

LANNETT CO INC
Form 10-Q
May 10, 2016
Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2016

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

FOR THE TRANSITION PERIOD FROM TO

Commission File No. 001-31298

LANNETT COMPANY, INC.

(Exact Name of Registrant as Specified in its Charter)

State of Delaware
(State of Incorporation)

23-0787699
(I.R.S. Employer I.D. No.)

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9000 State Road

Philadelphia, PA 19136

(215) 333-9000

(Address of principal executive offices and telephone number)

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller reporting company)

Smaller reporting company

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

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

Class	Outstanding as of April 30, 2016
Common stock, par value \$0.001 per share	36,747,501

Table of Contents

Table of Contents

	Page No.
<u>PART I. FINANCIAL INFORMATION</u>	
<u>ITEM 1. FINANCIAL STATEMENTS</u>	
<u>Consolidated Balance Sheets as of March 31, 2016 (unaudited) and June 30, 2015</u>	3
<u>Consolidated Statements of Operations (unaudited) for the three and nine months ended March 31, 2016 and 2015</u>	4
<u>Consolidated Statements of Comprehensive Income (unaudited) for the three and nine months ended March 31, 2016 and 2015</u>	5
<u>Consolidated Statements of Changes in Stockholders' Equity (unaudited) for the nine months ended March 31, 2016</u>	6
<u>Consolidated Statements of Cash Flows (unaudited) for the nine months ended March 31, 2016 and 2015</u>	7
<u>Notes to Consolidated Financial Statements (unaudited)</u>	8
<u>ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	34
<u>ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	51
<u>ITEM 4. CONTROLS AND PROCEDURES</u>	51
<u>PART II. OTHER INFORMATION</u>	
<u>ITEM 1. LEGAL PROCEEDINGS</u>	52
<u>ITEM 1A. RISK FACTORS</u>	52
<u>ITEM 6. EXHIBITS</u>	52

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****LANNETT COMPANY, INC.****CONSOLIDATED BALANCE SHEETS**

(In thousands, except share and per share data)

	(Unaudited)	
	March 31, 2016	June 30, 2015
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 225,446	\$ 200,340
Investment securities	12,959	13,467
Accounts receivable, net	183,624	91,103
Inventories	116,511	46,191
Prepaid income taxes	15,253	
Deferred tax assets	23,808	16,270
Other current assets	23,995	3,175
Total current assets	601,596	370,546
Property, plant and equipment, net	220,199	94,556
Intangible assets, net	598,418	29,090
Goodwill	313,451	141
Deferred tax assets	10,036	12,495
Other assets	8,676	1,938
TOTAL ASSETS	\$ 1,752,376	\$ 508,766
<u>LIABILITIES</u>		
Current liabilities:		
Accounts payable	\$ 33,038	\$ 19,195
Accrued expenses	9,181	4,928
Accrued payroll and payroll-related expenses	6,717	10,397
Rebates payable	16,993	7,553
Royalties payable	5,779	
Restructuring liability	3,008	
Accrued interest payable	10,823	
Settlement liability	10,700	
Income taxes payable		1,340
Acquisition-related contingent consideration	35,000	
Current portion of long-term debt	45,640	135
Total current liabilities	176,879	43,548
Long-term debt, net	1,008,212	874
Restructuring liability	77	
Settlement liability	13,414	
Other liabilities	6,268	578
TOTAL LIABILITIES	1,204,850	45,000
Commitments and Contingencies (Note 13 and 14)		

STOCKHOLDERS EQUITY

Common stock (\$0.001 par value, 100,000,000 shares authorized; 37,112,119 and 36,783,381 shares issued; 36,569,363 and 36,264,585 shares outstanding at March 31, 2016 and June 30, 2015, respectively)	37	37
Additional paid-in capital	279,874	236,178
Retained earnings	274,784	233,573
Accumulated other comprehensive loss	(280)	(295)
Treasury stock (542,756 and 518,796 shares at March 31, 2016 and June 30, 2015, respectively)	(7,277)	(6,080)
Total Lannett Company, Inc. stockholders equity	547,138	463,413
Noncontrolling Interest	388	353
Total stockholders equity	547,526	463,766
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 1,752,376	\$ 508,766

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

Table of Contents

LANNETT COMPANY, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

(In thousands, except share and per share data)

	Three months ended March 31,		Nine months ended March 31,	
	2016	2015	2016	2015
Net sales	\$ 163,712	\$ 99,352	\$ 397,204	\$ 307,561
Settlement agreement	(23,598)		(23,598)	
Total net sales	140,114	99,352	373,606	307,561
Cost of sales	75,345	23,694	155,964	73,094
Amortization of intangibles	7,278	20	11,079	61
Gross profit	57,491	75,638	206,563	234,406
Operating expenses:				
Research and development expenses	16,495	9,159	32,092	23,358
Selling, general, and administrative expenses	16,157	11,617	46,359	32,923
Acquisition and integration-related expenses	1,473	587	23,000	2,656
Restructuring expenses	4,749		4,749	
Total operating expenses	38,874	21,363	106,200	58,937
Operating income	18,617	54,275	100,363	175,469
Other income (loss):				
Investment income (loss)	204	(8)	69	895
Interest expense	(26,988)	(8)	(38,820)	(119)
Other	(46)	(26)	(76)	(6)
Total other income (loss)	(26,830)	(42)	(38,827)	770
Income (loss) before income tax	(8,213)	54,233	61,536	176,239
Income tax expense (benefit)	(2,743)	17,973	20,270	60,208
Net income (loss)	(5,470)	36,260	41,266	116,031
Less: Net income attributable to noncontrolling interest	20	27	55	55
Net income (loss) attributable to Lannett Company, Inc.	\$ (5,490)	\$ 36,233	\$ 41,211	\$ 115,976
Earnings (loss) per common share attributable to Lannett Company, Inc.:				
Basic	\$ (0.15)	\$ 1.01	\$ 1.13	\$ 3.25
Diluted	\$ (0.15)	\$ 0.97	\$ 1.10	\$ 3.13
Weighted average common shares outstanding:				
Basic	36,495,961	35,880,954	36,398,030	35,715,061
Diluted	36,495,961	37,210,138	37,383,742	37,082,138

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

Table of Contents

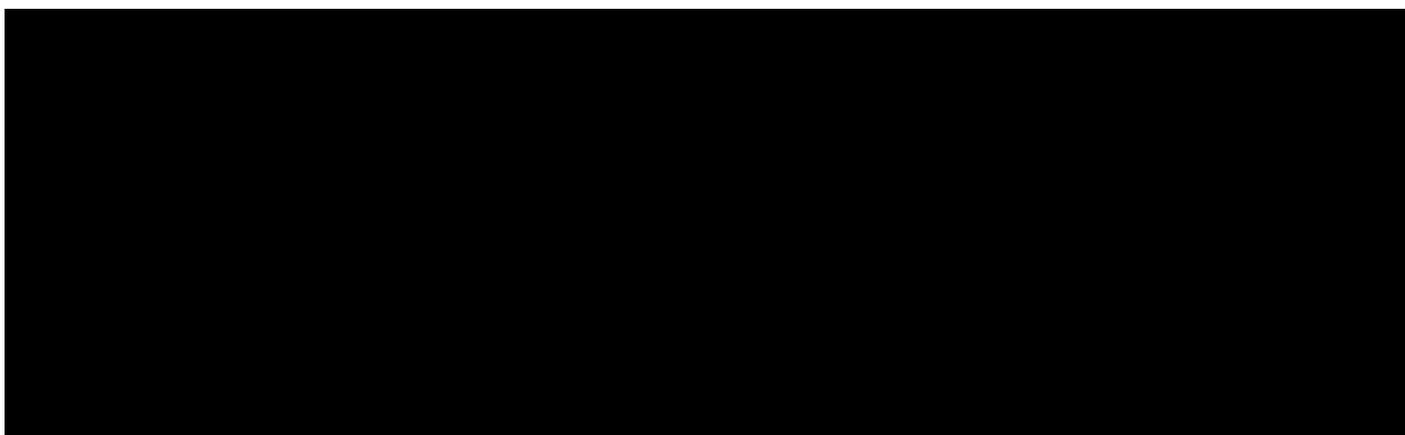
LANNETT COMPANY, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED)

(In thousands)

