the implementation of the Hatch-Waxman Act. As a result, the NDA owner remains entitled to an automatic 30-month stay if it initiates a patent infringement lawsuit within 45 days of its receipt of notice of a paragraph IV certification, but only if the patent infringement lawsuit is directed to patents that were listed in the FDA's Orange Book before the ANDA was filed. An ANDA applicant is now permitted to take legal action to enjoin or prohibit the listing of certain of these patents as a counterclaim in response to a claim by the NDA owner that its patent covers its approved drug product. To date, we have filed four paragraph IV certifications. In response to our paragraph IV certification with respect to the Zomig® nasal spray product, AstraZeneca AB, AstraZeneca UK Limited and Impax Laboratories, Inc. filed two patent infringement complaints against the Company in July 2014.

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If an ANDA applicant is the first-to-file a substantially complete ANDA with a paragraph IV certification and provides appropriate notice to the FDA, the NDA holder, and all patent owner(s) for a particular generic product, the applicant may be awarded a 180-day period of marketing exclusivity against other companies that subsequently file ANDAs for that same product. A substantially complete ANDA is one that contains all the information required by the Hatch-Waxman Act and the FDA's regulations, including the results of any required bioequivalence studies. The FDA may refuse to accept the filing of an ANDA that is not substantially complete or may determine during substantive review of the ANDA that additional information, such as an additional bioequivalence study, is required to support approval.

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Such a determination may affect an applicant's first to file status and eligibility for a 180-day period of marketing exclusivity for the generic product. The MMA also modified the rules governing when the 180-day marketing exclusivity period is triggered or forfeited and shared. Prior to the legislation, the 180-day marketing exclusivity period was triggered upon the first commercial marketing of the ANDA or a court decision holding the patent invalid, unenforceable, or not infringed. For ANDAs accepted for filing before March 2000, that court decision had to be final and non-appealable (other than a petition to the U.S. Supreme Court for a writ of certiorari). In March 2000, the FDA changed its position in response to two court cases that challenged the FDA's original interpretation of what constituted a court decision under the Hatch-Waxman Act. Under the changed policy, the 180-day marketing exclusivity period began running immediately upon a district court decision holding the patent at issue invalid, unenforceable, or not infringed, regardless of whether the ANDA had been approved and the generic product had been marketed. In codifying the FDA's original policy, the MMA retroactively applies a final and non-appealable court decision trigger for all ANDAs filed before December 8, 2003 leaving intact the first commercial marketing trigger. As for ANDAs filed after December 8, 2003, the marketing exclusivity period is only triggered upon the first commercial marketing of the ANDA product, but that exclusivity may be forfeited under certain circumstances, including, if the ANDA is not marketed within 75 days after a final and non-appealable court decision by the first-to-file or other ANDA applicant, or if the FDA does not tentatively approve the first-to-file applicant's ANDA within 30 months.

In addition to patent exclusivity, the holder of the NDA for the listed drug may be entitled to a period of non-patent market exclusivity, during which the FDA cannot approve an ANDA. If the listed drug is a new chemical entity (NCE), the FDA may not accept an ANDA for a bioequivalent product for up to five years following approval of the NDA for the NCE. If the listed drug is not a new chemical entity but the holder of the NDA conducted clinical trials essential to approval of the NDA or a supplement thereto, the FDA may not approve an ANDA for a bioequivalent product before expiration of three years. Certain other periods of exclusivity may be available if the listed drug is indicated for treatment of a rare disease or is studied for pediatric indications.

- **Section 505(b)(2) New Drug Applications:** For a drug that is identical to a previously approved drug, a prospective manufacturer need not go through the full NDA procedure. Instead, it may demonstrate safety and efficacy by relying on published literature and reports where at least some of information required for approval comes from studies not conducted by or for the applicant and for which the applicant has not obtained a right of reference. The Hatch-Waxman Act permits the applicant to rely upon certain preclinical or clinical studies conducted for an approved product. The manufacturer must also submit, if the FDA so requires, bioavailability or bioequivalence data illustrating that the generic drug formulation produces the same effects, within an acceptable range, as the previously approved innovator drug. Because published literature to support the safety and efficacy of post-1962 drugs may not be available, this procedure is of limited utility to generic drug manufacturers and the resulting approved product will not be interchangeable with the innovator drug as an ANDA drug would be unless bioequivalency testing were undertaken and approved by FDA. Moreover, the utility of Section 505(b)(2) applications have with the exception of Grandfathered drugs been diminished by the availability of the ANDA process, as described above.

Additionally, certain products marketed prior to the FDCA may be considered GRASE (Generally Recognized As Safe and Effective) or Grandfathered. 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 1938 act or the 1962 amendments to the act. Under the grandfather clause, such a product is exempted from the effectiveness requirements [of the act] if its composition and labeling have not changed since 1962 and if, on the day before the 1962 amendments became effective, it was (1) used or sold commercially in the United States, (2) not a new drug as defined by the act at that time, and (3) not covered by an effective application.

*Manufacturing cGMP Requirements*

Among the requirements for a new drug approval, a company's manufacturing methods must conform to FDA cGMP regulations before a facility may be used to manufacture a product. The FDA performs pre-approval inspections to assess a company's manufacturing methods as part of a

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new drug approval process. These inspections include reviews of procedures and operations used in the manufacture and testing of our products to assess compliance with application regulations. The cGMP regulations must be followed at all times during which the approved drug is manufactured and the manufacturing facilities are subject to periodic inspections by the FDA and other authorities. FDA's cGMP regulations require, among other things, quality control and quality assurance as well as the corresponding maintenance of records and documentation. In complying with the standards set forth in the cGMP regulations, we must continue to expend time, money, and effort in the areas of production and quality control to ensure full technical compliance.

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Failure to comply with statutory and regulatory requirements subject a manufacturer to possible legal or regulatory action, including but not limited to, the seizure or recall of non-complying drug products, injunctions, consent decrees placing significant restrictions on or suspending manufacturing operations, and/or civil and criminal penalties. Adverse experiences with the product must be reported to the FDA and could result in the imposition of market restriction through labeling changes or in product removal. Product approvals may be withdrawn if compliance with regulatory requirements is not maintained or if problems concerning safety or efficacy of the product occur following approval.

*Other Regulatory Requirements*

With respect to post-market product advertising and promotion, the FDA imposes a number of complex regulations on entities that advertise and promote pharmaceuticals, which include, among others, standards for direct-to-consumer advertising, off-label promotion, industry-sponsored scientific and educational activities, and promotional activities involving the internet. The FDA has very broad enforcement authority under the FDCA, and failure to abide by these regulations can result in penalties, including the issuance of a warning letter directing entities to correct deviations from FDA standards, a requirement that future advertising and promotional materials be pre-cleared by the FDA, and state and/or federal civil and criminal investigations and prosecutions.

We are also subject to various laws and regulations regarding laboratory practices, the experimental use of animals, and the use and disposal of hazardous or potentially hazardous substances in connection with our research. In each of these areas, as above, the FDA has broad regulatory and enforcement powers, including the ability to levy fines and civil penalties, suspend or delay issuance of approvals, seize or recall products, and withdraw approvals. Any one or a combination of FDA regulatory or enforcement actions against the Company could have a material adverse effect on our financial results.

*DEA Regulation*

We maintain registrations with the DEA that enable us to receive, manufacture, store, and distribute controlled substances in connection with our operations. Controlled substances are those drugs that appear on one of five schedules promulgated and administered by the DEA under the CSA. The CSA governs, among other things, the distribution, recordkeeping, handling, security, and disposal of controlled substances. We are subject to periodic and ongoing inspections by the DEA and similar state drug enforcement authorities to assess our ongoing compliance with the DEA's regulations. Any failure to comply with these regulations could lead to a variety of sanctions, including the revocation or a denial of renewal of our DEA registration, injunctions, or civil or criminal penalties.

*Fraud and Abuse Laws*

Because of the significant federal funding involved in Medicare and Medicaid, Congress and state legislatures have enacted, and actively enforce, a number of laws whose purpose is to eliminate fraud and abuse in federal health care programs. Our business is subject to compliance with these laws, such as Sarbanes-Oxley Act of 2002, Dodd-Frank, and the Foreign Corrupt Practices Act (FCPA).

*Anti-Kickback Statutes, Sunshine Act, and Federal False Claims Act*

The federal health care programs fraud and abuse law (sometimes referred to as the Anti-Kickback Statute) prohibits persons from knowingly and willfully soliciting, offering, receiving, or providing remuneration, directly or indirectly, in exchange for or to induce either the referral of an individual, or the furnishing or arranging for a good or service, for which payment may be made under a federal health care program such as Medicare or Medicaid. The definition of remuneration has been broadly interpreted to include anything of value, including for example gifts, certain discounts, the furnishing of free supplies, equipment or services, credit arrangements, payment of cash and waivers of payments. Several courts have interpreted the statute's intent requirement to mean that if any one purpose of an arrangement involving remuneration is to induce referrals of federal health care covered business, the statute has been violated. Penalties for violations include criminal penalties and civil sanctions such as fines, imprisonment, and possible exclusion from Medicare, Medicaid, and other federal health care programs. In addition some kickback allegations have been claimed to violate the Federal False Claims Act, discussed in more detail below.

The Anti-Kickback Statute is broad and prohibits many arrangements and practices that are lawful in businesses outside of the health care industry. Recognizing that the Anti-Kickback Statute is broad and may technically prohibit many innocuous or beneficial arrangements, Congress authorized the Office of Inspector General of the U.S. Department of Health and Human Services (OIG) to issue a series of regulations, known as safe harbors. These safe harbors, issued by the OIG beginning in July 1991, set forth provisions that, if all their applicable requirements are met, will assure health care providers and other parties that they will not be prosecuted under the Anti-Kickback Statute. The failure of a transaction or arrangement to fit precisely within one or more safe harbors does not necessarily mean that it is illegal or that prosecution will be pursued.

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However, conduct and business arrangements that do not fully satisfy each applicable safe harbor may result in increased scrutiny by government enforcement authorities such as OIG.

Many states have adopted laws similar to the Anti-Kickback Statute. Some of these state prohibitions apply to referral of patients for health care items or services reimbursed by any source, not only the Medicare and Medicaid programs.

Government officials have focused their enforcement efforts on marketing of health care services and products, among other activities, and recently have brought cases against companies, and certain sales, marketing, and executive personnel, for allegedly offering unlawful inducements to potential or existing customers in an attempt to procure their business.

Another development affecting the health care industry is the increased use of the Federal False Claims Act ( FFCA ), and in particular, action brought pursuant to the FFCA s Whistleblower or Qui Tam provisions. The FFCA imposes liability on any person or entity who, among other things, knowingly presents, or causes to be presented, a false or fraudulent claim for payment by a federal health care program. The qui tam provisions of the FFCA allow a private individual to bring actions on behalf of the federal government alleging that the defendant has submitted a false claim to the federal government, and to share in any monetary recovery. In recent years, the number of suits brought against health care providers by private individuals has increased dramatically. In addition, various states have enacted false claims law analogous to the FFCA, although many of these state laws apply where a claim is submitted to any third-party payer and not merely a federal health care program.

When an entity is determined to have violated the FFCA, it may be required to pay up to three times the actual damages sustained by the government, plus civil penalties. Liability arises, primarily, when an entity knowingly submits or causes another to submit a false claim for reimbursement to the federal government. The federal government has used the FFCA to assert liability on the basis of inadequate care, kickbacks, and other improper referrals, and improper use of Medicare numbers when detailing the provider of services, in addition to the more predictable allegations as to misrepresentations with respect to the services rendered. In addition, the federal government has prosecuted companies under the FFCA in connection with off-label promotion of products. Our future activities relating to the reporting of wholesale or estimated retail prices of our products, the reporting of discount and rebate information and other information affecting federal, state, and third-party reimbursement of our products, and the sale and marketing of our products may be subject to scrutiny under these laws. We are unable to predict whether we will be subject to actions under the FFCA or a similar state law, or the impact of such actions. However, the costs of defending such claims, as well as any sanctions imposed, could significantly affect our financial performance.

*Foreign Corrupt Practices Act*

The Foreign Corrupt Practices Act of 1977, as amended ( FCPA ), was enacted for the purpose of making it unlawful for certain classes of persons and entities to make payments to foreign government officials to assist in obtaining or retaining business. Specifically, the anti-bribery provisions of the FCPA prohibit the bribery of government officials.

*HIPAA and Other Fraud and Privacy Regulations*



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The Health Insurance Portability and Accountability Act of 1996 ( HIPAA ) created two new federal crimes: health care fraud and false statements relating to health care matters. The HIPAA health care fraud statute prohibits, among other things, knowing and willfully executing, or attempting to execute, a scheme to defraud any health care benefit program, including private payors. A violation of this statute is a felony and may result in fines, imprisonment, and/or exclusion from government-sponsored programs. The HIPAA false statements statute prohibits knowingly and willfully falsifying, concealing, or covering up a material fact or making any materially false, fictitious, or fraudulent statement or representation in connection with the delivery of or payment for health care benefits, items, or services. A violation of this statute is a felony and may result in fines and/or imprisonment.

### *Pricing*

In the United States, our sales are dependent upon the availability of coverage and reimbursement for our products from third-party payors, including federal and state programs such as Medicare and Medicaid, and private organizations such as commercial health insurance and managed care companies. Such third-party payors increasingly challenge the price of medical products and services and instituting cost containment measures to control or significantly influence the purchase of medical products and services.

Over the past several years, the rising costs of providing health care services has triggered legislation to make certain changes to the way in which pharmaceuticals are covered and reimbursed, particularly by government programs. For instance, recent federal legislation and regulations have created a voluntary prescription drug benefit, Medicare Part D, revised the formula used to reimburse health care providers and physicians under Part B and imposed significant revisions to the Medicaid Drug Rebate Program. These changes have resulted in, and may continue to result in, coverage and reimbursement restrictions and increased rebate obligations by manufacturers.

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In addition, there continue to be legislative and regulatory proposals at the federal and state levels directed at containing or lowering the cost of health care. Examples of how limits on drug coverage and reimbursement in the United States may cause reduced payments for drugs in the future include:

- changing Medicare reimbursement methodologies;
- revising drug rebate calculations under the Medicaid program;
- reforming drug importation laws;
- fluctuating decisions on which drugs to include in formularies; and
- requiring pre-approval of coverage for new or innovative drug therapies.

We cannot predict the likelihood or pace of such additional changes or whether there will be significant legislative or regulatory reform impacting our products, nor can we predict with precision what effect such governmental measures would have if they were ultimately enacted into law. However, in general, we believe that legislative and regulatory reform activity likely will continue.

The Company believes that under the current regulatory environment, the generic pharmaceutical industry as a whole will be the target of increased governmental scrutiny, especially with respect to state and federal anti-trust and price fixing claims. In July 2014, the Company and at least one of its competitors each received a subpoena and interrogatories from the Connecticut Attorney General's Office concerning its investigation into the pricing of digoxin. The Company maintains that it has acted in accordance with all applicable rules and regulations with respect to the pricing of all of its products, including digoxin.

*Other Applicable Laws*

We are also subject to federal, state and local laws of general applicability, including laws regulating working conditions and the storage, transportation, or discharge of items that may be considered hazardous substances, hazardous waste, or environmental contaminants. We monitor our compliance with laws and we believe we are in substantial compliance with all regulatory bodies.

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As a publicly-traded company, we are also subject to significant regulations and laws, included in the Sarbanes-Oxley Act of 2002. Since its enactment, we have developed and instituted a corporate compliance program based on what we believe are the current best practices and we continue to update the program in response to newly implemented or changing regulatory requirements.

### Employees

As of June 30, 2014, we had 399 employees.

### Securities and Exchange Act Reports

We maintain a website at [www.lannett.com](http://www.lannett.com). We make available on or through our website our current and periodic reports, including any amendments to those reports, that are filed with the Securities and Exchange Commission (the SEC) in accordance with the Securities Exchange Act of 1934, as amended (the Exchange Act). These reports include annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K. This information is available on our website free of charge as soon as reasonably practicable after we electronically file the information with, or furnish it to, the SEC. The contents of our website are not incorporated by reference in this Form 10-K and shall not be deemed filed under the Exchange Act.

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**ITEM 1A. RISK FACTORS**

**We materially rely on an uninterrupted supply of finished products from JSP for a majority of our sales. If we were to experience an interruption of that supply, our operating results would suffer.**

58% of our fiscal year 2014 net sales are of distributed products, primarily manufactured by JSP. Two of these products are Levothyroxine Sodium and Digoxin, which accounted for 37% and 20%, respectively, of our Fiscal 2014 net sales, and 38% and 8%, respectively, of our net sales for Fiscal 2013. On August 19, 2013, the Company entered into an agreement with JSP to extend its initial contract to continue as the exclusive distributor in the United States of three JSP products: Butalbital, Aspirin, Caffeine with Codeine Phosphate Capsules USP; Digoxin Tablets USP; Levothyroxine Sodium Tablets USP. The amendment to the original agreement extends the initial contract, which was due to expire on March 22, 2014, for five years through March 2019. Both Lannett and JSP have the right to terminate the contract if one of the parties does not cure a material breach of the contract within thirty (30) days of notice from the non-breaching party. If the supply of these products is interrupted in any way by any form of temporary or permanent business interruption to JSP, including but not limited to fire or other naturally-occurring, damaging event to their physical plant and/or equipment, condemnation of their facility, legislative or regulatory cease and desist declaration regarding their operations, FDA action, and any interruption in their source of API for their products, our operating results could be materially adversely affected. We do not have, at this time, a second source for these products.

**Our gross profit may fluctuate from period to period depending upon our product sales mix, our product pricing and our costs to manufacture or purchase products.**

Our future results of operations, financial condition and cash flows depend to a significant extent upon our product sales mix. Our sales of certain products that we manufacture tend to create higher gross margins than do the products we purchase and resell. As a result, our sales mix will significantly impact our gross profit from period to period.

Factors that may cause our sales mix to vary include:

- the number of new product introductions;
- marketing exclusivity, if any, which may be obtained on certain new products;
- the level of competition in the marketplace for certain products;
- the availability of raw materials and finished products from our suppliers; and

- the scope and outcome of governmental regulatory action that may involve us.

The profitability of our product sales is also dependent upon the prices we are able to charge for our products, the costs to purchase products from third parties, and our ability to manufacture our products in a cost effective manner. The Company experienced favorable trends in product pricing on several key products during Fiscal 2014. Although the Company has benefited from these favorable pricing trends, the level of competition in the marketplace is constantly changing and the Company cannot guarantee that these pricing trends will continue.

**The generic pharmaceutical industry is highly competitive.**

We face strong competition in our generic product business. Revenues and gross profit derived from the sales of generic pharmaceutical products tend to follow a pattern based on certain regulatory and competitive factors. As patents for brand name products and related exclusivity periods expire or fall under patent challenges, the first generic manufacturer to receive regulatory approval for generic equivalents of such products is generally able to achieve significant market penetration. As competing off-patent manufacturers receive regulatory approvals on similar products or as brand manufacturers launch generic versions of such products (for which no separate regulatory approval is required), market share, revenues and gross profit typically decline, in some cases dramatically. Accordingly, the level of market share, revenue and gross profit attributable to a particular generic product is normally related to the number of competitors in that product's market and the timing of that product's regulatory approval and launch, in relation to competing approvals and launches. Consequently, we must continue to develop and introduce new products in a timely and cost-effective manner to maintain our revenues and gross margins.

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**Extensive industry regulation has had, and will continue to have, a significant impact on our business, especially our product development, manufacturing and distribution capabilities.**

All pharmaceutical companies, including Lannett, are subject to extensive, complex, costly and evolving regulation by the federal government, including the FDA and in the case of controlled drugs, the DEA, and state government agencies. The FDCA, the CSA and other federal statutes and regulations govern or influence the development, testing, manufacturing, packing, labeling, storing, record keeping, safety, approval, advertising, promotion, sale and distribution of our products.

The process for obtaining governmental approval to manufacture and market pharmaceutical products is rigorous, time-consuming and costly, and we cannot predict the extent to which we may be affected by legislative and regulatory developments. We are dependent on receiving FDA and other governmental or third-party approvals prior to manufacturing, marketing and shipping our products. The FDA approval process for a particular product candidate can take several years and requires us to dedicate substantial resources to securing approvals, and we may not be able to obtain regulatory approval for our product candidates in a timely manner, or at all. In order to obtain approval for our generic product candidates, we must demonstrate that our drug product is bioequivalent to a drug previously approved by the FDA through the new drug approval process, known as an innovator drug. Bioequivalency may be demonstrated in vivo or in vitro by comparing the generic product candidate to the innovator drug product in dosage form, strength, route of administration, quality, dissolution performance characteristics, and intended use. The FDA may not agree that the bioequivalence studies we submit in the ANDA applications for our generic drug products are adequate to support approval. If it determines that an ANDA application is not adequate to support approval, the FDA could deny our application or request additional information, including clinical trials, which could delay approval of the product and impair our ability to compete with other versions of the generic drug product.

Consequently, there is always the chance that we will not obtain FDA or other necessary approvals, or that the rate, timing and cost of such approvals will adversely affect our product introduction plans or results of operations. We carry inventories of certain product(s) in anticipation of launch, and if such product(s) are not subsequently launched, we may be required to write-off the related inventory. Furthermore, the FDA also has the authority to revoke drug approvals previously granted and remove these products from the market for a variety of reasons, including a failure to comply with applicable regulations, the discovery of previously unknown problems with the product, or because the ingredients in the drug are no longer approved by the FDA.

Additionally, certain products marketed prior to the FDCA may be considered GRASE or Grandfathered. 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, 1938 Act or the 1962 amendments to the Act. Under the Grandfathered drug clause, such a product is exempted from the effectiveness requirements [of the act] if its composition and labeling have not changed since 1962 and if, on the day before the 1962 amendments became effective, it was (1) used or sold commercially in the United States, (2) not a new drug as defined by the act at that time, and (3) not covered by an effective application. Recently, the FDA has increased its efforts to force companies to file and seek FDA approval for GRASE or Grandfathered products. Efforts have included issuing notices to companies currently producing these products to cease its distribution of said products. Lannett currently manufactures and markets one product that is considered a GRASE or Grandfathered product, C-Topical® Solution. The Company is currently in the process of completing a Phase 3 clinical trial in preparation of submitting an NDA for C-Topical® Solution. The FDA is currently undertaking activities to force all companies who manufacture certain GRASE products to file applications and seek approval for these products or remove their products from the market. Due to such enforcement actions, Lannett voluntarily stopped manufacturing Oxycodone as of August 20, 2012 and marketing the product as of October 4, 2012. Lannett filed an ANDA in April 2012 and was granted expedited review by the FDA. The Company expects to have approval from the FDA and resume selling Oxycodone in the near future.

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In addition, Lannett, as well as many of our significant suppliers of distributed product and raw materials, is subject to periodic inspection of facilities, procedures and operations and/or the testing of the finished products by the FDA, the DEA and other authorities, which conduct periodic inspections to confirm that pharmaceutical companies are in compliance with all applicable regulations. The FDA conducts pre-approval and post-approval reviews and plant inspections to determine whether systems and processes are in compliance with cGMP, and other FDA regulations. Following such inspections, the FDA may issue notices on Form 483 that could cause us or our suppliers to modify certain activities identified during the inspection. A Form 483 notice is generally issued at the conclusion of a FDA inspection and lists conditions the FDA inspectors believe may violate cGMP or other FDA regulations. The DEA and comparable state-level agencies also heavily regulate the manufacturing, holding, processing, security, record-keeping, and distribution of drugs that are considered controlled substances. Some of the pain management products we manufacture contain controlled substances. The DEA periodically inspects facilities for compliance with its rules and regulations. If our manufacturing facilities or those of our suppliers fail to comply with applicable regulatory requirements, it could result in regulatory action and additional costs.

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Our inability or the inability of our suppliers to comply with applicable FDA and other regulatory requirements can result in, among other things, delays in or denials of new product approvals, warning letters, fines, consent decrees restricting or suspending manufacturing operations, injunctions, civil penalties, recall or seizure of products, total or partial suspension of sales, and/or criminal prosecution. Any of these or other regulatory actions could materially harm our operating results and financial condition. Although we have instituted internal compliance programs, if these programs do not meet regulatory agency standards or if compliance is deemed deficient in any significant way, it could materially harm our business. Additionally, if the FDA were to undertake additional enforcement activities with Lannett's GRASE product, their actions could result in, among other things, removal of some of the product from the market, seizure of the product and total or partial suspension of sales. Any of these regulatory actions could materially harm our operating results and financial condition.

**Our manufacturing operations as well as our suppliers manufacturing operations are subject to licensing by the FDA and/or DEA. If we or our suppliers are unable to maintain the proper agency licensing arrangements, our operating results would be materially negatively impacted.**

All of our manufacturing operations as well as those of our suppliers rely on maintaining active licenses to produce and develop generic drugs. Specifically, our Cody Labs operations rely on a DEA license to directly import and convert raw concentrated poppy straw into several APIs or dosage forms. This license is granted for a one year period and must be renewed successfully each year in order for us to maintain Cody's current operations and allow the Company to continue to work towards becoming a fully integrated narcotics supplier. If the Company is unable to successfully renew its FDA and/or DEA licenses, the financial results of Lannett would be negatively impacted.

**If we are unable to successfully develop or commercialize new products, our operating results will suffer.**

Our future results of operations will depend to a significant extent upon our ability to successfully commercialize new generic products in a timely manner. There are numerous difficulties in developing and commercializing new products, including:

- developing, testing and manufacturing products in compliance with regulatory standards in a timely manner;
- receiving requisite regulatory approvals for such products in a timely manner;
- the availability, on commercially reasonable terms, of raw materials, including APIs and other key ingredients;
- developing and commercializing a new product is time consuming, costly and subject to numerous factors that may delay or prevent the successful commercialization of new products; and



- commercializing generic products may be substantially delayed by the listing with the FDA of patents that have the effect of potentially delaying approval of the off-patent product by up to 30 months, and in some cases, such patents have been issued and listed with the FDA after the key chemical patent on the brand drug product has expired or been litigated, causing additional delays in obtaining approval.

As a result of these and other difficulties, products currently in development by Lannett may or may not receive the regulatory approvals necessary for marketing. If any of our products, when developed and approved, cannot be successfully or timely commercialized, our operating results could be adversely affected. We cannot guarantee that any investment we make in developing products will be recouped, even if we are successful in commercializing those products.

**The loss of key personnel could cause our business to suffer.**

The success of our present and future operations will depend, to a significant extent, upon the experience, abilities and continued services of our key personnel. If we lose the services of our key personnel, or if they are unable to devote sufficient attention to our operations for any other reason, our business may be significantly impaired. If the employment of any of our current key personnel is terminated, we cannot assure you that we will be able to attract and replace the employee with the same caliber of key personnel. As such, we have entered into employment agreements with all of our senior executive officers in order to help retain these key individuals.

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**If brand pharmaceutical companies are successful in limiting the use of generics through their legislative and regulatory efforts, our sales of generic products may suffer.**

Many brand pharmaceutical companies increasingly have used state and federal legislative and regulatory means to delay generic competition. These efforts have included:

- pursuing new patents for existing products which may be granted just before the expiration of one patent which could extend patent protection for additional years or otherwise delay the launch of generics;
- using the Citizen Petition process to request amendments to FDA standards;
- seeking changes to U.S. Pharmacopoeia, an organization which publishes industry recognized compendia of drug standards;
- attaching patent extension amendments to non-related federal legislation; and
- engaging in state-by-state initiatives to enact legislation that restricts the substitution of some generic drugs, which could have an impact on products that we are developing.

If brand pharmaceutical companies are successful in limiting the use of generic products through these or other means, our sales may decline. If we experience a material decline in product sales, our results of operations, financial condition and cash flows will suffer.

**Third parties may claim that we infringe on their proprietary rights and may prevent us from manufacturing and selling some of our products.**

The manufacture, use and sale of new products that are the subject of conflicting patent rights have been the subject of substantial litigation in the pharmaceutical industry. These lawsuits relate to the validity and infringement of patents or proprietary rights of third parties. We may have to defend against charges that we violated patents or proprietary rights of third parties. This is especially true in the case of generic products on which the patent covering the brand product is expiring, an area where infringement litigation is prevalent, and in the case of new brand products where a competitor has obtained patents for similar products. Litigation may be costly and time-consuming, and could divert the attention of our management and technical personnel. In addition, if we infringe on the rights of others, we could lose our right to develop or manufacture products or could be required to pay monetary damages or royalties to license proprietary rights from third parties. Although the parties to patent and intellectual property disputes in the pharmaceutical industry have often settled their disputes through licensing or similar arrangements, the costs associated with these arrangements may be substantial and could include ongoing royalties. Furthermore, we cannot be

certain that the necessary licenses would be available to us on terms we believe to be acceptable. As a result, an adverse determination in a judicial or administrative proceeding or failure to obtain necessary licenses could prevent us from manufacturing and selling a number of our products, which could harm our business, financial condition, results of operations and cash flows.

**If we are unable to obtain sufficient supplies from key suppliers that in some cases may be the only source of finished products or raw materials, our ability to deliver our products to the market may be impeded.**

We are required to identify the supplier(s) of all the raw materials for our products in our applications with the FDA. To the extent practicable, we attempt to identify more than one supplier in each drug application. However, some products and raw materials are available only from a single source and, in some of our drug applications, only one supplier of products and raw materials has been identified, even in instances where multiple sources exist. To the extent any difficulties experienced by our suppliers cannot be resolved within a reasonable time, and at reasonable cost, or if raw materials for a particular product become unavailable from an approved supplier and we are required to qualify a new supplier with the FDA, our profit margins and market share for the affected product could decrease, and our development and sales and marketing efforts could be delayed.

**Our policies regarding returns, allowances and chargebacks, and marketing programs adopted by wholesalers may reduce our revenues in future fiscal periods.**

Based on industry practice, generic drug manufacturers have liberal return policies and have been willing to give customers post-sale inventory allowances. Under these arrangements, from time to time we give our customers credits on our generic products that our customers hold in inventory after we have decreased the market prices of the same generic products due to competitive pricing. Therefore, if new competitors enter the marketplace and significantly lower the prices of any of their competing products, we would likely reduce the price of our product. As a result, we would be obligated to provide credits to our customers who are then holding inventories of such products, which could reduce sales revenue and gross margin for the period the credit is provided. Like our competitors, we also give credits for chargebacks to wholesalers that have contracts with us for their sales to hospitals, group purchasing organizations, pharmacies or other customers.

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A chargeback is the difference between the price the wholesaler pays and the price that the wholesaler's end-customer pays for a product. Although we establish reserves based on our prior experience and our best estimates of the impact that these policies may have in subsequent periods, we cannot ensure that our reserves are adequate or that actual product returns, allowances and chargebacks will not exceed our estimates.

**Health care initiatives and other third-party payor cost-containment pressures could cause us to sell our products at lower prices, resulting in decreased revenues.**

Some of our products are purchased or reimbursed by state and federal government authorities, private health insurers and other organizations, such as health maintenance organizations, or HMOs, and managed care organizations, or MCOs. Third-party payors increasingly challenge pharmaceutical product pricing. There also continues to be a trend toward managed health care in the United States. Pricing pressures by third-party payors and the growth of organizations such as HMOs and MCOs could result in lower prices and a reduction in demand for our products.

In addition, legislative and regulatory proposals and enactments to reform health care and government insurance programs could significantly influence the manner in which pharmaceutical products and medical devices are prescribed and purchased. We expect there will continue to be federal and state laws and/or regulations, proposed and implemented, that could limit the amounts that federal and state governments will pay for health care products and services. The extent to which future legislation or regulations, if any, relating to the health care industry or third-party coverage and reimbursement may be enacted or what effect such legislation or regulation would have on our business remains uncertain. For example, the American Recovery and Reinstatement Act of 2009, also known as the stimulus package, includes \$1.1 billion in funding to study the comparative effectiveness of health care treatments and strategies. The stimulus package funding is expected to be used for, among other things, to conduct, support or synthesize research that compares and evaluates the risk and benefits, clinical outcomes, effectiveness and appropriateness of products. Although Congress has indicated that this funding is intended for improvement in quality of health care, it remains unclear how the research will impact coverage, reimbursement or other third-party payor policies. Such measures or other health care system reforms that are adopted could have a material adverse effect on our industry generally and our ability to successfully commercialize our products or could limit or eliminate our spending on development projects and affect our ultimate profitability.

