LANNETT


**MANUFACTURING AND DISTRIBUTING
HIGH QUALITY PHARMACEUTICAL PRODUCTS**

LANNETT

## COMPANY PROFILE

Lannett Company, Inc. (AMEX: LCI) develops, manufactures and distributes generic prescription pharmaceutical products in tablet, capsule and oral liquid forms to customers throughout the United States.

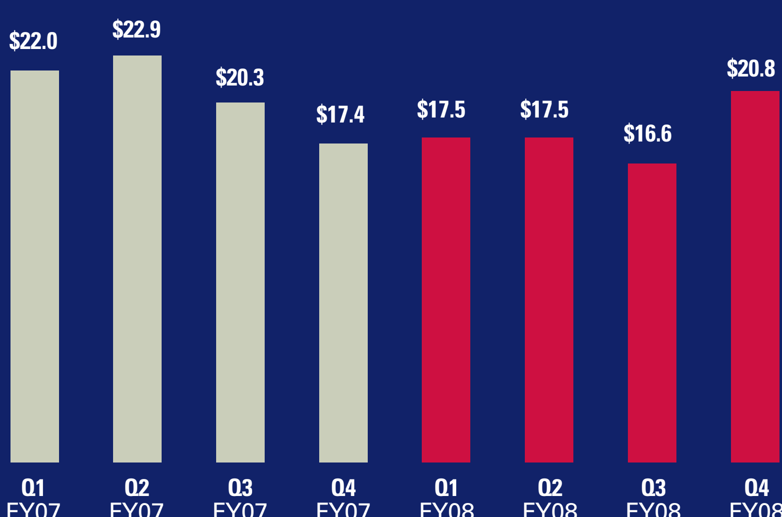
## FINANCIAL HIGHLIGHTS

| FISCAL YEAR ENDED JUNE 30, | 2008 | 2007 | 2006 | 2005 | 2004 |
|---|---|---|---|---|---|
| Net Sales | **$72,403,283** | $82,577,591 | $64,060,375 | $44,901,645 | $63,781,219 |
| Cost of Sales | **56,102,212** | 61,152,604 | 35,684,710 | 36,933,325 | 28,171,385 |
| Gross Profit | **16,301,071** | 21,424,987 | 28,375,665 | 7,968,320 | 35,609,834 |
| Operating Expenses | **21,731,605** | 27,389,396 | 19,921,747 | 61,607,978 | 14,778,765 |
| Operating (Loss) Income | **(5,430,534)** | (5,964,409) | 8,453,918 | (53,639,658) | 20,830,969 |
| Net (Loss) Income | **$(2,318,059)** | $(6,929,008) | $4,968,922 | $(32,779,596) | $13,215,454 |

| | | | |
|---|---|---|---|
| Total Current Assets | **$61,229,020** | $44,285,190 | $43,486,847 |
| Property and Equipment, Net | **24,734,103** | 27,443,161 | 19,645,549 |
| Total Assets | **116,858,608** | 104,656,100 | 105,992,064 |
| Current Liabilities | **35,638,552** | 22,250,243 | 20,040,608 |
| Long-Term Debt, Less Current Portion | **8,186,922** | 8,987,846 | 7,649,806 |
| Total Liabilities and Shareholders' Equity | **$ 116,858,608** | $104,656,100 | $105,992,064 |

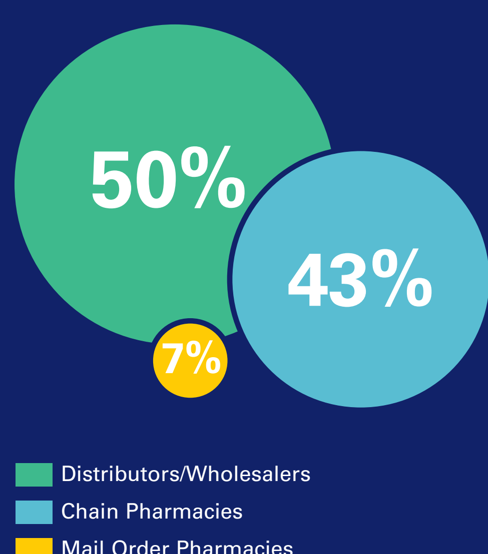
## QUARTERLY NET SALES TREND

(In Millions of Dollars)




## PERCENTAGE OF NET SALES

(By Customer Type)



Arthur P. Bedrosian
President and
Chief Executive Officer

"I promised my employees I would wear a Phillies shirt in the annual report if they won the World Series...who knew!!!"