Three months ended		Nine months ended	
March 31,		March 31,	
2016	2015	2016	2015



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

Table of Contents

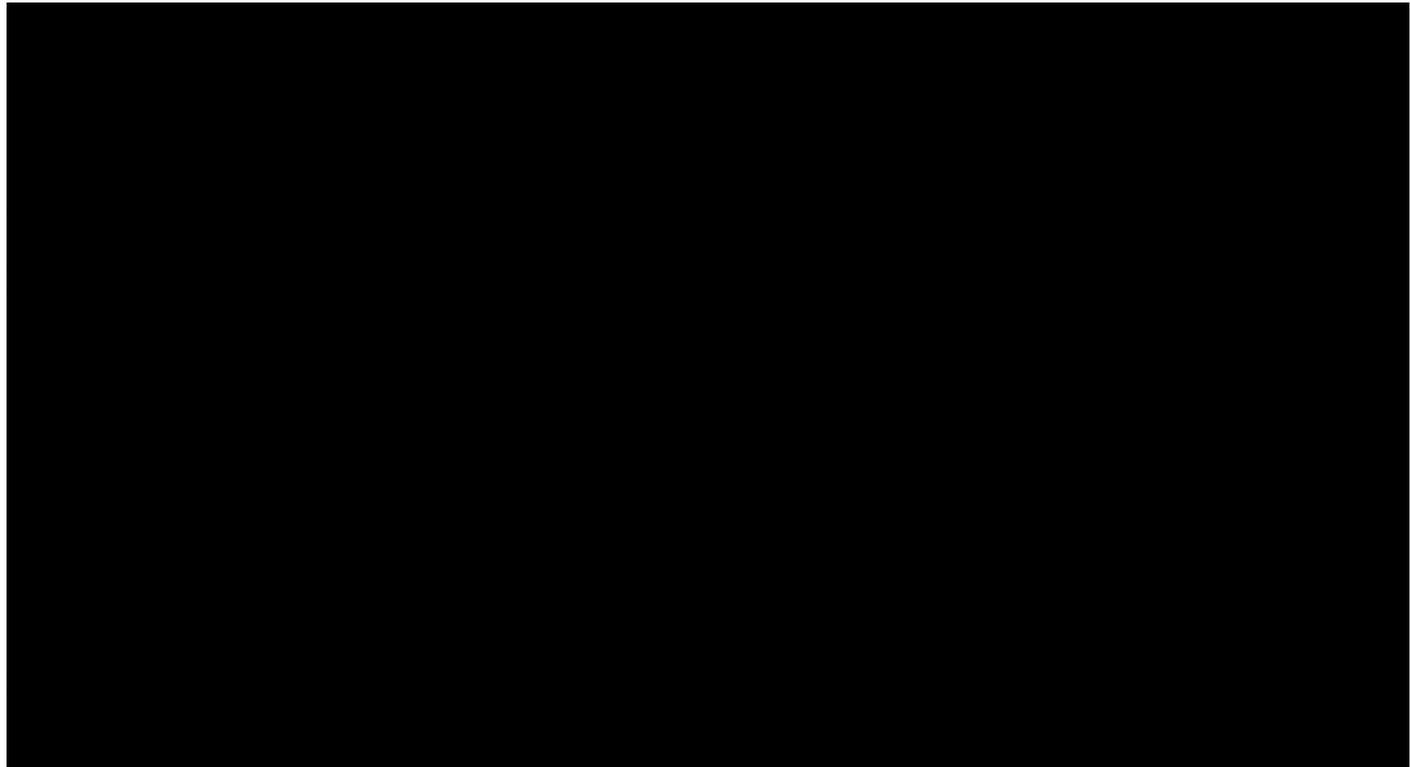
LANNETT COMPANY, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

(UNAUDITED)

(In thousands)

Common Stock		Stockholders Equity Attributable to Lannett Company Inc.				Stockholders Equity		Total
Shares	Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Attributable to Lannett Co., Inc.	Noncontrolling Interest	Stockholders Equity

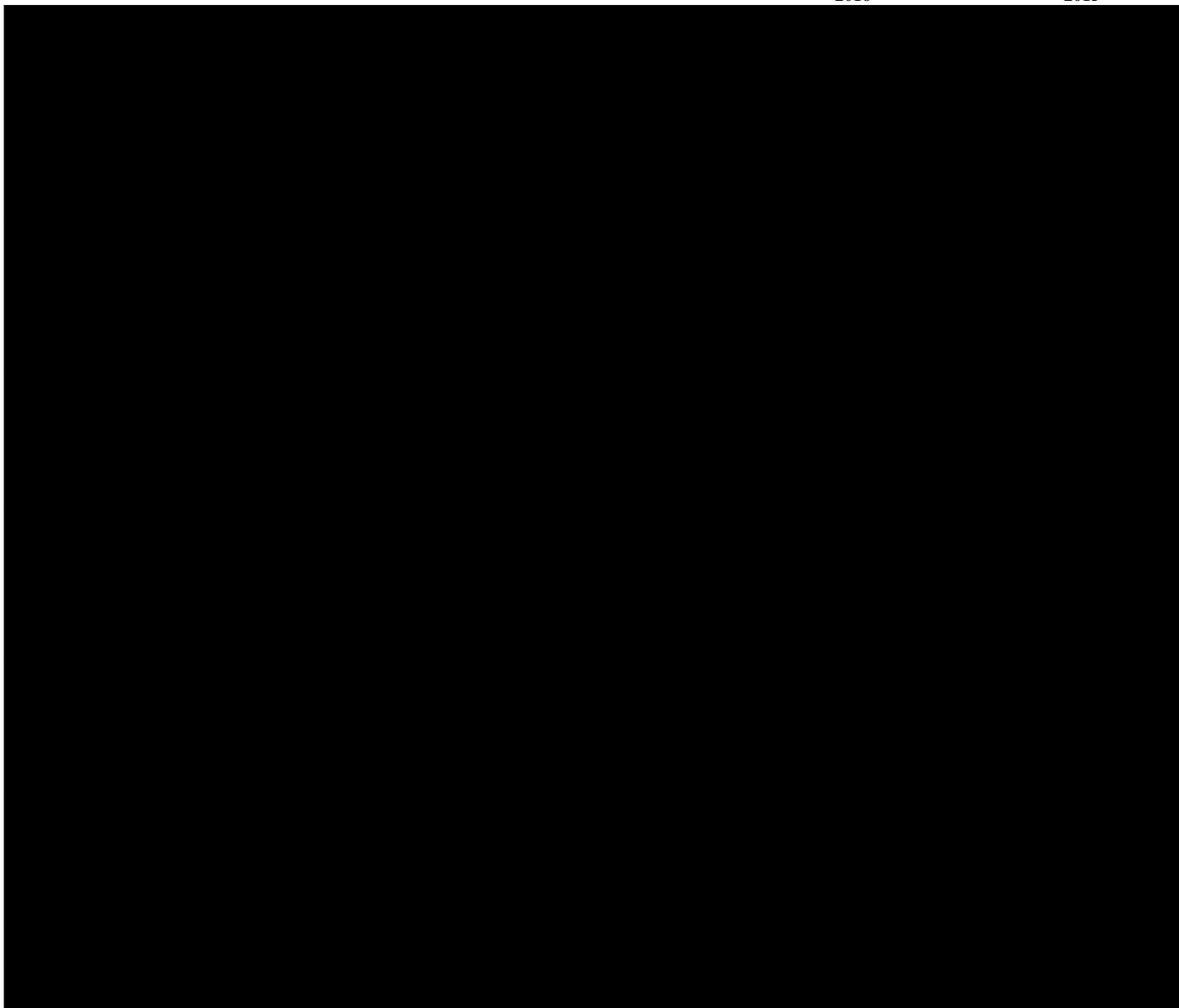


The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

LANNETT COMPANY, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(In thousands)

Nine months Ended
March 31,
2016 **2015**





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

Table of Contents

LANNETT COMPANY, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 1. Interim Financial Information

The accompanying unaudited financial statements have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) for the presentation of interim financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, the unaudited financial statements do not include all the information and footnotes necessary for a comprehensive presentation of the financial position, results of operations, and cash flows for the periods presented. In the opinion of management, the unaudited financial statements include all the normal recurring adjustments that are necessary for a fair presentation of the financial position, results of operations, and cash flows for the periods presented. Operating results for the three and nine months ended March 31, 2016 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2016. These unaudited financial statements should be read in combination with the other Notes in this section; Management's Discussion and Analysis of Financial Condition and Results of Operations appearing in Item 2; and the Consolidated Financial Statements, including the Notes to the Consolidated Financial Statements, included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2015.