**We may need to change our business practices to comply with changes to fraud and abuse laws.**

We are subject to various federal and state laws pertaining to health care fraud and abuse, including the Anti-Kickback Statute, which apply to our sales and marketing practices and our relationships with physicians. At the federal level, the Anti-Kickback Statute prohibits any person or entity from knowingly and willfully soliciting, receiving, offering, or paying any remuneration, including a bribe, kickback, or rebate, directly or indirectly, in return for or to induce the referral of patients for items or services covered by federal health care programs, or the furnishing, recommending, or arranging for products or services covered by federal health care programs. Federal health care programs have been defined to include plans and programs that provide health benefits funded by the federal government, including Medicare and Medicaid, among others. The definition of remuneration has been broadly interpreted to include anything of value, including, for example, gifts, discounts, the furnishing of supplies or equipment, credit arrangements, payments of cash, and waivers of payments. Several courts have interpreted the federal Anti-Kickback Statute's intent requirement to mean that if even one purpose in an arrangement involving remuneration is to induce referrals or otherwise generate business involving goods or services reimbursed in whole or in part under federal health care programs, the statute has been violated. The federal government has issued regulations, commonly known as safe harbors that set forth certain provisions which, if fully met, will assure parties that they will not be prosecuted under the federal Anti-Kickback Statute. The failure of a transaction or arrangement to fit within a specific safe harbor does not necessarily mean that the transaction or arrangement will be illegal or that prosecution under the federal Anti-Kickback Statute will be pursued, but such transactions or arrangements face an increased risk of scrutiny by government enforcement authorities and an ongoing risk of prosecution. If our sales and marketing practices or our relationships with physicians (such as physicians

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serving on our Scientific Advisory Board) are considered by federal or state enforcement authorities to be knowingly and willfully soliciting, receiving, offering, or providing any remuneration in exchange for arranging for or recommending our products and services, and such activities do not fit within a safe harbor, then these arrangements could be challenged under the federal Anti-Kickback Statute.

If our operations are found to be in violation of the federal Anti-Kickback Statute we may be subject to civil and criminal penalties including fines of up to \$25 thousand per violation, civil monetary penalties of up to \$50 thousand per violation, assessments of up to three times the amount of the prohibited remuneration, imprisonment, and exclusion from participating in the federal health care programs. In addition, HIPAA and its implementing regulations created two new federal crimes: health care fraud and false statements relating to health care matters. The HIPAA health care fraud statute prohibits, among other things, knowingly and willfully executing, or attempting to execute, a scheme to defraud any health care benefit program, including private payors. A violation of this statute is a felony and may result in fines, imprisonment and/or exclusion from government-sponsored programs. The HIPAA false statements statute prohibits, among other things, knowingly and willfully falsifying, concealing or covering up a material fact or making any materially false, fictitious or fraudulent statement or representation in connection with the delivery of or payment for health care benefits, items, or services.

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A violation of this statute is a felony and may result in fines and/or imprisonment. A number of states also have anti-fraud and anti-kickback laws similar to the federal Anti-Kickback Statute that prohibit certain direct or indirect payments if such arrangements are designed to induce or encourage the referral of patients or the furnishing of goods or services. Some states' anti-fraud and anti-kickback laws apply only to goods and services covered by Medicaid. Other states' anti-fraud and anti-kickback laws apply to all health care goods and services, regardless of whether the source of payment is governmental or private. Due to the breadth of these laws and the potential for changes in laws, regulations, or administrative or judicial interpretations, we may have to change our business practices or our existing business practices could be challenged as unlawful, which could materially adversely affect our business.

Certain federal and state governmental agencies, including the U.S. Department of Justice and the U.S. Department of Health and Human Services, have been investigating issues surrounding pricing information reported by drug manufacturers and used in the calculation of reimbursements as well as sales and marketing practices. For example, many government and third-party payors, including Medicare and Medicaid, reimburse doctors and others for the purchase of certain pharmaceutical products based on the product's AWP reported by pharmaceutical companies. While Lannett has only used Suggested Wholesale Prices since 2000, the federal government, certain state agencies, and private payors are investigating and have begun to file court actions related to pharmaceutical companies' reporting practices with respect to AWP, alleging that the practice of reporting prices for pharmaceutical products has resulted in a false and overstated AWP, which in turn is alleged to have improperly inflated the reimbursement paid by Medicare beneficiaries, insurers, state Medicaid programs, medical plans, and others to health care providers who prescribed and administered those products. In addition, some of these same payors are also alleging that companies are not reporting their "best price" to the states under the Medicaid program. We are not currently subject to any such investigations or actions and having not used AWP pricing since 2000 would not likely become subject to these investigations.

**We may become subject to federal and state false claims litigation brought by private individuals and the government.**

We are subject to state and federal laws that govern the submission of claims for reimbursement. The FFCA, also known as Qui Tam, imposes civil liability and criminal fines on individuals or entities that knowingly submit, or cause to be submitted, false or fraudulent claims for payment to the government. Violations of the FFCA and other similar laws may result in criminal fines, imprisonment, and civil penalties for each false claim submitted and exclusion from federally funded health care programs, including Medicare and Medicaid. The FFCA also allows private individuals to bring a suit on behalf of the government against an individual or entity for violations of the FFCA. These suits, also known as Qui Tam actions, may be brought by, with only a few exceptions, any private citizen who has material information of a false claim that has not yet been previously disclosed. These suits have increased significantly in recent years because the FFCA allows an individual to share in any amounts paid to the federal government in fines or settlement as a result of a successful Qui Tam action. If our past or present operations are found to be in violation of any of such laws or any other governmental regulations that may apply to us, we may be subject to penalties, including civil and criminal penalties, damages, fines, exclusion from federal health care programs, and/or the curtailment or restructuring of our operations. Any penalties, damages, fines, curtailment, or restructuring of our operations could adversely affect our ability to operate our business and our financial results, action against us for violation of these laws, even if we successfully defend against them, could cause us to incur significant legal expenses and divert our management's attention from the operation of our business.

**Sales of our products may continue to be adversely affected by the continuing consolidation of our distribution network and the concentration of our customer base.**

Our principal customers are wholesale drug distributors and major retail drug store chains. These customers comprise a significant part of the distribution network for pharmaceutical products in the U.S. This distribution network is continuing to undergo significant consolidation marked by mergers and acquisitions among wholesale distributors and the growth of large retail drug store chains. As a result, a small number of large wholesale distributors control a significant share of the market, and the number of independent drug stores and small drug store chains has decreased. We expect that consolidation of drug wholesalers and retailers will increase pricing and other competitive pressures on drug

manufacturers, including Lannett.

Our three largest customers accounted for 19%, 13% and 9%, respectively, of our net sales for the fiscal year ended June 30, 2014, and 17%, 12% and 10%, respectively, of our net sales for the fiscal year ended June 30, 2013. The loss of any of these customers could materially adversely affect our business, results of operations and financial condition and our cash flows. In addition, the Company generally does not enter into long-term supply agreements with its customers that would require them to purchase our products.

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**The design, development, manufacture and sale of our products involves the risk of product liability claims by consumers and other third parties, and insurance against such potential claims is expensive and may be difficult to obtain.**

The design, development, manufacture and sale of our products involve an inherent risk of product liability claims and the associated adverse publicity. Insurance coverage is expensive and may be difficult to obtain, and may not be available in the future on acceptable terms, or at all. Although we currently maintain product liability insurance for our products in amounts we believe to be commercially reasonable, if the coverage limits of these insurance policies are not adequate, a claim brought against Lannett, whether covered by insurance or not, could have a material adverse effect on our business, results of operations, financial condition and cash flows.

**Rising insurance costs, as well as the inability to obtain certain insurance coverage for risks faced by Lannett, could negatively impact profitability.**

The cost of insurance, including workers compensation, product liability and general liability insurance, has risen in recent years and may increase in the future. In response, we may increase deductibles and/or decrease certain coverage to mitigate these costs. These increases, and our increased risk due to increased deductibles and reduced coverage, could have a negative impact on our results of operations, financial condition and cash flows.

Additionally, certain insurance coverage may not be available to Lannett for risks faced by Lannett. Sometimes the coverage obtained by Lannett for certain risks may not be adequate to fully reimburse the amount of damage that Lannett could possibly sustain. Should either of these events occur, the lack of insurance to cover the entire cost to the Company would adversely affect our results of operations and financial condition.

**Federal regulation of arrangements between manufacturers of brand and generic products could adversely affect our business.**

As part of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, companies are now required to file with the Federal Trade Commission (FTC) and the Department of Justice certain types of agreements entered into between brand and generic pharmaceutical companies related to the manufacture, marketing and sale of generic versions of brand drugs. This new requirement could affect the manner in which generic drug manufacturers resolve intellectual property litigation and other disputes with brand pharmaceutical companies and could result generally in an increase in private-party litigation against pharmaceutical companies or additional investigations or proceedings by the FTC or other governmental authorities. The impact of this new requirement and the potential private-party lawsuits associated with arrangements between brand name and generic drug manufacturers is uncertain, and could adversely affect our business.



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**ITEM 2. DESCRIPTION OF PROPERTY**

Lannett owns five facilities in Philadelphia, Pennsylvania. Certain administrative functions, manufacturing and production facilities and our quality control laboratory are located in a 31,000 square foot facility at 9000 State Road Philadelphia, PA. The second facility consists of 63,000 square feet, and is located within one mile of the State Road facility at 9001 Torresdale Avenue Philadelphia, PA. Our research laboratory and packaging functions are located at this location. Additionally, the facility has capacity for additional manufacturing space, if needed. We also own a building at 13200 Townsend Road Philadelphia, PA consisting of 66,000 square feet on 7.3 acres of land which is used for certain administrative functions, warehouse space, and shipping. It also has capacity for additional manufacturing space, if needed.

On December 20, 2013, the Company acquired two separate properties located in Philadelphia, Pennsylvania for \$4.0 million and \$5.0 million, respectively. The buildings are 196,000 and 400,000 square feet, respectively, and the Company intends to use the two properties for future expansion including, but not limited to, additional manufacturing, product development, and warehousing capabilities. In connection with the purchase of these two buildings, the Company expects to incur significant capital expenditures for fit out costs over the next several years.

The manufacturing facility of our wholly-owned subsidiary, Cody Labs, consists of a 73,000 square foot structure located on approximately 15.0 acres in Cody, Wyoming. Cody Labs manufacturing facility currently has capacity for further expansion, both inside and outside the existing structure.

**ITEM 3. LEGAL PROCEEDINGS**

Information pertaining to legal proceedings can be found in Note 11. Legal and Regulatory Matters under Item 15. Exhibits and Financial Statement Schedules and is incorporated by reference herein.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable

Table of Contents**PART II****ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS****Market Information**

The Company's common stock trades on the NYSE. The following table sets forth certain information with respect to the high and low intraday prices of the Company's common stock during Fiscal 2014 and 2013, as quoted by the NYSE and NYSE MKT. The Company began trading on the NYSE on December 13, 2013. Such quotations reflect inter-dealer prices without retail mark-up, markdown, or commission and may not represent actual transactions.

**Fiscal Year Ended June 30, 2014**

|                | High     | Low      |
|----------------|----------|----------|
| First quarter  | \$ 22.19 | \$ 11.75 |
| Second quarter | \$ 33.95 | \$ 17.00 |
| Third quarter  | \$ 46.51 | \$ 31.13 |
| Fourth quarter | \$ 51.45 | \$ 29.12 |

**Fiscal Year Ended June 30, 2013**

|                | High     | Low     |
|----------------|----------|---------|
| First quarter  | \$ 5.15  | \$ 4.20 |
| Second quarter | \$ 5.06  | \$ 3.93 |
| Third quarter  | \$ 11.05 | \$ 4.86 |
| Fourth quarter | \$ 13.07 | \$ 9.15 |

 **Holders**

As of June 30, 2014, there were 363 holders of record of the Company's common stock.

### **Dividends**

The Company did not pay cash dividends in Fiscal 2014 or Fiscal 2013. The Company intends to use available funds for working capital, plant and equipment additions, and various product extension ventures. The Company does not expect to pay, nor should stockholders expect to receive, cash dividends in the foreseeable future.

### **October 2013 Stock Offering Use of Proceeds**

On December 7, 2012, our registration statement on Form S-3 (File No. 333-184721) was declared effective by the Securities and Exchange Commission. The Company completed an offering of its common stock on October 4, 2013 at an offering price of \$18.00 per share. The offering of 4.25 million shares yielded net proceeds of \$71.5 million after deducting underwriting, legal and accounting fees totaling \$5.0 million. Our intent is to use such net proceeds for general corporate purposes, including, without limitation, research and development, general and administrative, manufacturing and marketing expenses, and for potential acquisitions of companies, products, ANDAs, technologies and assets that complement its business. To date, the unused proceeds have been temporarily invested in short-term investments.

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The following table sets forth certain information with respect to the Company's share repurchase activity.

**ISSUER PURCHASES OF EQUITY SECURITIES**

| <b>Period<br/>(In thousands)</b> | <b>(a) Total<br/>Number of<br/>Shares (or<br/>Units)<br/>Purchased*</b> | <b>(b) Average<br/>Price Paid<br/>per Share (or<br/>Unit)</b> | <b>(c) Total<br/>Number of<br/>Shares (or<br/>Units)<br/>Purchased as<br/>Part of<br/>Publicly<br/>Announced<br/>Plans or<br/>Programs</b> | <b>(d) Maximum<br/>Number (or<br/>Approximate<br/>Dollar Value)<br/>of Shares (or<br/>Units) that<br/>May Yet Be<br/>Purchased<br/>Under the<br/>Plans or<br/>Programs</b> |
|----------------------------------|---|---|--|--|
| April 1 to April 30, 2014        | 739   | \$ 34.66  |  | \$   |
| May 1 to May 31, 2014            |   |   |  |  |
| June 1 to June 30, 2014          | 64,575  | 49.61   |  |  |
| Total                            | 65,314  | 49.44   |  |  |

\*Shares were repurchased to settle employee tax withholding obligations pursuant to equity award programs.

**Stock Performance Chart**

The following graph presents a comparison of the cumulative total stockholder return on the Company's stock with the cumulative total return of various indexes for the period of five years commencing July 1, 2009 and ending June 30, 2014. The graph assumes that \$100 was invested on July 1, 2009 in each of the various indexes.



Table of Contents**ITEM 6. SELECTED FINANCIAL DATA**

The following financial information as of and for the five years ended June 30, 2014, has been derived from our consolidated financial statements. This information should be read in conjunction with our consolidated financial statements and related notes thereto included elsewhere herein. Certain prior year amounts have been reclassified to conform to the current year financial statement presentation.

**Lannett Company, Inc. and Subsidiaries****Financial Highlights**

(In thousands, except per share data)

As of and for the Fiscal Year Ended June 30,

|  | 2014       | 2013       | 2012       | 2011       | 2010       |
|--|------------|------------|------------|------------|------------|
| <b>Operating Highlights</b>                                    |            |            |            |            |            |
| Net sales  | \$ 273,771 | \$ 151,054 | \$ 122,990 | \$ 106,835 | \$ 125,178 |
| Gross profit   | \$ 154,408 | \$ 57,420  | \$ 38,947  | \$ 23,320  | \$ 41,340  |
| Operating income (loss)  | \$ 88,089  | \$ 18,757  | \$ 6,910   | \$ (1,179) | \$ 12,713  |
| Net income (loss) Lannett Company, Inc.                        | \$ 57,101  | \$ 13,317  | \$ 3,948   | \$ (277)   | \$ 7,821   |
| Basic earnings (loss) per common share Lannett Company, Inc.   | \$ 1.70    | \$ 0.47    | \$ 0.14    | \$ (0.01)  | \$ 0.32    |
| Diluted earnings (loss) per common share Lannett Company, Inc. | \$ 1.62    | \$ 0.46    | \$ 0.14    | \$ (0.01)  | \$ 0.31    |
| <b>Balance Sheet Highlights</b>                                |            |            |            |            |            |
| Total Assets   | \$ 342,773 | \$ 167,752 | \$ 142,592 | \$ 134,580 | \$ 124,715 |
| Total Debt   | \$ 1,138   | \$ 6,514   | \$ 7,161   | \$ 7,822   | \$ 7,720   |
| Long Term Debt, less Current Portion                           | \$ 1,009   | \$ 5,844   | \$ 6,513   | \$ 7,193   | \$ 2,869   |
| Total Stockholders Equity                                      | \$ 294,765 | \$ 128,809 | \$ 111,313 | \$ 105,689 | \$ 88,958  |

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**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis describes material changes in the financial condition and results of operations, as well as liquidity and capital resources of Lannett Company, Inc. (the Company). Additionally, it addresses accounting policies that management has deemed are critical accounting policies. This discussion and analysis should be read in conjunction with the Consolidated Financial Statements, the Notes to the Consolidated Financial Statements and other sections of this Form 10-K.

In addition to historical information, this Form 10-K contains forward-looking information. The forward-looking information is subject to certain risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. Important factors that might cause such a difference include, but are not limited to, those discussed in the following section, entitled Management's Discussion and Analysis of Financial Condition and Results of Operations. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date of this Form 10-K. The Company undertakes no obligation to publicly revise or update these forward-looking statements to reflect events or circumstances that may occur. Readers should carefully review the risk factors described in other documents the Company files from time to time with the SEC, including the Quarterly Reports on Form 10-Q to be filed by the Company in Fiscal 2015, and any Current Reports on Form 8-K filed by the Company.

**Company Overview**

Lannett Company, Inc. (a Delaware corporation) and subsidiaries (the Company or Lannett) develop, manufacture, package, market, and distribute solid oral (tablets and capsules), extended release, topical, nasal, and oral solution finished dosage forms of drugs, that address a wide range of therapeutic areas. The Company also manufactures active pharmaceutical ingredients through its Cody Labs subsidiary, providing a vertical integration benefit. Additionally the Company is pursuing partnerships, research contracts and internal expansion for the development and production of other dosage forms including: ophthalmic, nasal, patch, foam, buccal, sublingual, soft gel, injectable, and oral dosages.

The Company operates pharmaceutical manufacturing plants in Philadelphia, Pennsylvania and Cody, Wyoming. Customers of the Company's pharmaceutical products include generic pharmaceutical distributors, drug wholesalers, chain drug stores, private label distributors, mail-order pharmacies, other pharmaceutical manufacturers, managed care organizations, hospital buying groups, governmental entities and health maintenance organizations.

**Financial Summary**

For Fiscal 2014, net sales increased to \$273.8 million representing 81% growth over the prior year period. Gross profit increased \$97.0 million to \$154.4 million, compared to the prior year period, and included the \$20.1 million charge related to the JSP contract renewal. The JSP contract renewal charge equated to a 7 percentage-point reduction in gross profit percentage. R&D expenses increased 71% to \$27.7 million compared to the prior year period while SG&A expenses increased 72% to \$38.6 million. Operating income for Fiscal 2014 was \$88.1 million compared to \$18.8 million in the prior year period. Net income attributable to Lannett for Fiscal 2014 was \$57.1 million, or \$1.62 per diluted share, and included the \$20.1 million pre-tax charge (\$0.36 per diluted share) related to the JSP contract renewal. Comparatively, net income attributable to Lannett in the prior year was \$13.3 million, or \$0.46 per diluted share, which included a favorable pre-tax litigation settlement of

\$1.3 million (\$0.03 per diluted share).

A more detailed discussion of the Company's financial results can be found below.



Table of Contents**Results of Operations – Fiscal 2014 compared to Fiscal 2013**

Net sales increased 81% to \$273.8 million for the fiscal year ended June 30, 2014. The following table identifies the Company's approximate net product sales by medical indication for the fiscal years ended June 30, 2014 and 2013:

| (In thousands)<br>Medical Indication | Fiscal Year Ended June 30, |            |
|--------------------------------------|----------------------------|------------|
|                                      | 2014                       | 2013       |
| Antibiotic                           | \$ 13,572                  | \$ 9,167   |
| Cardiovascular                       | 62,121                     | 25,876     |
| Gallstone                            | 6,578                      | 6,114      |
| Glaucoma                             | 11,987                     | 6,410      |
| Gout                                 | 10,822                     | 5,092      |
| Migraine                             | 14,527                     | 5,418      |
| Obesity                              | 4,032                      | 4,721      |
| Pain Management                      | 27,174                     | 21,232     |
| Thyroid Deficiency                   | 102,248                    | 57,978     |
| Other                                | 20,710                     | 9,046      |
| Total                                | \$ 273,771                 | \$ 151,054 |

Product price increases contributed \$115.1 million to the overall increase in net sales, while increased volumes added \$7.6 million. The Company experienced favorable trends in product pricing on several key products during the period, as discussed below. Although the Company has benefited from these favorable pricing trends, the level of competition in the marketplace is constantly changing and the Company cannot guarantee that these pricing trends will continue.

The following chart details price and volume changes by medical indication:

| Medical indication | Sales volume change % | Sales price change % |
|--------------------|-----------------------|----------------------|
| Antibiotic         | 38%                   | 10%                  |
| Cardiovascular     | (10)%                 | 150%                 |
| Gallstone          | (23)%                 | 31%                  |
| Glaucoma           | 1%                    | 86%                  |
| Gout               | 105%                  | 8%                   |
| Migraine           | 44%                   | 124%                 |
| Obesity            | (6)%                  | (8)%                 |
| Pain Management    | (6)%                  | 34%                  |
| Thyroid Deficiency | 7%                    | 69%                  |

**Thyroid Deficiency.** Net sales of drugs used for the treatment of thyroid deficiency increased by \$44.3 million, primarily as a result of price increases on key products.

**Cardiovascular.** Net sales of drugs used for cardiovascular treatment increased by \$36.2 million, primarily as a result of price increases on products used to treat congestive heart failure. The increase in net sales was partially offset by a decrease in net sales on products used to treat hypertension due to pricing pressures and modest volume decreases on several products within the indication.

**Migraine.** Net sales of drugs used to treat migraines increased by \$9.1 million. The increase in net sales was attributable to increased volumes as well as price increases on key products.

**Pain Management.** Net sales of pain management products increased \$5.9 million. The increase in net sales was mainly attributable to a price increase on the Company's C-Topical® Solution product. The increase in net sales was partially offset by lower sales volume of the Company's C-Topical® Solution product. Net sales of the Company's Oxycodone HCl Oral Solution product were lower due to FDA enforcement actions against market participants which caused the Company and others to voluntarily exit the market by October 4, 2012. The Company is awaiting FDA approval for this product and anticipates resuming product sales in the near future.

**Gout.** Net sales of drugs used for gout treatment increased by \$5.7 million. The increase in net sales was primarily attributable to increased volumes.

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**Glaucoma.** Net sales of drugs used for treatment of Glaucoma increased by \$5.6 million. The increase in net sales was primarily attributable to price increases.

**Antibiotic.** Net sales of antibiotics increased by \$4.4 million. The increase in net sales was primarily attributable to increased volumes across various products.

The Company sells its products to customers in various distribution channels. The table below presents the Company's net sales to each distribution channel for the fiscal year ended June 30:

| (In thousands)                | June 30, |         | June 30, |         |
|-------------------------------|----------|---------|----------|---------|
| Customer Distribution Channel | 2014     |         | 2013     |         |
| Wholesaler/Distributor        | \$       | 172,503 | \$       | 83,582  |
| Retail Chain                  |          | 80,710  |          | 52,479  |
| Mail-Order Pharmacy           |          | 20,558  |          | 14,993  |
| Total                         | \$       | 273,771 | \$       | 151,054 |

Net sales to wholesaler/distributor increased primarily as a result of increased sales in a variety of products for gout, thyroid deficiency and cardiovascular, as discussed above. Retail chain net sales increased primarily as a result of increased sales of drugs for the treatment of thyroid deficiency and cardiovascular, as discussed above.

**Cost of Sales.** Cost of sales for the fiscal year ended June 30, 2014 increased \$25.7 million to \$119.4 million, which included the \$20.1 million charge related to the JSP contract renewal. The remaining increase primarily reflected the impact of the increase in sales volumes. Amortization expense included in cost of sales totaled \$1.4 million for the fiscal years ended June 30, 2014 and 2013.

**Gross Profit.** Gross profit for the fiscal year ended June 30, 2014 increased 169% to \$154.4 million or 56% of net sales. In comparison, gross profit for the fiscal year ended June 30, 2013 was \$57.4 million or 38% of net sales. The gross profit percentage change for the fiscal year ended June 30, 2014 was mainly attributable to changes in the mix of products sold and product price increases, as discussed above, offset by the charge related to the JSP contract renewal, which negatively impacted gross margin by 7 percentage-points.

The Company is continuously seeking to keep product costs low, however there can be no guarantee that gross profit percentages will stay consistent in future periods. Pricing pressure from competitors and costs of producing or purchasing new drugs may also fluctuate in future periods. Changes in future product sales mix may also occur.

**Research and Development.** Research and development expenses increased 71% to \$27.7 million for the fiscal year ended June 30, 2014 compared to \$16.3 million in the prior year period. The increase is primarily due to increased costs for third-party laboratory services totaling \$4.1 million, bioequivalence studies totaling \$1.2 million and other costs for product development and FDA submissions totaling \$4.4 million.

**Selling, General and Administrative.** Selling, general and administrative expenses increased 72% to \$38.6 million for the fiscal year ended June 30, 2014 compared with \$22.4 million in the prior year period. The increase is primarily due to additional compensation-related costs totaling \$9.9 million and expenses related to marketing the Company's C-Topical® Solution product totaling \$1.9 million. Additional increases were attributable to general corporate spending totaling \$2.2 million.

The Company is focused on controlling selling, general and administrative costs, however increases in personnel and other costs to facilitate improvements in the Company's infrastructure and expansion may impact selling, general and administrative expenses in future periods.

**Other Income (Expense).** Interest expense for the fiscal year ended June 30, 2014 totaled \$130 thousand compared to \$251 thousand for the fiscal year ended June 30, 2013. Interest and dividend income totaling \$295 thousand for the fiscal year ended June 30, 2014 was higher compared with \$116 thousand for the prior year period. The Company also recorded a net gain on investment securities during the fiscal year ended June 30, 2014 totaling \$1.9 million compared to a net gain on investment securities totaling \$699 thousand in the prior year period.

**Income Tax.** The Company recorded income tax expense for the fiscal year ended June 30, 2014 of \$32.9 million compared to \$7.3 million for the fiscal year ended June 30, 2013. The effective tax rate for the fiscal year ended June 30, 2014 was 36.5%, compared to 35.3% for the prior year period. The increase in the effective tax rate in the fiscal year ended June 30, 2014 as compared to the fiscal year ended June 30, 2013 was due to an increase in non-deductible items and a decrease in tax credits, both relative to pre-tax income for the comparable periods. The effective rate increase was partially offset by the effects of a Pennsylvania tax law change which lowered the Company's apportionment factor within the state in Fiscal 2013.

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The impact of this change caused the Company to reduce its deferred tax assets thereby increasing the effective tax rate by 1.1% in Fiscal 2013.

At June 30, 2014, the Company had recognized a net deferred tax asset of \$25.5 million. The net deferred tax asset is net of a valuation allowance of \$2.3 million that is primarily related to the Cody notes receivable impairment recorded in conjunction with the acquisition of Cody Labs. The Company expects the remaining net deferred tax assets to be fully realizable based on the Company's history and future expectations of generating sufficient taxable income.

**Net Income.** For the fiscal year ended June 30, 2014, the Company reported net income attributable to Lannett Company, Inc. of \$57.1 million, or \$1.70 basic and \$1.62 per diluted share. Net income attributable to Lannett Company, Inc. included the charge related to the JSP contract renewal equal to \$0.36 per diluted share. Comparatively, net income attributable to Lannett in the prior year was \$13.3 million, or \$0.47 basic and \$0.46 per diluted share, which included the favorable litigation settlement equal to \$0.03 per diluted share.

**Results of Operations Fiscal 2013 compared to Fiscal 2012**

Net sales increased 23% from \$123.0 million in Fiscal 2012 to \$151.1 million in Fiscal 2013. The following table identifies the Company's approximate net product sales by medical indication for the fiscal years ended June 30, 2013 and 2012:

| (In thousands)<br>Medical Indication | Fiscal Year Ended June 30, |            |
|--------------------------------------|----------------------------|------------|
|                                      | 2013                       | 2012       |
| Antibiotic                           | \$ 9,167                   | \$ 6,724   |
| Cardiovascular                       | 25,876                     | 18,142     |
| Gallstone                            | 6,114                      | 5,991      |
| Glaucoma                             | 6,410                      | 4,252      |
| Gout                                 | 5,092                      | 484        |
| Migraine                             | 5,418                      | 5,971      |
| Obesity                              | 4,721                      | 3,755      |
| Pain Management                      | 21,232                     | 20,870     |
| Thyroid Deficiency                   | 57,978                     | 50,849     |
| Other                                | 9,046                      | 5,952      |
| Total                                | \$ 151,054                 | \$ 122,990 |

The following price and volume changes contributed to the \$28.1 million increase in net sales:

| Medical indication | Sales volume change % | Sales price change % |
|--------------------|-----------------------|----------------------|
| Antibiotic         | 36%                   | 1%                   |
| Cardiovascular     | 50%                   | (8)%                 |
| Gallstone          | (2)%                  | 4%                   |
| Glaucoma           | 8%                    | 43%                  |
| Gout               | 949%                  | 4%                   |
| Migraine           | (15)%                 | 6%                   |

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|                    |       |     |
|--------------------|-------|-----|
| Obesity            | (44)% | 69% |
| Pain Management    | (30)% | 33% |
| Thyroid Deficiency | 11%   | 3%  |

**Thyroid Deficiency.** Sales of drugs used for the treatment of thyroid deficiency increased by \$7.1 million, primarily as a result of both volume and price increases on key products within this medical indication.

**Cardiovascular.** Sales of drugs for cardiovascular treatment increased by \$7.7 million primarily due to increased volumes related to a product used for the treatment of hypertension which commenced shipping at the end of December 2011.

**Antibiotic.** Sales of drugs in the antibiotic medical indication increased by \$2.4 million primarily as a result of increased volumes on selected key products within the medical indication.

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**Pain Management.** Sales related to pain management products were relatively flat during Fiscal 2013 compared to Fiscal 2012. Additional pain management sales as a result of a price increase on the Company's C-Topical® Solution product were offset by lower volumes shipped of Morphine Sulfate Oral Solution and Oxycodone HCL Oral Solution. Lower volumes of Oxycodone resulted from FDA enforcement actions against market participants which caused the Company and others to voluntarily exit the market by October 4, 2012. The Company is awaiting FDA approval for this product and anticipates resuming product sales in the near future.

**Gout.** Increased sales of drugs used for gout treatment, resulting from additional volume, also contributed an additional \$4.6 million to the overall increase in sales.

**Glaucoma.** Sales of drugs used for the treatment of glaucoma increased by \$2.2 million mainly due to price increases on key products within the medical indication.

The Company sells its products to customers in various distribution channels. The table below presents the Company's net sales to each distribution channel.

| (In thousands)                | Fiscal 2013 |         | Fiscal 2012 |         |
|-------------------------------|-------------|---------|-------------|---------|
| Customer Distribution Channel | Net Sales   |         | Net Sales   |         |
| Wholesaler/Distributor        | \$          | 83,582  | \$          | 68,082  |
| Retail Chain                  |             | 52,479  |             | 45,633  |
| Mail-Order Pharmacy           |             | 14,993  |             | 9,275   |
| Total                         | \$          | 151,054 | \$          | 122,990 |

The sales to wholesaler/distributor increased primarily as a result of increased net sales in a variety of products including the gout and thyroid deficiency medical indications as discussed above. Retail chain sales increased primarily as a result of increased sales for the treatment of thyroid deficiency medical indication as discussed above. Mail-order pharmacy sales increased primarily as a result of increased sales of products in the cardiovascular and thyroid deficiency medical indications.

**Cost of Sales.** Cost of sales increased to \$93.6 million in Fiscal 2013 from \$84.0 million in Fiscal 2012. The increase primarily reflected the impact of the 23% increase in net sales, partially offset by changes in the mix of products sold, as well as increased manufacturing efficiencies. Amortization expense included in cost of sales above primarily relates to the JSP Distribution Agreement.

**Gross Profit.** Gross profit margins for Fiscal 2013 and Fiscal 2012 were 38% and 32%, respectively. Gross profit percentage increased primarily due to a change in the mix of products sold as discussed above, in addition to improved manufacturing efficiencies. While the Company is continuously striving to keep product costs low, there can be no guarantee that profit margins will stay consistent in future periods. Pricing pressure from competitors and costs of producing or purchasing new drugs may also fluctuate in future periods. Changes in the future sales product mix may also occur.

**Research and Development.** Research and development expenses increased 37% to \$16.3 million in Fiscal 2013 from \$11.8 million in Fiscal 2012. The increase is primarily due to increased costs related to biostudies as a result of the timing of milestone achievements and third-party laboratory service costs for products in development. Additional compensation-related costs incurred in Fiscal 2013 as compared to Fiscal 2012 also contributed to the increase.

The Company expenses all production costs as R&D until the drug is approved by the FDA. R&D expenses may fluctuate from period to period, based on R&D plans for submission to the FDA.

**Selling, General and Administrative.** Selling, general and administrative expenses increased 11% to \$22.4 million in Fiscal 2013 from \$20.2 million in Fiscal 2012. The increase is primarily due to additional compensation-related costs, partially offset by a decrease in legal expenses in Fiscal 2013, as compared to Fiscal 2012.

While the Company is focused on controlling costs, increases in personnel costs may have an ongoing and longer lasting impact on the administrative cost structure. Other costs are being incurred to facilitate improvements in the Company's infrastructure. These costs are expected to be temporary investments in the future of the Company and may not continue at the same level.