# DEAR SHAREHOLDERS:

In Fiscal 2008, we made tremendous progress positioning Lannett for future growth. We significantly expanded our product offering and pipeline, prepared our bulk raw materials supplier to better develop pain management products, and demonstrated our ability to seize opportunities amid changing market dynamics. We believe these accomplishments will enable Lannett to continue to grow in an increasingly more competitive environment.

Net sales for Fiscal 2008 were $72.4 million, compared with $82.6 million for the prior year. Gross profit was $16.3 million, compared with $21.4 million for the prior year. Net loss was $2.3 million, or $0.10 per share, compared with a net loss of $6.9 million, or $0.29 per share, for the prior year, which included a $7.8 million write-down of debt associated with the acquisition Cody Laboratories, a bulk raw materials supplier, in April 2007.

## PRODUCT APPROVALS/LAUNCHES

In Fiscal 2008, we received FDA approvals for six new products, including Phentermine Hydrochloride Capsules 30mg, indicated for the short-term management of obesity; Dipyridamole Tablets 25mg, 50mg, and 75mg, indicated as an adjunct to coumarin anticoagulants; and Rifampin Capsules 150mg and 300mg, indicated in the treatment of all forms of tuberculosis; among others.

In addition to product approvals, in fiscal 2008 we commenced marketing Amantadine Hydrochloride Soft Gel Capsules 100mg, indicated for the prophylaxis and treatment of signs and symptoms of infection caused by various strains of influenza A virus. We currently have a number of product applications pending at the FDA and an even larger number of product candidates in various stages of development, which bodes well for the company's future growth.

## RESEARCH AND DEVELOPMENT

In April 2007, Lannett announced the acquisition of Cody Laboratories, a manufacturer/supplier of bulk active pharmaceutical ingredients (API). We have made significant progress preparing Cody to play a more prominent role in our company. In July 2008, we announced that Cody was granted an import license from the U.S. Drug Enforcement Administration (DEA), allowing the company to enter the pain management market. Adding pain management products to our portfolio will expand and diversify our customer base in a market with relatively few competitors and favorable demographics.

LANNETT






**To succeed in today's generic pharmaceutical industry, it is imperative that our company continues to provide the market with products that adhere to the highest standards in quality**

To further enhance Lannett's opportunities in the pain management market, we received approval in October 2008 from the United States Patent and Trademark Office for our patent regarding a method for the preparation of Hydromorphone and Hydrocodone, two widely prescribed pharmaceuticals. This method greatly enhances our ability to manufacture these products quickly and efficiently, as well as optimize our production assets.

## MARKET OPPORTUNITIES

Of course, these developments alone are not enough to stave off the competition. In Fiscal 2008, market conditions improved for several of Lannett's products as a result of the high quality of our products and flexible manufacturing capabilities. Specifically, the FDA's announcement in October 2007 that it was tightening label requirements for Levothyroxine Sodium, presented an opportunity for Lannett to further supply the market with a product that already met the more stringent FDA specifications.

And, when the FDA recalled the branded version of Digoxin this past year, we were able to work with our supplier to ramp up production of this critical drug. We worked closely with the FDA to ensure an uninterrupted and safe supply of Digoxin.

## MOVING FORWARD

To succeed in today's generic pharmaceutical industry, it is imperative that our company continues to provide the market with products that adhere to the highest standards in quality. Economic conditions continue to challenge consumers on a global scale, and we believe that Lannett is well positioned to help ease the burden of rising medical costs by providing equivalent generic drug alternatives.

Fiscal 2008 was a year of tremendous progress as we shape Lannett's future. Our positive Fiscal 2009 first quarter financial results are testament to our improvement. We are excited about the opportunities ahead, and confident that our hard work will enhance the value of our company and ultimately realize the goals of our customers, employees, and shareholders.