Note 2. The Business And Nature of Operations

Lannett Company, Inc. (a Delaware corporation) and its subsidiaries (collectively, the Company or Lannett) develop, manufacture, package, market, and distribute solid oral and extended release (tablets and capsules), topical, and oral solution finished dosage forms of drugs, that address a wide range of therapeutic areas. Certain of these products are manufactured by others and distributed by the Company. 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.

On November 25, 2015, the Company completed the acquisition of Kremers Urban Pharmaceuticals Inc. (KUPI), the U.S. specialty generic pharmaceuticals subsidiary of global biopharmaceuticals company UCB S.A. KUPI is a specialty pharmaceuticals manufacturer focused on the development of products that are difficult to formulate or utilize specialized delivery technologies. Strategic benefits of the acquisition include expanded manufacturing capacity, a diversified product portfolio and pipeline, and complementary research and development expertise.

The Company operates pharmaceutical manufacturing plants in Philadelphia, Pennsylvania, Cody, Wyoming, Carmel, New York, and Seymour, Indiana. The Company's customers 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 3. 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.

Business Combinations

Acquired businesses are accounted for using the acquisition method of accounting, which requires that the assets acquired and liabilities assumed be recorded at the date of acquisition at their respective estimated fair values. The fair values and useful lives assigned to each class of assets acquired and liabilities assumed are based on, among other factors, the expected future period of benefit of the asset, the various characteristics of the asset and projected future cash flows. Significant judgment is employed in determining the assumptions utilized as of the acquisition date and for each subsequent measurement period. Accordingly, changes in assumptions described above, could have a material impact on our consolidated results of operations.

Table of Contents

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, including goodwill and intangible assets, income taxes, contingencies, share-based compensation, and contingent consideration. 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 (loss). 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.

Investment securities

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The Company's investment securities consist of publicly traded equity securities 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 (loss).

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 obligations 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 each of the three months ended March 31, 2016 and 2015 was \$4.3 million and \$1.4 million, respectively. Depreciation expense for each of the nine months ended March 31, 2016 and 2015 was \$8.5 million and \$4.0 million, respectively.

Table of Contents

Intangible Assets

Definite-lived intangible assets are stated at cost less accumulated amortization. Amortization of definite-lived intangible assets 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 intangible assets are not amortized, but instead are tested at least annually for impairment. Costs to renew or extend the term of a recognized intangible asset are expensed as incurred.

Valuation of Long-Lived Assets, including Intangible Assets

The Company's long-lived assets primarily consist of property, plant and equipment and definite and indefinite-lived intangible assets. Property, plant and equipment and definite-lived intangible 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 asset's carrying value is compared 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. Indefinite-lived intangible assets are tested for impairment at least annually during the fourth quarter of each fiscal year or more frequently if events or changes in circumstances indicate that the asset might be impaired. An impairment loss is measured as the excess of the asset's carrying value over its fair value. The judgments made in determining estimated fair values can materially impact our results of operations.

In-Process Research and Development

Amounts allocated to in-process research and development (IPR&D) in connection with a business combination are recorded at fair value and are considered indefinite-lived intangible assets subject to impairment testing in accordance with the Company's impairment testing policy for indefinite-lived intangible assets. As products in development are approved for sale, amounts will be allocated to product rights and will be amortized over their estimated useful lives. These valuations reflect, among other things, the impact of changes to the development programs, the projected development and regulatory time frames and the current competitive environment. Changes in any of the Company's assumptions may result in a reduction to the estimated fair value of the IPR&D asset and could result in future impairment charges.

Goodwill

Goodwill, which represents the excess of purchase price over the fair value of net assets acquired, is carried at cost. Goodwill is tested for impairment on an annual basis during the fourth quarter of each fiscal year or more frequently if events or changes in circumstances indicate that the asset might be impaired. The Company first performs a qualitative assessment to determine if the quantitative impairment test is required. If changes in circumstances indicate an asset may be impaired, the Company performs the quantitative impairment test. In accordance with accounting standards, a two-step quantitative method is used for determining goodwill impairment. In the first step, the Company determines the fair value of our reporting unit (generic pharmaceuticals). If the net book value of our reporting unit exceeds its fair value, the second step of the impairment test which requires allocation of our reporting unit's fair value to all of its assets and liabilities using the acquisition method prescribed under authoritative guidance for business combinations would then be performed. Any residual fair value is allocated to goodwill. An impairment charge is recognized only if the implied fair value of our reporting unit's goodwill is less than its carrying amount.

Table of Contents

Segment Information

The Company operates in 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 the three and nine months ended March 31, 2016 and 2015:

(In thousands) Medical Indication	For the Three Months Ended March 31,		For the Nine months Ended March 31,	
	2016	2015	2016	2015
[REDACTED]				

Customer, Supplier and Product Concentration

The following table presents the percentage of net sales, for the three and nine months ended March 31, 2016 and 2015, 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:

	For the Three Months Ended March 31,		For the Nine months Ended March 31,	
	2016	2015	2016	2015
Product 1	23%	37%	29%	37%
Product 2	9%	21%	13%	16%
Product 3	4%	7%	5%	13%

The following table presents the percentage of net sales, for the three and nine months ended March 31, 2016 and 2015, for certain of the Company's customers which accounted for at least 10% of net sales in any of those periods:

	For the Three Months Ended		For the Nine months Ended	
	2016	2015	2016	2015
Customer A	22%	27%	25%	30%
Customer B	17%	15%	16%	10%

The Company's primary finished goods inventory supplier is Jerome Stevens Pharmaceuticals, Inc. (JSP), in Bohemia, New York. Purchases of finished goods inventory from JSP accounted for approximately 53% and 66% of the Company's inventory purchases during the three months ended March 31, 2016 and 2015, respectively. Purchases of finished goods inventory from JSP accounted for approximately 59% and 68% of the Company's inventory purchases during the nine months ended March 31, 2016 and 2015, respectively. See Note 22 Material Contracts with Suppliers for more information.

Table of Contents

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 gross sales 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 \$144.8 million and \$69.4 million at March 31, 2016 and June 30, 2015, respectively. Rebates payable at March 31, 2016 and June 30, 2015 were \$17.0 million and \$7.6 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, including Amortization of Intangibles

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 or extend recognized intangible assets, freight charges and other shipping and handling expenses. Product royalties included in cost of sales for the three months ended March 31, 2016 and 2015 were \$6.2 million and \$44 thousand, respectively. Product royalties included in cost of sales for the nine months ended March 31, 2016 and 2015 were \$10.6 million and \$129 thousand, respectively.

Research and Development

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

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.

Contingent Consideration

Contingent consideration resulting from the KUPI acquisition was recorded at its fair value on the acquisition date. The Company has agreed to a 50/50 split of the additional tax liabilities UCB will incur associated with the IRS Section 338(H)(10) tax election, up to \$35.0 million. This election is expected to result in additional tax benefits to the Company of approximately \$100.0 million. Decreases in the fair value of the contingent consideration will be recorded as gains in the Consolidated Statements of Operations. Decreases in the fair value of the contingent consideration obligation can result from lower tax liabilities incurred by UCB associated with the IRS Section 338(H)(10) tax election. These fair value measurements represent Level 3 measurements, as they are based on significant inputs not observable in the market.

Restructuring Costs

The Company records charges associated with approved restructuring plans to remove duplicative headcount and infrastructure associated with business acquisitions or to simplify business processes. Restructuring charges can include severance costs to eliminate a specified number of employees, infrastructure charges to vacate facilities and consolidate operations, and contract cancellation costs. The Company records restructuring charges based on estimated employee terminations, site closure and consolidation plans. The

Table of Contents

Company accrues severance and other employee separation costs under these actions when it is probable that benefits will be paid and the amount is reasonably estimable.

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 expected 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

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.

Earnings (Loss) Per Common Share

Basic earnings (loss) per common share attributable to Lannett Company, Inc. is computed by dividing net income (loss) attributable to Lannett Company, Inc. common stockholders by the weighted average number of shares outstanding during the period. Diluted earnings (loss) per common share attributable to Lannett Company, Inc. is computed by dividing net income (loss) 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. These potentially dilutive securities primarily consist of stock options, unvested restricted stock, and an outstanding warrant. Anti-dilutive securities are excluded from the calculation. Dilutive shares are also excluded in the

calculation in periods of net loss because the effect of including such securities would be anti-dilutive.