**Other Income (Expense).** During the first quarter of Fiscal 2013, the Company entered into a favorable settlement agreement related to litigation the Company had been involved in since January 2010. As a result of the agreement the Company recorded a gain in the amount of \$1.3 million. As of June 30, 2013, the Company had recorded all amounts related to the agreement.

In Fiscal 2013 interest expense totaled \$251 thousand compared to \$273 thousand in Fiscal 2012. Interest and dividend income totaling \$116 thousand was lower compared with \$142 thousand in Fiscal 2012. The Company also recorded a gain on investment securities during Fiscal 2013 totaling \$699 thousand compared to a loss on investment securities totaling \$103 thousand in Fiscal 2012.



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**Income Tax.** The Company recorded income tax expense totaling \$7.3 million in Fiscal 2013 compared to an income tax expense totaling \$2.6 million in Fiscal 2012. The effective tax rate for Fiscal 2013 was 35.3% compared to 39.3% for Fiscal 2012. The effective tax rate for Fiscal 2013 was lower compared to Fiscal 2012 due primarily to the impact of nondeductible incentive stock option compensation expense relative to pretax income for Fiscal 2012 compared to Fiscal 2013. An increase in disqualifying dispositions of incentive stock options in Fiscal 2013, as compared to Fiscal 2012, provided additional benefits. The overall decrease was partially offset by the effects of a Pennsylvania tax law change which lowered the Company's apportionment factor within the state. The impact of this change caused the Company to reduce its deferred tax assets thereby increasing the effective tax rate by 1.1%.

At June 30, 2013, the Company had recognized a net deferred tax asset of \$12.9 million. The net deferred tax asset is net of a valuation allowance of \$2.1 million that is primarily related to the Cody notes receivable impairment recorded in conjunction with the acquisition of Cody Labs. The Company has provided for the valuation allowance related to the notes receivable impairment as this benefit will be realized only upon the disposition of Cody Labs. As the Company has no current plans to dispose of its holdings in Cody, a full valuation allowance has been established. The Company expects the remaining net deferred tax assets to be fully realizable based on the Company's history and future expectations of generating sufficient taxable income.

**Net Income.** The Company reported net income attributable to Lannett Company, Inc. of \$13.3 million for Fiscal 2013, or \$0.47 basic and \$0.46 diluted earnings per share, compared to net income attributable to Lannett Company, Inc. of \$3.9 million for Fiscal 2012, or \$0.14 basic and diluted loss per share.

Liquidity and Capital Resources

**Cash Flow**

The Company has historically financed its operations with cash flow generated from operations, supplemented with borrowings from various government agencies and financial institutions. At June 30, 2014, working capital was \$218.5 million as compared to \$83.0 million at June 30, 2013, an increase of \$135.5 million. Current product portfolio sales as well as sales related to future product approvals are anticipated to continue to generate positive cash flow from operations.

Net cash from operating activities of \$45.1 million for the fiscal year ended June 30, 2014 reflected net income of \$57.2 million after adjustments for non-cash items of \$13.5 million, as well as cash used by changes in operating assets and liabilities of \$25.6 million. In comparison, net cash from operating activities of \$26.5 million for the fiscal year ended June 30, 2013 reflected net income of \$13.4 million after adjustments for non-cash items of \$7.4 million, as well as cash provided by changes in operating assets and liabilities of \$5.7 million.

Significant changes in operating assets and liabilities from June 30, 2013 to June 30, 2014 are comprised of:

- An increase in accounts receivable of \$34.9 million, mainly due to an increase in gross accounts receivable as a result of increased sales, partially offset by increases in total revenue-related reserves. The Company's days sales outstanding (DSO) at June 30, 2014, based on

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annualized gross sales and gross accounts receivable at June 30, 2014, was 60 days. The level of DSO at June 30, 2014 was comparable to the Company's expectation that DSO will be in the 60 to 70 day range based on 60 day payment terms for most customers.

- An increase in income taxes payable totaling \$11.4 million, mainly resulting from Fiscal 2014 taxable income offset by the timing of estimated tax payments made during Fiscal 2014 and excess tax benefits on share-based compensation awards.
- An increase in inventories of \$12.3 million, primarily due to the timing of customer order fulfillment.
- An increase in rebates payable of \$3.5 million due to an increase in rebates accrued resulting from sales qualifying for existing rebate programs.
- An increase in accrued payroll and payroll-related expenses of \$6.0 million, due to an increase in incentive compensation in Fiscal 2014 compared to Fiscal 2013.

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Significant changes in operating assets and liabilities from June 30, 2012 to June 30, 2013 are comprised of:

- A decrease in accounts receivable of \$173 thousand, mainly due to an increase in total revenue-related reserves, partially offset by increased sales in the fourth quarter of Fiscal 2013 compared to the fourth quarter of Fiscal 2012. The Company's days sales outstanding ( DSO ), based on gross sales and gross accounts receivable, for Fiscal 2013 was 61 days. The level of DSO at June 30, 2013 is comparable to the Company's expectation that DSO will be in the 60 to 70 day range based on 60 day payment terms for most customers.
- A decrease in income taxes receivable and an increase in income taxes payable totaling \$2.5 million. The amount is mainly the result of a federal tax refund received in the amount of \$2.2 million as well as estimated tax payments related to expected taxable income for Fiscal 2013.
- An increase in inventories of \$5.5 million, primarily due to the fulfillment of customer orders and inventory on hand related to new product approvals.
- An increase in accounts payable of \$4.7 million, due to the timing of payments at the end of Fiscal 2013.
- An increase in accrued payroll and payroll-related expenses of \$3.7 million, primarily related to accrued incentive compensation costs in Fiscal 2013, partially offset by Fiscal 2013 payments of incentive compensation accrued during Fiscal 2012.

Net cash used in investing activities of \$56.4 million for the year ended June 30, 2014 is mainly the result of purchases of investment securities of \$53.7 million and purchases of property, plant and equipment of \$26.1 million, partially offset by proceeds from the sale of investment securities of \$23.4 million. Net cash used in investing activities of \$8.6 million for the year ended June 30, 2013 is mainly the result of purchases of investment securities of \$23.6 million and purchases of property, plant and equipment of \$7.8 million, partially offset by proceeds from the sale of investment securities of \$22.5 million.

Net cash provided by financing activities of \$74.2 million for the year ended June 30, 2014 was primarily due to proceeds from an offering of the Company's common stock of \$71.5 million, proceeds from the issuance of stock pursuant to share-based compensation plans of \$5.4 million and excess tax benefits on share-based compensation awards of \$7.0 million, partially offset by debt repayments of \$5.4 million and purchases of treasury stock of \$3.9 million. Net cash provided by financing activities of \$2.2 million for the year ended June 30, 2013 was primarily due to proceeds from the issuance of stock pursuant to share-based compensation plans of \$3.1 million, partially offset by scheduled repayments of debt of \$647 thousand and purchases of treasury stock of \$440 thousand.

**Credit Facilities**

The Company has previously entered into and may enter future agreements with various government agencies and financial institutions to provide additional cash to help finance the Company's various capital investments and potential strategic opportunities. These borrowing arrangements as of June 30, 2014 are as follows:

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In December 2013, the Company entered into a credit agreement (the Citibank Line of Credit ) with Citibank, N.A., as administrative agent and certain other financial institutions. The Citibank Line of Credit provides for a revolving loan commitment in the amount of up to \$50.0 million. Any loans under the Citibank Line of Credit will bear interest at either a Eurodollar Rate or a Base Rate plus a specified margin. The Company is also required to pay a commitment fee on any undrawn commitments under the Citibank Line of Credit ranging from 0.2% - 0.3% per annum according to the average daily balance of borrowings under the agreement. The Citibank Line of Credit is collateralized by substantially all of the Company's assets. In connection with securing the Citibank Line of Credit, the Company repaid substantially all of its outstanding debt, except for the Cody LCI Realty, LLC ( Realty ) mortgage. As of June 30, 2014, the Company had \$50.0 million available under the Citibank Line of Credit.

The Citibank Line of Credit contains representations and warranties, affirmative, negative and financial covenants, and events of default, applicable to the Company and its subsidiaries which are customary for credit facilities of this type. As of June 30, 2014 the Company was in compliance with all financial covenants.

The Company is the primary beneficiary to a VIE called Realty. The VIE owns land and a building which is being leased to Cody Labs. 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 thousand. As of June 30, 2014 and June 30, 2013, the effective rate was 4.5%. The mortgage is collateralized by the land and building with a net book value of \$1.5 million. As of June 30, 2014, \$1.1 million is outstanding under the mortgage loan, of which \$129 thousand is classified as currently due.

Table of Contents**Other Liquidity Matters**

On December 20, 2013, the Company acquired two separate properties located in Philadelphia, Pennsylvania for \$4.0 million and \$5.0 million, respectively. The buildings are 196,000 and 400,000 square feet, respectively, and the Company intends to use the two properties for future expansion including, but not limited to, additional manufacturing, product development, and warehousing capabilities. In connection with the purchase of these two buildings, the Company expects to incur significant capital expenditures for fit out costs over the next several years.

The Company completed an offering of its common stock on October 4, 2013 at an offering price of \$18.00 per share. The offering of 4.25 million shares yielded net proceeds of \$71.5 million after deducting underwriting, legal and accounting fees totaling \$5.0 million.

We are continuously evaluating the potential for product and company acquisitions as a part of our future growth strategy. In conjunction with a potential acquisition the Company may utilize current resources or seek additional sources of capital to finance any such acquisition, which could have an impact on future liquidity.

**Contractual Obligations**

The following table represents annual contractual obligations as of June 30, 2014:

| (In thousands)          | Total      | Less than 1<br>year | 1-3 years | 3-5 years | More than 5<br>Years |
|-------------------------|------------|---------------------|-----------|-----------|----------------------|
| Long-Term Debt          | \$ 1,138   | \$ 129              | \$ 276    | \$ 302    | \$ 431               |
| Purchase Obligations    | 143,986    | 19,986              | 62,000    | 62,000    |                      |
| Interest on Obligations | 705        | 148                 | 278       | 253       | 26                   |
| Total                   | \$ 145,829 | \$ 20,263           | \$ 62,554 | \$ 62,555 | \$ 457               |

The purchase obligations above are primarily due to the agreement with Jerome Stevens Pharmaceuticals, Inc. ( JSP ). If the minimum purchase requirement is not met, JSP has the right to terminate the contract within 60 days of Lannett's failure to meet the requirement. If JSP terminates the contract, Lannett does not pay any fee, but could lose its exclusive distribution rights in the United States. If Lannett's management believes that it is not in the Company's best interest to fulfill the minimum purchase requirements, it can also terminate the contract without any penalty. If either party were to terminate the purchase agreement, there would be a significant impact on the operating cash flows of the Company. See Note 19 Material Contracts with Suppliers to our Consolidated Financial Statements for more information on the terms, conditions and financial impact of the JSP Distribution Agreement.

Interest on Obligations amount above includes interest on the Cody mortgage as well as the unused commitment fee related to the Citibank line of credit. Refer to Note 9 Bank Line of Credit and Note 10 Long-Term Debt for additional information.

### **Research and Development Arrangements**

In the normal course of business, the Company has entered into certain research and development and other arrangements. As part of these arrangements the Company has agreed to certain contingent payments which generally become due and payable only upon the achievement of certain developmental, regulatory, commercial and/or other milestones. In addition, under certain arrangements, we may be required to make royalty payments based on a percentage of future sales, or other metric, for products currently in development in the event that the Company begins to market and sell the product. Due to the inherent uncertainty related to these developmental, regulatory, commercial and/or other milestones, it is unclear if the Company will ever be required to make such payments. As such, these contingencies are not reflected in the expected cash requirements for Contractual Obligations in the table above.

### **Prospects for the Future**

Lannett continues to see substantial growth year over year in many important financial metrics. Each year, our knowledge, skills and talent increase, as the Company learns from its experience. The Company is strengthening and building momentum to push to the next level within the generic pharmaceutical industry. There are several strategic initiatives on which the Company is embarking to continue its growth.

One initiative at the core of the Company's strategy is to continue leveraging the asset we acquired in 2007, Cody Labs. In July 2008, the DEA granted Cody Labs a license to directly import concentrated poppy straw for conversion into opioid-based APIs for use in various dosage forms for pain management. The value of this license comes from the fact that, to date, only six other companies in the U.S. have been granted this license. This license, along with Cody Labs' expertise in API development and manufacture, allows the Company to perform in a market with high barriers to entry, no foreign competition, and limited domestic competition.

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Because of this vertical integration, the Company has direct control of its supply and can avoid increased costs associated with buying APIs from third-party manufacturers, thereby achieving higher margins. The Company can also leverage this vertical integration not only for direct supply of opioid-based APIs, but also for the manufacture of non-opioid-based APIs.

The Company believes that the demand for controlled substance, pain management drugs will continue to grow as the Baby Boomer generation ages. By concentrating additional resources in the development of opioid-based APIs and dosage forms, the Company is well-positioned to take advantage of this opportunity. The Company is currently vertically integrated on two products, with several others in various stages of development.

One product which the Company manufactures is a cocaine hydrochloride solution. This product is being manufactured and marketed under the brand name C-Topical® Solution. This product is an analgesic topical solution, with vasoconstriction as a side effect, for use primarily by ear, nose and throat doctors during surgical procedures. This product represents the Company's first foray into the brand market. Selling brand versus generic products requires a dedicated sales force to detail and educate physicians on the product. The Company strongly believes that C-Topical®, once the clinical trials are completed and the FDA has granted approval, will be an important contributor to total revenue, with higher than average profit margins as a result of vertical integration.

The Company's strategic goal is to continue investing in controlled substance product development so that, within five years, at least 50% of revenues from manufactured products are derived from controlled substance products which carry with them higher-than-average gross margins. As the Company continues to invest in, and focus, on process and manufacturing optimization, Cody Labs will continue to be an important part of our future growth plan.

In addition to focusing on the development and manufacture of opioid-based APIs and dosage forms, the Company has made a strategic decision to develop products, both in-house and with external partners, which require a paragraph four (P-IV) certification when filing the ANDA. A P-IV certification is required when an ANDA is submitted for a product for which the innovator's patent has not expired. The certification must state whether the patent on the reference listed drug (RLD) is being challenged on grounds of it being invalid, or if the patent is being circumvented. This path to product approval represents a major opportunity for generic drug companies because they do not have to wait until a particular patent expires to potentially enter the market. Secondly, if a company is the first to file a P-IV on a product, and they successfully invalidate or circumvent the patent, the FDA may grant 180 days of market exclusivity. This allows the generic manufacturer to be the sole competitor to the brand company for six months, during which time it will capture a significant portion of the market from the brand company, albeit at lower prices.

The challenge for generic manufacturers with this strategy is the legal costs involved. Before a product is selected for development, the Company must perform a thorough review of the existing patents and determine if they are going to try to invalidate the patent or try to circumvent it. In either case, once the Company submits a P-IV the brand company will have 45 days to respond with a determination on whether they are going to file a suit against the generic company to defend their patent. A generic company needs to be prepared not only for the time and effort associated with a protracted legal challenge, but the associated fees which can easily reach in excess of several million dollars. This strategy provides a high risk, high reward path to product approval. The Company filed its first ANDA with a P-IV certification in Fiscal 2013. To date, we have filed four paragraph IV certifications. In response to our paragraph IV certification with respect to the Zomig® nasal spray product, AstraZeneca AB, AstraZeneca UK Limited and Impax Laboratories, Inc. filed two patent infringement complaints against the Company in July 2014. With the right research and analysis performed up front, the Company believes it can target suitable products for which to file a P-IV certification, be successful, and reap the rewards of limited competition.

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Another area of focus for the Company is in mergers, acquisitions and other strategic alliances, whether new or continuing. The Company is party to supply and development agreements with international companies, including, Azad Pharma AG, Swiss Caps of Switzerland, Pharma 2B (formerly Pharmaseed), The GC Group of Israel and HEC Pharm Group, as well as domestic companies, including JSP, Cerovene, and Summit Bioscience LLC. The Company is currently in negotiations on similar agreements with other companies, and is actively seeking additional strategic partnerships, through which it will market and distribute products manufactured in-house or by third parties.



Table of Contents**Critical Accounting Policies**

The preparation of our consolidated financial statements in accordance with accounting principles generally accepted in the United States and the rules and regulations of the U.S. Securities & Exchange Commission requires the use of estimates and assumptions. A listing of the Company's significant accounting policies are detailed in Note 2 Summary of Significant Accounting Policies. A subsection of these accounting policies have been identified by management as Critical Accounting Policies. Critical accounting policies are those which require management to make estimates using assumptions that were uncertain at the time the estimate was made and for which the use of different assumptions, which reasonably could have been used, could have a material impact on the financial condition or results of operations.

Management has identified the following as Critical Accounting Policies: Revenue Recognition, Inventories, Income Taxes, Valuation of Long-Lived Assets, and Share-based Compensation.

**Revenue Recognition**

The Company recognizes revenue when 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. The Company also considers all other relevant criteria specified in Securities and Exchange Commission Staff Accounting Bulletin No. 104, Topic No. 13, Revenue Recognition, in determining when to recognize revenue.

When revenue is recognized a simultaneous adjustment to revenue is made for chargebacks, rebates, returns, promotional adjustments, and other potential adjustments. These provisions are primarily estimated based on historical experience, future expectations, contractual arrangements with wholesalers and indirect customers, and other factors known to management at the time of accrual. Accruals for provisions are presented in the Consolidated Financial Statements as a reduction to gross sales with the corresponding reserve presented as a reduction of accounts receivable or included as rebates payable. The reserves presented as a reduction of accounts receivable totaled \$51.9 million and \$17.5 million at June 30, 2014 and June 30, 2013, respectively. Rebates payable at June 30, 2014 and June 30, 2013 included \$4.6 million and \$1.0 million, respectively, for certain rebate programs, primarily related to Medicare Part D and Medicaid, and certain sales allowances and other adjustments paid to indirect customers.

The following table identifies the activity and ending balances of each major category of revenue reserve for fiscal years 2014, 2013 and 2012:

**Reserve Category**

| (In thousands)                   | Chargebacks | Rebates  | Returns  | Other   | Total     |
|----------------------------------|-------------|----------|----------|---------|-----------|
| Balance at July 1, 2011          | \$ 5,497    | \$ 2,925 | \$ 5,142 | \$ 509  | \$ 14,073 |
| Current period provision         | 68,433      | 21,178   | 4,692    | 6,792   | 101,095   |
| Credits issued during the period | (66,867)    | (19,667) | (4,294)  | (6,596) | (97,424)  |
| Balance at June 30, 2012         | 7,063       | 4,436    | 5,540    | 705     | 17,744    |
| Current period provision         | 67,898      | 23,731   | 4,490    | 10,249  | 106,368   |
| Credits issued during the period | (67,694)    | (24,586) | (3,341)  | (9,954) | (105,575) |
| Balance at June 30, 2013         | 7,267       | 3,581    | 6,689    | 1,000   | 18,537    |

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|                                  |           |           |          |          |           |
|----------------------------------|-----------|-----------|----------|----------|-----------|
| Current period provision         | 144,578   | 56,346    | 6,632    | 21,462   | 229,018   |
| Credits issued during the period | (121,525) | (44,836)  | (3,980)  | (20,675) | (191,016) |
| Balance at June 30, 2014         | \$ 30,320 | \$ 15,091 | \$ 9,341 | \$ 1,787 | \$ 56,539 |

For the years ending June 30, 2014, 2013 and 2012, as a percentage of gross sales the provision for chargebacks was 28.8%, 26.4% and 30.6%, the provision for rebates was 11.2%, 9.2% and 9.5%, the provision for returns was 1.3%, 1.7% and 2.1%, and the provision for other adjustments was 4.3%, 4.0% and 3.0%, respectively.

The increase in total reserves from June 30, 2013 to June 30, 2014 was mainly due to an increase in the rebates and chargebacks reserves. The increase in the rebates reserve resulted from the timing of credits issued, increased gross sales qualifying for rebate programs and pricing changes, while the increase in the chargebacks reserve resulted from increased inventory levels at wholesale distribution centers due to a strategic partnership between two of the companies customers, partially offset by reduced chargeback rates. The activity in the Other category for the fiscal year ended June 30, 2014 and 2013 includes shelf-stock, shipping and other sales adjustments including prompt payment discounts. The increased provision in the Other category during the fiscal year ended June 30, 2014, compared to the fiscal year ended June 30, 2013, primarily resulted from contractual price protection arrangements with customers in connection with various product price increases. Historically, we have not recorded any material amounts in the current period related to prior period reserves.

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Provisions for chargebacks, rebates, returns and other adjustments require varying degrees of subjectivity. While rebates generally are based on contractual terms and require minimal estimation, chargebacks and returns require management to make more subjective assumptions. Each major category is discussed in detail below:

***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. The Company enters into agreements with its indirect customers to establish pricing for certain products. The indirect customers then independently select a wholesaler from which to purchase the products. If the price paid by the indirect customers is lower than the price paid by the wholesaler, the Company will provide a credit, called a chargeback, to the wholesaler for the difference between the contractual price with the indirect customers and the wholesaler purchase price. 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 (decrease), the reserve for chargebacks will also generally increase (decrease). However, the size of the increase (decrease) depends on product mix and the amount of sales made to 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 may differ from the actual chargeback reserve.

***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 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. Additionally, 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 both approved by the FDA as 505(b)(2) NDAs, they are considered brand drugs for purposes of the PPACA. Drugs purchased within the Medicare Part D coverage gap (commonly referred to as the donut hole) result in additional rebates. The Company estimates the reserve for rebates and other promotional credit programs based on the specific terms in each agreement when revenue is recognized. The reserve for rebates increases (decreases) as sales to certain wholesale and retail customers increase (decrease). However, since these rebate programs are not identical for all customers, the size of the reserve will depend on the mix of sales to 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 time period prior to and subsequent to the product's 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, credit terms and any extenuating circumstances known to management. While historical experience has allowed for reasonable estimations in the past, future returns may or may not follow historical trends. The Company continually monitors the reserve for returns and makes adjustments when management believes that actual product returns may differ from the

established reserve. Generally, the reserve for returns increases as net sales increase.

***Other Adjustments***

Other adjustments consist primarily of price adjustments, also known as shelf-stock adjustments and price protections, which are both credits issued to reflect increases or decreases in the invoice or contract prices of the Company's products. In the case of a price decrease a credit is given for product remaining in customer's inventories at the time of the price reduction. Contractual price protection results in a similar credit when the invoice or contract prices of the Company's products increase, effectively allowing customers to purchase products at previous prices for a specified period of time. Amounts recorded for estimated shelf-stock adjustments and price protections are based upon specified terms with direct customers, estimated changes 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 also include prompt payment discounts.

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***Inventories***

Inventories are stated at the lower of cost or market determined by the first-in, first-out method. Inventories are regularly reviewed and provisions for excess and obsolete inventory are recorded based primarily on current inventory levels and estimated sales forecasts. During the fiscal years ended June 30, 2014, 2013 and 2012, the Company recorded provisions for excess and obsolete inventory of \$2.9 million, \$876 thousand and \$1.7 million, respectively.

***Income Taxes***

The Company uses an asset and liability approach to account for income taxes as prescribed by ASC 740, Income Taxes. Deferred taxes are recorded to reflect the tax consequences on future years of events that the Company has already recognized in the financial statement or tax returns. Deferred income tax assets and liabilities are adjusted to recognize the effect of changes in tax law or tax rates in the period during which the new law is enacted. Under ASC 740, Income Taxes, a valuation allowance is required when it is more likely than not that all or some portion of the deferred tax assets will not be realized through generating sufficient future taxable income. 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.

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 benefit from uncertain tax positions recorded in the financial statements was immaterial for all periods presented.

The Company's future effective income tax rate is highly reliant on future projections of taxable income, tax legislation, and potential tax planning strategies. A change in any of these factors could materially affect the effective income tax rate of the Company in future periods.

***Valuation of Long-Lived Assets***

The Company's long-lived assets primarily consist of property, plant and equipment as well as definite-lived intangible assets. Intangible assets are stated at cost less accumulated amortization and are not material to the consolidated financial statements at June 30, 2014. Amortization is computed on a straight-line basis over the assets' estimated useful lives, generally for periods ranging from 10 to 15 years. Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation is computed on a straight-line basis over the assets' estimated useful lives, generally for periods ranging from 5 to 39 years. The Company continually evaluates the reasonableness of the useful lives of these assets.

Long-lived assets are reviewed for impairment whenever events or changes in circumstances ( triggering events ) indicate that the carrying amount of the asset may not be recoverable. The nature and timing of triggering events by their very nature are unpredictable; however management regularly considers the performance of an asset as compared to its expectations, industry events, industry and economic trends, as

well as any other relevant information known to management when determining if a triggering event occurred.

If a triggering event is determined to have occurred, the first step in the impairment test is to compare the asset's carrying value to the undiscounted cash flows expected to be generated by the asset. If the carrying value exceeds the undiscounted cash flow of the asset then impairment exists. An impairment loss is measured as the excess of the asset's carrying value over its fair value, which in most cases is calculated using a discounted cash flow model. Discounted cash flow models are highly reliant on various assumptions which are considered Level 3 inputs, including estimates of future cash flows (including long-term growth rates), discount rates, and the probability of achieving the estimated cash flows.

#### *Share-based Compensation*

Share-based compensation costs are recognized over the vesting period, using a straight-line method, 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 market price on the grant date to value restricted stock. The Black-Scholes valuation model includes various assumptions, including the expected volatility, the expected life of the award, dividend yield, and the risk-free interest rate. 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.

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The following table presents the weighted average assumptions used to estimate fair values of the stock options granted during the years ended June 30 and the estimated annual forfeiture rates used to recognize the associated compensation expense:

|                          | <b>Stock<br/>Options<br/>FY 2014</b> | <b>Stock<br/>Options<br/>FY 2013</b> | <b>Stock<br/>Options<br/>FY 2012</b> |
|--------------------------|--------------------------------------|--------------------------------------|--------------------------------------|
| Risk-free interest rate  | 2.1%                                 | 1.0%                                 | 1.1%                                 |
| Expected volatility      | 62.8%                                | 61.6%                                | 63.5%                                |
| Expected dividend yield  | 0.0%                                 | 0.0%                                 | 0.0%                                 |
| Forfeiture rate          | 7.5%                                 | 7.5%                                 | 7.5%                                 |
| Expected term (in years) | 5.9 years                            | 6.1 years                            | 5.2 years                            |

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. The Company uses historical information to estimate the expected term, which represents the period of time that options granted are expected to be outstanding. The risk-free rate for the period equal to the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. 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. Additionally, the expected dividend yield is equal to zero, as the Company has not historically issued, and has no immediate plans to issue, a dividend.

***Recent Accounting Pronouncements***

In May 2014, the FASB issued authoritative guidance on revenue recognition. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The authoritative guidance is effective for annual reporting periods beginning after December 15, 2016. Early application is not permitted. The Company is currently in the process of assessing the impact this guidance will have on the consolidated financial statements.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

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 thousand. As of June 30, 2014 and June 30, 2013, the effective interest rate was 4.5%. The mortgage is collateralized by the land and building with a net book value of \$1.5 million. As of June 30, 2014, \$1.1 million is outstanding under the mortgage loan.

In December 2013, the Company entered into a credit agreement (the Citibank Line of Credit) with Citibank, N.A., as administrative agent and certain other financial institutions. The Citibank Line of Credit provides for a revolving loan commitment in the amount of up to \$50.0 million. Any loans under the Citibank Line of Credit will bear interest at either a Eurodollar Rate or a Base Rate plus a specified margin. The Company is also required to pay a commitment fee on any undrawn commitments under the Citibank Line of Credit ranging from 0.2% - 0.3% per annum according to the average daily balance of borrowings under the agreement. The Citibank Line of Credit is collateralized by substantially all of

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the Company's assets. As of June 30, 2014, the Company had \$50.0 million available under the Citibank Line of Credit.

The Citibank Line of Credit contains representations and warranties, affirmative, negative and financial covenants, and events of default, applicable to the Company and its subsidiaries which are customary for credit facilities of this type. As of June 30, 2014 the Company was in compliance with all financial covenants.

The Company invests in equity securities, U.S. government agency securities and corporate bonds, which are exposed to market and interest rate fluctuations. The interest and dividends earned on these investments may vary based on fluctuations in interest rate and market conditions.

### **ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The Consolidated Financial Statements and Report of the Independent Registered Public Accounting Firm is set forth in Item 15 of this Annual Report on Form 10-K under the caption "Consolidated Financial Statements" and incorporated herein by reference.



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**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9A. CONTROLS AND PROCEDURES**

*Disclosure Controls and Procedures*

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 such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934 (the Exchange Act), as amended, for financial reporting as of June 30, 2014. Based on that evaluation, our chief executive officer and chief financial officer concluded that these controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported as specified in Securities and Exchange Commission rules and forms. There were no changes in these controls or procedures identified in connection with the evaluation of such controls or procedures that occurred during our last fiscal quarter, or in other factors that have materially affected, or are reasonably likely to materially affect these controls or procedures.

Our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified in the rules and forms of the Securities and Exchange Commission. These disclosure controls and procedures include, among other things, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act 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.

*Management's Report on Internal Control over Financial Reporting*

The report of management of the Company regarding internal control over financial reporting is set forth in Item 15 of this Annual Report on Form 10-K under the caption Consolidated Financial Statements: Management's Report on Internal Control Over Financial Reporting and incorporated herein by reference.

*Attestation Report of Independent Registered Public Accounting Firm*

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The attestation report of the Company's independent registered public accounting firm regarding internal control over financial reporting is set forth in Item 15 of this Annual Report on Form 10-K under the caption "Consolidated Financial Statements: Report of Independent Registered Public Accounting Firm" and incorporated herein by reference.

### *Changes in Internal Control over Financial Reporting*

During the quarter ended June 30, 2014, there were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

### **ITEM 9B. OTHER INFORMATION**

None.

Table of Contents**PART III****ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE****Directors and Executive Officers**

The directors and executive officers of the Company are set forth below:

|                          | Age | Position  |
|--------------------------|-----|---|
| <b><u>Directors:</u></b> |     |   |
| William Farber           | 82  | Chairman Emeritus   |
| Jeffrey Farber           | 54  | Chairman of the Board   |
| Arthur P. Bedrosian      | 68  | Director  |
| David Drabik             | 46  | Director  |
| Paul Taveira             | 54  | Director  |
| James M. Maher           | 61  | Director  |
| <b><u>Officers:</u></b>  |     |   |
| Arthur P. Bedrosian      | 68  | President and Chief Executive Officer                             |
| Martin P. Galvan         | 62  | Vice President of Finance, Chief Financial Officer and Treasurer  |
| William F. Schreck       | 65  | Chief Operating Officer   |
| Kevin R. Smith           | 54  | Vice President of Sales and Marketing                             |
| Ernest J. Sabo           | 66  | Vice President of Regulatory Affairs and Chief Compliance Officer |
| Robert Ehlinger          | 56  | Vice President of Logistics and Chief Information Officer         |

**William Farber** was elected as Chairman of the Board of Directors in August 1991. From April 1993 to the end of 1993, Mr. Farber was the President and a director of Auburn Pharmaceutical Company. From 1990 through March 1993, Mr. Farber served as Director of Purchasing for Major Pharmaceutical Corporation. From 1965 through 1990, Mr. Farber was the Chief Executive Officer of Michigan Pharmacal Corporation. Mr. Farber was previously a registered pharmacist in the State of Michigan for more than 40 years until his retirement from active employment in the pharmaceutical industry. On June 1, 2011, Mr. Farber retired from his position as Chairman of the Board and was appointed Chairman Emeritus.

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**Jeffrey Farber** was elected a Director of the Company in May 2006 and was appointed Chairman of the Board of Directors in July 2012. Jeffrey Farber joined the Company in August 2003 as Secretary. Since 1994, Mr. Farber has been President and the owner of Auburn Pharmaceutical ( Auburn ), a national generic pharmaceutical distributor. Prior to starting Auburn, Mr. Farber served in various positions at Major Pharmaceutical ( Major ), where he was employed for over 15 years. At Major, Mr. Farber was involved in sales, purchasing and eventually served as President of the mid-west division. Mr. Farber also spent time working at Major's manufacturing division Vitarine Pharmaceuticals where he served on its Board of Directors. Mr. Farber graduated from Western Michigan University with a Bachelors of Science Degree in Business Administration and participated in the Pharmacy Management Graduate Program at Long Island University. Mr. Farber is the son of William Farber, the Chairman Emeritus of the Board of Directors of the Company.

The Governance and Nominating Committee concluded that Mr. Farber is qualified and should continue to serve, due, in part, to his significant experience in the generic drug industry and his ongoing role as the owner of a highly regarded and successful generic drug distributor. His skills include a thorough knowledge of the generic drug marketplace and drug supply chain management.