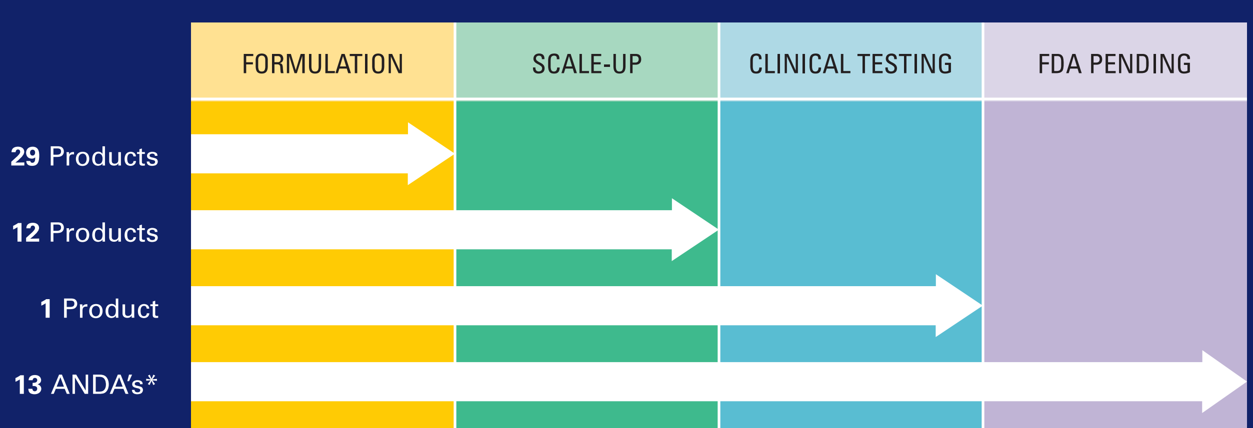
Arthur P. Bedrosian

Arthur P. Bedrosian, J.D.
President and
Chief Executive Officer

## PRODUCTS

| NAME | MEDICAL INDICATION | EQUIVALENT |
|---|---|---|
| Acetazolamide Tablets | Glaucoma | Diamox® |
| Baclofen Tablets | Muscle Relaxer | Lioresal® |
| Bethanechol Chloride Tablets | Urinary Retention | Urecholine® |
| Butalbital, Aspirin and Caffeine Capsules | Migraine Headache | Fiorinal® |
| Butalbital, Aspirin, Caffeine with Codeine Phosphate Capsules | Migraine Headache | Fiorinal w/Codeine #3® |
| Clindamycin HCl Capsules | Antibiotic | Cleocin® |
| Danazol Capsules | Endometriosis | Danocrine |
| Dicyclomine Tablets/Capsules | Irritable Bowels | Bentyl® |
| Digoxin Tablets | Congestive Heart Failure | Lanoxin® |
| Dipyridamole Tablets | Blood Clot Reduction | Persantine® |
| Doxycycline Tablets | Antibiotic | Adoxa® |
| Doxycycline Hyclate Tablets | Antibiotic | Periostat® |
| Hydrochlorothiazide Tablet | Diuretic | Hydrodiuril |
| Hydromorphone HCl Tablets | Pain Management | Dilaudid® |
| Levothyroxine Sodium Tablets | Thyroid Deficiency | Levoxyl®/Synthroid® |
| Methyltestosterone/Esterified Estrogens Tablets | Hormone Replacement | Estratest® |
| Morphine Sulfate Oral Solution | Pain Management | Roxanol® |
| Oxycodone HCl Oral Solution | Pain Management | Roxicodone |
| Phentermine HCl Tablets | Weight Loss | Adipex-P® |
| Pilocarpine HCl Tablets | Dryness of the Mouth | Salagen® |
| Primidone Tablets | Epilepsy | Mysoline® |
| Probenecid Tablets | Gout | Benemid® |
| Rifampin Capsules | Antibiotic | Rifadin® |
| Sulfamethoxazole w/Trimethoprim | Antibacterial | Bactrim® |
| Terbutaline Sulfate Tablets | Bronchospasms | Brethine® |
| Unithroid® Tablets | Thyroid Deficiency | N/A |