Comprehensive Income (Loss)

Comprehensive income (loss) includes all changes in equity during a period except those that resulted from investments by or distributions to the Company's stockholders. Other comprehensive income (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 Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*. 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. In July 2015, the FASB extended

Table of Contents

the effective date of the guidance by one year to December 15, 2017. The Company is currently in the process of assessing the impact this guidance will have on the consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs* which changes the presentation of debt issuance costs in financial statements. ASU 2015-03 requires an entity to present such costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. Amortization of the costs will continue to be reported as interest expense. It is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2015. Early adoption is permitted. The new guidance will be applied retrospectively to each prior period presented. The Company has elected to early adopt ASU 2015-03 as of December 31, 2015.

In July 2015, the FASB issued ASU 2015-11, *Inventory – Simplifying the Measurement of Inventory*. ASU 2015-11 requires inventory to be subsequently measured using the lower of cost and net realizable value, thereby eliminating the market value approach. Net realizable value is defined as the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. ASU 2015-11 is effective for reporting periods beginning after December 15, 2016 and is applied prospectively. Early adoption is permitted. The Company is currently in the process of assessing the impact this guidance will have on the consolidated financial statements.

In September 2015, the FASB issued ASU 2015-16, *Business Combinations – Simplifying the Accounting for Measurement-Period Adjustments*. ASU 2015-16 requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. ASU 2015-16 also requires that the acquirer record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. ASU 2015-16 is effective for reporting periods beginning after December 15, 2015 and is applied prospectively. Early adoption is permitted. The Company has elected to early adopt ASU 2015-16 as of March 31, 2016.

In November 2015, the FASB issued ASU 2015-17, *Income Taxes – Balance Sheet Classification of Deferred Taxes*. ASU 2015-17 requires all deferred tax assets and liabilities to be classified as noncurrent on the balance sheet. The guidance may be applied either prospectively or retrospectively. ASU 2015-17 is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2016. Early adoption is permitted. The Company is currently in the process of assessing the impact this guidance will have on the consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases*. ASU 2016-02 requires an entity to recognize right-of-use assets and liabilities on its balance sheet for all leases with terms longer than 12 months. Lessees and lessors are required to disclose quantitative and qualitative information about leasing arrangements to enable a user of the financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period, and requires a modified retrospective application, with early adoption permitted. The Company is currently in the process of assessing the impact this guidance will have on the consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, *Compensation – Stock Compensation: Improvements to Employee Share-Based Payment Accounting*. ASU 2016-09 clarifies several aspects of accounting for share-based compensation including the accounting for excess tax benefits and deficiencies, accounting for forfeitures and the classification of excess tax benefits on the cash flow statement. ASU 2016-09 is effective for fiscal years beginning after December 15, 2016 and in interim periods within those fiscal years, with early adoption permitted. The Company is currently in the process of assessing the impact this guidance will have on the consolidated financial statements.

Note 4. Acquisitions

Kremers Urban Pharmaceuticals Inc.

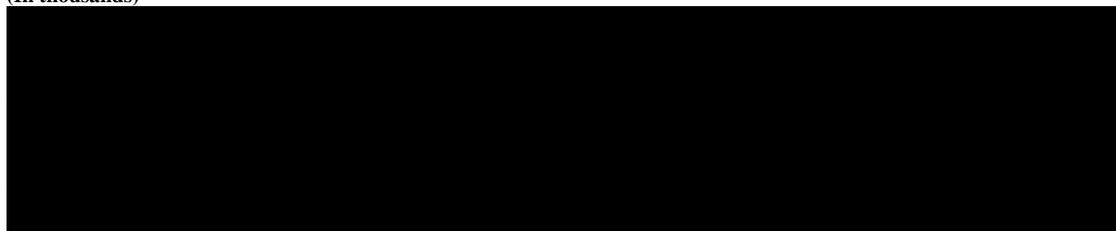
On November 25, 2015, the Company completed the acquisition of Kremers Urban Pharmaceuticals Inc. (KUPI), the U.S. specialty generic pharmaceuticals subsidiary of global biopharmaceuticals company UCB S.A., pursuant to the terms and conditions of a Stock Purchase Agreement. KUPI is a specialty pharmaceuticals manufacturer focused on the development of products that are difficult to formulate or utilize specialized delivery technologies. Strategic benefits of the acquisition include expanded manufacturing capacity, a diversified product portfolio and pipeline, and complementary research and development expertise.

Pursuant to the terms of the Stock Purchase Agreement, Lannett purchased 100% of the outstanding equity interests of KUPI for total estimated consideration of approximately \$1.21 billion, subject to a customary post-closing working capital adjustment.

Table of Contents

The following table summarizes the fair value of total consideration transferred to KUPI shareholders at the acquisition date of November 25, 2015:

(In thousands)



The Company funded the acquisition and transaction expenses with proceeds from the issuance of the \$910.0 million Senior Secured Credit Facility, \$22.8 million borrowings on the Revolving Credit Facility, the issuance of the \$250.0 million Senior Notes (see Note 12 Long-term Debt) and cash on hand of \$90.1 million. Lannett also issued a warrant with an estimated fair value of \$29.9 million.

As part of the acquisition, the Company and UCB have agreed to jointly make an election under Section 338(h)(10) of the Internal Revenue Code of 1986, as amended, and under the corresponding provisions of state law, to treat the acquisition as a deemed purchase and sale of assets for income tax purposes. The Company has agreed to reimburse UCB for 50% of the incremental tax cost of making such election, subject to a reimbursement cap of \$35.0 million. This liability has been recorded as Acquisition-related contingent consideration on the Consolidated Balance Sheet. This election is expected to result in additional tax benefits to the Company of approximately \$100.0 million.

The Company also agreed to contingent payments related to Methylphenidate ER provided the FDA reinstates the AB-rating and certain sales thresholds are met.

The Company used the acquisition method of accounting to account for this transaction. Under the acquisition method of accounting, the assets acquired and liabilities assumed in the transaction were recorded at the date of acquisition at their respective fair values using assumptions that are subject to change. The Company has not finalized its valuation of certain assets and liabilities recorded in connection with this transaction. Thus, the estimated fair values recorded to date are subject to change and any changes will be recorded as adjustments to the fair value of those assets and liabilities and residual amounts will be allocated to goodwill. The final valuation adjustments may also require adjustment to the Consolidated Statements of Operations and Cash Flows.

Table of Contents

The preliminary purchase price has been allocated to the assets acquired and liabilities assumed for the KUPI business as follows:

(In thousands)	Preliminary Purchase Price Allocation as of December 31, 2015 (a)	Measurement Period Adjustments (b)	Preliminary Purchase Price Allocation as of March 31, 2016
Cash and cash equivalents	\$ 16,877	\$	\$ 16,877
Accounts receivable, net of revenue-related reserves	149,209	(6,190)	143,019
Inventories	83,815	(215)	83,600
Other current assets	12,873	(1,468)	11,405
Property, plant and equipment	97,418	20,169	117,587
Product rights	409,000	21,000	430,000
Trade name	2,920		2,920
Other intangible assets	20,000	(1,000)	19,000
In-process research and development	232,000	(103,000)	129,000
Goodwill	240,575	72,735	313,310
Deferred tax assets	4,956		4,956
Other assets	4,859		4,859
Total assets acquired	1,274,502	2,031	1,276,533
Accounts payable	(19,249)		(19,249)
Accrued expenses	(4,161)	(1,918)	(6,079)
Accrued payroll and payroll-related expenses	(20,731)	(309)	(21,040)
Rebates payable	(9,816)		(9,816)
Royalties payable	(3,798)	196	(3,602)
Other long-term liabilities	(5,369)		(5,369)
Total net assets acquired	\$ 1,211,378	\$	\$ 1,211,378

(a) As originally reported in the Company's Quarterly Report on Form 10-Q for the period ended December 31, 2015.

(b) The measurement period adjustments are for 1) certain working capital adjustments and 2) updated valuations on inventories, property, plant and equipment and intangible assets. These adjustments did not have a significant impact on the Company's previously reported consolidated financial statements.

Included in the preliminary purchase price allocation above are indemnification assets totaling approximately \$15.3 million, of which \$10.4 million relates to compensation-related payments and \$4.9 million relates to unrecognized tax benefits. The inventory balance above includes \$19.1 million to reflect fair value step-up adjustments. KUPI's intangible assets primarily consist of product rights and in-process research and development. See Note 11 Goodwill and Intangible Assets.