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**David Drabik** was elected a Director of the Company in January 2011. Mr. Drabik is a National Association of Corporate Directors Governance Fellow. Since 2002, Mr. Drabik has been President of Cranbrook & Co., LLC (Cranbrook), an advisory firm primarily serving the private equity and venture capital community. At Cranbrook, Mr. Drabik assists and advises its clientele on originating, structuring, and executing private equity and venture capital transactions. From 1995 to 2002, Mr. Drabik served in various roles and positions with UBS Capital Americas (and its predecessor UBS Capital LLC), a New York City based private equity and venture capital firm that managed \$1.5 billion of capital. From 1992 to 1995, Mr. Drabik was a banker with Union Bank of Switzerland's Corporate and Institutional Banking division in New York City. Mr. Drabik graduated from the University of Michigan with a Bachelors of Business Administration degree.

The Governance and Nominating Committee concluded that Mr. Drabik is well qualified and should be nominated to serve as a Director due, in part to his understanding and involvement in investment banking. As a global investment bank professional with extensive experience advising senior management, his skills include business analytics, financing and a strong familiarity with SEC documentation.

**Paul Taveira**, was elected a Director of the Company in May 2012. Mr. Taveira has been Chief Executive Officer of A&D Environmental Services Inc., an environmental and industrial services company, since 2009. He currently serves on their Board of Directors. From 2007 to 2009, Mr. Taveira was a Managing Partner of Precision Source LLC, a manufacturer of precision parts for various industries across the United States. From 1997 to 2007, Mr. Taveira held several positions at PSC Inc., a national provider of environmental services, including President, Vice President and Regional General Manager. From 1987 to 1997, Mr. Taveira held several management positions with Clean Harbors Inc., an international provider of environmental and energy services. Mr. Taveira graduated from Worcester State University with a Bachelor of Science degree in Biology.

The Governance and Nominating Committee concluded that Mr. Taveira is well qualified and should be nominated to serve as a Director due, in part to his understanding and experience as a Chief Executive Officer and Director of A&D Environmental Services Inc. Additionally, Mr. Taveira has experience as a Managing Partner of Precision Source LLC, a manufacturer of precision parts for various industries across the United States.

**James M. Maher**, was appointed as a Director of the Company in June 2013. He spent his entire 37 year professional career with PricewaterhouseCoopers (PwC) LLP, including 27 years as a partner, before retiring in June 2012. Most recently, Maher served as the managing partner of PwC's U.S. assurance practice, comprised of more than 1,100 partners and 12,000 staff. Previously, he served as the regional assurance leader for the metro assurance practice. During his tenure at PwC, Maher worked closely with senior management at several multinational companies, dealing extensively with significant acquisitions, divestitures, initial public offerings and secondary offerings. Maher earned a bachelor's degree in Accounting from LIU Post.

The Governance and Nominating Committee concluded that Mr. Maher is well qualified and should be nominated to serve as a Director, due to his extensive experience at PricewaterhouseCoopers. Additionally, Mr. Maher has significant experience in dealing with acquisitions, divestitures, initial public offerings and secondary offerings.

**Arthur P. Bedrosian, J.D.** was promoted to President of the Company in May 2002 and CEO in January of 2006. Previously, he served as the Company's Vice President of Business Development from January 2002 to April 2002. Mr. Bedrosian was elected as a Director in February 2000 and served to January 2002. Mr. Bedrosian was re-elected a Director in January 2006. Mr. Bedrosian has operated generic drug manufacturing, sales, and marketing businesses in the healthcare industry for many years. Prior to joining the Company, from 1999 to 2001, Mr. Bedrosian served as President and Chief Executive Officer of Trinity Laboratories, Inc., a medical device and drug manufacturer. Mr. Bedrosian also operated Pharmaceutical Ventures Ltd, a healthcare consultancy, Pharmeral, Inc. a drug representation company selling

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generic drugs, and Interl Corporation, a computer consultancy to Fortune 100 companies. Mr. Bedrosian holds a Bachelor of Arts Degree in Political Science from Queens College of the City University of New York and a Juris Doctorate from Newport University in California.

The Governance and Nominating Committee concluded that Mr. Bedrosian is qualified to serve as a director, in part, because his experience as our President and Chief Executive Officer has been instrumental in the Company's growth and provides the board with a compelling understanding of our operations, challenges and opportunities. In addition, his background includes over 40 years in the generic pharmaceutical industry that encompasses a broad background and knowledge in the underlying scientific, sales, marketing and supply chain management which brings special expertise to the board in developing our business strategies. His recent qualification to FINRA's list of arbitrators recognizes his expertise and experience.

**Martin P. Galvan, CPA** was appointed as the Company's Vice President of Finance, Chief Financial Officer and Treasurer in August 2011. Most recently, he was Chief Financial Officer of CardioNet, Inc., a medical technology and service company. From 2001 to 2007, Mr. Galvan was employed by Viasys Healthcare Inc., a healthcare technology company that was acquired by Cardinal Health, Inc. in June 2007. Prior to the acquisition, he served as Executive Vice President, Chief Financial Officer and Director Investor Relations.

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From 1999 to 2001, Mr. Galvan served as Chief Financial Officer of Rodel, Inc., a precision surface technologies company in the semiconductor industry. From 1979 to 1998, Mr. Galvan held several positions with Rhone-Poulenc Rorer Inc., a pharmaceutical company, including Vice President, Finance – The Americas; President & General Manager, RPR Mexico & Central America; Vice President, Finance, Europe/Asia Pacific; and Chief Financial Officer, United Kingdom & Ireland. Mr. Galvan began his career with the international accounting firm Ernst & Young LLP. He earned a Bachelor of Arts degree in economics from Rutgers University and is a member of the American Institute of Certified Public Accountants.

**William F. Schreck** joined the Company in January 2003 as Materials Manager. In May 2004, he was promoted to Vice President of Logistics. In August 2009, Mr. Schreck was promoted to Senior Vice President and General Manager. In January 2011, Mr. Schreck was promoted to Chief Operating Officer. Prior to this, from 1999 to 2001, he served as Vice President of Operations at Nature's Products, Inc., an international nutritional and over-the-counter drug product manufacturing and distribution company. From 2001 to 2002 he served as an independent consultant for various companies. Mr. Schreck's prior experience also includes comprehensive executive management positions at Ivax Pharmaceuticals, Inc., a division of Ivax Corporation, Zenith-Goldline Laboratories and Rugby-Darby Group Companies, Inc. Mr. Schreck has a Bachelor of Arts Degree from Hofstra University.

**Kevin R. Smith** joined the Company in January 2002 as Vice President of Sales and Marketing. Prior to this, from 2000 to 2001, he served as Director of National Accounts for Bi-Coastal Pharmaceutical, Inc., a pharmaceutical sales representation company. Prior to this, from 1999 to 2000, he served as National Accounts Manager for Mova Laboratories Inc., a pharmaceutical manufacturer. Prior to this, from 1991 to 1999, Mr. Smith served as National Sales Manager at Sidmak Laboratories, a pharmaceutical manufacturer. Mr. Smith has extensive experience in the generic sales market, and brings to the Company a vast network of customers, including retail chain pharmacies, wholesale distributors, mail-order wholesalers and generic distributors. Mr. Smith has a Bachelor of Science Degree in Business Administration from Gettysburg College.

**Ernest J. Sabo** joined the Company in March 2005 as Director of Quality Assurance. In May 2008, Mr. Sabo was promoted to Vice President of Regulatory Affairs and Chief Compliance Officer. Prior to this, he served at Wyeth Pharmaceuticals as Manager of QA Compliance from 2001 to 2003 and as Associate Director of QA Compliance from 2003 to 2005. Mr. Sabo held former positions as Director of Validation, Quality Assurance, Quality Control and R&D at Delavau/Accucorp, Inc. from 1993 thru 2001. He has over 30 years of experience in the pharmaceutical industry, his background spans from Quality Assurance, Quality Control, Cleaning/Process Validation and Manufacturing turn-key operations. Mr. Sabo holds a Bachelor of Arts in Biology from Trenton State College (now known as The College of New Jersey).

**Robert Ehlinger** joined the Company in July 2006 as Chief Information Officer. In June 2011, Mr. Ehlinger was promoted to Vice President of Logistics and Chief Information Officer. Prior to joining Lannett, Mr. Ehlinger was the Vice President of Information Technology at MedQuist, Inc., a healthcare services provider, where his career spanned 10 years in progressive operational and technology roles. Prior to MedQuist, Mr. Ehlinger was with Kennedy Health Systems as their Corporate Director of Information Technology supporting acute care and ambulatory care health information systems and biomedical support services. Earlier on, Mr. Ehlinger was with Dowty Communications where he held various technical and operational support roles prior to assuming the role of International Distribution Sales Executive managing the Latin America sales distribution channels. Mr. Ehlinger received a Bachelor's of Arts degree in Physics from Gettysburg College in Gettysburg, PA.

To the best of the Company's knowledge, there have been no events under any bankruptcy act, no criminal proceedings and no judgments or injunctions that are material to the evaluation of the ability or integrity of any director, executive officer, or significant employee during the past five years.





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**Section 16(a) Beneficial Ownership Reporting Compliance**

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's directors, officers, and persons who own more than 10% of a registered class of the Company's equity securities to file with the SEC reports of ownership and changes in ownership of common stock and other equity securities of the Company. Officers, directors and greater-than-10% stockholders are required by SEC regulations to furnish the Company with copies of all Section 16(a) forms they file.

Based solely on review of the copies of such reports furnished to the Company or written representations that no other reports were required, the Company believes that during Fiscal 2014 all filing requirements applicable to its officers, directors and greater-than-10% beneficial owners under Section 16(a) of the Exchange Act were complied with in a timely manner, except for a Form 3 related to Jim Maher's appointment as a director of the Company; Form 4s related to a grant of stock options to various executive officers on September 5, 2013; a Form 4 for Farber Properties, LLC and Jeffrey Farber related to a distribution of shares from Farber Properties, LLC on November 19, 2013; a Form 4 for Kevin Smith relating to an exercise of stock options on November 15, 2013; Form 4s related to a grant of restricted stock to various directors and executive officers on January 22, 2014; a Form 4 for Kevin Smith related to an exercise of stock options on February 13, 2014; a Form 4 for David Farber related to an exercise of stock options on February 28, 2014; a Form 4 for William Schreck related to an exercise of stock options on March 11, 2014; a Form 4 for Arthur Bedrosian related to shares withheld by the Company to satisfy tax withholding obligations for a restricted stock grant on April 24, 2014; and Form 4s for various executive officers related to a restricted stock grant on April 24, 2014.

**Code of Ethics and Financial Expert**

The Company has adopted the Code of Professional Conduct (the "code of ethics"), a code of ethics that applies to the Company's Chief Executive Officer and Chief Financial Officer, as well as all other company personnel. The code of ethics is publicly available on our website at [www.lannett.com](http://www.lannett.com). If the Company makes any substantive amendments to the code of ethics or grant any waiver, including any implicit waiver, from a provision of the code to our Chief Executive Officer, Chief Financial Officer, or any other executive, we will disclose the nature of such amendment or waiver on our website or in a report on Form 8-K.

The Board of Directors has determined that Mr. Maher, current director of Lannett, is the audit committee financial expert as defined in section 3(a)(58) of the Exchange Act and the related rules of the Commission.

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**ITEM 11. EXECUTIVE COMPENSATION**

**Compensation Discussion and Analysis**

This Compensation Discussion and Analysis (CD&A) describes our 2014 Executive Compensation Program. It provides an overview of the compensation for the following Named Executive Officers (NEOs) and how the Compensation Committee of the Board of Directors (the Committee) made its decisions for our 2014 fiscal year.

| NEO                 | Title/Role  |
|---------------------|---|
| Arthur P. Bedrosian | President and Chief Executive Officer                             |
| Martin P. Galvan    | Vice President of Finance, Chief Financial Officer and Treasurer  |
| William Schreck     | Chief Operating Officer   |
| Kevin Smith         | Senior Vice President of Sales and Marketing                      |
| Ernest Sabo         | Vice President of Regulatory Affairs and Chief Compliance Officer |

*Where We Are Today*

At our annual shareholders meeting in January 2012, our shareholders supported a triennial cycle for say-on-pay advisory votes relating to our Executive Compensation Program for NEOs. At that time, we provided our shareholders with the opportunity to approve, or to vote against, the compensation of our NEOs, as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and approximately 99% of the shareholders who voted on the say-on-pay proposal supported our program.

Although this vote is non-binding, its outcome, along with shareholder feedback and the competitive business environment, plays an important role in how the Committee makes decisions about the program's structure. To this end, during the past few years, the Committee conducted periodic reviews of the Executive Compensation Program, monitored industry practices and sought feedback from some of our largest investors. During the same time, the Company experienced outstanding financial performance and significant increases in stock price and total shareholder return.

The following pages of this CD&A highlight performance results since Fiscal 2011 that have had a direct impact on the compensation paid to our NEOs over the same period of time. It looks specifically at the performance measures used in the short- and long-term incentive awards under the Executive Compensation Program that the Committee believes drive shareholder value. It also describes recently approved changes for Fiscal 2015 to further align our Executive Compensation Program with our objectives and best competitive practice.

*A Word About Risk*

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The Committee believes that incentive plans, along with the other elements of the Executive Compensation Program, provide appropriate rewards to our NEOs to keep them focused on our goals. The Committee also believes that the program's structure, along with its oversight, continues to provide a setting that does not encourage the NEOs to take excessive risks in their business decisions.

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**Executive Summary**

*Business Highlights*

Fiscal 2014 marked another extraordinary year for Lannett. We experienced the strongest growth in net sales and profitability in our Company's history, and our stock price increased by 317% during the 12-month period ending June 30, 2014 and by 896% over the past three years. We also further strengthened our balance sheet to help fund future growth opportunities. Our results demonstrate our leadership team's commitment to stability, growth and focus on long-term profitability and creating shareholder value.

In addition to our financial results, we made important advances in product development and mix, market share, and the regulatory approval process, allowing us to efficiently and safely place our products that span a variety of categories (e.g., thyroid deficiencies, cardiovascular, pain management) on the market. We currently have over 30 products available to the market, with an additional 24 Abbreviated New Drug Applications (ANDAs) pending regulatory approval. We also continued to capitalize on our strategic partnerships. Specifically, we extended our agreement with our primary inventory supplier (Jerome Stevens Pharmaceuticals (JSP)), which now gives us exclusive distribution rights in the U.S. for a number of key product lines.

Key financial performance highlights include:

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*\*TSR for Sagent Pharmaceuticals, Inc is as of the company's IPO on April, 20, 2011.*

*Peer Group average excludes Astex Pharmaceuticals, Cornerstone Therapeutics and Hi-Tech Pharmacal as they were all acquired prior to 6/30/2014.*

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*2014 Executive Compensation Program Changes*

As our Company grows, the Committee is committed to the evolution and improvement of our Executive Compensation Program to ensure alignment with our business strategy and stockholder interests, as well as best competitive practices. The Committee made the following adjustments to the program's core compensation elements for 2014:

| <b>What's Changed</b>                | <b>How It's Changed</b>   | <b>Explanation</b>  |
|--------------------------------------|---|---|
| Base Salary                          | <ul style="list-style-type: none"> <li>Positioned base salaries at the 50th percentile of comparable organizations.</li> </ul>  | <p>A study conducted in 2013 by our independent compensation consultant found that NEO base salaries were below the 25th percentile of our peer group. The Committee believes raising NEO base salaries to align with the 50th percentile of the peer group, consistent with our compensation philosophy, is critical to improve pay competitiveness and to recognize our highly-qualified and experienced executive officers.</p>  |
| Short-Term Incentives (Annual Bonus) | <ul style="list-style-type: none"> <li>Established threshold, target and maximum performance goals, as well as corresponding award opportunities, expressed as percents of salary.</li> <li>Capped maximum award opportunities at 200% of target levels.</li> <li>Added net sales as one of the performance metrics.</li> <li>Increased weighting on corporate financial metrics from 60% to 75% of total award opportunity.</li> <li>Reduced weighting on individual performance from 40% to 25%.</li> </ul> | <p>The Committee believes that this new structure enhances the plan's motivational impact, reinforces key business objectives and strategic priorities, and further strengthens the alignment between pay and performance. The cap on the award also provides greater structure around the Committee's discretion.</p> <p>(Previously, the bonus pool was based on a fixed percentage (20%) of adjusted operating income). The Committee also believes these changes encourage a focus on profitable growth and Company-wide collaboration.</p> |
| Long-Term Incentives                 | <ul style="list-style-type: none"> <li>Began granting restricted stock, in addition to stock options, as part of the core award mix, with grant levels tied to Company performance.</li> </ul>  | <p>The Committee increased the emphasis on long-term incentives, relative to other pay components and linked grant levels to Company performance to strengthen alignment with stockholder interests. Restricted stock is less dilutive than stock options, which helps to further manage potential stockholder dilution and equity plan share reserves. The Committee also believes restricted stock is integral to its leadership retention strategy.</p>  |

*Special Recognition Award: Restricted Stock*

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Granting restricted stock gives our NEOs a meaningful equity stake in our business. The value of the award depends on the value of our stock when the shares vest, further aligning the interests of our NEOs with those of our shareholders over the long term. It also supports our need to retain key talent. For Fiscal 2014, in addition to the regular stock options and restricted stock granted to the NEOs, the Committee approved a one-time, special restricted stock award in recognition of performance that far exceeded the Committee's expectations. This special recognition award vests three years from the date of grant and has two parts. The first part of the award, equal to 25% of the total award, was granted in April 2014 to recognize year- to-date contributions. The remaining 75% was granted after the end of the fiscal year. Please see page 58 of this CD&A for details.

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*Looking Ahead: Executive Compensation Program Changes for Fiscal 2015*

In addition to 2014 changes, the Committee also made several modifications for the 2015 program, including:

- **Short-Term Incentives (Annual Bonus).** For Fiscal 2015, performance metrics will include operating income, Earnings Per Share (EPS), subject to adjustment for any significant capital transactions, net sales, and personal objectives. The target annual bonus opportunities for each NEO remain the same as those for Fiscal 2014.
- **Long-Term Incentives.** For Fiscal 2015, the Committee approved target long-term incentive award opportunities equal to 100% of base salary for each of our NEOs, which will be provided in an equal value mix of stock options and restricted stock. Actual grant levels can range from 0% to 150% of target levels, based on the Company's Fiscal 2015 financial performance using the same metrics as under the annual bonus plan:

| Fiscal 2015 Performance Result | Percentage of Target Equity Grants Earned<br>(as % of Target Grant) |
|--------------------------------|---|
| Below Threshold                | 0% (subject to Committee discretion)                                |
| Threshold (80% of Budget)      | 50%   |
| Target (100% of Budget)        | 100%  |
| Superior (120% of Budget)      | 150%  |

Grants, if any, will occur following the end of fiscal 2015, with stock options and restricted stock vesting in three equal annual increments based on continued service with the Company.

- **Stock Ownership Guidelines.** The Committee approved stock ownership guidelines for our executive officers, including NEOs, and non-employee directors, effective as of July 2014. Under these guidelines, NEOs are required to own qualifying shares with targeted values equal to 3X salary for our CEO and 1.5X salary for other executive officers. Non-employee directors are required to own qualifying shares with targeted values equal to 3X the cash board retainer. Shares that count towards ownership requirements include common shares held directly or indirectly and shares in employee benefit plans. Executive officers and non-employee directors have five years from the time of first being subject to guidelines to achieve ownership requirements. Until guidelines are met, executive officers and non-employee directors are required to hold at least 50% of net after-tax shares received from equity grants. If after five years guidelines still are not met, 100% of all net after-tax shares from equity grants must be held.



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**Overview of the Executive Compensation Program**

*Our Philosophy*

A fundamental objective of our Executive Compensation Program is to focus our executives on creating long-term shareholder value. All aspects of our program are rooted in this goal and designed around the following guiding principles:

- **Pay for performance:** A significant portion of compensation should be variable and directly linked to corporate and individual performance goals and results.
- **Competitiveness:** Compensation should be sufficiently competitive to attract, motivate and retain an executive team fully capable of driving exceptional performance.
- **Alignment:** The interests of executives should be aligned with those of our stockholders through equity-based compensation and performance measures that help to drive shareholder value over the long term.

To support these guiding principles, our program includes the following compensation elements:

| Pay Element                          | Form              | Purpose  |
|--------------------------------------|-------------------|--|
| Base Salary                          | Cash (Fixed)      | Provides a competitive level of compensation that reflects position responsibilities, strategic importance of the position and individual experience.  |
| Short-Term Incentives (Annual Bonus) | Cash (Variable)   | Provides a cash-based award that recognizes the achievement of corporate goals in support of the annual business plan, as well as specific, qualitative and quantitative individual goals for the most recently completed fiscal year. |
| Long-Term Incentives                 | Equity (Variable) | Provides incentives for management to execute on financial and strategic growth goals that drive long-term shareholder value creation and support the Company's retention strategy.  |

*Compensation Mix*

The charts below show that most of our NEO's compensation is variable (82% for our CEO and an average of 78% for our other NEOs) based upon fiscal year 2014 compensation as reported in the Summary Compensation Table on page 60 of this Form 10-K. The charts also show the breakdown of cash vs. equity (i.e., stock options and restricted stock).



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*How Compensation Decisions Are Made*

- **The Role of the Compensation Committee.** The Committee, composed entirely of independent directors, is responsible for making executive compensation decisions for the NEOs. The Committee works closely with its independent compensation consultant, Pearl Meyer & Partners (PM&P) and management to examine pay and performance matters throughout the year. The Committee's charter, which sets out its objectives and responsibilities, can be found at our website at [www.lannett.com](http://www.lannett.com) under Investor Relations.

The Committee has authority and responsibility to establish and periodically review our Executive Compensation Program and compensation philosophy. Importantly, the Committee also has the sole responsibility for approving the corporate performance goals upon which compensation for the CEO is based, evaluating the CEO's performance and determining and approving the CEO's compensation, including equity-based compensation, based on the achievement of his goals. The Committee also reviews and approves compensation levels for other NEOs, taking into consideration recommendations from the CEO.

In making its determinations, the Committee considers market data and advice from PM&P, as well as budgets, reports, performance assessments and other information provided by management. It also considers other factors, such as the experience, skill sets, and contributions of each NEO towards our overall success. However, the Committee is ultimately responsible for all compensation-related decisions for the NEOs and may exercise its own business judgment when evaluating performance results and making compensation decisions.

*Timing of Committee Meetings and Grants; Option and Share Pricing*

The Committee meets as necessary to fulfill its responsibilities, and the timing of these meetings is established during the year. The Committee holds special meetings from time to time as its workload requires. Historically, annual grants of equity awards have typically been accomplished at a meeting of the Committee in August/September of each year to reward prior year performance. The Committee approved additional grants during fiscal 2014 to recognize our exceptional performance. Individual grants (for example, associated with the hiring of a new NEO or promotion to an NEO position) may occur at any time of year. The Committee generally expects to coordinate the timing of equity award grants to be made within 30 days of our earnings release announcement following the completion of each fiscal year. The exercise price of each option and restricted stock awarded to our NEOs is the closing price of our common stock on the date of grant.

- **The Role of the CEO.** The CEO does not play any role in the Committee's determination of his own compensation. However, he presents the Committee with recommendations for each element of compensation including base salaries and short- and long-term incentive awards for the other NEOs, as well as non-executive employees who are eligible for equity grants. The CEO bases these recommendations upon his assessment of each individual's performance, as well as market practice. The Committee has full discretion to modify the recommendations of the CEO in the course of its approvals.

- **The Role of the Independent Consultant.** The Committee consults, as needed, with an outside compensation consulting firm. As it makes decisions about executive compensation, the Committee reviews data and advice from its consultant about current compensation practices and trends among publicly-traded companies in general and comparable generic pharmaceutical companies in particular. The Committee also reviews recommendations from its outside consultant and makes recommendations to the Board about the compensation for non-employee directors.

In late Fiscal 2013, PM&P was retained by the Committee, as its independent consultant, to review the competitiveness of the Executive Compensation Program. PM&P provided the Committee with compensation data with respect to similarly sized biopharmaceutical and life sciences companies and consulted with the Committee about a variety of issues related to competitive compensation practices and incentive plan designs. PM&P was also retained by the Committee in Fiscal 2014 to provide ongoing advice relating to the Executive Compensation Program. The Committee assessed the independence of PM&P pursuant to the applicable SEC rules and concluded that no conflict of interest exists that would prevent PM&P from independently advising the Committee.

Table of Contents*Peer Group and Benchmarking*

The Committee evaluates industry-specific and general market compensation practices and trends to ensure the Executive Compensation Program is appropriately competitive. When making decisions about the program for Fiscal 2014, the Committee considered publicly-available data, as well as a market study conducted by PM&P in June 2013. Using this information, the Committee compared the program to the compensation practices of the following companies, which the Committee believes are comparable to us in terms of size, scope and business complexity (the peer group):

LANNETT COMPANY, INC.

Lannett Company, Inc. vs. 14 Peer Companies

| <b>Company Name</b>                | <b>Fiscal Year<br/>End # of<br/>Employees</b> | <b>Equity<br/>Market Cap.<br/>6/30/2014<br/>(\$mm)</b> | <b>Fiscal Year<br/>End<br/>Operating<br/>Income<br/>(\$mm)</b> | <b>Fiscal<br/>Year End<br/>Sales<br/>(\$mm)</b> | <b>Cumulative<br/>3 YR TSR<br/>6/30/2014</b> |
|------------------------------------|---|--|--|---|--|
| Acorda Therapeutics, Inc.          | 421   | \$ 1,407   | \$ 31  | \$ 245  | 4.3%   |
| Akorn, Inc.                        | 1,104   | 3,455  | 91   | 336   | 375.0%                                       |
| Astex Pharmaceuticals, Inc.*       | 421   | 0  | 0  | 318   |  |
| Cambrex Corporation.               | 1,104   | 634  | 45   | 218   | 348.1%                                       |
| Cornerstone Therapeutics Inc.*     | 136   | 0  | 22   | 336   |  |
| Cumberland Pharmaceuticals, Inc.   | 936   | 80   | 14   | 316   | -21.7%                                       |
| Emergent BioSolutions, Inc.        | 1,353   | 840  | (17)   | 116   | -0.4%  |
| Genomic Health Inc.                | 684   | 856  | (4)  | 31  | -1.8%  |
| Hi-Tech Pharmacal Co., Inc.*       | 448   | 0  | 51   | 313   |  |
| Pernix Therapeutics Holdings, Inc. | 191   | 339  | (12)   | 262   | 5.5%   |
| Sagent Pharmaceuticals, Inc.       | 269   | 824  | 38   | 232   | 29.9%  |
| Santarus, Inc.*                    | 290   | 0  | (18)   | 85  |  |
| SciClone Pharmaceuticals, Inc.     | 105   | 271  | 20   | 127   | -12.9%                                       |
| Sucampo Pharmaceuticals, Inc.      | 96  | 301  | (18)   | 90  | 68.3%  |
| <i>Lannett Company, Inc.</i>       | 399   | \$ 1,765   | \$ 88  | \$ 274  | 896.4%                                       |
| <i>% Rank</i>                      | 45%   | 94%  | 100%   | 63%   | 100%   |

\*Companies were acquired following the 2013 market study

Table of Contents**2014 Executive Compensation Program Decisions***Base Salary*

We attribute much of our success to our highly-experienced executive management team and the strength of their leadership has been clearly demonstrated by our exceptional performance results. In order to remain competitive among our industry peers, the Committee believes it must set compensation at market-competitive levels that reflect the executive's experience, role and responsibilities. To bring base salaries to the 50th percentile of comparable organizations, the Committee approved the following base salary increases, ranging from approximately 15% to 35%, effective as of July 1, 2013:

| NEO                 | 2013 Annual Base Salary | 2014 Annual Base Salary | % Change* |
|---------------------|-------------------------|-------------------------|-----------|
| Arthur P. Bedrosian | \$ 440,000              | \$ 539,000              | +23%      |
| Martin P. Galvan    | \$ 275,000              | \$ 317,000              | +15%      |
| William Schreck     | \$ 257,000              | \$ 346,000              | +35%      |
| Kevin Smith         | \$ 220,000              | \$ 278,000              | +26%      |
| Ernest Sabo         | \$ 175,000              | \$ 230,000              | +31%      |

\*Rounded to the nearest whole percentage.

*Short-Term Incentives (Annual Bonus)*

The Company's NEOs participate in an annual bonus program, which is designed to recognize yearly performance achievements focused primarily on operating results and profitable growth. Actual payouts can range from 0% (below threshold) to 200% (superior performance) of target and are paid in cash. The Committee sets each NEO's threshold, target and maximum bonus opportunity as a percentage of base salary, as follows:

| Title                                | Annual Bonus Opportunity As a % of Salary |                            |                              |
|--------------------------------------|---|----------------------------|------------------------------|
|                                      | Threshold<br>(25% of Target)              | Target<br>(100% of Target) | Superior<br>(200% of Target) |
| CEO                                  | 18.75%                                    | 75%                        | 150%                         |
| COO, CFO, SVP of Sales and Marketing | 15%                                       | 60%                        | 120%                         |
| Other NEOs                           | 12.5%                                     | 50%                        | 100%                         |

The overall annual bonus is comprised of two components:

- **Seventy-five percent (75%)** is tied to operating results versus budget to promote a focus on Company-wide profitable growth and collaboration:

| Performance Metric        | Weighting<br>(Out of 100%) |
|---------------------------|----------------------------|
| Adjusted Operating Income | 52.5%                      |
| Net Sales                 | 22.5%                      |

Adjusted operating income is defined as operating income excluding bonus and stock-based compensation expense, as further adjusted for certain non-recurring items such as legal settlements or contract renewal fees.

- Twenty-five percent (25%)** is based on the achievement of pre-established quantitative and qualitative individual goals, to promote individual accountability and line of sight. Fiscal 2014 goals were tied to various strategic, financial and operational objectives, taking into consideration each NEO's job function and responsibilities. For competitive harm reasons, Lannett does not disclose specific details on individual goals and strategic objectives, although major accomplishments in Fiscal 2014 for each NEO are listed on page 56.

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*2014 Short-Term Incentives (Annual Bonus): Results and Payouts*

- **Operational Results (75% of Target Award).** For Fiscal 2014, the Committee established financial performance goals ranging from 85% of budget (threshold) to 150% of budget (superior):

| Performance Metric        | Weighting<br>(Out of 100%) | Threshold | Performance Goals |          | Actual   |
|---------------------------|----------------------------|-----------|-------------------|----------|----------|
|                           |                            |           | Target            | Superior |          |
| Adjusted Operating Income | 52.5%                      | \$ 22.9   | \$ 26.9           | \$ 40.4  | \$ 124.4 |
| Net Sales                 | 22.5%                      | \$ 146.4  | \$ 172.2          | \$ 258.3 | \$ 273.8 |

Actual adjusted operating income results for fiscal 2014 excluded the \$20.1 million renewal fee associated with the contract extension with JSP. Note, however, if these fees had been included, adjusted operating income would still have been well above the superior performance level.

- **Individual Results (Collectively Weighted 25% of Target Award).**

| NEO                 | Performance Highlights  |
|---------------------|---|
| Arthur P. Bedrosian | <ul style="list-style-type: none"> <li>• Led three new product development projects for our Cody Labs subsidiary (CODY) and completed three process validation lots for validation and the availability of the signed summary report</li> <li>• Met capital projects goal for CODY</li> <li>• Worked with Human Resources and senior management to develop and maintain the leadership/succession plan</li> </ul>                             |
| Martin P. Galvan    | <ul style="list-style-type: none"> <li>• Delivered accurate and timely financial reports on a required quarterly and annual basis as an accelerated filer with the Securities and Exchange Commission</li> <li>• Enhanced financial performance through the management of receivables, automating bill-backs, charge-backs and rebate processes</li> <li>• Contributed to the achievement of Company annual operating plan targets</li> </ul> |



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|                 |  |
|-----------------|--|
| William Schreck | <ul style="list-style-type: none"><li>• Installed a manufacturing suite at our Townsend Road facility</li><li>• Identified and completed due diligence related to the purchase of a new facility for future expansion</li><li>• Contributed to the achievement of Company annual operating plan targets</li></ul>                                |
| Kevin Smith     | <ul style="list-style-type: none"><li>• Exceeded Company sales goals while limiting rebates, charge-backs and other related sales deductions</li><li>• Increased market share on existing products and obtained market share on new product launches</li><li>• Contributed to the achievement of Company annual operating plan targets</li></ul> |
| Ernest Sabo     | <ul style="list-style-type: none"><li>• Maintained compliance with DEA and FDA requirements by reviewing policies and procedures</li><li>• Provided technical and research capabilities to ensure a flow of new products</li><li>• Contributed to the achievement of Company annual operating plan targets</li></ul>                             |

Table of Contents**Total Annual Bonus**

Based on our exceptional performance results and significant individual contributions, the NEOs earned the maximum amount on the corporate operational component and varying amounts for the individual component under the annual bonus program. Total awards for each of the NEOs were as follows:

| NEO                 | Operational Results Portion of the Bonus (75%) |         | Individual Results Portion of the Bonus (25%) |         | Total Actual Bonus |
|---------------------|--|---------|---|---------|--------------------|
| Arthur P. Bedrosian | \$   | 606,375 | \$  | 202,125 | \$ 808,500         |
| Martin P. Galvan    | \$   | 285,300 | \$  | 95,100  | \$ 380,400         |
| William Schreck     | \$   | 311,400 | \$  | 56,222  | \$ 367,622         |
| Kevin Smith         | \$   | 250,200 | \$  | 83,400  | \$ 333,600         |
| Ernest Sabo         | \$   | 172,500 | \$  |         | \$ 172,500         |

Short-term incentive awards earned in Fiscal 2014 were generally higher than Fiscal 2013 levels, reflecting our extraordinary performance results. These awards were capped at 200% of target levels. Note that if the former (Fiscal 2013) annual bonus plan, which established an award pool of up to 20% of adjusted operating income, had still been in effect, Fiscal 2014 payouts would have been considerably higher than those under the new plan, because adjusted operating income more than quadrupled in fiscal 2014 as compared with Fiscal 2013. The Committee considered this outcome when determining long-term incentives for Fiscal 2014.