## DRUG DEVELOPMENT PIPELINE




*Abbreviated New Drug Application

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

## FORM 10-K/A

**(Mark One)**

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

**For the fiscal year ended June 30, 2008**

**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)

| | |
|---|---|
| **State of Delaware** | **23-0787699** |
| State of Incorporation | 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:
**None**

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

**Common Stock, $.001 Par Value**
(Title of class)

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):

| | |
|---|---|
| Large accelerated filer ☐ | Accelerated filer ☐ |
| Non-accelerated filer ☒<br>(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** ☒

Aggregate market value of Common stock held by non-affiliates of the Registrant, as of December 31, 2007 was $30,654,552 based on the closing price of the stock on the American Stock Exchange.

As of September 25, 2008, there were 24,340,402 shares of the issuer's common stock, $.001 par value, outstanding.

**Explanatory Note:**

This Amendment No. 1 on Form 10-K/A ( this “Form 10-K/A”) amends our annual report for the fiscal year ended June 30, 2008, originally filed with the Securities and Exchange Commission (“SEC”) on September 29, 2008 (the “Form 10-K”). We are filing this Form 10-K/A to delete an earlier draft of the opinion letter regarding Schedule II – “Valuation and Qualifying Accounts” that was inadvertently included along with the final version of the opinion letter in the September 29, 2008 filing.

No other information contained in the original filing is amended by this Form 10-K/A. The Form 10-K has been corrected and furnished in its entirety in this Form 10-K/A.

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## CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

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 located elsewhere in this Annual 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 and 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

### General

Lannett Company, Inc. (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 pharmaceutical products. The Company reports financial information on a quarterly and fiscal year basis, the most recent being the fiscal year ended June 30, 2008. All references herein to a fiscal year refer to the Company's fiscal year ending June 30.

The Company is focused on increasing our share of the generic pharmaceutical market. We plan to improve our financial performance by expanding our line of generic products, increasing unit sales to current customers and reducing overhead and administrative costs. In addition, our recent acquisition of Cody Laboratories, Inc. allows us to work toward vertically integrating our dosage form manufacturing in order to reduce active pharmaceutical ingredients (API) costs. Some of the new generic products sold by Lannett were developed and are manufactured by Lannett while other products are manufactured by other companies. The products manufactured or distributed by Lannett and their brand name equivalents are identified in the section entitled "**Products**" in Item 1 of this Form 10-K.

Over the past several years, Lannett has consistently devoted resources to research and development (R&D) projects, including new generic product offerings. The costs of these R&D efforts are expensed during the periods incurred. The Company believes that such investments may be recovered in future years as it submits applications to the Food and Drug Administration (FDA), and when it receives marketing approval from the FDA to distribute such products. In addition to using cash generated from its operations, the Company has entered into financing agreements with third parties to provide additional cash when needed. These financing agreements are more fully described in the section entitled "**Liquidity and Capital Resources**" in Item 7 of this Form 10-K. The Company has embarked on a plan to grow in future years. In addition to organic growth to be achieved through its own R&D efforts, the Company has also initiated marketing projects with other companies in order to expand future revenue. The Company expects that its growing list of generic drugs under development will drive future growth. The Company also intends to use the infrastructure it has created, and to continually devote resources to additional R&D projects. The following steps outline Lannett's efforts:

***Research and Development Process***

There are numerous stages in the generic drug development process:

1.) Formulation and Analytical Method Development: After a drug candidate is selected for future sales, product development chemists 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 the Company's subsequent development process. Various formulations are tested in the laboratory to measure results against the innovator drug. During this time, the Company may use reverse engineering methods on samples of the innovator drug to determine the type and quantity of inactive ingredients. During the formulation phase, the Company's research and development chemists begin to develop an analytical, laboratory testing method. The successful development of this test method will allow the Company 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 Chemical, Manufacturing and Controls section of the Abbreviated New Drug Application (ANDA) submitted to the FDA in the generic drug application.