Amounts allocated to acquired in-process research and development represent an estimate of the fair value of purchased in-process technology for research projects that, as of the closing date of the acquisition, had not yet reached technological feasibility and had no alternative future use. The fair value of in-process research and development was based on the excess earnings method, which utilizes forecasts of expected cash inflows (including estimates for ongoing costs) and other contributory charges, on a project-by-project basis at the appropriate discount rate for the inherent risk in each project, and will be tested for impairment in accordance with the Company's policy for testing indefinite-lived intangible

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assets.

Goodwill of \$313.3 million arising from the acquisition consists largely of the value of the employee workforce and the value of products to be developed in the future. The goodwill was assigned to the Company's only reporting unit. Goodwill recognized is expected to be fully deductible for income tax purposes.

The amounts of KUPI Revenue and Net income attributable to Lannett Company, Inc. included in the Company's Consolidated Statements of Operations from November 25, 2015 to March 31, 2016 are as follows:

(In thousands, except per share data)	For the Three Months Ended March 31, 2016		For the Nine Months Ended March 31, 2016	
Revenues	\$	69,933	\$	96,064
Net income (loss) attributable to Lannett Company, Inc.		2,260		(4,047)
Earnings (loss) per common share attributable to Lannett Company, Inc.:				
Basic	\$	0.06	\$	(0.11)
Diluted	\$	0.06	\$	(0.11)

Table of Contents

During the nine months ended March 31, 2016, the Company recorded \$21.5 million of acquisition-related expenses directly related to the KUPI acquisition.

Unaudited Pro Forma Financial Results

The following supplemental unaudited pro forma information presents the financial results as if the acquisition of KUPI had occurred on July 1, 2014 for the three and nine months ended March 31, 2016 and 2015. This supplemental pro forma information has been prepared for comparative purposes and does not purport to be indicative of what would have occurred had the acquisition been made on July 1, 2014, nor are they indicative of any future results.

(In thousands, except per share data)	For the Three Months Ended March 31,			For the Nine Months Ended March 31,		
	2016	2015		2016	2015	
Revenues	\$ 163,712	\$ 193,612	\$	\$ 520,867	\$ 616,083	\$
Net income attributable to Lannett Company, Inc.	896	29,889		55,596	89,527	
Earnings per common share attributable to Lannett Company, Inc.:						
Basic	\$ 0.02	\$ 0.83	\$	1.53	2.50	\$
Diluted	\$ 0.02	\$ 0.80	\$	1.49	2.41	\$

The supplemental pro forma earnings for the three months ended March 31, 2016 were adjusted to exclude \$8.6 million of expense related to the amortization of fair value step-up adjustments to acquisition-date inventory.

The supplemental pro forma earnings for the three months ended March 31, 2015 were adjusted to exclude \$1.0 million of acquisition-related costs incurred by KUPI.

The supplemental pro forma earnings for the nine months ended March 31, 2016 were adjusted to exclude \$28.9 million of acquisition-related costs, of which \$21.5 million was incurred by Lannett and \$7.4 million was incurred by KUPI, and \$14.4 million of expense related to the amortization of fair value adjustments to acquisition-date inventory.

The supplemental pro forma earnings for the nine months ended March 31, 2015 were adjusted to include \$30.7 million of acquisition-related costs, of which \$21.5 million was incurred by Lannett and \$9.2 million was incurred by KUPI, as well as \$18.9 million of expense related to the amortization of fair value step-up adjustments to acquisition-date inventory.

Silarx

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On June 1, 2015, the Company completed the acquisition of Silarx Pharmaceuticals, Inc., a New York corporation, and Stoneleigh Realty, LLC, a New York limited liability company (together "Silarx"), pursuant to the terms and conditions of a Stock Purchase Agreement. Silarx manufactures and markets high-quality liquid pharmaceutical products, including generic prescription and over-the-counter products. Silarx operates within a manufacturing facility located in Carmel, New York. Strategic benefits of the acquisition include an FDA-approved manufacturing facility, research and development expertise and added diversity to Lannett's portfolio of existing and pipeline products.

Pursuant to the terms of the Stock Purchase Agreement, Lannett purchased 100% of the outstanding equity interests of Silarx for cash consideration totaling \$42.5 million, subject to a post-closing working capital adjustment. The Company used the acquisition method of accounting to account for this transaction. Under the acquisition method of accounting, the assets acquired and liabilities assumed in the transaction were recorded at the date of acquisition at their respective fair values using assumptions that are subject to change. Any adjustments, if necessary, will be recorded in the measurement period.

Table of Contents

The preliminary purchase price has been allocated to the assets acquired and liabilities assumed for the Silarx business as follows:

(In thousands)		
Cash	\$	664
Accounts receivable, net of revenue-related reserves		4,396
Inventories		2,705
Other current assets		467
Property, plant and equipment		7,247
Product rights		10,000
In-process research and development		18,000
Goodwill		141
Other assets		9
Total assets acquired		43,629
Accounts payable		(711)
Income taxes payable		(392)
Total net assets acquired	\$	42,526

Amounts allocated to acquired in-process research and development represent an estimate of the fair value of purchased in-process technology for research projects that, as of the closing date of the acquisition, had not yet reached technological feasibility and had no alternative future use. The fair value of in-process research and development was based on the excess earnings method, which utilizes forecasts of expected cash inflows (including estimates for ongoing costs) and other contributory charges, on a project-by-project basis at the appropriate discount rate for the inherent risk in each project, and will be tested for impairment in accordance with the Company's policy for testing indefinite-lived intangible assets.

Product rights totaling \$10.0 million are comprised of currently marketed products that have an estimated useful life of 15 years. The goodwill of \$141 thousand arising from the acquisition consists largely of the value of the employee workforce and the value of products to be developed in the future. The goodwill was assigned to the Company's only reporting unit. Goodwill recognized is expected to be fully deductible for income tax purposes.

Unaudited Pro Forma Financial Results

The results of Silarx are included in the Company's Consolidated Financial Statements from the date of acquisition. The pro forma results assuming the acquisition had occurred as of July 1, 2013 were not material to the Company's revenues, net income, and earnings per share.

Note 5. Restructuring Charges*2016 Restructuring Program*

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On February 1, 2016, in connection with the acquisition of Kremers, the Company formulated a plan related to the future integration of Kremers and the Company's businesses. The integration plan focuses on the closure of Kremers corporate functions and the consolidation of manufacturing, sales, research and development, and distribution functions. The Company estimates that it will incur an aggregate of up to approximately \$23.0 million in restructuring charges for actions that have been announced or communicated since the 2016 Restructuring Program began. Of this amount, approximately \$14.0 million relates to employee separation costs, approximately \$1.0 million relates to contract termination costs and approximately \$8.0 million relates to facility closure costs and other actions. The expenses associated with the restructuring program included in restructuring expenses during the three and nine months ended March 31, 2016 were as follows:

(In thousands)	Three and Nine Months Ended March 31, 2016	
Employee separation costs	\$	3,870
Contract termination costs		701
Facility closure costs		178
Total	\$	4,749

Table of Contents

A reconciliation of the changes in restructuring liabilities associated with the 2016 Restructuring Program from June 30, 2015 through March 31, 2016 is set forth in the following table:

(In thousands)	Employee Separation Costs	Contract Termination Costs	Facility Closure Costs	Total
Balance at June 30, 2015	\$	\$	\$	\$
Restructuring Charges	3,870	701	178	4,749
Payments	(1,486)		(178)	(1,664)
Balance at March 31, 2016	\$ 2,384	\$ 701	\$	\$ 3,085

Note 6. Accounts Receivable

Accounts receivable consisted of the following components at March 31, 2016 and June 30, 2015:

(In thousands)	March 31, 2016	June 30, 2015
Gross accounts receivable	\$ 328,989	\$ 160,960
Less Chargebacks reserve	(63,064)	(35,801)
Less Rebates reserve	(34,820)	(12,945)
Less Returns reserve	(37,546)	(19,209)
Less Other deductions	(9,396)	(1,528)
Less Allowance for doubtful accounts	(539)	(374)
Accounts receivable, net	\$ 183,624	\$ 91,103

For the three months ended March 31, 2016, the Company recorded a provision for chargebacks, rebates (including rebates presented as rebates payable), returns, and other deductions of \$185.2 million, \$54.5 million, \$3.5 million, and \$11.7 million, respectively. For the three months ended March 31, 2015, the Company recorded a provision for chargebacks, rebates (including rebates presented as rebates payable), returns, and other deductions of \$74.3 million, \$18.4 million, \$5.9 million, and \$7.8 million, respectively.