*Long-Term Incentives*

Prior to Fiscal 2014, stock options were used as the primary long-term incentive award vehicle for NEOs, with grants provided on a periodic, discretionary basis. In 2014, the Committee changed its approach and granted a combination of stock options and restricted stock, to further align executive and stockholder interests, enhance key employee retention, encourage long-term stockholder creation and recognize each NEO's contributions towards our extraordinary performance results.

- **Stock options.** To recognize Fiscal 2013 performance, the Committee approved the following stock option grants to NEOs effective as of September 5, 2013:

| NEO                 | # of Stock Options Granted |
|---------------------|----------------------------|
| Arthur P. Bedrosian | 90,000                     |
| Martin P. Galvan    | 50,000                     |
| William Schreck     | 45,000                     |
| Kevin Smith         | 45,000                     |
| Ernest Sabo         | 39,000                     |

These stock options vest in three equal annual increments, beginning on the first anniversary of grant and expire on the tenth anniversary from the date of grant. Each stock option has an exercise price of \$13.86, equal to our closing stock price on the date of grant. In determining grant

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levels, the Committee considered each NEO's contributions towards our strong financial performance results in Fiscal 2013, which included a 23% increase in net sales and a 131% increase in adjusted operating income as compared with Fiscal 2012 results.

- **Restricted stock.** By the end of the first quarter of Fiscal 2014, the Committee realized that the Company was on track to significantly exceed its performance expectations, based on its revised financial forecast for the remainder of the year. To recognize this accomplishment and motivate executives to continue performing at a high level, the Committee approved the following restricted stock grants to NEOs on October 29, 2013:

| NEO                 | # of Restricted Shares Granted |
|---------------------|--------------------------------|
| Arthur P. Bedrosian | 22,500                         |
| Martin P. Galvan    | 22,500                         |
| William Schreck     | 10,000                         |
| Kevin Smith         | 10,050                         |
| Ernest Sabo         | 7,800                          |

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Recognizing that annual bonus payouts for Fiscal 2014 would have been considerably higher under the former (Fiscal 2013) bonus pool design than actual payouts under the new (2014) design, the Committee decided to allow these restricted stock grants to vest as of June 30, 2014.

- **Special recognition award (restricted stock).** As the year progressed, and Company performance continued to exceed expectations, the Committee decided it would be appropriate to provide one-time, special recognition grants of restricted stock to reward contributions towards our record-setting results and strengthen retention. On April 24, 2014, the Committee approved the following special recognition awards, with 25% to be granted immediately and the remaining 75% granted after the end of the fiscal year, if performance results are achieved:

| NEO                 | Number of Special Recognition Restricted Shares Granted |  | Total # of Shares Granted |
|---------------------|---|--|---------------------------|
|                     | First Installment*<br>(25%, Granted 4/24/14)            | Second Installment (75%,<br>Granted 7/23/14) |                           |
| Arthur P. Bedrosian | 5,000   | 15,000                                       | 20,000                    |
| Martin P. Galvan    | 2,500   | 7,500  | 10,000                    |
| William Schreck     | 1,225   | 3,675  | 4,900                     |
| Kevin Smith         | 3,000   | 9,000  | 12,000                    |
| Ernest Sabo         | 500   | 1,500  | 2,000                     |

\*The number of shares granted to each of the NEOs is also shown on the *Grants of Plan-Based Awards* table on page 61 of this Form 10-K. Its value is also included in the *Summary Compensation Table* on page 60.

In approving these special recognition grants, the Committee considered each NEO's contributions towards the Company's Fiscal 2014 performance results. It also considered the recommendations of the CEO (who makes recommendations for the NEOs, but not for himself). To further enhance retention, these grants vest on the third anniversary from the date of grant, based on continued service with the Company.

*Other Policies, Programs and Guidelines*

The Company does not currently maintain a clawback policy, but notes that under the Sarbanes-Oxley Act incentive awards for the CEO and CFO are subject to recoupment in the event of a material financial restatement triggered by fraud or misconduct. Additionally, any employee who violates the provisions of the Company's Code of Business Conduct and Ethics is subject to disciplinary penalties that may include termination of employment. The Committee intends to comply with any regulatory requirements pertaining to clawback provisions under the Dodd-Frank Act once rules are finalized by the SEC and New York Stock Exchange.

NEOs, like all other employees, have retirement programs and other benefits as part of their overall compensation package. The Committee believes that these programs and benefits support our compensation philosophy, part of which is to provide compensation that is sufficiently competitive to attract, motivate and retain an executive team fully capable of driving exceptional performance. The Committee periodically reviews these programs to validate that they are reasonable and consistent with market practice. Attributed costs of the personal benefits available to the NEOs are included in column (i) of the Summary Compensation Table on page 60.

- **Retirement Benefits.** Each of our NEOs is eligible to participate in a 401(k) plan that is available to all employees. The Company provides matching contributions on a \$0.50 basis up to 8% of the contributing employee's base salary, subject to limitations of the 401(k) plan and applicable law.
- **Other Benefits.** Our NEOs are eligible to participate in the same health benefits available to all other employees – there are no special medical plans for our NEOs. Lannett provides life insurance for NEOs which would, in the event of death, pay \$115,000 to designated beneficiaries. Premiums paid for coverage above \$50,000 are treated as imputed income. Lannett also provides short- and long-term disability insurance which would, in the event of disability, pay the NEO 60% of his base salary up to the plan limits of \$2,000 per week for short-term disability and \$15,000 per month for long-term disability. The NEOs are also provided with car allowances, for which the taxes are also paid by the Company.
- **Post-Termination Pay.** The Committee believes that reasonable severance and change-in-control benefits are necessary in order to recruit and retain qualified senior executives and are generally required by the competitive recruiting environment within our industry and the marketplace in general. These severance benefits reflect the fact that it may be difficult for our NEOs to find comparable employment within a short period of time, and are designed to alleviate concerns about the loss of his or her position without cause.

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The Committee also believes that a change-in-control arrangement will provide security that will likely reduce the reluctance of an NEO to pursue a change in control transaction that could be in the best interest of our stockholders. Lannett's severance plan is designed to pay severance benefits to a NEO for a qualifying separation. For the CEO, the severance plan provides for payment of three times base salary, plus a pro-rated annual cash bonus for the current year calculated as if all targets and goals are achieved. For the other NEOs, the severance plan provides for a payment of 18-months of base salary, plus a pro-rated annual cash bonus for the current year calculated as if all targets and goals are achieved.

- **Tax and Accounting Implications.** Section 162(m) of the Internal Revenue Code of 1986, as amended, precludes the deductibility of a NEO's compensation that exceeds \$1,000,000 per year unless the compensation is paid under a performance-based plan that has been approved by stockholders. The Committee believes that it is generally preferable to comply with the requirements of 162(m) through, for example, the use of our Incentive Plan. However, to maintain flexibility in compensating NEOs in a manner consistent with our compensation philosophy, the Committee may elect to provide compensation outside those requirements when it deems appropriate. The Committee believes that stockholder interests are best served by not restricting the Committee's discretion in this regard, even though such compensation may result in non-deductible compensation expenses to the Company.

REPORT OF THE COMPENSATION COMMITTEE

The Compensation Committee has reviewed, discussed and approved the CD&A as set forth above with management. Taking this review and discussion into account, the undersigned Committee members recommend to the Board of Directors that the CD&A be included in the annual report on Form 10-K.

*Paul Taveira, Chairman*  
*David Drabik*  
*James Maher*

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## COMPENSATION OF EXECUTIVE OFFICERS

**Overview**

The tables and narratives set forth below provide specified information concerning the compensation of our Named Executive Officers (NEOs) for the fiscal year ended June 30, 2014.

*Summary Compensation Table*

This table summarizes all compensation paid to or earned by our NEOs for fiscal years 2014, 2013 and 2012.

| Name and Principal Position (a)   | Fiscal Year (b) | Salary (c) | Stock Awards (e) | Options Awards (f) | Non-equity incentive plan compensation (g) | All Other Compensation (i) | Total (j)    |
|---|-----------------|------------|------------------|--------------------|--|----------------------------|--------------|
| Arthur P. Bedrosian, President and Chief Executive Officer                        | 2014            | \$ 539,000 | \$ 995,450       | \$ 726,825         | \$ 808,500                                 | \$ 64,286                  | \$ 3,134,061 |
|   | 2013            | 437,513    | 25,300           | 150,810            | 588,784                                    | 62,587                     | 1,264,994    |
|   | 2012            | 425,096    | 20,250           | 171,315            | 198,908                                    | 22,542                     | 838,111      |
| Martin P. Galvan, Vice President of Finance and Chief Financial Officer           | 2014            | \$ 317,000 | \$ 637,450       | \$ 403,792         | \$ 380,400                                 | \$ 20,645                  | \$ 1,759,287 |
|   | 2013            | 270,193    |                  | 75,405             | 368,076                                    | 20,041                     | 733,715      |
|   | 2012            | 235,577    |                  | 107,364            | 116,320                                    | 14,873                     | 474,134      |
| William F. Schreck, Chief Operating Officer                                       | 2014            | \$ 346,000 | \$ 287,259       | \$ 363,413         | \$ 367,622                                 | \$ 36,107                  | \$ 1,400,400 |
|   | 2013            | 255,856    |                  | 82,474             | 344,319                                    | 21,985                     | 704,634      |
|   | 2012            | 250,000    |                  | 205,292            | 116,320                                    | 18,263                     | 589,875      |
| Kevin R. Smith, Vice President of Sales and Marketing                             | 2014            | \$ 278,000 | \$ 350,004       | \$ 363,413         | \$ 333,600                                 | \$ 23,399                  | \$ 1,348,416 |
|   | 2013            | 218,965    |                  | 82,474             | 294,673                                    | 26,682                     | 622,794      |
|   | 2012            | 212,755    |                  | 95,707             | 99,549                                     | 22,013                     | 430,024      |
| Ernest J. Sabo, Vice President of Regulatory Affairs and Chief Compliance Officer | 2014            | \$ 230,000 | \$ 208,274       | \$ 314,958         | \$ 172,500                                 | \$ 19,247                  | \$ 944,979   |
|   | 2013            | 173,983    |                  | 82,474             | 234,137                                    | 15,708                     | 506,302      |
|   | 2012            | 170,000    |                  | 95,707             | 79,098                                     | 15,642                     | 360,447      |

*All Other Compensation*

The following summarizes the components of column (i) of the Summary Compensation Table above:

| Name | Fiscal Year | Company Match Contributions 401(k) Plan | Auto Allowance | Pay in Lieu of Vacation | ESPP Benefit Earnings | Excess Life Insurance | Health Insurance Benefits | Signing Bonus | Total     |
|------|-------------|---|----------------|-------------------------|-----------------------|-----------------------|---------------------------|---------------|-----------|
|      | 2014        | \$ 9,438                                | \$ 13,500      | \$ 40,425               |                       | \$ 923                |                           |               | \$ 64,286 |

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|                            |      |    |        |    |        |    |        |  |     |     |        |        |
|----------------------------|------|----|--------|----|--------|----|--------|--|-----|-----|--------|--------|
| <b>Arthur P. Bedrosian</b> | 2013 |    | 8,433  |    | 13,500 |    | 39,760 |  | 894 |     | 62,587 |        |
|                            | 2012 |    | 8,280  |    | 13,500 |    |        |  | 762 |     | 22,542 |        |
| <b>Martin P. Galvan</b>    | 2014 | \$ | 9,380  | \$ | 10,800 |    |        |  | \$  | 465 | \$     | 20,645 |
|                            | 2013 |    | 8,601  |    | 10,800 |    |        |  |     | 640 |        | 20,041 |
|                            | 2012 |    | 4,327  |    | 10,177 |    |        |  |     | 369 |        | 14,873 |
| <b>William F. Schreck</b>  | 2014 | \$ | 10,411 | \$ | 10,800 | \$ | 13,973 |  | \$  | 923 | \$     | 36,107 |
|                            | 2013 |    | 7,592  |    | 10,800 |    | 2,968  |  |     | 625 |        | 21,985 |
|                            | 2012 |    | 7,067  |    | 10,800 |    |        |  |     | 396 |        | 18,263 |
| <b>Kevin R. Smith</b>      | 2014 | \$ | 9,737  | \$ | 13,500 |    |        |  | \$  | 162 | \$     | 23,399 |
|                            | 2013 |    | 8,794  |    | 13,500 |    | 4,234  |  |     | 154 |        | 26,682 |
|                            | 2012 |    | 8,375  |    | 13,500 |    |        |  |     | 138 |        | 22,013 |
| <b>Ernest J. Sabo</b>      | 2014 | \$ | 7,553  | \$ | 10,800 |    |        |  | \$  | 894 | \$     | 19,247 |
|                            | 2013 |    | 4,283  |    | 10,800 |    |        |  |     | 625 |        | 15,708 |
|                            | 2012 |    | 4,446  |    | 10,800 |    |        |  |     | 396 |        | 15,642 |



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*Grants of Plan-Based Awards in Fiscal 2014*

| Name<br>(a)                | Grant Date<br>(b) | Estimated Future Payouts<br>Under Non-Equity Incentive<br>Plan Awards |                       |                        | Estimated Future Payouts Under<br>Equity Incentive Plan Awards |                       |                        | All Other<br>Stock<br>Awards:<br>Number of<br>Shares of | All Other<br>Option<br>Awards:<br>Number of<br>Securities (1) | Exercise<br>or Base<br>Price of<br>Option (2)<br>Awards | Grant Date<br>Fair Value of<br>Stock and<br>Option Awards<br>(3) |
|----------------------------|-------------------|---|-----------------------|------------------------|--|-----------------------|------------------------|---|---|---|--|
|                            |                   | Threshold<br>(\$)<br>(c)  | Target<br>(\$)<br>(d) | Maximum<br>(\$)<br>(e) | Threshold<br>(\$)<br>(f)                                       | Target<br>(\$)<br>(g) | Maximum<br>(\$)<br>(h) | Stocks or<br>Units (#)<br>(i)                           | Underlying<br>Options (#)<br>(j)                              | (\$/sh)<br>(k)  | Options<br>Awards<br>(i)   |
| <b>Arthur P. Bedrosian</b> | 8/28/2013<br>(4)  |   |                       |                        |  |                       |                        | 7,500   |   |   | \$ 95,325  |
|                            | 9/5/2013          |   |                       |                        |  |                       |                        |   | 90,000  | \$ 13.86  | 726,825  |
|                            | 10/29/2013<br>(5) |   |                       |                        |  |                       |                        | 24,375  |   |   | 596,700  |
|                            | 1/22/2014<br>(4)  |   |                       |                        |  |                       |                        | 1,875   |   |   | 65,138   |
|                            | 4/24/2014<br>(5)  |   |                       |                        |  |                       |                        | 6,875   |   |   | 238,288  |
| <b>Martin P. Galvan</b>    | 9/5/2013          |   |                       |                        |  |                       |                        |   | 50,000  | \$ 13.86  | \$ 403,792   |
|                            | 10/29/2013        |   |                       |                        |  |                       |                        | 22,500  |   |   | 550,800  |
|                            | 4/24/2014         |   |                       |                        |  |                       |                        | 2,500   |   |   | 86,650   |
| <b>William F. Schreck</b>  | 9/5/2013          |   |                       |                        |  |                       |                        |   | 45,000  | \$ 13.86  | \$ 363,413   |
|                            | 10/29/2013        |   |                       |                        |  |                       |                        | 10,000  |   |   | 244,800  |
|                            | 4/24/2014         |   |                       |                        |  |                       |                        | 1,225   |   |   | 42,459   |
| <b>Ernest J. Sabo</b>      | 9/5/2013          |   |                       |                        |  |                       |                        |   | 39,000  | \$ 13.86  | \$ 314,958   |
|                            | 10/29/2013        |   |                       |                        |  |                       |                        | 7,800   |   |   | 190,944  |
|                            | 4/24/2014         |   |                       |                        |  |                       |                        | 500   |   |   | 17,330   |
| <b>Kevin R. Smith</b>      | 9/5/2013          |   |                       |                        |  |                       |                        |   | 45,000  | \$ 13.86  | \$ 363,413   |
|                            | 10/29/2013        |   |                       |                        |  |                       |                        | 10,050  |   |   | 246,024  |
|                            | 4/24/2014         |   |                       |                        |  |                       |                        | 3,000   |   |   | 103,980  |

(1)Reflects stock options granted to recognize the Company's fiscal 2013 performance, which vest in three equal annual increments.

(2)The exercise price was equal to the Company's closing stock price on the date of grant.

(3) Stock options were valued using the Black-Scholes option pricing model. The assumptions used in fair value calculations are described in Note 15, Share-Based Compensation, in the Form 10-K. The grant date fair value for other stock grants reflects the number of shares multiplied by the Company's closing stock price on the applicable date of grant.

(4)Reflects common stock grants provided to all directors for board service.

(5)Includes 1,875 common shares for Board service.

Table of Contents*Outstanding Equity Awards at 2014 Fiscal Year End*

The following table sets forth information concerning the outstanding stock awards held at June 30, 2014 by each of the NEOs. The options were granted ten years prior to the option expiration date and vest over three years from that grant date. Restricted shares vest three years from the date of grant.

| Name<br>(a)                    | Option Awards   |   |   |   |                                     | Stock Awards  |   | Equity<br>Incentive<br>Plan<br>Awards:<br>Market or<br>Payout<br>Value of<br>Unearned<br>Shares,<br>Units or<br>Rights<br>That Have<br>Not Vested<br>(\$) |  |
|--------------------------------|---|---|---|---|-------------------------------------|---|---|---|--|
|                                | Number of<br>Securities<br>Underlying<br>Unexercised<br>Options (#)<br>Exercisable<br>(b) | Number of<br>Securities<br>Underlying<br>Unexercised<br>Options (#)<br>Unexercisable<br>(c) | Equity<br>Incentive Plan<br>Awards:<br>Number of<br>Securities<br>Underlying<br>Unexercised<br>Options (#)<br>(d) | Option<br>Exercise<br>Price (\$)<br>(e) | Option<br>Expiration<br>Date<br>(f) | Number of<br>Shares or<br>Units of<br>Stock That<br>Have Not<br>Vested (#)<br>(g) | Market<br>Value of<br>Shares or<br>Units of<br>Stock That<br>Have Not<br>Vested (\$)<br>(h) | Equity<br>Incentive<br>Plan<br>Awards:<br>Number of<br>Unearned<br>Shares,<br>Units or<br>Rights<br>That Have<br>Not Vested<br>(#)<br>(i)                 | Equity<br>Incentive<br>Plan<br>Awards:<br>Market or<br>Payout<br>Value of<br>Unearned<br>Shares,<br>Units or<br>Rights<br>That Have<br>Not Vested<br>(\$)<br>(j) |
| <b>Arthur P.<br/>Bedrosian</b> | 25,000  |   |   | \$ 8.00                                 | 1/18/2016                           |   |   |   |  |
|                                | 30,000  |   |   | \$ 6.89                                 | 11/27/2016                          |   |   |   |  |
|                                | 75,000  |   |   | \$ 4.03                                 | 9/17/2017                           |   |   |   |  |
|                                | 30,000  |   |   | \$ 2.80                                 | 9/18/2018                           |   |   |   |  |
|                                | 75,000  |   |   | \$ 6.94                                 | 10/29/2019                          |   |   |   |  |
|                                | 59,666  | 29,834  |   | \$ 3.55                                 | 8/25/2021                           |   |   |   |  |
|                                | 21,333  | 42,667  |   | \$ 4.16                                 | 10/25/2022                          |   |   |   |  |
|                                |   | 90,000  | \$ 13.86  | 9/4/2023                                |                                     |   |   |   |  |
|                                |   |   |   |   |                                     | 5,000   | \$ 248,100  |   |  |
| <b>Martin P.<br/>Galvan</b>    | 26,666  | 13,334  |   | \$ 4.73                                 | 7/15/2021                           |   |   |   |  |
|                                | 10,666  | 21,334  |   | \$ 4.16                                 | 10/25/2022                          |   |   |   |  |
|                                |   | 50,000  |   | \$ 13.86                                | 9/4/2023                            |   |   |   |  |
|                                |   |   |   |   |                                     | 2,500   | \$ 124,050  |   |  |
| <b>William F.<br/>Schreck</b>  |   | 8,334   |   | \$ 5.02                                 | 7/8/2021                            |   |   |   |  |
|                                |   | 23,334  |   | \$ 3.55                                 | 8/25/2021                           |   |   |   |  |
|                                |   | 23,334  |   | \$ 4.16                                 | 10/25/2022                          |   |   |   |  |
|                                |   | 45,000  |   | \$ 13.86                                | 9/4/2023                            |   |   |   |  |
|                                |   |   |   |   |                                     | 1,225   | \$ 60,785   |   |  |
| <b>Ernest J.<br/>Sabo</b>      | 3,260   |   |   | \$ 7.48                                 | 3/1/2015                            |   |   |   |  |
|                                | 4,000   |   |   | \$ 5.18                                 | 10/25/2015                          |   |   |   |  |
|                                | 7,500   |   |   | \$ 6.89                                 | 11/27/2016                          |   |   |   |  |
|                                | 50,000  |   |   | \$ 6.94                                 | 10/29/2019                          |   |   |   |  |
|                                | 16,667  | 16,667  |   | \$ 3.55                                 | 8/25/2021                           |   |   |   |  |
|                                | 11,666  | 23,334  |   | \$ 4.16                                 | 10/25/2022                          |   |   |   |  |
|                                |   | 39,000  | \$ 13.86  | 9/4/2023                                |                                     |   |   |   |  |
|                                |   |   |   |   |                                     | 500   | \$ 24,810   |   |  |

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|                       |        |        |          |            |                  |
|-----------------------|--------|--------|----------|------------|------------------|
| <b>Kevin R. Smith</b> | 10,200 |        | \$ 4.03  | 9/17/2017  |                  |
|                       |        | 16,667 | \$ 3.55  | 8/25/2021  |                  |
|                       |        | 23,334 | \$ 4.16  | 10/25/2022 |                  |
|                       |        | 45,000 | \$ 13.86 | 9/4/2023   |                  |
|                       |        |        |          |            | 3,000 \$ 148,860 |

*Options Exercised and Stock Vested During the Fiscal Year Ended June 30, 2014*

The following table sets forth information concerning stock options exercised and stock awards that vested during fiscal year 2014 for each of the NEOs.

| Name                       | Options                               |                            | Stock Awards                         |                           |
|----------------------------|---------------------------------------|----------------------------|--------------------------------------|---------------------------|
|                            | Number of Shares Acquired on Exercise | Value Realized on Exercise | Number of Shares Acquired on Vesting | Value Realized on Vesting |
| <b>Arthur P. Bedrosian</b> | 30,000                                | \$ 842,100                 | 35,625                               | \$ 1,387,800              |
| <b>Martin P. Galvan</b>    |                                       |                            | 22,500                               | 1,116,450                 |
| <b>William F. Schreck</b>  | 242,998                               | 9,258,144                  | 10,000                               | 496,200                   |
| <b>Ernest J. Sabo</b>      |                                       |                            | 7,800                                | 387,036                   |
| <b>Kevin R. Smith</b>      | 132,799                               | 4,607,774                  | 10,050                               | 498,681                   |

Table of Contents*Employment Agreements*

The Company has entered into employment agreements with Arthur P. Bedrosian, President and Chief Executive Officer, Martin P. Galvan, VP of Finance, Chief Financial Officer and Treasurer, Kevin R. Smith, SVP of Sales and Marketing, William F. Schreck, Chief Operating Officer, Ernest J. Sabo, VP of Regulatory Affairs and Chief Compliance Officer, and Robert Ehlinger, VP of Logistics and Chief Information Officer. Each of the agreements provides 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. 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 these executives severance compensation as discussed in the table below.

*Potential Payments upon Termination or Change in Control*

The following table assumes that the relevant triggering event occurred on June 30, 2014. The fair market values of share-based compensation (i.e. Stock Options and Restricted Stock) were calculated using the closing price of Lannett Company, Inc. stock (\$49.62) on June 30, 2014, which was the last trading day of Fiscal 2014. The spread, the difference between the fair market value of Lannett Company's stock on June 30, 2014, and the option exercise price, was used for valuing stock options.

|                                 |    |           |    |         |    |           |    |         |    |        |    |       |    |           |
|---------------------------------|----|-----------|----|---------|----|-----------|----|---------|----|--------|----|-------|----|-----------|
| <b>Arthur P. Bedrosian</b>      |    |           |    |         |    |           |    |         |    |        |    |       |    |           |
| Without Cause/With Good         |    |           |    |         |    |           |    |         |    |        |    |       |    |           |
| Reason (1) (2)                  | \$ | 1,617,000 | \$ | 808,500 | \$ | 6,532,494 | \$ | 248,100 | \$ | 38,778 | \$ | 7,232 | \$ | 9,252,104 |
| For Cause (3) (4)               |    |           |    | 808,500 |    |           |    |         |    |        |    | 7,232 |    | 815,732   |
| Retirement / Death / Disability |    |           |    |         |    |           |    |         |    |        |    |       |    |           |
| (3)                             |    |           |    | 808,500 |    |           |    |         |    |        |    | 7,232 |    | 815,732   |
| Change in Control (5)           |    | 1,617,000 |    | 808,500 |    | 6,532,494 |    | 248,100 |    | 38,778 |    | 7,232 |    | 9,252,104 |
| <b>Martin P. Galvan</b>         |    |           |    |         |    |           |    |         |    |        |    |       |    |           |
| Without Cause/With Good         |    |           |    |         |    |           |    |         |    |        |    |       |    |           |
| Reason (1) (2)                  | \$ | 475,500   | \$ | 380,400 | \$ | 3,356,407 | \$ | 124,050 | \$ | 30,864 | \$ | 5,316 | \$ | 4,372,537 |
| For Cause (3) (4)               |    |           |    | 380,400 |    |           |    |         |    |        |    | 5,316 |    | 385,716   |
| Retirement / Death / Disability |    |           |    |         |    |           |    |         |    |        |    |       |    |           |
| (3)                             |    |           |    | 380,400 |    |           |    |         |    |        |    | 5,316 |    | 385,716   |
| Change in Control (5)           |    | 475,500   |    | 380,400 |    | 3,356,407 |    | 124,050 |    | 30,864 |    | 5,316 |    | 4,372,537 |
| <b>William F. Schreck</b>       |    |           |    |         |    |           |    |         |    |        |    |       |    |           |
| Without Cause/With Good         |    |           |    |         |    |           |    |         |    |        |    |       |    |           |
| Reason (1) (2)                  | \$ | 519,000   |    | 367,622 | \$ | 4,116,657 | \$ | 60,785  | \$ | 29,822 | \$ | 6,028 | \$ | 5,099,914 |
| For Cause (3) (4)               |    |           |    | 367,622 |    |           |    |         |    |        |    | 6,028 |    | 373,650   |
| Retirement / Death / Disability |    |           |    |         |    |           |    |         |    |        |    |       |    |           |
| (3)                             |    |           |    | 367,622 |    |           |    |         |    |        |    | 6,028 |    | 373,650   |
| Change in Control (5)           |    | 519,000   |    | 367,622 |    | 4,116,657 |    | 60,785  |    | 29,822 |    | 6,028 |    | 5,099,914 |
| <b>Ernest J. Sabo</b>           |    |           |    |         |    |           |    |         |    |        |    |       |    |           |
| Without Cause/With Good         |    |           |    |         |    |           |    |         |    |        |    |       |    |           |
| Reason (1) (2)                  | \$ | 345,000   |    | 172,500 | \$ | 3,223,252 | \$ | 24,810  | \$ | 15,348 | \$ | 3,692 | \$ | 3,784,602 |
| For Cause (3) (4)               |    |           |    | 172,500 |    |           |    |         |    |        |    | 3,692 |    | 176,192   |
|                                 |    |           |    | 172,500 |    |           |    |         |    |        |    | 3,692 |    | 176,192   |

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|                                 |            |            |              |            |           |          |              |
|---------------------------------|------------|------------|--------------|------------|-----------|----------|--------------|
| Retirement / Death / Disability |            |            |              |            |           |          |              |
| (3)                             |            |            |              |            |           |          |              |
| Change in Control (5)           | 345,000    | 172,500    | 3,223,252    | 24,810     | 15,348    | 3,692    | 3,784,602    |
| <b>Kevin R. Smith</b>           |            |            |              |            |           |          |              |
| Without Cause/With Good         |            |            |              |            |           |          |              |
| Reason (1) (2)                  | \$ 417,000 | \$ 333,600 | \$ 3,437,812 | \$ 148,860 | \$ 38,118 | \$ 4,896 | \$ 4,380,286 |
| For Cause (3) (4)               |            | 333,600    |              |            |           | 4,896    | 338,496      |
| Retirement / Death / Disability |            |            |              |            |           |          |              |
| (3)                             |            |            |              |            |           |          |              |
| Change in Control (5)           | 417,000    | 333,600    | 3,437,812    | 148,860    | 38,118    | 4,896    | 4,380,286    |

(1) Each employment agreement ranges from 1-3 years and is automatically renewed unless notice is given by either party. Any non-renewal of the existing employment agreements by the Company and any resignation of the Executive with Good Reason both constitute a termination without Cause. Under the existing employment agreements base salary continuation for a period of 18-36 months, pro-rated cash bonus as if all targets and goals were achieved subject to any applicable cap on cash payments, acceleration of exercisability of unvested stock option awards, acceleration of unvested restricted stock, and insurance benefit continuation for a period of 18 months (collectively Severance Compensation ) will only be made if the Executive executes and delivers to the Company, in a form prepared by the Company, a release of all claims against the Company and other appropriate parties, excluding the Company's performance obligation to pay Severance Compensation and the Executive's vested rights under the Company sponsored retirement plans, 401(k) plans and stock ownership plans ( General Release ). Severance Compensation is paid in equal monthly installments over a 12 month period to commence on the 90th day following the Termination Date provided the Executive has not revoked the General Release prior to that date. Earned but unpaid base salary, accrued but unpaid annual bonus (if the Executive otherwise meets the eligibility requirements) and accrued but unpaid paid time off and other miscellaneous items are to be paid in a single lump sum in cash no later than the earlier of: (1) the date required under applicable law; or (2) 60 days following the Termination Date.

(2) Under the existing employment agreements, Good Reason is defined as giving written notice of his resignation within thirty (30) days after Executive has actual knowledge of the occurrence, without the written consent of Executive, of one of the following events: (A) the assignment to Executive of duties materially and adversely inconsistent with Executive's position or a material and adverse alteration in the nature of his duties, responsibilities and/or reporting obligations, (B) a reduction in Executive's Base Salary or a failure to pay any such amounts when due; or (C) the relocation of Company headquarters more than 100 miles from its current location. Good Reason is also defined to include any other reason provided the Executive gives at least thirty (30) days prior written notice to Company.

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(3) Under the existing employment agreements, if the Executive is terminated For Cause; by death; by disability; resigns without Good Reason; or retires; earned but unpaid base salary, accrued but unpaid annual bonus (if the Executive otherwise meets the eligibility requirements) and accrued but unpaid paid time off and other miscellaneous items are to be paid in a single lump sum in cash no later than the earlier of: (1) the date required under applicable law; or (2) 60 days following the Termination Date.

(4) For Cause generally means Executive's willful commission of an act constituting fraud, embezzlement, breach of fiduciary duty, material dishonesty with respect to the Company, gross negligence or willful misconduct in performance of Executive duties, willful violation of any law, rule or regulation relating to the operation of the Company, abuse of illegal drugs or other controlled substances or habitual intoxication, willful violation of published business conduct guidelines, code of ethics, conflict of interest or other similar policies, and Executive becoming under investigation by or subject to any disciplinary charges by any regulatory agency having jurisdiction over the Company (including but not limited to the Drug Enforcement Administration (DEA), Food and Drug Administration (FDA) or the Securities and Exchange Commission (SEC)) or if any complaint is filed against the Executive by any such regulatory agency.