2.) Scale-up: After the product development scientists and the R&D chemists agree on a final formulation to use in moving the drug candidate forward in the developmental process, the Company will 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 will affect the amount of raw material that is input into the manufacturing process and the number of expected tablets or capsules to be created during the production cycle. The Company attempts 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 the Company's commercial manufacturing facilities. During this manufacturing process, the Company will 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, will be included in the Company's generic drug application submitted to the FDA.

3.) Clinical testing: After a successful scale-up of the generic drug batch, the Company then schedules and performs clinical testing procedures on the product 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 the Company to determine the "success" of the generic drug product. Success, in this context, means the successful comparison of the Company's product related to the innovator product. Since bioequivalence and a stable formula are the primary requirements for a generic drug approval (assuming the manufacturing plant is in compliance with the FDA's good manufacturing quality standards), lengthy and costly clinical trials proving safety and efficacy, which are generally required by the FDA for innovator drug approvals, are unnecessary for generic companies. If the results are successful, the Company will continue the collection of documentation and information 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"). An ANDA represents a generic drug company's application to the FDA to manufacture and/or distribute a drug that is the generic equivalent to an already-approved brand named ("innovator") drug. Once bioequivalence studies are complete, the generic drug company submits an ANDA to the FDA for marketing approval.

According to the September 2008 issue of Generics Bulletin the current review time exceeds 19 months. While we have received approvals in 14 months we have also gone well beyond the 19 as discussed in the article. We see no improvement in this in the short term.

When a generic drug company files an ANDA with the FDA, it must certify that no patents are listed in the Orange Book, the FDA's reference listing of approved drugs and listed patents. An ANDA filer must certify, with respect to each application, whether the filer is challenging a patent that no patent was filed for the listed drug (a "paragraph I" certification), that the patent has expired (a "paragraph II" certification), 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 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 can trigger an automatic 30 month stay of the ANDA if the innovator company files a claim. It will delay the approval of the generic company's ANDA. Currently, Lannett has filed no paragraph IV certifications with its ANDAs.

Over the past several years, the Company has hired additional personnel in product development, production, formulation and the R&D laboratory. Lannett believes that its ability to select appropriate products for development, develop such products on a timely basis, obtain FDA approval, and achieve economies in production will be critical for its success in the generic industry. The strategy involves a combination of decisions focusing on long-term profitability and a secure market position with fewer challenges from competitors.

Competition in generic pharmaceutical manufacturing should continue to grow as more pharmaceutical products lose patent protection. However, the Company believes that with strong technical know-how, low overhead expenses, and efficient product development, manufacturing and marketing, it can remain competitive. It is the intention of the Company to reinvest as much capital as possible to develop new products as the success of any generic pharmaceutical manufacturer depends on its ability to continually introduce new generic products to the market. Over time, if a generic drug market for a specific product remains stable and consumer demand remains consistent, it is likely that additional generic manufacturing companies will pursue the generic product by developing it, submitting an ANDA, and potentially receiving marketing approval from the FDA. If this occurs, the generic competition for the drug increases, and a company's market share may drop. In addition to reduced unit sales, the unit selling price may also drop due to the product's availability from additional suppliers. This may have the effect of reducing a generic company's future net sales of the product. Due to these factors that may potentially affect a generic company's future results of operations, the ability to properly assess the competitive effect of new products, including market share, the number of competitors and the generic unit price erosion, is critical to a generic company's R&D plan. A generic company may be able to reduce the potential exposure to competitive influences that negatively affect its sales and profits by having several drug candidates in its R&D pipeline. As such, a generic company may be able to avoid becoming materially dependent on the sales of one drug. Please refer to the following section entitled "**Products**" for more descriptive information on the 28 products the Company currently produces or sells. Unlike the branded, innovator companies, Lannett does not develop new molecules nevertheless it has filed and received 2 patents at its Cody Wyoming facility with an additional one pending. However, the typical intellectual property in the generic drug industry are the ANDAs that generic drug companies own.

**Validated Pharmaceutical Capabilities**

Lannett's manufacturing facility consists of 31,000 square feet on 3.5 acres owned by the Company. In addition, the Company owns a 63,000 square foot building located within 1 mile of the manufacturing facility, which houses packaging, warehousing, shipping, R&D and a number of administrative functions. In addition, we lease a third building located several miles from the manufacturing facility, consisting of 65,000 square feet. This building is currently being used as a warehouse.