For the nine months ended March 31, 2016, the Company recorded a provision for chargebacks, rebates (including rebates presented as rebates payable), returns, and other deductions of \$424.9 million, \$124.6 million, \$14.3 million, and \$27.0 million, respectively. For the nine months ended March 31, 2015, the Company recorded a provision for chargebacks, rebates (including rebates presented as rebates payable), returns, and other deductions of \$252.3 million, \$58.2 million, \$14.2 million, and \$22.9 million, respectively.

Table of Contents**Note 7. Inventories**

Inventories at March 31, 2016 and June 30, 2015 consisted of the following:

(In thousands)	March 31, 2016	June 30, 2015
Raw materials	\$ 45,769	\$ 22,385
Work-in-process	22,293	5,246
Finished goods	48,449	18,560
Total	\$ 116,511	\$ 46,191

The reserve for excess and obsolete inventory was \$3.9 million and \$5.0 million at March 31, 2016 and June 30, 2015, respectively.

Note 8. Property, Plant and Equipment

Property, plant and equipment at March 31, 2016 and June 30, 2015 consisted of the following:

(In thousands)	Useful Lives	March 31, 2016	June 30, 2015
Land		\$ 7,041	\$ 5,891
Building and improvements	10 - 39 years	99,642	51,446
Machinery and equipment	5 - 10 years	110,760	47,681
Furniture and fixtures	5 - 7 years	4,072	1,748
Construction in progress		46,839	28,228
Property, plant and equipment, gross		268,354	134,994
Less accumulated depreciation		(48,155)	(40,438)
Property, plant and equipment, net		\$ 220,199	\$ 94,556

Note 9. 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.

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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.

Table of Contents

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 assets and liabilities measured at fair value at March 31, 2016 and June 30, 2015, were as follows:

(In thousands)	March 31, 2016			Total
	Level 1	Level 2	Level 3	
[REDACTED]				

(In thousands)	June 30, 2015			Total
	Level 1	Level 2	Level 3	
Assets				
Equity securities	\$ 13,467	\$	\$	\$ 13,467
Total Assets	\$ 13,467	\$	\$	\$ 13,467

Note 10. 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 \$125 thousand during the three months ended March 31, 2016, which included an unrealized gain related to securities still held at March 31, 2016 of \$279 thousand. The Company had a net loss on investment securities of \$103 thousand during the three months ended March 31, 2015, which included an unrealized loss related to securities still held at March 31, 2015 of \$666 thousand.

The Company had a net loss on investment securities of \$209 thousand during the nine months ended March 31, 2016, which included an unrealized loss related to securities still held at March 31, 2016 of \$125 thousand. The Company had a net gain on investment securities of \$592 thousand during the nine months ended March 31, 2015, which included an unrealized loss related to securities still held at March 31, 2015 of \$954 thousand.

Table of Contents**Note 11. Goodwill and Intangible Assets**

The changes in the carrying amount of goodwill for the nine months ended March 31, 2016 are as follows:

(In thousands)	Generic Pharmaceuticals	
Balance at June 30, 2015	\$	141
Goodwill acquired		313,310
Balance at March 31, 2016	\$	313,451

Intangible assets, net as of March 31, 2016 and June 30, 2015, consisted of the following:

(In thousands)	Weighted Avg. Life (Yrs.)	Gross Carrying Amount		Accumulated Amortization		Intangible Assets, Net	
		March 31, 2016	June 30, 2015	March 31, 2016	June 30, 2015	March 31, 2016	June 30, 2015
<u>Definite-lived:</u>							
Cody Labs import license	15	\$ 582	\$ 582	\$ (299)	\$ (269)	\$ 283	\$ 313
KUPI product rights	15	430,000		(10,073)		419,927	
KUPI trade name	2	2,920		(513)		2,407	
KUPI other intangible assets	15	19,000		(445)		18,555	
Silarx product rights	15	10,000	10,000	(555)	(56)	9,445	9,944
Other product rights	14	653	653	(301)	(269)	352	384
Total definite-lived		\$ 463,155	\$ 11,235	\$ (12,186)	\$ (594)	\$ 450,969	\$ 10,641
<u>Indefinite-lived:</u>							
KUPI in-process research and development		\$ 129,000	\$	\$	\$	\$ 129,000	\$
Silarx in-process research and development		18,000	18,000			18,000	18,000
Other product rights		449	449			449	449
Total indefinite-lived		147,449	18,449			147,449	18,449
Total intangible assets, net		\$ 610,604	\$ 29,684	\$ (12,186)	\$ (594)	\$ 598,418	\$ 29,090

For the three months ended March 31, 2016 and 2015, the Company incurred amortization expense of \$7.6 million and \$20 thousand, respectively. For the nine months ended March 31, 2016 and 2015, the Company incurred amortization expense of \$11.6 million and \$61 thousand, respectively.

Future annual amortization expense consisted of the following as of March 31, 2016:

(In thousands)	Annual Amortization Expense
Fiscal Year Ending June 30,	

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2016	\$	8,035
2017		32,142
2018		31,264
2019		30,679
2020		30,672
Thereafter	\$	318,177
		450,969

Table of Contents

Note 12. Long-Term Debt

Secured Credit Facility

On November 25, 2015, in connection with its acquisition of KUPI, Lannett entered into a credit and guaranty agreement (the Credit and Guaranty Agreement) among certain of its wholly-owned domestic subsidiaries, as guarantors, Morgan Stanley Senior Funding, Inc., as administrative agent and collateral agent, and other lenders providing for a secured credit facility (the Senior Secured Credit Facility). The Senior Secured Credit Facility consisted of Tranche A term loans in an aggregate principal amount of \$275.0 million, Tranche B term loans in an aggregate principal amount of \$635.0 million, and a Revolving Credit Facility providing for revolving loans in an aggregate principal amount of up to \$125.0 million. As of March 31, 2016, the Company had \$125.0 million available under the Revolving Credit Facility. On April 8, 2016, the Company drew down the full \$125.0 million Revolving Credit Facility for working capital and other general purposes.

The Term Loan A Facility will mature on November 25, 2020. The Tranche A Term Loans amortize in quarterly installments (a) through December 31, 2017 in amounts equal to 1.25% of the original principal amount of the Term Loan A Facility and (b) from January 1, 2018 through September 30, 2020 in amounts equal to 2.50% of the original principal amount of the Term Loan A Facility, with the balance payable on November 25, 2020. The Term Loan B Facility will mature on November 25, 2022. The Tranche B Term Loans amortize in equal quarterly installments in amounts equal to 1.25% of the original principal amount of the Term Loan B Facility with the balance payable on November 25, 2022. The Revolving Commitments will terminate and outstanding Revolving Loans will mature on November 25, 2020.

The Secured Credit Facility is guaranteed by all of Lannett's significant wholly-owned domestic subsidiaries (the Subsidiary Guarantors) and is collateralized by substantially all present and future assets of Lannett and the Subsidiary Guarantors.

The interest rates applicable to the Term Loan Facility are based on a fluctuating rate of interest of the greater of an adjusted London Inter-bank Offered Rate (LIBOR) and 1.00%, plus a borrowing margin of 4.75% (for Tranche A Term Loans) or 5.375% (for Tranche B Term Loans). The interest rates applicable to the Revolving Credit Facility will be based on a fluctuating rate of interest of an adjusted LIBOR plus a borrowing margin of 4.75%. The interest rate applicable to the unused commitment for the Revolving Credit Facility is initially 0.50%. After Lannett delivers its financial statements for the fiscal quarter ending March 31, 2016, the interest margins and unused commitment fee on the Revolving Credit Facility will be subject to a leveraged based pricing grid.

The Senior Secured Credit Facility contains a number of covenants that, among other things, limit the ability of Lannett and its restricted subsidiaries to: incur more indebtedness; pay dividends; redeem stock or make other distributions of equity; make investments; create restrictions on the ability of Lannett's restricted subsidiaries that are not Subsidiary Guarantors to pay dividends to Lannett or make intercompany transfers; create negative pledges; create liens; transfer or sell assets; merge or consolidate; enter into sale leasebacks; enter into certain transactions with Lannett's affiliates; and prepay or amend the terms of certain indebtedness.