(5) Under the existing employment agreements a Change in Control is defined as a change in ownership of the Company, a change in effective control of the Company, or a change in ownership of a substantial portion of the Company's assets. If the Executive is terminated by the Company without Cause or resigns with Good Reason within 24 months of a Change in Control event, the Executive shall be entitled to earned but unpaid base salary, accrued but unpaid annual bonus (if the Executive otherwise meets the eligibility requirements) and accrued but unpaid paid time off and other miscellaneous items. These items are to be paid in a single lump sum in cash no later than the earlier of: (1) the date required under applicable law; or (2) 60 days following the Termination Date. Additionally, the Executive shall be entitled to Severance Compensation to be paid in equal monthly installments over a 12 month period to commence on the 90th day following the Termination Date provided the Executive has not revoked the General Release prior to that date. A written notice that the Executive's employment term is not extended within the 24-month period after a Change in Control shall be deemed a termination without Cause, unless the Executive and the Company execute a new employment agreement.

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## COMPENSATION OF DIRECTORS

For Fiscal 2014, our non-employee directors received a cash retainer of \$90,000, payable in monthly increments of \$7,500, for board and committee service. No other cash retainers or meeting fees were provided.

In August 2013, each board member received an award of 7,500 common shares, immediately vested at grant, for board service in Fiscal 2013. In Fiscal 2014, board members received quarterly grants of 1,875 common shares, beginning in October 2013, which were immediately vested at grant. Grant date values shown in the table below are associated with board service in Fiscal 2013 and three quarters of Fiscal 2014 (the last quarterly grant for fiscal 2014 board service occurred in July 2014), and reflect the Company's strong performance and significant stock price appreciation over that period.

Effective in July 2014, the Board of Directors approved stock ownership guidelines for non-employee directors equal to three times their cash retainer. Non-employee directors must meet required ownership levels within five years of first becoming subject to the guidelines.

The following table shows compensation information for fiscal 2014 for non-employee members of our Board of Directors.

| Name                        | Fees<br>Earned   | Stock<br>Awards (1) | Options<br>Awards | Non-Equity<br>Incentive Plan<br>Compensation | Change in<br>Pension Value<br>and Nonqualified<br>Deferred<br>Compensation | All Other<br>Compensation | Total             |
|-----------------------------|------------------|---------------------|-------------------|--|--|---------------------------|-------------------|
| (a)                         | (\$)<br>(b)      | (\$)<br>(c)         | (\$)<br>(d)       | (\$)<br>(e)                                  | (\$)<br>(f)  | (\$)<br>(g)               | (\$)<br>(h)       |
| <b>Jeffrey Farber</b>       | <b>\$ 90,000</b> | <b>\$ 271,350</b>   |                   |  |  |                           | <b>\$ 361,350</b> |
| <b>Kenneth Sinclair (2)</b> | <b>45,000</b>    | <b>206,363</b>      |                   |  |  |                           | <b>251,363</b>    |
| <b>David Drabik</b>         | <b>90,000</b>    | <b>271,350</b>      |                   |  |  |                           | <b>361,350</b>    |
| <b>Paul Taveira</b>         | <b>90,000</b>    | <b>271,350</b>      |                   |  |  |                           | <b>361,350</b>    |
| <b>James Maher (3)</b>      | <b>90,000</b>    | <b>207,800</b>      |                   |  |  |                           | <b>297,800</b>    |

(1) Reflects grant date award value for equity grants received in fiscal 2014. Includes, as applicable, grant of 7,500 common shares on 8/28/13 for board service in fiscal 2013. Also includes, as applicable, quarterly grants of 1,875 common shares for fiscal 2014 board service made on 10/29/13, 1/22/14, and 4/24/14.

(2) Dr. Sinclair did not stand for re-election at the January 2014 annual shareholders meeting.

(3) Mr. Maher joined the Board in July 2013.





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The following table sets forth, as of July 31, 2014, information regarding the security ownership of the directors and certain executive officers of the Company and persons known to the Company to be beneficial owners of more than five (5%) percent of the Company's common stock. Although grants of restricted stock under the Company's 2006, 2011 and 2014 Long Term Incentive Plans (LTIPs) generally vest equally over a three year period from the grant date, the restricted shares are included below because the voting rights with respect to such restricted stock are acquired immediately upon grant.

| Name and Address of Beneficial Owner / Director / Executive Officer  | Office  | Shares Held Directly | Excluding Options (*)  |              | Percent of Class | Including Options (**) |                  |
|--|---|----------------------|------------------------|--------------|------------------|------------------------|------------------|
|  |   |                      | Shares Held Indirectly | Total Shares |                  | Number of Shares       | Percent of Class |
| Arthur P. Bedrosian<br>13200 Townsend Road<br>Philadelphia, PA 19154 | President and Chief Executive Officer         | 648,817              | 41,650                 | 690,467(1)   | 1.93%            | 1,066,300(1),(2)       | 2.96%            |
| David Drabik<br>13200 Townsend Road<br>Philadelphia, PA 19154        | Director                                      | 27,500               | 0                      | 27,500       | 0.08%            | 27,500                 | 0.08%            |
| Robert Ehlinger<br>13200 Townsend Road<br>Philadelphia, PA 19154     | VP of Logistics and Chief Information Officer | 31,064               | 0                      | 31,064       | 0.09%            | 170,321(3)             | 0.48%            |
| William Farber<br>13200 Townsend Road<br>Philadelphia, PA 19154      | Chairman Emeritus                             | 3,315,812            | 0                      | 3,315,812    | 9.29%            | 3,315,815              | 9.29%            |
| Jeffrey Farber<br>13200 Townsend Road<br>Philadelphia, PA 19154      | Chairman of the Board, Director               | 522,470              | 4,470,050              | 4,992,520(4) | 13.99%           | 5,017,520(4),(5)       | 14.05%           |
| David Farber<br>6884 Brook Hollow Ct<br>West Bloomfield, MI 48322    |   | 80,870               | 4,581,581              | 4,662,451(6) | 13.07%           | 4,662,451(6)           | 13.07%           |
| Farber Properties<br>1775 John R Road<br>Troy, MI 48083              |   | 3,850,000            | 0                      | 3,850,000(7) | 10.79%           | 3,850,000(7)           | 10.79%           |
| Farber Family LLC<br>1775 John R Road<br>Troy, MI 48083              |   | 528,142              | 0                      | 528,142(8)   | 1.48%            | 528,142(8)             | 1.48%            |
| Farber Investment LLC<br>1775 John R Road<br>Troy, MI 48083          |   | 38,000               | 0                      | 38,000(9)    | 0.11%            | 38,000(9)              | 0.11%            |
| Martin Galvan<br>13200 Townsend Road<br>Philadelphia, PA 19154       | VP of Finance, Chief Financial                | 31,499               | 0                      | 31,499(10)   | 0.09%            | 98,831(10),(11)        | 0.28%            |

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| Officer and Treasurer   |   |           |           |             |        |                  |        |
|---|---|-----------|-----------|-------------|--------|------------------|--------|
| James M. Maher<br>13200 Townsend Road<br>Philadelphia, PA 19154     | Director  | 10,500    | 0         | 10,500      | 0.03%  | 10,500           | 0.03%  |
| Ernest J. Sabo<br>13200 Townsend Road<br>Philadelphia, PA 19154     | VP of Regulatory Affairs and Chief Compliance Officer | 23,395    | 0         | 23,395(12)  | 0.07%  | 146,155(12),(13) | 0.41%  |
| William F. Schreck<br>13200 Townsend Road<br>Philadelphia, PA 19154 | Chief Operating Officer                               | 219,357   | 0         | 219,357(14) | 0.61%  | 266,025(14),(15) | 0.74%  |
| Kevin R. Smith<br>13200 Townsend Road<br>Philadelphia, PA 19154     | VP of Sales and Marketing                             | 67,752    | 0         | 67,752(16)  | 0.19%  | 109,619(16),(17) | 0.31%  |
| Paul Taveira<br>13200 Townsend Road<br>Philadelphia, PA 19154       | Director  | 17,500    | 0         | 17,500      | 0.05%  | 17,500           | 0.05%  |
| All directors and executive officers as a group (11 persons)        |   | 1,599,854 | 4,511,700 | 6,111,554   | 17.13% | 6,930,271        | 18.99% |

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- (1) Includes 41,650 shares owned by Arthur P. Bedrosian's wife. Mr. Bedrosian disclaims beneficial ownership of these shares. Includes 20,000 unvested shares received pursuant to a restricted stock awards granted in April 2014 and July 2014.
- (2) Includes 25,000 vested options to purchase common stock at an exercise price of \$8.00 per share, 30,000 vested options to purchase common stock at an exercise price of \$6.89 per share, 75,000 vested options to purchase common stock at an exercise price of \$4.03 per share, 30,000 vested options to purchase common stock at an exercise price of \$2.80, 75,000 vested options to purchase common stock at an exercise price of \$6.94 per share, 89,500 vested options to purchase common stock at an exercise price of \$3.55, 21,333 vested options to purchase common stock at an exercise price of \$4.16, and 30,000 vested options to purchase common stock at an exercise price of \$13.86.
- (3) Includes 10,425 vested options to purchase common stock at an exercise price of \$5.05 per share, 7,500 vested options to purchase common stock at an exercise price of \$6.89 per share, 15,000 vested options to purchase common stock at an exercise price of \$4.03 per share, 15,000 vested options to purchase common stock at an exercise price of \$6.94 per share, 18,000 vested options to purchase common stock at an exercise price of \$5.02, 50,000 vested options to purchase common stock at an exercise price of \$3.55, 11,666 vested options to purchase common stock at an exercise price of \$4.16, and 11,666 vested options to purchase common stock at an exercise price of \$13.86.
- (4) Includes 3,850,000 shares held by Farber Properties Group LLC ( FPG ). FPG is managed and jointly owned by Jeffrey Farber and David Farber. David Farber and Jeffrey Farber each disclaim beneficial ownership of 1,925,000 shares held by FPG. Includes 528,142 shares held by Farber Family LLC ( FFLLC ) which is managed by Jeffrey and David Farber. David Farber and Jeffrey Farber each disclaim beneficial ownership of these shares. Includes 36,629 shares held by Jeffrey Farber as custodian for his children, 17,279 shares held as joint custodian with David Farber for a relative, and also includes 38,000 shares held by Farber Investment Company ( FIC ). Jeffrey Farber and David Farber each beneficially own 25% of FIC and each disclaim beneficial ownership of all but 9,500 shares held by FIC.
- (5) Includes 20,000 vested options to purchase common stock at an exercise price of \$4.55, and 5,000 vested options to purchase common stock at an exercise price of \$6.89.
- (6) Includes 3,850,000 shares held by FPG. FPG is managed and jointly owned by Jeffrey Farber and David Farber. David Farber and Jeffrey Farber each disclaim beneficial ownership of 1,925,000 shares held by FPG. Includes 528,142 shares held by FFLLC which is managed by Jeffrey and David Farber. David Farber and Jeffrey Farber each disclaim beneficial ownership of these shares. Includes 148,160 shares held by David Farber as custodian for his children and 17,279 shares held as joint custodian with Jeffrey Farber for a relative. Also includes 38,000 shares held by FIC. Jeffrey Farber and David Farber each beneficially own 25% of FIC and each disclaim beneficial ownership of all but 9,500 shares held by FIC.
- (7) Farber Properties Group, LLC is managed and jointly owned by Jeffrey Farber and David Farber.
- (8) Farber Family LLC is managed by Jeffrey Farber and David Farber.
- (9) Farber Investment LLC is beneficially owned 25% each by Jeffrey and David Farber and 50% by Larry Farber.

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- (10) Includes 10,000 unvested shares received pursuant to a restricted stock awards granted in April 2014 and July 2014.
- (11) Includes 40,000 vested options to purchase common stock at an exercise price of \$4.73 per share, 10,666 vested options to purchase common stock at an exercise price of \$4.16 per share, and 16,666 vested options to purchase common stock at an exercise price of \$13.86.
- (12) Includes 2,000 unvested shares received pursuant to a restricted stock awards granted in April 2014 and July 2014.
- (13) Includes 3,260 vested options to purchase common stock at an exercise price of \$7.48 per share, 4,000 vested options to purchase common stock at an exercise price of \$5.18 per share, 7,500 vested options to purchase common stock at an exercise price of \$6.89 per share, 50,000 vested options to purchase common stock at an exercise price of \$6.94 per share, 33,334 vested options to purchase common stock at an exercise price of \$3.55, 11,666 vested options to purchase common stock at an exercise price of \$4.16 per share, and 13,000 vested options to purchase common stock at an exercise price of \$13.86.
- (14) Includes 4,900 unvested shares received pursuant to a restricted stock awards granted in April 2014 and July 2014.
- (15) Includes 8,334 vested options to purchase common stock at an exercise price of \$5.02, 23,334 vested options to purchase common stock at an exercise price of \$3.55, and 15,000 vested options to purchase common stock at an exercise price of \$13.86 per share.
- (16) Includes 12,000 unvested shares received pursuant to a restricted stock awards granted in April 2014 and July 2014.
- (17) Includes 10,200 vested options to purchase common stock at an exercise price of \$4.03 per share, 16,667 vested options to purchase common stock at an exercise price of \$3.55, and 15,000 vested options to purchase common stock at an exercise price of \$13.86 per share.

\* Percent of class calculation is based on 35,684,367 outstanding shares of common stock at July 31, 2014.

\*\* Assumes that all options exercisable within sixty days have been exercised.

Table of Contents**Equity Compensation Plan Information**

The following table summarizes the equity compensation plans as of June 30, 2014:

| (In thousands, except for weighted average exercise price)<br>Plan Category | Number of securities to<br>be issued upon exercise<br>of outstanding options,<br>warrants and rights<br>(a) | Weighted average<br>exercise price of<br>outstanding<br>options, warrants<br>and rights<br>(b) | Number of securities<br>remaining available for<br>future issuance under<br>equity compensation plans<br>(excluding securities<br>reflected in column (a))<br>(c) |
|---|---|--|---|
| Equity Compensation plans approved by security holders                      | 2,205   | \$ 7.84  | 3,043   |
| Equity Compensation plans not approved by security holders                  |   |  |   |
| <b>Total</b>  | <b>2,205</b>  | <b>\$ 7.84</b>   | <b>3,043</b>  |

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE**

The Company had sales of \$2.3 million, \$1.3 million and \$757 thousand during the fiscal years ended June 30, 2014, 2013, and 2012, respectively, to a generic distributor, Auburn Pharmaceutical Company ( Auburn ). Jeffrey Farber, Chairman of the Board and the son of William Farber, Chairman Emeritus of the Board of Directors and principal stockholder of the Company, is the owner of Auburn. Accounts receivable includes amounts due from Auburn of \$980 thousand and \$200 thousand at June 30, 2014 and 2013, respectively. In the Company's opinion, the terms of these transactions were not more favorable to Auburn than would have been to a non-related party.

Lannett Company, Inc. paid a management consultant, who is related to Mr. Bedrosian, \$105 thousand in fees and \$24 thousand in reimbursable expenses during Fiscal 2014 and \$107 thousand in fees and \$38 thousand in reimbursable expenses during Fiscal 2013. This consultant provided management, construction planning, laboratory set up and administrative services in regards to the Company's initial set up of its bio-study laboratory in a foreign country. It is expected that this consultant will continue to be utilized into fiscal year 2015. In the Company's opinion, the fee rates paid to this consultant and the expenses reimbursed to him were not more favorable than what would have been paid to a non-related party.

Table of Contents**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

Grant Thornton LLP served as the independent auditors of the Company during Fiscal 2014, 2013 and 2012. No relationship exists, other than the usual relationship between independent public accountant and client. The following table identifies the fees incurred for services rendered by Grant Thornton LLP in Fiscal 2014, 2013 and 2012.

| (In thousands) | Audit Fees | Audit-Related | Tax Fees (1) | All Other Fees (2) | Total Fees |
|----------------|------------|---------------|--------------|--------------------|------------|
| Fiscal 2014:   | \$ 444     | \$            | \$ 69        | \$                 | \$ 513     |
| Fiscal 2013:   | \$ 375     | \$            | \$ 103       | \$ 14              | \$ 492     |
| Fiscal 2012:   | \$ 338     | \$            | \$ 107       | \$                 | \$ 445     |

(1) Tax fees include fees paid for preparation of annual federal, state and local income tax returns, quarterly estimated income tax payments, and various tax planning services.

(2) Other fees include fees paid for review of various correspondences, miscellaneous studies, etc.

The non-audit services provided to the Company by Grant Thornton LLP were pre-approved by the Company's Audit Committee. Prior to engaging its auditor to perform non-audit services, the Company's Audit Committee reviews the particular service to be provided and the fee to be paid by the Company for such service and assesses the impact of the service on the auditor's independence.

Table of Contents**PART IV****ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES**1. *Consolidated Financial Statements:*

See accompanying Index to Consolidated Financial Statements.

2. *Consolidated Financial Statement Schedules:***Lannett Company, Inc.****Schedule II - Valuation and Qualifying Accounts****For the years ended June 30:**

| Description<br>(In thousands)                 | Balance at<br>Beginning of<br>Fiscal Year | Charged to<br>(Reduction of)<br>Expense | Deductions | Balance at<br>End of Fiscal<br>Year |
|---|---|---|------------|-------------------------------------|
| <b>Allowance for Doubtful Accounts</b>        |   |   |            |                                     |
| 2014  | \$ 41                                     | \$ 74                                   | \$         | \$ 115                              |
| 2013  | 124                                       | (83)                                    |            | 41                                  |
| 2012  | 124                                       |   |            | 124                                 |
| <b>Inventory Valuation</b>                    |   |   |            |                                     |
| 2014  | \$ 2,002                                  | \$ 2,918                                | \$ 2,536   | \$ 2,384                            |
| 2013  | 1,472                                     | 876                                     | 346        | 2,002                               |
| 2012  | 3,486                                     | 1,745                                   | 3,759      | 1,472                               |
| <b>Deferred Tax Asset Valuation Allowance</b> |   |   |            |                                     |
| 2014  | \$ 2,140                                  | \$ 149                                  | \$         | \$ 2,289                            |
| 2013  | 2,112                                     | 28                                      |            | 2,140                               |
| 2012  | 2,032                                     | 80                                      |            | 2,112                               |

3. *Exhibits:*



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Those exhibits marked with a (\*) refer to management contracts or compensatory plans or arrangements.

| <b>Exhibit Number</b> | <b>Description</b>                               | <b>Method of Filing</b>   |
|-----------------------|--|---|
| 3.1                   | Certificate of Incorporation                     | Incorporated by reference to the Proxy Statement filed with respect to the Annual Meeting of Shareholders held on December 6, 1991 (the 1991 Proxy Statement ). |
| 3.2                   | By-Laws, as amended                              | Incorporated by reference to the 1991 Proxy Statement.  |
| 3.3                   | Amendment No. 1 to amended and restated By-Laws  | Incorporated by reference to Exhibit 3.3 on Form 8-K dated January 16, 2014   |
| 3.4                   | Amendment No. 2 to amended and restated By-Laws  | Incorporated by reference to Exhibit 3.4 on Form 8-K dated July 17, 2014  |
| 3.5                   | Updated and Amended Certificate of Incorporation | Filed Herewith  |
| 3.6                   | Updated and Amended By-Laws                      | Filed Herewith  |

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| Exhibit Number | Description  | Method of Filing   |
|----------------|--|--|
| 4              | Specimen Certificate for Common Stock  | Incorporated by reference to Exhibit 4(a) to Form 8 dated April 23, 1993 (Amendment No. 3 to Form 10-KSB for Fiscal 1992) ( Form 8 ) |
| 10.1           | Line of Credit Note dated March 11, 1999 between the Company and First Union National Bank   | Incorporated by reference to Exhibit 10(ad) to the Annual Report on 1999 Form 10-KSB   |
| 10.2           | Philadelphia Authority for Industrial Development Taxable Variable Rate Demand/Fixed Rate Revenue Bonds, Series of 1999                              | Incorporated by reference to Exhibit 10(ae) to the Annual Report on 1999 Form 10-KSB   |
| 10.3           | Philadelphia Authority for Industrial Development Tax-Exempt Variable Rate Demand/Fixed Revenue Bonds (Lannett Company, Inc. Project) Series of 1999 | Incorporated by reference to Exhibit 10(af) to the Annual Report on 1999 Form 10-KSB   |
| 10.4           | Letter of Credit and Agreements supporting bond issues between the Company and First Union National Bank   | Incorporated by reference to Exhibit 10(ag) to the Annual Report on 1999 Form 10-KSB   |
| 10.5*          | 2003 Stock Option Plan   | Incorporated by reference to the Proxy Statement for Fiscal Year Ending June 30, 2002  |
| 10.6*          | Employment Agreement with Kevin Smith  | Incorporated by reference to Exhibit 10.6 to the Annual Report on 2003 Form 10-KSB   |
| 10.7*          | Employment Agreement with Arthur Bedrosian   | Incorporated by reference to Exhibit 10 to the Quarterly Report on Form 10-Q dated May 12, 2004.                                     |
| 10.9           | Agreement between Lannett Company, Inc and Siegfried (USA), Inc.   | Incorporated by reference to Exhibit 10.9 to the Annual Report on 2003 Form 10-KSB   |
| 10.10          | Agreement between Lannett Company, Inc and Jerome Stevens, Pharmaceutical, Inc.  | Incorporated by reference to Exhibit 2.1 to Form 8-K dated April 20, 2004  |
| 10.11*         | Terms of Employment Agreement with Stephen J. Kovary   | Incorporated by reference to Exhibit 10.11 to the Annual Report on 2009 Form 10-K  |
| 10.12          | Agreement of Sale Between Anvil Construction Company, Inc. and Lannett Company, Inc.   | Incorporated by reference to Exhibit 10.12 to the Annual Report on 2009 Form 10-K  |
| 10.13*         | 2006 Long Term Incentive Plan  | Incorporated by reference to the Proxy Statement dated January 5, 2007   |
| 10.15*         | 2011 Long Term Incentive Plan  | Incorporated by reference to the Proxy Statement dated January 19, 2011  |
| 10.16*         | Terms of Employment Agreement with Martin P. Galvan  | Incorporated by reference to Exhibit 10.1 on Form 8-K dated August 8, 2011   |
| 10.17          | Amended and Restated Loan Agreement dated April 29, 2011 between the Company and Wells Fargo Bank, N. A.   | Incorporated by reference to Exhibit 10.17 to the Annual Report on 2011 Form 10-K  |



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| Exhibit Number | Description   | Method of Filing  |
|----------------|---|---|
| 10.18          | Loan Agreement dated May 26, 2011 between the Company, the Pennsylvania Industrial Development Authority ( PIDA ) and PIDC Financing Corporation  | Incorporated by reference to Exhibit 10.18 to the Annual Report on 2011 Form 10-K |
| 10.19*         | Second Amended and Restated Employment Agreement of Arthur P. Bedrosian   | Incorporated by reference to Exhibit 10.19 on Form 8-K dated January 3, 2013      |
| 10.20*         | Amended and Restated Employment Agreement of Martin P. Galvan   | Incorporated by reference to Exhibit 10.20 on Form 8-K dated January 3, 2013      |
| 10.21*         | Amended and Restated Employment Agreement of William F. Schreck   | Incorporated by reference to Exhibit 10.21 on Form 8-K dated January 3, 2013      |
| 10.22*         | Amended and Restated Employment Agreement of Kevin Smith  | Incorporated by reference to Exhibit 10.22 on Form 8-K dated January 3, 2013      |
| 10.23*         | Amended and Restated Employment Agreement of Ernest J. Sabo   | Incorporated by reference to Exhibit 10.23 on Form 8-K dated January 3, 2013      |
| 10.24*         | Amended and Restated Employment Agreement of Robert Ehlinger  | Incorporated by reference to Exhibit 10.24 on Form 8-K dated January 3, 2013      |
| 10.25          | Amendment to Agreement dated March 23, 2004 by and between Lannett Company, Inc. and Jerome Stevens Pharmaceuticals, Inc.   | Incorporated by reference to Exhibit 10.25 on Form 8-K dated August 19, 2013      |
| 10.26          | Credit Agreement dated as of December 18, 2013 among Lannett Company Inc., as the Borrower, Certain Financial Institutions as the Lenders, and Citibank, N.A., as Administrative Agent                | Incorporated by reference to Exhibit 10.26 on Form 8-K dated December 19, 2013    |
| 10.27          | Guaranty and Security Agreement dated as of December 18, 2013, among Lannett Company, Inc., the Subsidiaries of Lannett Company, Inc. identified therein, and Citibank, N.A., as Administrative Agent | Incorporated by reference to Exhibit 10.27 on Form 8-K dated December 19, 2013    |
| 21             | Subsidiaries of the Company   | Filed Herewith  |
| 23.1           | Consent of Grant Thornton, LLP  | Filed Herewith  |
| 31.1           | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  | Filed Herewith  |
| 31.2           | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  | Filed Herewith  |
| 32             | Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002   | Filed Herewith  |
| 101.INS        | XBRL Instance Document  |   |
| 101.SCH        | XBRL Extension Schema Document  |   |



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| <b>Exhibit<br/>Number</b> | <b>Description</b>                  | <b>Method of Filing</b> |
|---------------------------|-------------------------------------|-------------------------|
| 101.CAL                   | XBRL Calculation Linkbase Document  |                         |
| 101.DEF                   | XBRL Definition Linkbase Document   |                         |
| 101.LAB                   | XBRL Label Linkbase Document        |                         |
| 101.PRE                   | XBRL Presentation Linkbase Document |                         |

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

LANNETT COMPANY, INC.

Date: August 29, 2014

By: /s/ Arthur P. Bedrosian  
Arthur P. Bedrosian,  
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Date: August 29, 2014

By: /s/ Martin P. Galvan  
Martin P. Galvan  
Vice President of Finance, Chief Financial Officer and  
Treasurer

Date: August 29, 2014

By: /s/ G. Michael Landis  
G. Michael Landis  
Director of Financial Reporting and Principal Accounting  
Officer

Date: August 29, 2014

By: /s/ Jeffrey Farber  
Jeffrey Farber,  
Director, Chairman of the Board of Directors

Date: August 29, 2014

By: /s/ Arthur P. Bedrosian  
Arthur P. Bedrosian,  
Director, President and Chief Executive Officer

Date: August 29, 2014

By: /s/ David Drabik  
David Drabik,  
Director, Chairman of Governance and Nominating Committee

Date: August 29, 2014

By: /s/ Paul Taveira  
Paul Taveira,  
Director, Chairman of Compensation Committee

Date: August 29, 2014

By: /s/ James M. Maher  
James M. Maher,  
Director, Chairman of Audit Committee





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Supplementary Financial Information**

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**Management's Report on Internal Control over Financial Reporting**

Management of Lannett Company Inc. ( the Company ) is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended. The Company's internal control framework was designed to provide the Company's management, and Board of Directors, reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

Management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *1992 Internal Control-Integrated Framework* in conducting its assessment as of June 30, 2014. As a result of this assessment, management has concluded that, as of June 30, 2014, the Company's internal control over financial reporting is effective.

The Company's independent registered public accounting firm, Grant Thornton, LLP, has issued its report on the effectiveness of the Company's internal control over financial reporting as of June 30, 2014. Grant Thornton, LLP's opinion on the Company's internal control over financial reporting appears on page 78 of this Form 10-K.

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders of

Lannett Company, Inc.

We have audited the accompanying consolidated balance sheets of Lannett Company, Inc. (a Delaware corporation) and Subsidiaries (collectively, the Company) as of June 30, 2014 and 2013, and the related consolidated statements of operations, comprehensive income, changes in stockholders' equity, and cash flows for each of the three fiscal years in the period ended June 30, 2014. Our audits of the basic consolidated financial statements included the financial statement schedules listed in the index appearing under Item 15. These financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Lannett Company, Inc. and Subsidiaries as of June 30, 2014 and 2013 and the results of its operations and its cash flows for each of the three fiscal years in the period ended June 30, 2014 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of June 30, 2014, based on criteria established in *1992 Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated August 29, 2014 expressed an unqualified opinion.

/s/ GRANT THORNTON LLP

Philadelphia, Pennsylvania

August 29, 2014



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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders of

Lannett Company, Inc.

We have audited Lannett Company, Inc. and Subsidiaries (a Delaware Corporation) internal control over financial reporting as of June 30, 2014, based on criteria established in *1992 Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Lannett Company, Inc. and Subsidiaries management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on Lannett Company, Inc. and Subsidiaries internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Lannett Company, Inc. and Subsidiaries maintained, in all material respects, effective internal control over financial reporting as of June 30, 2014, based on criteria established in *1992 Internal Control - Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of the Company as of and for the year ended June 30, 2014, and our report dated August 29, 2014 expressed an unqualified opinion.

/s/ GRANT THORNTON LLP

Philadelphia, Pennsylvania

August 29, 2014

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## LANNETT COMPANY, INC.

## CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

|  | June 30, 2014     | June 30, 2013     |
|--|-------------------|-------------------|
| <b>ASSETS</b>  |                   |                   |
| <b>Current assets:</b>   |                   |                   |
| Cash and cash equivalents  | \$ 105,587        | \$ 42,689         |
| Investment securities  | 40,693            | 8,461             |
| Accounts receivable, net   | 61,325            | 26,413            |
| Inventories, net   | 44,844            | 32,531            |
| Deferred tax assets  | 11,265            | 4,874             |
| Other current assets   | 1,833             | 1,161             |
| Total current assets   | 265,547           | 116,129           |
| <b>Property, plant and equipment, net</b>  | <b>61,704</b>     | <b>40,141</b>     |
| <b>Intangible assets, net</b>  | <b>927</b>        | <b>2,547</b>      |
| <b>Deferred tax assets</b>   | <b>14,234</b>     | <b>8,005</b>      |
| <b>Other assets</b>  | <b>361</b>        | <b>930</b>        |
| <b>TOTAL ASSETS</b>  | <b>\$ 342,773</b> | <b>\$ 167,752</b> |
| <b>LIABILITIES</b>   |                   |                   |
| <b>Current liabilities:</b>  |                   |                   |
| Accounts payable   | \$ 20,982         | \$ 22,668         |
| Accrued expenses   | 3,901             | 1,630             |
| Accrued payroll and payroll-related expenses   | 12,860            | 6,910             |
| Rebates payable  | 4,558             | 1,067             |
| Income taxes payable   | 4,569             | 154               |
| Current portion of long-term debt  | 129               | 670               |
| Total current liabilities  | 46,999            | 33,099            |
| <b>Long-term debt, less current portion</b>  | <b>1,009</b>      | <b>5,844</b>      |
| <b>TOTAL LIABILITIES</b>   | <b>48,008</b>     | <b>38,943</b>     |
| Commitments and Contingencies (Note 12)  |                   |                   |
| <b>STOCKHOLDERS EQUITY</b>   |                   |                   |
| <b>Common stock</b> (\$0.001 par value, 100,000,000 and 50,000,000 shares authorized; 36,088,272 and 29,284,592 shares issued; 35,571,280 and 28,848,679 shares outstanding at June 30, 2014 and 2013, respectively) | 36                | 29                |
| <b>Additional paid-in capital</b>  | <b>216,793</b>    | <b>104,075</b>    |
| <b>Retained earnings</b>   | <b>83,654</b>     | <b>26,553</b>     |
| <b>Accumulated other comprehensive loss</b>  | <b>(54)</b>       | <b>(47)</b>       |
| <b>Treasury stock</b> (516,992 and 435,913 shares at June 30, 2014 and 2013, respectively)   | <b>(5,959)</b>    | <b>(2,034)</b>    |
| Total Lannett Company, Inc. stockholders equity  | 294,470           | 128,576           |
| <b>Noncontrolling Interest</b>   | <b>295</b>        | <b>233</b>        |
| Total stockholders equity  | 294,765           | 128,809           |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>   | <b>\$ 342,773</b> | <b>\$ 167,752</b> |

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





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## LANNETT COMPANY, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except share and per share data)

|   | 2014       | Fiscal Year Ended June 30, |  | 2012       |
|---|------------|----------------------------|--|------------|
|   |            | 2013                       |  |            |
| <b>Net sales</b>  | \$ 273,771 | \$ 151,054                 |  | \$ 122,990 |
| <b>Cost of sales</b>  | 99,263     | 93,634                     |  | 84,043     |
| <b>JSP contract renewal cost</b>  | 20,100     |                            |  |            |
| <b>Gross profit</b>   | 154,408    | 57,420                     |  | 38,947     |
| <b>Operating expenses:</b>  |            |                            |  |            |
| Research and development  | 27,713     | 16,253                     |  | 11,844     |
| Selling, general, and administrative                                    | 38,606     | 22,410                     |  | 20,193     |
| Total operating expenses  | 66,319     | 38,663                     |  | 32,037     |
| <b>Operating income</b>   | 88,089     | 18,757                     |  | 6,910      |
| <b>Other income (expense):</b>  |            |                            |  |            |
| Foreign currency gain (loss)  | 1          | 3                          |  | (62)       |
| Gain (loss) on sale of assets   | (142)      | 111                        |  | 4          |
| Gain (loss) on investment securities                                    | 1,907      | 699                        |  | (103)      |
| Litigation settlement   |            | 1,250                      |  |            |
| Interest and dividend income  | 295        | 116                        |  | 142        |
| Interest expense  | (130)      | (251)                      |  | (273)      |
| Total other income (expense)  | 1,931      | 1,928                      |  | (292)      |
| <b>Income before income taxes</b>                                       | 90,020     | 20,685                     |  | 6,618      |
| <b>Income tax expense</b>   | 32,857     | 7,303                      |  | 2,600      |
| <b>Net income</b>   | 57,163     | 13,382                     |  | 4,018      |
| Less: Net income attributable to noncontrolling interest                | 62         | 65                         |  | 70         |
| <b>Net income attributable to Lannett Company, Inc.</b>                 | \$ 57,101  | \$ 13,317                  |  | \$ 3,948   |
| <b>Earnings per common share attributable to Lannett Company, Inc.:</b> |            |                            |  |            |
| Basic   | \$ 1.70    | \$ 0.47                    |  | \$ 0.14    |
| Diluted   | \$ 1.62    | \$ 0.46                    |  | \$ 0.14    |
| <b>Weighted average common shares outstanding:</b>                      |            |                            |  |            |
| Basic   | 33,663,589 | 28,467,598                 |  | 28,263,335 |
| Diluted   | 35,193,376 | 28,942,933                 |  | 28,408,432 |

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

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## LANNETT COMPANY, INC.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

|  | 2014             | Fiscal Year Ended June 30,<br>2013 | 2012            |
|--|------------------|------------------------------------|-----------------|
| <b>Net income</b>  | \$ 57,163        | \$ 13,382                          | \$ 4,018        |
| <b>Other comprehensive income (loss), before taxes:</b>                  |                  |                                    |                 |
| Foreign currency translation gain (loss)                                 | (7)              | 16                                 | (85)            |
| Unrealized holding loss on investment securities                         |                  |                                    | (3)             |
| Total other comprehensive income (loss), before taxes                    | (7)              | 16                                 | (88)            |
| Income tax related to items of other comprehensive income                |                  |                                    | 1               |
| Total other comprehensive income (loss), net of taxes                    | (7)              | 16                                 | (87)            |
| <b>Comprehensive income</b>  | <b>57,156</b>    | <b>13,398</b>                      | <b>3,931</b>    |
| Less: Total comprehensive income attributable to noncontrolling interest | 62               | 65                                 | 70              |
| <b>Comprehensive income attributable to Lannett Company, Inc.</b>        | <b>\$ 57,094</b> | <b>\$ 13,333</b>                   | <b>\$ 3,861</b> |

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

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## LANNETT COMPANY, INC.