The manufacturing facility of Lannett's wholly-owned subsidiary, Cody Laboratories, Inc. (Cody) consists of 73,000 square feet on 16.2 acres in Cody, Wyoming. Cody leases the facility from Cody LCI Realty, LLC, Wyoming, which is 50% owned by Lannett and 50% by an officer of Cody.

Many FDA regulations relating to current Good Manufacturing Practices (cGMP) have been adopted by the Company in the last several years. In designing its 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 are a few examples of the sophisticated product development, manufacturing and packaging equipment the Company uses. In addition, the Company's Quality Control laboratory facilities are equipped with high precision instruments, such as automated high-pressure liquid chromatographs, gas chromatographs, robots and laser particle sizers.

Lannett continues to pursue its comprehensive plan for improving and maintaining quality control and quality assurance programs for its pharmaceutical development and manufacturing facilities. The FDA periodically inspects the Company's production facilities to determine the Company's compliance with the FDA's manufacturing standards. Typically, after the FDA completes its inspection, it will issue the Company a report, entitled a Form 483, containing the FDA's observations of possible violations of cGMP which may be minor or severe in nature. The degree of severity of the observation is generally determined by the time necessary to remediate the cGMP violation, any consequences on the consumer of the products, and whether the observation is subject to a Warning Letter from the FDA. By strictly enforcing the various FDA guidelines, namely current Good Manufacturing Practices (cGMPs) and Good Laboratory Practices (cGLPs), as well as adherence to Lannett's Standard Operating Procedures (SOPs) the Company has successfully minimized the number of observations in its FDA inspections.

**Sales and Customer Relationships**

The Company sells its 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 and health maintenance organizations. It promotes its products through direct sales, trade shows, trade publications, and bids. The Company also licenses the marketing of its products to other manufacturers and/or marketers in private label agreements.

The Company continues to expand its sales to the major chain drug stores. Its policy of maintaining an adequate inventory and fulfilling orders in a timely manner has contributed to the Company's reputation among its customers as a dependable supplier of high quality generic pharmaceuticals. Its Cody Labs subsidiary sells to dosage form manufacturers.

**Management**

The Company has been focused on increasing the size and quality of its management team in anticipation of continued growth. Managers from large, established, brand pharmaceutical companies as well as competing generic companies have been brought in to complement the skills and knowledge of the existing management team. As the Company continues to grow, additional managers may need to be added to the team. We intend to hire the best people available to expand the knowledge and expertise within the Company, in order to achieve the Company's goals.

**Products**

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

| | Name of Product | Medical Indication | Equivalent Brand |
|---|---|---|---|
| 1 | Acetazolamide Tablets | Glaucoma | Diamox® |
| 2 | Baclofen Tablets | Muscle Relaxer | Lioresal® |
| 3 | Bethanechol Chloride Tablets | Urinary Retention | Urecholine® |
| 4 | Butalbital, Aspirin and Caffeine Capsules | Migraine Headache | Fiorinal® |
| 5 | Butalbital, Aspirin, Caffeine with Codeine Phosphate Capsules | Migraine Headache | Fiorinal w/ Codeine #3® |
| 6 | Clidamycin HCl Capsules | Antibiotic | Cleocin® |
| 7 | Danazol Capsules | Endometriosis | Danocrine® |
| 8 | Dicyclomine Tablets/Capsules | Irritable Bowels | Bentyl® |
| 9 | Digoxin Tablets | Congestive Heart Failure | Lanoxin® |
| 10 | Dipyridamole Tablets | Blood Clot Reduction | Persantine® |
| 11 | Doxycycline Tablets | Antibiotic | Adoxa® |
| 12 | Doxycycline Hyclate Tablets | Antibiotic | Periostat® |
| 13 | Hydrochlorothiazide Tablet | Water Retention | Hydrodiuril® |
| 14 | Hydromorphone HCl Tablets | Pain Management | Dilaudid® |
| 15 | Levothyroxine Sodium Tablets | Thyroid Deficiency | Levoxyl®/ Synthroid® |
| 16 | Esterified Estrogen & Methyltestoterone Tablets | Hormone Replacement | Estratest® |
| 17 | Morphine Sulfate Oral Solution | Pain Management | Roxanol® |
| 18 | Multivitamin with Minerals | Prenatal Vitamin | PrimaCare ONE ® |
| 19 | Oxycodone HCl Oral Solution | Pain Management | Roxicodone® |
| 20 | Phentermine HCl Tablets | Weight Loss | Adipex-P® |
| 21 | Phentermine HCl Capsules | Weight Loss | Fastin® |
| 22 | Pilocarpine HCl Tablets | Dryness of the Mouth | Salagen® |
| 23 | Primidone Tablets | Epilepsy | Mysoline® |
| 24 | Probenecid Tablets | Gout | Benemid® |
| 25 | Rifampin Capsules | Antibiotic | Rifadin® |
| 26 | Sulfamethoxazole with Trimethoprim | Antibacterial | Bactrim® |
| 27 | Terbutaline Sulfate Tablets | Bronchospasms | Brethine® |
| 28 | Unithroid® Tablet | Thyroid Deficiency | N/A |