The Senior Secured Credit Facility contains a springing financial performance covenant that is triggered when the aggregate principal amount of outstanding Revolving Credit Loans and outstanding letters of credit as of the last day of the most recent fiscal quarter is greater than 30% of the aggregate commitments under the Revolving Credit Facility. The covenant provides that Lannett shall not permit its first lien net senior secured

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leverage ratio as of the last day of any four consecutive fiscal quarters (i) from and after December 31, 2015, to be greater than 4.25:1.00 (ii) from and after December 31, 2017 to be greater than 3.75:1.00 and (iii) from and after December 31, 2019 to be greater than 3.25:1.00.

The Senior Secured Credit Facility also contains a financial performance covenant for the benefit of the Tranche A Term Loan lenders which provides that Lannett shall not permit its net senior secured leverage ratio as of the last day of any four consecutive fiscal quarters (i) prior to December 31, 2017, to be greater than 4.25:1.00, (ii) as of December 31, 2017 and prior to December 31, 2019 to be greater than 3.75:1.00 and (iii) as of December 31, 2019 and thereafter to be greater than 3.25:1.00.

The Senior Secured Credit Facility also contains certain affirmative covenants, including financial and other reporting requirements.

12.0% Senior Notes due 2023

On November 25, 2015, Lannett issued \$250.0 million aggregate principal amount of its unsecured 12.0% Senior Notes due 2023 under an Indenture. Interest on the Senior Notes accrues at the rate of 12.0% per annum and is payable semi-annually on June 15 and December 15 of each year. The Notes mature on December 15, 2023. The Notes are guaranteed by each of Lannett's current and future domestic subsidiaries that guarantee Lannett's obligations under the Secured Credit Facility. The Notes may be redeemed at par, in whole but not in part, at any time prior to October 1, 2016.

Table of Contents

The Indenture contains covenants that, among other things, limit the ability of Lannett and Lannett's restricted subsidiaries to: incur additional indebtedness, guarantee indebtedness or issue certain preferred shares; pay dividends on, redeem or repurchase stock or make other distributions in respect of its capital stock; repurchase, prepay or redeem subordinated indebtedness; make loans and investments; create restrictions on the ability of Lannett's restricted subsidiaries to pay dividends to Lannett or the Subsidiary Guarantors or make other intercompany transfers; create liens; transfer or sell assets; consolidate, merge or sell or otherwise dispose of all or substantially all of its assets; enter into certain transactions with affiliates; and designate subsidiaries as unrestricted subsidiaries.

Upon the occurrence of certain events constituting a change of control triggering event, Lannett is required to make an offer to repurchase all of the Notes at a purchase price equal to 101% of their principal amount, plus accrued and unpaid interest, if any to the repurchase date. If Lannett sells assets under certain circumstances, it must use the proceeds to make an offer to purchase the Notes at a price equal to 100% of their principal amount, plus accrued and unpaid interest, if any, to the repurchase date.

In connection with the Secured Credit Facility and the Senior Notes, the Company incurred an initial purchaser's discount of \$72.1 million and debt issuance costs of \$32.7 million. These costs are recorded as a reduction of long-term debt in the Consolidated Balance Sheet.

Citibank Line of Credit

On November 25, 2015, in connection with the acquisition of KUPI, the Company terminated the Citibank Line of Credit.

Long-term debt, net consisted of the following:

(In thousands)	March 31, 2016	June 30, 2015
First National Bank of Cody mortgage	\$ 908	\$ 1,009
Term Loan A due 2020	271,563	
Unamortized discount and other debt issuance costs	(23,614)	
Term Loan A, net	247,949	
Term Loan B due 2022	627,062	
Unamortized discount and other debt issuance costs	(66,371)	
Term Loan B, net	560,691	
Senior Notes due 2023, (includes \$200.0 million of notes due to UCB (see Note 21))	250,000	
Unamortized debt issuance costs	(5,696)	
Senior Notes, net	244,304	
Total debt, net	1,053,852	1,009
Less current portion	(45,640)	(135)
Total long-term debt, net	\$ 1,008,212	\$ 874

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 March 31, 2016 and June 30,

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2015, the effective interest rate was 4.5% per annum. The mortgage is collateralized by the land and building with a net book value of \$1.5 million.

Long-term debt amounts due for the twelve month periods ending March 31 were as follows:

(In thousands)		Amounts Payable to Institutions
2017	\$	45,640
2018		49,084
2019		59,403
2020		59,410
2021		217,542
Thereafter		718,454
Total	\$	1,149,533

Weighted-average interest rates for the three and nine months ended March 31, 2016 was 9.2% and 9.4%, respectively.

Table of Contents

Note 13. 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 that he can prove was lost as a result of his termination. 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. Although Mr. Asherman originally sought to require that Lannett acquire his interest in Realty for an unspecified price and/or to dissolve Realty, those claims have been dismissed.

The Company strongly disputes the claims in the Complaint. If Mr. Asherman is 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 any stock options which Mr. Asherman can prove were capable of being exercised and were actually exercised within three months of his termination. The Company does not believe that he is entitled to any payments with respect to the options, plus a continuation of benefits. 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, results of operations or cash flows.

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. 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 continues to cooperate with the Connecticut Attorney General s investigation.

Federal Investigation into the Generic Pharmaceutical Industry

In fiscal year 2015, the Company and certain affiliated individuals each were served with a grand jury subpoena relating to a federal investigation of the generic pharmaceutical industry into possible violations of the Sherman Act. The subpoenas request corporate documents of the Company relating to corporate, financial, and employee information, communications or correspondence with competitors regarding the sale of generic prescription medications, and the marketing, sale, or pricing of certain products, generally for the period of 2005 through the dates of

the subpoenas.

Based on reviews performed to date by outside counsel, the Company currently believes that it has acted in compliance with all applicable laws and regulations and continues to cooperate with the federal investigation.

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.

Table of Contents

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 No. 206350 constitutes an act of patent infringement and seeking a declaration that the two patents at issue are valid and infringed.

In September 2014, the Company filed a motion to dismiss one patent infringement lawsuit for lack of standing and responded to the second lawsuit by denying that any valid patent claim would be infringed. In the second lawsuit, the Company also counterclaimed for a declaratory judgment that the patent claims are invalid and not infringed. The Court has consolidated the two actions and denied the motion to dismiss the first action without prejudice.

In July 2015, the Company filed with the United States Patent and Trademark Office (USPTO) a Petition for Inter Partes Review of each of the patents in suit seeking to reject as invalid all claims of the patents in suit. The USPTO has issued a decision denying initiation of the Inter Partes Review.

Thalomid®

The Company filed with the Food and Drug Administration an Abbreviated New Drug Application (ANDA) No. 206601, along with a paragraph IV certification, alleging that the fifteen patents associated with the Thalomid drug product (U.S. Patent Nos. 6,045,501; 6,315,720; 6,561,976; 6,561,977; 6,755,784; 6,869,399; 6,908,432; 7,141,018; 7,230,012; 7,435,745; 7,874,984; 7,959,566; 8,204,763; 8,315,886; 8,589,188 and 8,626,53) are invalid, unenforceable and/or not infringed. On January 30, 2015, Celgene Corporation and Children's Medical Center Corporation filed a patent infringement lawsuit in the United States District Court for the District of New Jersey, alleging that the Company's filing of ANDA No. 206601 constitutes an act of patent infringement and seeking a declaration that the patents at issue are valid and infringed. The Company filed an answer and affirmative defenses to the complaint.

The Company has responded to the complaint by filing a motion challenging personal jurisdiction. The court has decided to allow limited discovery on the issue of personal jurisdiction and has administratively terminated the motion while discovery is taken on the issue.

Dilaudid®

The Company filed with the Food and Drug Administration an Abbreviated New Drug Application (ANDA) No. 207108, along with a paragraph IV certification, alleging that US Patent 6,589,960 associated with the Dilaudid® (hydromorphone oral solution) would not be infringed by the Company's proposed hydromorphone oral solution product and/or that the patent is invalid. On August 8, 2015, Purdue Pharmaceutical Products L.P., Purdue Pharma L.P., and Purdue Pharma Technologies Inc. filed a patent infringement lawsuit in the United States District Court for the District of New Jersey, alleging that the Company's filing of ANDA No. 207108 constitutes an act of patent infringement and seeking a declaration that the patent at issue was infringed by the submission of ANDA No. 207108. The Company filed an answer and affirmative defenses to the complaint.