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(In thousands)

|   | Common Stock  |        | Stockholders' Equity Attributable to Lannett Company Inc. |                   |   |                | Stockholders' Equity              |        | Noncontrolling Interest | Total Stockholders' Equity |
|---|---------------|--------|---|-------------------|---|----------------|-----------------------------------|--------|-------------------------|----------------------------|
|   | Shares Issued | Amount | Additional Paid-In Capital                                | Retained Earnings | Accumulated Other Comprehensive Income (loss) | Treasury Stock | Attributable to Lannett Co., Inc. |        |                         |                            |
| <b>Balance, July 1, 2011</b>                                    | 28,404        | \$ 28  | \$ 97,082   | \$ 9,288          | \$ 24   | \$ (872)       | \$ 105,550                        | \$ 139 | \$ 105,689              |                            |
| Shares issued in connection with share-based compensation plans | 190           | 1      | 271   |                   |   |                | 272                               |        | 272                     |                            |
| Share-based compensation  |               |        | 2,162   |                   |   |                | 2,162                             |        | 2,162                   |                            |
| Purchase of treasury stock                                      |               |        |   |                   |   | (722)          | (722)                             |        | (722)                   |                            |
| Distribution to noncontrolling interest                         |               |        |   |                   |   |                |                                   | (19)   | (19)                    |                            |
| Other comprehensive loss, net of income tax                     |               |        |   |                   | (87)  |                | (87)                              |        | (87)                    |                            |
| Net income  |               |        |   | 3,948             |   |                | 3,948                             | 70     | 4,018                   |                            |
| <b>Balance, June 30, 2012</b>                                   | 28,594        | \$ 29  | \$ 99,515   | \$ 13,236         | \$ (63)                                       | \$ (1,594)     | \$ 111,123                        | \$ 190 | \$ 111,313              |                            |
| Shares issued in connection with share-based compensation plans | 691           |        | 3,083   |                   |   |                | 3,083                             |        | 3,083                   |                            |
| Share-based compensation  |               |        | 1,477   |                   |   |                | 1,477                             |        | 1,477                   |                            |
| Purchase of treasury stock                                      |               |        |   |                   |   | (440)          | (440)                             |        | (440)                   |                            |
| Distribution to noncontrolling interests                        |               |        |   |                   |   |                |                                   | (22)   | (22)                    |                            |
| Other comprehensive income, net of income tax                   |               |        |   |                   | 16  |                | 16                                |        | 16                      |                            |
| Net income  |               |        |   | 13,317            |   |                | 13,317                            | 65     | 13,382                  |                            |
| <b>Balance, June 30, 2013</b>                                   | 29,285        | \$ 29  | \$ 104,075  | \$ 26,553         | \$ (47)                                       | \$ (2,034)     | \$ 128,576                        | \$ 233 | \$ 128,809              |                            |
| Shares issued in connection with share-based compensation plans | 1,053         | 1      | 5,368   |                   |   |                | 5,369                             |        | 5,369                   |                            |
| Share-based compensation  |               |        | 9,026   |                   |   |                | 9,026                             |        | 9,026                   |                            |
|   | 1,500         | 2      | 20,098  |                   |   |                | 20,100                            |        | 20,100                  |                            |

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|   |               |              |                   |                  |                |                   |                   |               |           |                |
|---|---------------|--------------|-------------------|------------------|----------------|-------------------|-------------------|---------------|-----------|----------------|
| Shares issued in connection with the JSP contract renewal |               |              |                   |                  |                |                   |                   |               |           |                |
| Shares issued in connection with stock offering           | 4,250         | 4            | 71,474            |                  |                |                   | 71,478            |               |           | 71,478         |
| Excess tax benefits on share-based compensation awards    |               |              | 6,752             |                  |                |                   | 6,752             |               |           | 6,752          |
| Purchase of treasury stock                                |               |              |                   |                  |                | (3,925)           | (3,925)           |               |           | (3,925)        |
| Other comprehensive loss, net of income tax               |               |              |                   |                  |                | (7)               | (7)               |               |           | (7)            |
| Net income  |               |              | 57,101            |                  |                |                   | 57,101            | 62            |           | 57,163         |
| <b>Balance, June 30, 2014</b>                             | <b>36,088</b> | <b>\$ 36</b> | <b>\$ 216,793</b> | <b>\$ 83,654</b> | <b>\$ (54)</b> | <b>\$ (5,959)</b> | <b>\$ 294,470</b> | <b>\$ 295</b> | <b>\$</b> | <b>294,765</b> |

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

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## LANNETT COMPANY, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

|  | Fiscal Year Ended June 30, |                  |                  |
|--|----------------------------|------------------|------------------|
|  | 2014                       | 2013             | 2012             |
| <b>OPERATING ACTIVITIES:</b>   |                            |                  |                  |
| Net income   | \$ 57,163                  | \$ 13,382        | \$ 4,018         |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |                            |                  |                  |
| Depreciation and amortization  | 5,984                      | 6,198            | 5,735            |
| Deferred income tax expense (benefit)  | (12,886)                   | 783              | 1,082            |
| Share-based compensation   | 9,026                      | 1,477            | 2,162            |
| Excess tax benefits on share-based compensation awards                                   | (7,017)                    | (240)            |                  |
| Loss (gain) on sale of assets  | 142                        | (111)            | (4)              |
| Loss (gain) on investment securities   | (1,907)                    | (699)            | 103              |
| JSP contract renewal cost  | 20,100                     |                  |                  |
| Other noncash expenses   | 111                        | 16               | 15               |
| <b>Changes in assets and liabilities which provided (used) cash:</b>                     |                            |                  |                  |
| Trade accounts receivable  | (34,912)                   | 173              | (6,285)          |
| Inventories  | (12,313)                   | (5,467)          | (161)            |
| Income taxes payable   | 11,432                     | 2,514            | 1,516            |
| Prepaid expenses and other assets  | 154                        | 317              | (110)            |
| Rebates payable  | 3,491                      | (345)            | 1,012            |
| Accounts payable   | (1,686)                    | 4,679            | (389)            |
| Accrued expenses   | 2,271                      | 111              | 164              |
| Accrued payroll and payroll related  | 5,950                      | 3,712            | 2,263            |
| Net cash provided by operating activities  | 45,103                     | 26,500           | 11,121           |
| <b>INVESTING ACTIVITIES:</b>   |                            |                  |                  |
| Purchases of property, plant and equipment   | (26,082)                   | (7,788)          | (5,237)          |
| Proceeds from sale of property, plant and equipment                                      | 48                         | 279              | 7                |
| Proceeds from sale of investment securities  | 23,374                     | 22,456           | 35,910           |
| Purchase of investment securities  | (53,699)                   | (23,550)         | (23,301)         |
| Net cash provided by (used in) investing activities                                      | (56,359)                   | (8,603)          | 7,379            |
| <b>FINANCING ACTIVITIES:</b>   |                            |                  |                  |
| Repayments of debt   | (5,376)                    | (647)            | (661)            |
| Proceeds from issuance of stock in connection with share-based compensation plans        | 5,369                      |                  |                  |
| Excess tax benefits on share-based compensation awards                                   | 7,017                      | 240              |                  |
| Proceeds from issuance of stock  | 71,478                     | 3,083            | 272              |
| Deferred financing fees  | (402)                      |                  |                  |
| Purchase of treasury stock   | (3,925)                    | (440)            | (722)            |
| Distribution to noncontrolling interest  |                            | (22)             | (19)             |
| Net cash provided by (used in) financing activities                                      | 74,161                     | 2,214            | (1,130)          |
| Effect on cash and cash equivalents of changes in foreign exchange rates                 | (7)                        | 16               | (85)             |
| <b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>   | <b>62,898</b>              | <b>20,127</b>    | <b>17,285</b>    |
| <b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>                                    | <b>42,689</b>              | <b>22,562</b>    | <b>5,277</b>     |
| <b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>  | <b>\$ 105,587</b>          | <b>\$ 42,689</b> | <b>\$ 22,562</b> |
| <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>                                 |                            |                  |                  |

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|                   |    |        |    |       |    |     |
|-------------------|----|--------|----|-------|----|-----|
| Interest paid     | \$ | 130    | \$ | 251   | \$ | 272 |
| Income taxes paid | \$ | 34,311 | \$ | 4,006 | \$ | 1   |

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

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**LANNETT COMPANY, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. The Business And Nature of Operations**

Lannett Company, Inc. (a Delaware corporation) and subsidiaries (the Company or Lannett) develop, manufacture, package, market, and distribute solid oral (tablets and capsules), extended release, topical, and oral solution finished dosage forms of drugs, that address a wide range of therapeutic areas. The Company also manufactures active pharmaceutical ingredients through its Cody Laboratories, Inc. (Cody Labs) subsidiary, providing a vertical integration benefit. Additionally, the Company distributes products under various distribution agreements, most notably the Jerome Stevens Distribution Agreement.

The Company operates pharmaceutical manufacturing plants in Philadelphia, Pennsylvania and Cody, Wyoming. Customers of the Company's pharmaceutical products include generic pharmaceutical distributors, drug wholesalers, chain drug stores, private label distributors, mail-order pharmacies, other pharmaceutical manufacturers, managed care organizations, hospital buying groups, governmental entities and health maintenance organizations.

**Note 2. Summary of Significant Accounting Policies**

***Principles of consolidation***

The Consolidated Financial Statements include the accounts of Lannett Company, Inc., and its wholly owned subsidiaries, as well as Cody LCI Realty, LLC (Realty), a variable interest entity (VIE) in which the Company has a 50% ownership interest. Noncontrolling interest in Realty is recorded net of tax as net income attributable to the noncontrolling interest. Additionally, all intercompany accounts and transactions have been eliminated.

***Reclassifications***

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

***Use of estimates***

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates and assumptions are required in the determination of revenue recognition and sales deductions for estimated chargebacks, rebates, returns and other adjustments including a provision for the Company's liability under the Medicare Part D program. Additionally, significant estimates and assumptions are required when determining the fair value of long-lived assets, income taxes, contingencies, and share-based compensation. Because of the inherent subjectivity and complexity involved in these estimates and assumptions, actual results could differ from those estimates.

***Foreign currency translation***

The Consolidated Financial Statements are presented in U.S. Dollars, the reporting currency of the Company. The financial statements of the Company's foreign subsidiary are maintained in local currency and translated into U.S. dollars at the end of each reporting period. Assets and liabilities are translated at period-end exchange rates, while revenues and expenses are translated at average exchange rates during the period. The adjustments resulting from the use of differing exchange rates are recorded as part of stockholders' equity in accumulated comprehensive income (loss). Gains and losses resulting from transactions denominated in foreign currencies are recognized in the Consolidated Statements of Operations under Other income (expense). Amounts recorded due to foreign currency fluctuations are immaterial to the consolidated financial statements.

***Cash and cash equivalents***

The Company considers all highly liquid investments with original maturities less than or equal to three months at the date of purchase to be cash and cash equivalents. Cash and cash equivalents are stated at cost, which approximates fair value, and consist of bank deposits and certificates of deposit that are readily convertible into cash. The Company maintains its cash deposits and cash equivalents at well-known, stable financial institutions. Such amounts frequently exceed insured limits.



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***Investment securities***

The Company's investment securities consist of publicly traded equity securities and certificates of deposit with original maturities greater than three months which are classified as trading investments. Investment securities are recorded at fair value based on quoted market prices from broker or dealer quotations or transparent pricing sources at each reporting date. Gains and losses are included in the Consolidated Statements of Operations under Other income (expense).

***Allowance for doubtful accounts***

The Company continuously monitors collections and payments from its customers and maintains a provision for estimated credit losses. The Company determines its allowance for doubtful accounts by considering a number of factors, including the length of time balances 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 be uncollectible.

***Inventories***

Inventories are stated at the lower of cost or market determined by the first-in, first-out method. Inventories are regularly reviewed and provisions for excess and obsolete inventory are recorded based primarily on current inventory levels and estimated sales forecasts.

***Property, Plant and Equipment***

Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation is computed on a straight-line basis over the assets estimated useful lives. Depreciation expense for the fiscal years ended June 30, 2014, 2013, and 2012 was \$4.6 million, \$4.3 million and \$3.9 million, respectively.

***Intangible Assets***

Intangible assets are stated at cost less accumulated amortization. Amortization is computed on a straight-line basis over the assets' 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. Indefinite-lived and 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. Costs to renew or extend the term of a recognized intangible asset are expensed as incurred. The Company has one indefinite-lived intangible asset related to a product Abbreviated New Drug Application (ANDA), valued at \$149 thousand. Amortization on this indefinite-lived intangible will begin at such time as the Company begins shipping the product and determines a finite useful life.

**Segment Information**

The Company operates one reportable segment, generic pharmaceuticals. As such, the Company aggregates its financial information for all products. The following table identifies the Company's net sales by medical indication for fiscal years ended June 30, 2014, 2013 and 2012:

| <b>(In thousands)</b>     | <b>Fiscal Year Ended June 30,</b> |                   |                   |
|---------------------------|-----------------------------------|-------------------|-------------------|
| <b>Medical Indication</b> | <b>2014</b>                       | <b>2013</b>       | <b>2012</b>       |
| Antibiotic                | \$ 13,572                         | \$ 9,167          | \$ 6,724          |
| Cardiovascular            | 62,121                            | 25,876            | 18,142            |
| Gallstone                 | 6,578                             | 6,114             | 5,991             |
| Glaucoma                  | 11,987                            | 6,410             | 4,252             |
| Gout                      | 10,822                            | 5,092             | 484               |
| Migraine                  | 14,527                            | 5,418             | 5,971             |
| Obesity                   | 4,032                             | 4,721             | 3,755             |
| Pain Management           | 27,174                            | 21,232            | 20,870            |
| Thyroid Deficiency        | 102,248                           | 57,978            | 50,849            |
| Other                     | 20,710                            | 9,046             | 5,952             |
| <b>Total</b>              | <b>\$ 273,771</b>                 | <b>\$ 151,054</b> | <b>\$ 122,990</b> |

Table of Contents***Customer, Supplier and Product Concentration***

The following table presents the percentage of total net sales, for the fiscal years ended June 30, 2014, 2013 and 2012, for certain of the Company's products, defined as products containing the same active ingredient or combination of ingredients, which accounted for at least 10% of net sales in any of those periods:

|           | <b>June 30,<br/>2014</b> | <b>June 30,<br/>2013</b> | <b>June 30,<br/>2012</b> |
|-----------|--------------------------|--------------------------|--------------------------|
| Product 1 | 37%                      | 38%                      | 41%                      |
| Product 2 | 20%                      | 8%                       | 9%                       |
| Product 3 | 8%                       | 10%                      | 8%                       |

The following table presents the percentage of total net sales, for the fiscal years ended June 30, 2014, 2013 and 2012, for certain of the Company's customers which accounted for at least 10% of net sales in any of those periods:

|            | <b>June 30,<br/>2014</b> | <b>June 30,<br/>2013</b> | <b>June 30,<br/>2012</b> |
|------------|--------------------------|--------------------------|--------------------------|
| Customer A | 19%                      | 12%                      | 11%                      |
| Customer B | 13%                      | 17%                      | 18%                      |
| Customer C | 9%                       | 10%                      | 12%                      |

At June 30, 2014 and June 30, 2013, four customers accounted for 67% and 78%, respectively of the Company's net accounts receivable balance, respectively. Credit terms are offered to customers based on evaluations of the customers' financial condition and collateral is generally not required.

The Company's primary finished product inventory supplier is Jerome Stevens Pharmaceuticals, Inc. ( JSP ), in Bohemia, New York. Purchases of finished goods inventory from JSP accounted for 62%, 60% and 64% of the Company's inventory purchases in fiscal year 2014, 2013 and 2012, respectively. See Note 19 Material Contracts with Suppliers for more information.

***Revenue Recognition***

The Company recognizes revenue when title and risk of loss have transferred to the customer and provisions for rebates, promotional adjustments, price adjustments, returns, chargebacks, and other potential adjustments are reasonably determinable. The Company also considers all other relevant criteria specified in Securities and Exchange Commission Staff Accounting Bulletin No. 104, Topic No. 13, Revenue Recognition, in determining when to recognize revenue.

*Net Sales Adjustments*

When revenue is recognized a simultaneous adjustment to revenue is made for chargebacks, rebates, returns, promotional adjustments, and other potential adjustments. These provisions are primarily estimated based on historical experience, future expectations, contractual arrangements with wholesalers and indirect customers, and other factors known to management at the time of accrual. Accruals for provisions are presented in the Consolidated Financial Statements as a reduction to gross sales with the corresponding reserve presented as a reduction of accounts receivable or included as rebates payable, depending on the nature of the reserve. The reserves, presented as a reduction of accounts receivable, totaled \$51.9 million and \$17.5 million at June 30, 2014 and 2013, respectively. Rebates payable at June 30, 2014 and 2013 included \$4.6 million and \$1.0 million, respectively, for certain rebate programs, primarily related to Medicare Part D and Medicaid, and certain sales allowances and other adjustments paid to indirect customers.

*Cost of Sales*

Cost of sales includes all costs related to bringing products to their final selling destination, which includes direct and indirect costs, such as direct material, labor, and overhead expenses. Additionally, cost of sales includes product royalties, depreciation, amortization and costs to renew and extend recognized intangible assets, freight charges and other shipping and handling expenses.

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***Research and Development***

Research and development costs are expensed as incurred, including all production costs until a drug candidate is approved by the FDA. Research and development expenses include costs associated with internal projects as well as costs associated with third-party research and development contracts.

***Valuation of Long-Lived Assets***

The Company's long-lived assets primarily consist of property, plant and equipment as well as definite-lived intangible assets. Long-lived assets are reviewed for impairment whenever events or changes in circumstances ( triggering events ) indicate that the carrying amount of the asset may not be recoverable. If a triggering event is determined to have occurred the first step in the impairment test is to compare the asset's carrying value to the future undiscounted cash flows expected to be generated by the asset. If the carrying value exceeds the undiscounted cash flow of the asset then impairment exists. An impairment loss is measured as the excess of the asset's carrying value over its fair value, which in most cases is calculated using a discounted cash flow model. Discounted cash flow models are highly reliant on various assumptions which are considered Level 3 inputs, including estimates of future cash flows (including long-term growth rates), discount rates, and the probability of achieving the estimated cash flows.

***Contingencies***

Loss contingencies, including litigation related contingencies, are included in the Consolidated Statements of Operations when the Company concludes that a loss is both probable and reasonably estimable. Legal fees related to litigation-related matters are expensed as incurred and included in the Consolidated Statements of Operations under the Selling, general and administrative line item.

***Share-based Compensation***

Share-based compensation costs are recognized over the vesting period, using a straight-line method, 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 stock price on the grant date to value restricted stock. The Black-Scholes valuation model includes various assumptions, including the expected volatility, the expected life of the award, dividend yield, and the risk-free interest rate. 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.

***Income Taxes***

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The Company uses the asset and liability method to account for income taxes as prescribed by Accounting Standards Codification ( ASC ) 740, 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. Deferred income tax assets and liabilities are adjusted to recognize the effects of changes in tax laws or enacted tax rates in the period during which they are signed into law.

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 Financial Accounting Standards Board ( 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. Under ASC 740, Income Taxes, a valuation allowance is required when it is more likely than not that all or some portion of the deferred tax assets will not be realized through generating sufficient future taxable income. 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.

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***Earnings Per Common Share***

Basic earnings per common share attributable to Lannett Company, Inc. is computed by dividing net income attributable to Lannett Company, Inc. common stockholders by the weighted average number of shares outstanding during the period. Diluted earnings per common share attributable to Lannett Company, Inc. is computed by dividing net income attributable to Lannett Company, Inc. common stockholders by the weighted average number of shares outstanding during the period including additional shares that would have been outstanding related to potentially dilutive securities. Anti-dilutive securities are excluded from the calculation. These potentially dilutive securities primarily consist of stock options and unvested restricted stock.

***Comprehensive Income (Loss)***

Comprehensive income (loss) includes all changes in equity during a period except those that resulted from investments by or distributions to a company's stockholders. Other comprehensive income or loss refers to revenues, expenses, gains and losses that are included in comprehensive income (loss), but excluded from net income as these amounts are recorded directly as an adjustment to stockholders' equity.

***Recent Accounting Pronouncements***

In May 2014, the FASB issued authoritative guidance on revenue recognition. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The authoritative guidance is effective for annual reporting periods beginning after December 15, 2016. Early application is not permitted. The Company is currently in the process of assessing the impact this guidance will have on the consolidated financial statements.

Table of Contents**Note 3. Accounts Receivable**

Accounts receivable consisted of the following components at June 30, 2014 and 2013:

| (In thousands)                       | June 30,<br>2014 | June 30,<br>2013 |
|--------------------------------------|------------------|------------------|
| Gross accounts receivable            | \$ 113,420       | \$ 43,923        |
| Less Chargebacks reserve             | (30,320)         | (7,267)          |
| Less Rebates reserve                 | (10,532)         | (2,513)          |
| Less Returns reserve                 | (9,341)          | (6,689)          |
| Less Other deductions                | (1,787)          | (1,000)          |
| Less Allowance for doubtful accounts | (115)            | (41)             |
| Account receivable, net              | \$ 61,325        | \$ 26,413        |

For the fiscal year ended June 30, 2014, the Company recorded a provision for chargebacks, rebates, returns, and other deductions of \$144.6 million, \$56.3 million, \$6.6 million, and \$21.5 million, respectively. For the fiscal year ended June 30, 2013, the Company recorded a provision for chargebacks, rebates, returns, and other deductions of \$67.9 million, \$23.7 million, \$4.5 million, and \$10.2 million, respectively. For the fiscal year ended June 30, 2012, the Company recorded a provision for chargebacks, rebates, returns, and other deductions of \$68.4 million, \$21.2 million, \$4.7 million, and \$6.8 million, respectively.

**Note 4. Inventories**

Inventories, net of allowances, at June 30, 2014 and 2013 consisted of the following:

| (In thousands)     | June 30,<br>2014 | June 30,<br>2013 |
|--------------------|------------------|------------------|
| Raw Materials      | \$ 19,767        | \$ 14,224        |
| Work-in-process    | 5,440            | 3,122            |
| Finished Goods     | 17,592           | 13,133           |
| Packaging Supplies | 2,045            | 2,052            |
| Total              | \$ 44,844        | \$ 32,531        |

During the fiscal years ended June 30, 2014, 2013 and 2012, the Company recorded provisions for excess and obsolete inventory of \$2.9 million, \$876 thousand and \$1.7 million, respectively. The reserve for excess and obsolete inventory was \$2.4 million and \$2.0 million at June 30, 2014 and 2013, respectively.

**Note 5. Property, Plant and Equipment**



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Property, plant and equipment at June 30, 2014 and 2013 consisted of the following:

| (In thousands)                       | Useful Lives  | June 30,<br>2014 | June 30,<br>2013 |
|--------------------------------------|---------------|------------------|------------------|
| Land                                 |               | \$ 4,641         | \$ 1,350         |
| Building and improvements            | 10 - 39 years | 42,013           | 32,992           |
| Machinery and equipment              | 5 - 10 years  | 37,678           | 32,620           |
| Furniture and fixtures               | 5 - 7 years   | 1,416            | 1,290            |
| Construction in progress             |               | 11,454           | 2,892            |
| Property, plant and equipment, gross |               | 97,202           | 71,144           |
| Less accumulated depreciation        |               | (35,498)         | (31,003)         |
| Property, plant and equipment, net   |               | \$ 61,704        | \$ 40,141        |

During the fiscal years ended June 30, 2014, 2013 and 2012, the Company had no impairment charges. Property, plant and equipment, net included amounts held in foreign countries in the amount of \$1.1 million and \$1.3 million at June 30, 2014 and 2013, respectively.

Table of Contents**Note 6. Fair Value Measurements**

The Company's financial instruments recorded in the Consolidated Balance Sheets include cash and cash equivalents, accounts receivable, investment securities, accounts payable, accrued expenses, and debt obligations. Included in cash and cash equivalents are certificates of deposit with maturities less than or equal to three months at the date of purchase and money market funds. 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 their maturity dates. The carrying amount of the Company's debt obligations approximates fair value based on current interest rates available to the Company on similar debt obligations.

The Company follows the authoritative guidance of ASC Topic 820 Fair Value Measurements and Disclosures. 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. The Company's financial assets and liabilities measured at fair value are entirely within Level 1 of the hierarchy as defined below:

Level 1 Quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity can access at the measurement date.

Level 2 Directly or indirectly observable inputs, other than quoted 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.

Level 3 Unobservable inputs that are supported by little or no market activity and that are material to the fair value of the asset or liability. 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 are examples of Level 3 assets and liabilities.

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 Company's financial assets and liabilities measured at fair value at June 30, 2014 and June 30, 2013 were as follows:

| (In thousands)          | June 30, 2014 |         |         | Total     |
|-------------------------|---------------|---------|---------|-----------|
|                         | Level 1       | Level 2 | Level 3 |           |
| <b><u>Assets</u></b>    |               |         |         |           |
| Equity securities       | \$ 15,193     | \$      | \$      | \$ 15,193 |
| Certificates of Deposit | 25,500        |         |         | 25,500    |

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Total Investment Securities \$ 40,693 \$ 40,693

| (In thousands)              | June 30, 2013 |         |         | Total    |
|-----------------------------|---------------|---------|---------|----------|
|                             | Level 1       | Level 2 | Level 3 |          |
| <b>Assets</b>               |               |         |         |          |
| Equity securities           | \$ 8,461      | \$      | \$      | \$ 8,461 |
| Total Investment Securities | \$ 8,461      | \$      | \$      | \$ 8,461 |

**Note 7. Investment Securities**

The Company uses the specific identification method to determine the cost of securities sold, which consisted entirely of securities classified as trading.

The Company had a net gain on investment securities of \$1.9 million during the fiscal year ended June 30, 2014, which included an unrealized gain related to securities still held at June 30, 2014 of \$745 thousand.

The Company had a net gain on investment securities during the fiscal year ended June 30, 2013 of \$699 thousand, which included an unrealized gain related to securities still held at June 30, 2013 of \$75 thousand.

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The Company had a net loss on investment securities of \$103 thousand during the fiscal year ended June 30, 2012, which included an unrealized loss related to securities still held at June 30, 2012 of \$204 thousand.

**Note 8. Intangible Assets**

Intangible assets, net as of June 30, 2014 and 2013, consisted of the following:

| (In thousands)                        | Gross Carrying Amount |                  | Accumulated Amortization |                  | Intangible Assets, Net |                  |
|---------------------------------------|-----------------------|------------------|--------------------------|------------------|------------------------|------------------|
|                                       | June 30,<br>2014      | June 30,<br>2013 | June 30,<br>2014         | June 30,<br>2013 | June 30,<br>2014       | June 30,<br>2013 |
| JSP Marketing and Distribution Rights | \$ 16,062             | \$ 16,062        | \$ (16,062)              | \$ (14,723)      | \$                     | \$ 1,339         |
| Cody Labs Import License              | 582                   | 582              | (232)                    | (193)            | 350                    | 389              |
| Morphine Sulfate Oral Solution NDA    | 202                   | 398              | (65)                     | (51)             | 137                    | 347              |
| Other ANDA Product Rights(A)          | 600                   | 600              | (160)                    | (128)            | 440                    | 472              |
|                                       | \$ 17,446             | \$ 17,642        | \$ (16,519)              | \$ (15,095)      | \$ 927                 | \$ 2,547         |

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

For the fiscal years ended June 30, 2014, 2013 and 2012, the Company recorded amortization expense of \$1.4 million, \$1.9 million, and \$1.9 million, respectively. There were no impairments related to intangible assets during fiscal year 2014, 2013 and 2012.

On September 30, 2013, the Company received a letter from the FDA indicating that a portion of the nonrefundable Morphine Sulfate Oral Solution NDA fee, originally estimated at \$398 thousand, would be refunded to the Company. As a result of this letter, the Company adjusted the carrying value of the Morphine Sulfate Oral Solution NDA intangible asset. Further adjustments to the Morphine Sulfate Oral Solution NDA intangible asset may be necessary in the future should the Company receive additional refunds.

Future annual amortization expense consists of the following:

| (In thousands)              | Annual Amortization Expense |
|-----------------------------|-----------------------------|
| Fiscal Year Ending June 30, |                             |
| 2015                        | \$ 82                       |
| 2016                        | 82                          |
| 2017                        | 82                          |
| 2018                        | 82                          |

|            |    |     |
|------------|----|-----|
| 2019       |    | 79  |
| Thereafter |    | 371 |
|            | \$ | 778 |

**Note 9. Bank Line of Credit**

In December 2013, the Company entered into a credit agreement (the "Citibank Line of Credit") with Citibank, N.A., as administrative agent, and another financial institution. The Citibank Line of Credit provides for a revolving loan commitment in the amount of up to \$50.0 million. Any loans under the Citibank Line of Credit will bear interest at either a Eurodollar Rate or a Base Rate plus a specified margin. The Company is also required to pay a commitment fee on any undrawn commitments under the Citibank Line of Credit ranging from 0.2% - 0.3% per annum according to the average daily balance of borrowings under the agreement. The Citibank Line of Credit is collateralized by substantially all of the Company's assets. In connection with securing the Citibank Line of Credit, the Company repaid substantially all of its outstanding debt. See Note 10 Long-Term Debt for more information. As of June 30, 2014, the Company had \$50.0 million available under the Citibank Line of Credit.

The Citibank Line of Credit contains representations and warranties, affirmative, negative and financial covenants, and events of default, applicable to the Company and its subsidiaries which are customary for credit facilities of this type. As of June 30, 2014 the Company was in compliance with all financial covenants.

Table of Contents**Note 10. Long-Term Debt**

Long-term debt consisted of the following:

| (In thousands)   | June 30,<br>2014 | June 30,<br>2013 |
|--|------------------|------------------|
| Pennsylvania Industrial Development Authority loan                   | \$               | \$ 696           |
| Tax-exempt bond loan (PAID)  |                  | 150              |
| Wells Fargo N.A. Townsend Road mortgage                              |                  | 2,614            |
| Pennsylvania Industrial Development Authority Townsend Road mortgage |                  | 1,794            |
| First National Bank of Cody mortgage                                 | 1,138            | 1,260            |
| Total debt   | 1,138            | 6,514            |
| Less current portion   | 129              | 670              |
| Long term debt   | \$ 1,009         | \$ 5,844         |

Current Portion of Long Term Debt:

| (In thousands)   | June 30,<br>2014 | June 30,<br>2013 |
|--|------------------|------------------|
| Pennsylvania Industrial Development Authority loan                   | \$               | \$ 84            |
| Tax-exempt bond loan (PAID)  |                  | 150              |
| Wells Fargo N.A. Townsend Road mortgage                              |                  | 204              |
| Pennsylvania Industrial Development Authority Townsend Road mortgage |                  | 109              |
| First National Bank of Cody mortgage                                 | 129              | 123              |
| Total current portion of long term debt                              | \$ 129           | \$ 670           |

The Company financed \$1.3 million through the Pennsylvania Industrial Development Authority ( PIDA ). In December 2013, the Company repaid, in full, the PIDA loan.

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 \$3.7 million 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 \$170 thousand. In February 2014, the Company repaid, in full, the PAID bond.

The Company negotiated a set of mortgages on its Townsend Road facility with both Wells Fargo and the PIDA. In December 2013, the Company repaid, in full, both mortgages associated with its Townsend Road facility. The Wells Fargo portion of the loan was originally for \$3.1 million, had a floating interest rate of the one month LIBOR rate plus 2.95%, was amortized over a 15 year term and had an 8 year maturity date. The effective interest rate at June 30, 2013 was 3.14%. The PIDA portion of the loan was originally for \$2.0 million, had an interest rate of 3.75% and matured in 15 years. As of June 30, 2013, the Company was in compliance with the financial covenants under the agreements. The Company had also previously executed Security Agreements with Wells Fargo, PIDA and Philadelphia Industrial Development Corporation ( PIDC ) in which the Company had agreed to pledge its working capital, some equipment and its Townsend Road property to collateralize the

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amounts due. These Security Agreements were terminated in December 2013 as a result of the Company's repayment of both mortgages in connection with establishing the Citibank Line of Credit.

The Company is the primary beneficiary to a VIE called Realty. The VIE owns land and a building which is leased to Cody Labs. 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 thousand. As of June 30, 2014 and June 30, 2013, the effective interest rate was 4.5%. The mortgage is collateralized by the land and building with a net book value of \$1.5 million.

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

| (In thousands) | Amounts Payable<br>to Institutions |       |
|----------------|------------------------------------|-------|
| 2015           | \$                                 | 129   |
| 2016           |                                    | 135   |
| 2017           |                                    | 141   |
| 2018           |                                    | 148   |
| 2019           |                                    | 154   |
| Thereafter     |                                    | 431   |
| Total          | \$                                 | 1,138 |

**Note 11. Legal and Regulatory Matters**Richard Asherman

On April 16, 2013, Richard Asherman ( Asherman ), the former President of and a member in Realty, filed a complaint ( Complaint ) in Wyoming state court against the Company and Cody Labs. At the same time, he also filed an application for a temporary restraining order to enjoin certain operations at Cody Labs, claiming, among other things, that Cody Labs is in violation of certain zoning laws and that Cody Labs is required to increase the level of its property insurance and to secure performance bonds for work being performed at Cody Labs. Mr. Asherman claims Cody Labs is in breach of his employment agreement and is required to pay him severance under his employment agreement, including 18 months of base salary, vesting of unvested stock options and continuation of benefits. The Company estimates that the aggregate value of the claimed severance benefits is approximately \$350 thousand to \$400 thousand, plus the value of any stock options. Mr. Asherman also asserts that the Company is in breach of the Realty Operating Agreement and, among other requested remedies, he seeks to have the Company (i) pay him 50% of the value of 1.66 acres of land that Realty previously agreed to donate to an economic development entity associated with the City of Cody, Wyoming, which contemplated transaction has since been avoided and cancelled and (ii) acquire Mr. Asherman's interest in Realty for an unspecified price. Alternatively, Mr. Asherman seeks to dissolve Realty.

The Company strongly disputes the claims in the Amended Complaint, including that the Company is required to acquire Mr. Asherman's interest in Realty. If Mr. Asherman were successful on his claim for breach of his employment agreement, he would be entitled to his contractual severance 18 months salary plus the vesting of certain stock options and continuation of benefits. The amount the Company would be required to pay to Mr. Asherman if he were successful in compelling the buyout of his interest in Realty is dependent upon the value of the real property owned by Realty. If a buyout were required, Realty would become wholly owned by the Company. At this time the Company is unable to reasonably estimate a range or aggregate dollar amount of Mr. Asherman's claims or of any potential loss, if any, to the Company. The Company does not believe that the ultimate resolution of the matter will have a significant impact on the Company's financial position or results of operations.

Connecticut Attorney General Inquiry



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In July 2014, the Company received interrogatories and subpoena from the State of Connecticut Office of the Attorney General concerning its investigation into pricing of digoxin. According to the subpoena, the Connecticut Attorney General is investigating whether anyone engaged in any activities that resulted in (a) fixing, maintaining or controlling prices of digoxin or (b) allocating and dividing customers or territories relating to the sale of digoxin in violation of Connecticut antitrust law. The Company maintains that it acted in compliance with all applicable laws and regulations and intends to cooperate with the Connecticut Attorney General's investigation.

### Class Action - David Schaefer

On August 27, 2014, David Schaefer, as an alleged class representative, filed a class action complaint in the United States District Court, Eastern District of Pennsylvania (14-cv-05008) against the Company and certain of its officers, alleging violations of federal securities laws arising out of statements about the Company made in its securities filings during the period of September 10, 2013 through July 16, 2014. The complaint alleges that the statements were false and misleading because the defendants allegedly knew at the time the statements were made that the Company was in violation of Connecticut antitrust laws relating to its sale of digoxin. The Company believes that the complaint is without merit and intends to vigorously dispute the allegations contained in the complaint. At this time the Company is unable to reasonably estimate a range or aggregate dollar amount of Mr. Schaefer's claims or of any potential loss, if any, to the Company.

### Patent Infringement (Paragraph IV Certification)

There is substantial litigation in the pharmaceutical industry with respect to the manufacture, use, and sale of new products which are the subject of conflicting patent and intellectual property claims. Certain of these claims relate to paragraph IV certifications, which allege that an innovator patent is invalid or would not be infringed upon by the manufacture, use, or sale of the new drug.

### Zomig®

The Company filed with the Food and Drug Administration an Abbreviated New Drug Application (ANDA) No. 206350, along with a paragraph IV certification, alleging that the two patents associated with the Zomig® nasal spray product (U.S. Patent No. 6,750,237 and U.S. Patent No. 6,722,767) are invalid. In July 2014, AstraZeneca AB, AstraZeneca UK Limited, and Impax Laboratories, Inc. filed two patent infringement lawsuits in the United States District Court for the District of Delaware, alleging that the Company's filing of ANDA constitutes an act of patent infringement and seeking a declaration that the two patents at issue are valid and infringed.

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The deadline for filing answers to the complaints is September 3, 2014. Although the ultimate resolution of this matter is unknown, the legal fees associated with this patent challenge may have a significant impact on the Company's financial position or results of operations in future periods.

**Note 12. Commitments and Contingencies***Leases*

The Company leases certain manufacturing and office equipment in the ordinary course of business for initial lease terms not greater than 12 months, which are typically renewed annually. Rental and lease expense was not material for all periods presented. In addition, the Company owns all of its properties.

**Note 13. Accumulated Other Comprehensive Loss**

The Company's Accumulated Other Comprehensive Loss was comprised of the following components as of June 30, 2014 and 2013:

| (In thousands)  | June 30,<br>2014 | June 30,<br>2013 |
|---|------------------|------------------|
| <b>Foreign Currency Translation</b>   |                  |                  |
| Beginning Balance, July 1   | \$ (47)          | \$ (63)          |
| Net gain (loss) on foreign currency translation (net of tax of \$0 and \$0) | (7)              | 16               |
| Reclassifications to net income (net of tax of \$0 and \$0)                 |                  |                  |
| Other comprehensive income (loss), net of tax                               | (7)              | 16               |
| Ending Balance, June 30   | (54)             | (47)             |
| <b>Total Accumulated Other Comprehensive Loss</b>                           | <b>\$ (54)</b>   | <b>\$ (47)</b>   |

**Note 14. 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 potentially dilutive securities and is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted earnings per common share is computed using the treasury stock method and includes the effect of potential dilution from the exercise of outstanding stock options and treats unvested restricted stock as if it were vested. Potentially dilutive securities have been excluded in the weighted average number of common 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 was as follows:

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| (In thousands, except share and per share data)                    | For Fiscal Year Ended June 30, |            |            |
|--|--------------------------------|------------|------------|
|  | 2014                           | 2013       | 2012       |
| Net Income Attributable to Lannett Company, Inc.                   | \$ 57,101                      | \$ 13,317  | \$ 3,948   |
| Basic weighted average common shares outstanding                   | 33,663,589                     | 28,467,598 | 28,263,335 |
| Effect of potentially dilutive options and restricted stock awards | 1,529,787                      | 475,335    | 145,097    |
| Diluted weighted average common shares outstanding                 | 35,193,376                     | 28,942,933 | 28,408,432 |
| Earnings per common share attributable to Lannett Company, Inc.:   |                                |            |            |
| Basic  | \$ 1.70                        | \$ 0.47    | \$ 0.14    |
| Diluted  | \$ 1.62                        | \$ 0.46    | \$ 0.14    |

The number of anti-dilutive shares that have been excluded in the computation of diluted earnings per share for the fiscal years ended June 30, 2014, 2013 and 2012 were 18 thousand, 1.0 million, and 2.3 million, respectively.

Table of Contents**Note 15. Share-based Compensation**

At June 30, 2014, the Company had four share-based employee compensation plans (the 2003 Plan, the 2006 Long-term Incentive Plan ( LTIP ), or 2006 LTIP , the 2011 LTIP and the 2014 LTIP). Together these plans authorized an aggregate total of 8.1 million shares to be issued. The plans have a total of 3.0 million shares available for future issuances.

The Company issues share-based compensation awards with a vesting period ranging up to 3 years and a maximum contractual term of 10 years. The Company issues new shares of stock when stock options are exercised. As of June 30, 2014, there was \$5.0 million of total unrecognized compensation cost related to non-vested share-based compensation awards granted under the Plans. That cost is expected to be recognized over a weighted average period of 2.1 years.

**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 fiscal years ended June 30 and the estimated annual forfeiture rates used to recognize the associated compensation expense:

|                             | June 30,<br>2014 | June 30,<br>2013 | June 30,<br>2012 |
|-----------------------------|------------------|------------------|------------------|
| Risk-free interest rate     | 2.1%             | 1.0%             | 1.1%             |
| Expected volatility         | 62.8%            | 61.6%            | 63.5%            |
| Expected dividend yield     | 0.0%             | 0.0%             | 0.0%             |
| Forfeiture rate             | 7.5%             | 7.5%             | 7.5%             |
| Expected term (in years)    | 5.9 years        | 6.1 years        | 5.2 years        |
| Weighted average fair value | \$8.55           | \$2.53           | \$2.03           |

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. The Company uses historical information to estimate the expected term, which represents the period of time that options granted are expected to be outstanding. The risk-free rate for the period equal to the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. 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. Additionally, the expected dividend yield is equal to zero, as the Company has not historically issued, and has no immediate plans to issue, a dividend.

A summary of stock option award activity under the Plans as of June 30, 2014, 2013 and 2012 and changes during the years then ended, is presented below:

**Weighted**

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| (In thousands, except for weighted average price and life data) | Awards | Weighted-Average Exercise Price | Aggregate Intrinsic Value | Average Remaining Contractual Life (yrs.) |
|---|--------|---------------------------------|---------------------------|---|
| Outstanding at July 1, 2011                                     | 1,946  | \$ 7.57                         |                           |   |
| Granted   | 852    | 3.74                            |                           |   |
| Exercised   | (8)    | 3.21                            | \$ 7                      |   |
| Forfeited, expired or repurchased                               | (43)   | 5.59                            |                           |   |
| Outstanding at June 30, 2012                                    | 2,747  | 6.42                            |                           |   |
| Granted   | 565    | 4.30                            |                           |   |
| Exercised   | (511)  | 5.44                            | \$ 1,825                  |   |
| Forfeited, expired or repurchased                               | (482)  | 8.39                            |                           |   |
| Outstanding at June 30, 2013                                    | 2,319  | 5.71                            |                           |   |
| Granted   | 780    | 13.90                           |                           |   |
| Exercised   | (783)  | 6.41                            | \$ 24,375                 |   |
| Forfeited, expired or repurchased                               | (111)  | 6.49                            |                           |   |
| Outstanding at June 30, 2014                                    | 2,205  | \$ 7.84                         | \$ 92,119                 | 7.4                                       |
| Vested and expected to vest at June 30, 2014                    | 2,115  | \$ 7.69                         | \$ 88,682                 | 7.3                                       |
| Exercisable at June 30, 2014                                    | 854    | \$ 4.97                         | \$ 38,132                 | 5.5                                       |

Table of Contents**Restricted Stock**

The Company measures restricted stock compensation costs based on the stock price at the grant date less an estimate for forfeitures. The annual forfeiture rate used to calculate compensation expense was 7.5% for fiscal years ended June 30, 2014, 2013, and 2012.

A summary of restricted stock awards as of June 30, 2014, 2013, and 2012 and changes during the fiscal years then ended, is presented below:

| (In thousands)              | Awards | Weighted<br>Average Grant -<br>date Fair Value | Aggregate<br>Intrinsic Value |
|-----------------------------|--------|--|------------------------------|
| Non-vested at July 1, 2011  | 155    | \$ 6.94  |                              |
| Granted                     | 35     | 3.62   |                              |
| Vested                      | (113)  | 5.91   | \$ 459                       |
| Forfeited                   | (3)    | 6.94   |                              |
| Non-vested at June 30, 2012 | 74     | 6.94   |                              |
| Granted                     | 38     | 5.06   |                              |
| Vested                      | (110)  | 6.30   | \$ 491                       |
| Forfeited                   | (2)    | 6.94   |                              |
| Non-vested at June 30, 2013 |        |  |                              |
| Granted                     | 269    | 24.07  |                              |
| Vested                      | (252)  | 23.45  | \$ 10,440                    |
| Forfeited                   | (1)    | 24.48  |                              |
| Non-vested at June 30, 2014 | 16     | \$ 34.01                                       |                              |

**Employee Stock Purchase Plan**

In February 2003, the Company's stockholders approved an Employee Stock Purchase Plan ( ESPP ). Employees eligible to participate in the ESPP may purchase shares of the Company's stock at 85% of the lower of the fair market value of the common stock on the first day of the calendar quarter, or the last day of the calendar quarter. Under the ESPP, employees can authorize the Company to withhold up to 10% of their compensation during any quarterly offering period, subject to certain limitations. The ESPP was implemented on April 1, 2003 and is qualified under Section 423 of the Internal Revenue Code. The Board of Directors authorized an aggregate total of 1.1 million shares of the Company's common stock for issuance under the ESPP. During the fiscal year ended June 30, 2014 and 2013, 18 thousand shares and 70 thousand shares were issued under the ESPP, respectively. As of June 30, 2014, 426 thousand total cumulative shares have been issued under the ESPP.

The following table presents the allocation of share-based compensation costs recognized in the Consolidated Statements of Operations by financial statement line item:

| (In thousands)                      | For Fiscal Year Ended June 30, |          |          |
|-------------------------------------|--------------------------------|----------|----------|
|                                     | 2014                           | 2013     | 2012     |
| Selling, general and administrative | \$ 7,388                       | \$ 1,206 | \$ 1,619 |

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|                               |    |       |    |       |    |       |
|-------------------------------|----|-------|----|-------|----|-------|
| Research and development      |    | 675   |    | 99    |    | 252   |
| Cost of sales                 |    | 963   |    | 172   |    | 291   |
| Total                         | \$ | 9,026 | \$ | 1,477 | \$ | 2,162 |
| Tax benefit at statutory rate | \$ | 3,375 | \$ | 169   | \$ | 138   |

**Note 16. Employee Benefit Plan**

The Company has a 401k defined contribution plan (the Plan ) covering substantially all employees. Pursuant to the Plan provisions, the Company is required to make matching contributions equal to 50% of each employee s contribution, not to exceed 4% of the employee s compensation for the Plan year. Contributions to the Plan during the fiscal years ended June 30, 2014, 2013, and 2012 were \$748 thousand, \$603 thousand, and \$426 thousand, respectively.

Table of Contents**Note 17. Income Taxes**

The provision for income taxes consisted of the following for the fiscal years ended June 30:

| (In thousands)                              | June 30,<br>2014 | June 30,<br>2013 | June 30,<br>2012 |
|---|------------------|------------------|------------------|
| Current Income Tax Expense                  |                  |                  |                  |
| Federal                                     | \$ 41,497        | \$ 5,914         | \$ 1,513         |
| State and Local                             | 4,246            | 606              | 5                |
| Total Current Income Tax Expense            | 45,743           | 6,520            | 1,518            |
| Deferred Income Tax Expense (Benefit)       |                  |                  |                  |
| Federal                                     | (11,613)         | 216              | 828              |
| State and Local                             | (1,273)          | 567              | 254              |
| Total Deferred Income Tax Expense (Benefit) | (12,886)         | 783              | 1,082            |
| Total Income Tax Expense                    | \$ 32,857        | \$ 7,303         | \$ 2,600         |

A reconciliation of the differences between the effective rates and federal statutory rates was as follows:

|                                      | June 30,<br>2014 | June 30,<br>2013 | June 30,<br>2012 |
|--------------------------------------|------------------|------------------|------------------|
| Federal income tax at statutory rate | 35.0%            | 34.0%            | 34.0%            |
| State and local income tax, net      | 2.2%             | 2.6%             | 2.6%             |
| Nondeductible expenses               | 0.4%             | (0.2)%           | 5.7%             |
| Foreign rate differential            | 0.2%             | 0.5%             | 2.0%             |
| Income tax credits                   | (0.4)%           | (2.5)%           | (3.6)%           |
| Change in tax laws                   | %                | 1.1%             | %                |
| Other                                | (0.9)%           | (0.2)%           | (1.4)%           |
| Effective income tax rate            | 36.5%            | 35.3%            | 39.3%            |

The principal types of differences between assets and liabilities for financial statement and tax return purposes are accruals, reserves, impairment of intangibles, accumulated amortization, accumulated depreciation and share-based compensation expense. A deferred tax asset is recorded for the future benefits created by the timing of accruals and reserves and the application of different amortization lives for financial statement and tax return purposes. A deferred tax asset valuation allowance is established if it is more likely than not that the Company will be unable to realize certain of the deferred tax assets. A deferred tax liability is recorded for the future liability created by different depreciation methods for financial statement and tax return purposes.



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As of June 30, 2014 and 2013, temporary differences which give rise to deferred tax assets and liabilities were as follows:

| <b>(In thousands)</b>                             | <b>June 30,<br/>2014</b> | <b>June 30,<br/>2013</b> |
|---|--------------------------|--------------------------|
| <b>Deferred tax assets:</b>                       |                          |                          |
| Accrued expenses                                  | \$ 85                    | \$ 61                    |
| Share-based compensation expense                  | 1,261                    | 1,022                    |
| Reserve for returns                               | 3,489                    | 2,431                    |
| Reserves for accounts receivable and inventory    | 8,798                    | 2,995                    |
| Intangible impairment                             | 5,739                    | 6,702                    |
| Federal net operating loss                        | 865                      | 904                      |
| Impairment on Cody note receivable                | 2,018                    | 1,964                    |
| Accumulated amortization on intangible asset      | 9,338                    | 2,316                    |
| Foreign net operating loss                        | 271                      | 176                      |
| Other   | 48                       | 80                       |
| Total deferred tax asset                          | 31,912                   | 18,651                   |
| Valuation allowance                               | (2,289)                  | (2,140)                  |
| Total deferred tax asset less valuation allowance | 29,623                   | 16,511                   |
| <b>Deferred tax liabilities:</b>                  |                          |                          |
| Prepaid expenses                                  | 94                       | 66                       |
| Property, plant and equipment                     | 3,715                    | 3,512                    |
| Other   | 315                      | 54                       |
| Total deferred tax liability                      | 4,124                    | 3,632                    |
| Net deferred tax asset                            | \$ 25,499                | \$ 12,879                |

On April 10, 2007, the Company entered into a Stock Purchase Agreement to acquire Cody by purchasing all of the remaining shares of common stock of Cody. As a result of the acquisition, the Company recorded deferred tax assets related to Cody's federal net operation loss (NOL) carry-forwards totaling \$3.8 million at the date of acquisition with \$1.9 million expiring in 2026 and \$1.9 million in 2027. At June 30, 2014 and 2013, the remaining gross deferred tax asset was \$2.5 million and \$2.7 million, respectively. The income tax benefit associated with the NOL carry forwards has been recognized in accordance with Section 382 of the Internal Revenue Code of 1986.

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 of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, and income tax disclosures.

A reconciliation of the beginning and ending amount of gross unrecognized tax benefits (exclusive of interest and penalties) was as follows:

| <b>(In thousands)</b>                           | <b>Balance</b> |
|---|----------------|
| Balance at July 1, 2012                         | \$ 280         |
| Additions for tax positions of the current year | 62             |
| Additions for tax positions of prior years      | 18             |
| Reductions for tax positions of prior years     |                |

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|   |    |     |
|---|----|-----|
| Settlements                                     |    |     |
| Lapse of statute of limitations                 |    |     |
| Balance at June 30, 2013                        | \$ | 360 |
| Additions for tax positions of the current year |    | 58  |
| Additions for tax positions of prior years      |    | 10  |
| Reductions for tax positions of prior years     |    |     |
| Settlements                                     |    |     |
| Lapse of statute of limitations                 |    |     |
| Balance at June 30, 2014                        | \$ | 428 |

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The cumulative amount of unrecognized tax benefits above that, if recognized, would impact the Company's tax expense and effective tax rate is \$428 thousand, \$360 thousand, and \$280 thousand for the fiscal years ended June 30, 2014, 2013, 2012, respectively.

As of June 30, 2014 and 2013, the Company reported total unrecognized benefits of \$428 thousand and \$360 thousand, respectively. As a result of the positions taken during the period, the Company has not recorded any interest and penalties for the period ended June 30, 2014 in the statement of operations and no cumulative interest and penalties have been recorded either in the Company's statement of financial position as of June 30, 2014 and 2013. The Company will recognize interest accrued on unrecognized tax benefits in interest expense and any related penalties in operating expenses. The Company does not believe that the total unrecognized tax benefits will significantly increase or decrease in the next twelve months.

The Company files income tax returns in the United States federal jurisdiction, Pennsylvania, New Jersey and California. The Company's tax returns for fiscal year 2008 and prior generally are no longer subject to review as such years generally are closed. The Company believes that an unfavorable resolution for open tax years would not be material to the financial position of the Company.

**Note 18. Related Party Transactions**

The Company had sales of \$2.3 million, \$1.3 million and \$757 thousand during the fiscal years ended June 30, 2014, 2013, and 2012, respectively, to a generic distributor, Auburn Pharmaceutical Company ( Auburn ). Jeffrey Farber, Chairman of the Board and the son of William Farber, Chairman Emeritus of the Board and principal stockholder of the Company, is the owner of Auburn. Accounts receivable includes amounts due from Auburn of \$980 thousand and \$200 thousand at June 30, 2014 and 2013, respectively. In the Company's opinion, the terms of these transactions were not more favorable to Auburn than would have been to a non-related party.

**Note 19. Material Contracts with Suppliers**

Jerome Stevens Pharmaceuticals agreement:

The Company's primary finished goods inventory supplier is JSP, in Bohemia, New York. Purchases of finished goods inventory from JSP accounted for 62%, 60% and 64% of the Company's inventory purchases in the fiscal year ending June 30, 2014, 2013 and 2012, respectively.

On March 23, 2004, the Company entered into an agreement with JSP for the exclusive distribution rights in the United States to the current line of JSP products, in exchange for 4.0 million shares of the Company's common stock. The JSP products covered under the agreement included Butalbital, Aspirin, Caffeine with Codeine Phosphate Capsules; Digoxin Tablets; Levothyroxine Sodium Tablets, sold generically and under the brand name Unithroid®. On August 19, 2013, the Company entered into an agreement with JSP to extend its initial contract to continue as the exclusive distributor in the United States of three JSP products: Butalbital, Aspirin, Caffeine with Codeine Phosphate Capsules USP; Digoxin Tablets USP; Levothyroxine Sodium Tablets USP. The amendment to the original agreement extends the initial contract, which was due to expire on March 22, 2014, for five years through March 2019. In connection with the amendment, the Company issued 1.5 million shares of the Company's common stock to JSP and JSP's designees. In accordance with its policy related to renewal and extension costs for recognized

intangible assets, the Company recorded a \$20.1 million expense in cost of sales, which represents the fair value of the shares on August 19, 2013. If the parties agree to a second five year extension from March 23, 2019 to March 23, 2024, the Company is required to issue to JSP or its designees an additional 1.5 million shares of the Company's common stock. Both Lannett and JSP have the right to terminate the contract if one of the parties does not cure a material breach of the contract within thirty (30) days of notice from the non-breaching party.

During the renewal term of the agreement, the Company is required to use commercially reasonable efforts to purchase minimum dollar quantities of JSP products. Specifically, the Company is required to purchase, in the aggregate, \$31 million of products from JSP each year. The Company has met the minimum purchase requirement for the first ten years of the contract, but there is no guarantee that the Company will be able to continue to do so in Fiscal 2015 and in the future. If the Company does not meet the minimum purchase requirements, JSP's sole remedy is to terminate the agreement.

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**Note 20. Cody Expansion Project**

On December 20, 2012, the Company, through its subsidiaries Realty and Cody, entered into an agreement ( the Agreement ) with the City of Cody, Wyoming ( City of Cody ) and Forward Cody Wyoming, Inc. ( Forward Cody ), an unrelated non-profit corporation, which involves the construction of a building of approximately 24,000 square feet (the Project ). As part of the Agreement, Cody was obligated to make an additional capital investment in its existing facilities in the amount of \$5.2 million and create an additional 45 full time positions within three years starting June 30, 2011; Realty was required to contribute 1.66 acres of land to Forward Cody and enter into a 25 year lease agreement with Forward Cody for the Project. Realty will make annual rent payments totaling \$108 thousand beginning on the date a Certificate of Occupancy permit is issued by the City of Cody and the Project is legally available for occupancy. Cody will sublease the property from Realty. Upon the fifth anniversary of occupancy, Realty may, at its discretion, purchase the Project from Forward Cody. The purchase option continues until Realty purchases the Project. Nothing in the Agreement should be deemed to create any relationship between Forward Cody and Realty other than the relationship of landlord and tenant.

In June 2014, the Company amended the Agreement including changing the size of the building, eliminating the requirements to contribute any land, and removing Realty as a party to the agreement. Additionally, Cody Labs is required to provide a capital contribution to the project in the amount of \$565 thousand. None of the revisions are expected to be material to the Company s results of operations or financial position.

**Note 21. Subsequent Events**

Patent Infringement (Paragraph IV Certification)

In July 2014, in response to a paragraph IV certification with respect to the Zomig® nasal spray product, AstraZeneca AB, AstraZeneca UK Limited and Impax Laboratories, Inc. filed two patent infringement complaints against the Company. Refer to Note 11 Legal and Regulatory Matters for additional information.

Connecticut Attorney General Inquiry

In July 2014, the Company received interrogatories and subpoena from the State of Connecticut Office of the Attorney General concerning its investigation into pricing of digoxin. Refer to Note 11 Legal and Regulatory Matters for additional information.

Class Action-David Schaefer

On August 27, 2014, David Schaefer, as an alleged class representative, filed a class action complaint against the Company and certain of its officers. Refer to Note 11 Legal and Regulatory Matters for additional information.



Table of Contents**Note 22. Quarterly Financial Information (Unaudited)**

Lannett's quarterly consolidated results of operations are shown below:

| (In thousands, except per share data)                                     | Fourth<br>Quarter | Third<br>Quarter | Second<br>Quarter | First<br>Quarter |
|---|-------------------|------------------|-------------------|------------------|
| <b>Fiscal 2014</b>  |                   |                  |                   |                  |
| Net sales   | \$ 80,619         | \$ 79,997        | \$ 67,326         | \$ 45,829        |
| Cost of sales   | 24,691            | 23,865           | 26,284            | 44,523           |
| Gross profit  | 55,928            | 56,132           | 41,042            | 1,306            |
| Operating expenses  | 18,577            | 20,143           | 15,675            | 11,924           |
| Operating income (loss)   | 37,351            | 35,989           | 25,367            | (10,618)         |
| Other income  | 220               | 297              | 1,025             | 389              |
| Income tax expense (benefit)  | 14,019            | 13,280           | 9,800             | (4,242)          |
| Less: Net income (loss) attributable to noncontrolling interest           | 17                | 11               | 26                | 8                |
| Net income (loss) attributable to Lannett Company, Inc.                   | \$ 23,535         | \$ 22,995        | \$ 16,566         | \$ (5,995)       |
| Earnings (loss) per common share attributable to Lannett Company Inc. (1) |                   |                  |                   |                  |
| Basic   | \$ 0.66           | \$ 0.66          | \$ 0.48           | \$ (0.20)        |
| Diluted   | \$ 0.64           | \$ 0.63          | \$ 0.46           | \$ (0.20)        |

| (In thousands, except per share data)                              | Fourth<br>Quarter | Third<br>Quarter | Second<br>Quarter | First<br>Quarter |
|--|-------------------|------------------|-------------------|------------------|
| <b>Fiscal 2013</b>   |                   |                  |                   |                  |
| Net sales  | \$ 40,174         | \$ 39,022        | \$ 36,564         | \$ 35,294        |
| Cost of sales  | 24,971            | 23,852           | 23,143            | 21,668           |
| Gross profit   | 15,203            | 15,170           | 13,421            | 13,626           |
| Operating expenses   | 9,527             | 10,474           | 8,727             | 9,935            |
| Operating income   | 5,676             | 4,696            | 4,694             | 3,691            |
| Other income (expense)   | (109)             | 594              | (86)              | 1,529            |
| Income tax expense   | 1,950             | 1,327            | 1,749             | 2,277            |
| Less: Net income attributable to noncontrolling interest           | 54                | 16               | (22)              | 17               |
| Net income attributable to Lannett Company, Inc.                   | \$ 3,563          | \$ 3,947         | \$ 2,881          | \$ 206           |
| Earnings per common share attributable to Lannett Company Inc. (1) |                   |                  |                   |                  |
| Basic  | \$ 0.12           | \$ 0.14          | \$ 0.10           | \$ 0.10          |
| Diluted  | \$ 0.12           | \$ 0.14          | \$ 0.10           | \$ 0.10          |

| (In thousands, except per share data) | Fourth<br>Quarter | Third<br>Quarter | Second<br>Quarter | First<br>Quarter |
|---------------------------------------|-------------------|------------------|-------------------|------------------|
| <b>Fiscal 2012</b>                    |                   |                  |                   |                  |
| Net sales                             | \$ 35,690         | \$ 30,688        | \$ 27,734         | \$ 28,878        |
| Cost of sales                         | 23,677            | 19,797           | 20,307            | 20,262           |
| Gross profit                          | 12,013            | 10,891           | 7,427             | 8,616            |
| Operating expenses                    | 9,407             | 8,527            | 6,932             | 7,171            |
| Operating income                      | 2,606             | 2,364            | 495               | 1,445            |
| Other income (expense)                | (362)             | 427              | 654               | (1,011)          |

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|  |    |       |    |       |    |      |    |      |
|--|----|-------|----|-------|----|------|----|------|
| Income tax expense   |    | 812   |    | 1,057 |    | 519  |    | 212  |
| Less: Net income attributable to noncontrolling interest           |    | 17    |    | 16    |    | 21   |    | 16   |
| Net income attributable to Lannett Company, Inc.                   | \$ | 1,415 | \$ | 1,718 | \$ | 609  | \$ | 206  |
| Earnings per common share attributable to Lannett Company Inc. (1) |    |       |    |       |    |      |    |      |
| Basic  | \$ | 0.05  | \$ | 0.06  | \$ | 0.02 | \$ | 0.01 |
| Diluted  | \$ | 0.05  | \$ | 0.06  | \$ | 0.02 | \$ | 0.01 |



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(1) Due to differences in weighted average common shares outstanding, quarterly earnings per share may not add up to the totals reported for the full fiscal year.

Gross margin percentage improved during Fiscal 2014 as a result of favorable pricing trends, specifically on products within the thyroid and cardiovascular medical indications.

On August 19, 2013, the Company entered into an agreement with JSP to extend its initial contract to continue as the exclusive distributor in the United States of three JSP products: Butalbital, Aspirin, Caffeine with Codeine Phosphate Capsules USP; Digoxin Tablets USP; Levothyroxine Sodium Tablets USP. The amendment to the original agreement extends the initial contract, which was due to expire on March 22, 2014, for five years. In connection with the amendment, the Company issued 1.5 million shares of the Company's common stock to JSP and its designees. In accordance with its policy related to renewal and extension costs for recognized intangible assets, the Company recorded a \$20.1 million expense in cost of sales, which represents the fair value of the shares on August 19, 2013.

During the first quarter of Fiscal 2013, the Company entered into a favorable settlement agreement related to litigation the Company had been involved in since January 2010. As a result of the agreement the Company recorded a gain in the amount of \$1.3 million. As of June 30, 2013, the Company had recorded all amounts related to the agreement.