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Although the Company cannot currently predict the length or outcome of paragraph IV litigation, legal expenses associated with these lawsuits could have a significant impact on the financial position, results of operations and cash flows of the Company.

KUPI Litigation

In August 2015, KUPI received a letter from the Texas Office of the Attorney General alleging that they had inaccurately reported certain price information in violation of the Texas Medicaid Fraud Prevention Act. UCB, KUPI's previous parent company is handling the defense and is evaluating the allegations and cooperating with the Texas Attorney General's Office. Per the terms of the Stock Purchase Agreement the Company is fully indemnified for any losses associated with this matter. In conjunction with information received from UCB's legal counsel, the Company is currently unable to estimate the timing or the outcome of this matter.

KUPI Patent Infringement (Paragraph IV Certification)

Nexium®

KUPI was sued on December 5, 2013, by AstraZeneca AB, Aktiebolaget Hassle, AstraZeneca LP, KBI Inc., and KBI-E Inc., alleging infringement of U.S. Patent Nos. 5,714,504, 6,369,085, 7,411,070 and 8,466,175 through submission of an abbreviated new drug application (ANDA) to the U.S. Food and Drug Administration for approval to market 20 mg and 40 mg esomeprazole magnesium delayed-release tablets. Since the parties were not able to reach agreement on a settlement, KUPI answered the Complaint on July 8, 2015.

Although the Company cannot currently predict the length or outcome of paragraph IV litigation, legal expenses associated with these lawsuits could have a significant impact on the financial position, results of operations and cash flows of the Company.

Table of Contents

AWP Litigation

The Company and some of our competitors have been named as defendants in two lawsuits filed in 2016 alleging that the Company and a number of other generic pharmaceutical manufacturers caused the Average Wholesale Prices (AWPs) of our and their products to be inflated, thereby injuring government programs, entities and persons who reimbursed prescription drugs based on AWPs. The Company stopped using AWP as a basis for establishing prices in or around 2002 and dispute the allegations set forth in these lawsuits. The Company does not believe that the ultimate resolution of these lawsuits will have a significant impact on our financial position, results of operations or cash flows.

Private Antitrust Litigation

The Company and certain competitors have been named as defendants in four lawsuits filed in 2016 alleging that the Company and certain generic pharmaceutical manufacturers have conspired to fix prices of generic digoxin and doxycycline. The Company believes that we acted in compliance with all applicable laws and regulations. Accordingly, the Company disputes the allegations set forth in these class actions. The Company does not believe that the ultimate resolution of these lawsuits will have a significant impact on our financial position, results of operations or cash flows.

Other Litigation Matters

The Company is also subject to various legal proceedings arising out of the normal course of its business including, but not limited to, product liability, intellectual property, patent infringement claims, and antitrust matters. It is not possible to predict the outcome of these various proceedings. An adverse determination in any of these proceedings in the future could have a significant impact on the financial position, results of operations and cash flows of the Company.

Note 14. Commitments and Contingencies

Leases

The Company leases certain manufacturing and office equipment, in the ordinary course of business. These assets are typically renewed annually. Rental and lease expense was not material for all periods presented.

Future minimum lease payments under noncancelable operating leases (with initial or remaining lease terms in excess of one year) for the remainder of Fiscal 2016 and the twelve month periods ending June 30 thereafter are as follows:

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(In thousands)		Amounts Due
Remainder of 2016	\$	353
2017		1,718
2018		1,080
2019		1,080
2020		1,080
Thereafter		7,425
Total	\$	12,736

Table of Contents**Note 15. Accumulated Other Comprehensive Loss**

The Company's Accumulated Other Comprehensive Loss was comprised of the following components as of March 31, 2016 and 2015:

(In thousands)	March 31, 2016	March 31, 2015
Foreign Currency Translation		
Beginning Balance, July 1	\$ (295)	\$ (54)
Net gain (loss) on foreign currency translation (net of tax of \$0 and \$0)	15	(231)
Reclassifications to net income (net of tax of \$0 and \$0)		
Other comprehensive income (loss), net of tax	15	(231)
Ending Balance, March 31	(280)	(285)
Total Accumulated Other Comprehensive Loss	\$ (280)	\$ (285)

Note 16. Earnings Per Common Share

A dual presentation of basic and diluted earnings per common share is required on the face of the Company's Consolidated Statement of Operations as well as a reconciliation of the computation of basic earnings per common share to diluted earnings per common share. Basic earnings per common share excludes the dilutive impact of potentially dilutive securities and is computed by dividing net income (loss) attributable to Lannett Company, Inc. 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 a warrant 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 including such securities would be anti-dilutive. A reconciliation of the Company's basic and diluted earnings per common share was as follows:

(In thousands, except share and per share data)	Three Months Ended March 31,	
	2016	2015
Net income (loss) attributable to Lannett Company, Inc.	\$ (5,490)	\$ 36,233
Basic weighted average common shares outstanding	36,495,961	35,880,954
Effect of potentially dilutive stock options, warrants and restricted stock awards		1,329,184
Diluted weighted average common shares outstanding	36,495,961	37,210,138
Earnings (Loss) per common share attributable to Lannett Company, Inc.:		
Basic	\$ (0.15)	\$ 1.01
Diluted	\$ (0.15)	\$ 0.97
(In thousands, except share and per share data)	Nine months Ended March 31,	
	2016	2015
Net income attributable to Lannett Company, Inc.	\$ 41,211	\$ 115,976

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Basic weighted average common shares outstanding	36,398,030	35,715,061
Effect of potentially dilutive stock options, warrants and restricted stock awards	985,712	1,367,077
Diluted weighted average common shares outstanding	37,383,742	37,082,138

Earnings per common share attributable to Lannett Company, Inc.:

Basic	\$	1.13	\$	3.25
Diluted	\$	1.10	\$	3.13

The number of anti-dilutive shares that have been excluded in the computation of diluted earnings per share for the three months ended March 31, 2016 and 2015 were 4.4 million and 77 thousand, respectively. The number of anti-dilutive shares that have been excluded in the computation of diluted earnings per share for the nine months ended March 31, 2016 and 2015 were 2.6 million and 490 thousand, respectively.

Table of Contents**Note 17. Warrant**

In connection with the KUPI acquisition, Lannett issued to UCB Manufacturing a warrant to purchase up to a total of 2.5 million shares of Lannett's common stock (the "Warrant").

The Warrant has a term of three years (expiring November 25, 2018) and an exercise price of \$48.90 per share, subject to customary adjustments, including for stock splits, dividends, and combinations. The Warrant also has a weighted average anti-dilution adjustment provision. The estimated fair value included as part of the total consideration transferred to UCB at the acquisition date was \$29.9 million. The fair value assigned to the Warrant was determined using the Black-Scholes valuation model. The Company concluded that the warrant was indexed to its own stock and therefore the Warrant has been classified as an equity instrument.

Note 18. Share-based Compensation

At March 31, 2016, the Company had four share-based employee compensation plans (the 2003 Plan, the 2006 Long-term Incentive Plan ("LTIP"), the 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 2.4 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 March 31, 2016, there was \$10.8 million of total unrecognized compensation cost related to non-vested share-based compensation awards. That cost is expected to be recognized over a weighted average period of 1.8 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 nine months ended March 31, 2016 and 2015, the estimated annual forfeiture rates used to recognize the associated compensation expense and the weighted average fair value of the options granted:

	Nine months Ended	
	March 31, 2016	March 31, 2015
Risk-free interest rate	1.7%	1.7%
Expected volatility	48.3%	52.1%
Expected dividend yield	0.0%	0.0%
Forfeiture rate	6.5%	6.5%
Expected term	5.2 years	5.5 years
Weighted average fair value	\$ 26.24	\$ 17.67

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 actual forfeiture rate on historical awards. 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.

Table of Contents

A stock option roll-forward as of March 31, 2016 and changes during the nine months then ended is presented below:

(In thousands, except for weighted average price and life data)	Awards	Weighted- Average Exercise Price	Aggregate Intrinsic Value	Weighted Average Remaining Contractual Life (yrs.)
Outstanding at July 1, 2015	1,975	\$ 15.39		
Granted	58	\$ 59.20		
Exercised	(241)	\$ 12.94	\$ 5,975	
Forfeited, expired or repurchased	(42)	\$ 32.61		
Outstanding at March 31, 2016	1,750			