**Key Products**

All of the products currently manufactured and/or sold by the Company are prescription products. Of the products listed above, those containing Butalbital, Digoxin, Primidone, and Levothyroxine Sodium were the Company's key products, contributing approximately 76%, 63% and 71% of the Company's total net sales in fiscal 2008, 2007 and 2006 respectively. In Fiscal 2006, the Company began selling Sulfamethoxazole w/ Trimethoprim (SMZ/TMP). Because of a market opportunity, sales of SMZ/TMP grew from 3% of sales in 2006 to 19% of sales in 2007, but declined to 9% of net sales in 2008. This product is not included in the above key products because the supply agreement for the product expired in August 2008 and was not renewed.

The Company has two products containing Butalbital. One of the products, Butalbital with Aspirin and Caffeine capsules, has been manufactured and sold by Lannett for more than nine years. The other Butalbital product, Butalbital with Aspirin, Caffeine and Codeine Phosphate capsules is manufactured by Jerome Stevens Pharmaceuticals, Inc. (JSP). Lannett began buying this product from JSP and selling it to its customers in December 2002. Both products, which are in orally administered capsule dosage forms, are prescribed to treat tension headaches caused by contractions of the muscles in the neck and shoulder area and migraine. The drug is prescribed primarily for adults of various demographic backgrounds. Migraine headache is an increasingly prevalent condition in the United States. As conditions continue to grow, the demand for effective medical treatments will continue to grow. Common side effects of drugs which contain Butalbital include dizziness and drowsiness. The Company notes that although new innovator drugs to treat migraine headaches have been introduced by brand name drug companies, there is still a loyal following of doctors and consumers who prefer to use Butalbital products for treatment. As the brand name companies continue to promote products containing Butalbital, like Fiorinal®, the Company expects to continue to produce and sell its generic Butalbital products.

Digoxin tablets are produced and marketed with two different potencies (0.125 and 0.25 milligrams per tablet). This product is manufactured by JSP. Lannett began buying this product from JSP and selling it to its customers in September 2002. Digoxin tablets are used to treat congestive heart failure in patients of various ages and demographic backgrounds. The beneficial effects of Digoxin result from direct actions on the cardiac muscle, as well as indirect actions on the cardiovascular system mediated by effects on the autonomic nervous system. Side effects of Digoxin may include apathy, blurred vision, changes in heartbeat, confusion, dizziness, headaches, loss of appetite, nausea, vomiting and weakness.

Primidone tablets are produced and marketed with two different potencies (50 and 250 milligrams per tablet). This product was developed and is manufactured by Lannett. Lannett has been manufacturing and selling Primidone 250-milligram tablets for more than seven years. Lannett began selling Primidone 50-milligram tablets in June 2001. Both products, which are in orally administered tablet dosage forms, are prescribed to treat convulsion and seizures in epileptic patients of all ages and demographic backgrounds. Common side effects of Primidone include lack of muscle coordination, vertigo and severe dizziness.

The Company's products containing Levothyroxine Sodium tablets are produced and marketed with eleven different potencies. In addition to generic Levothyroxine Sodium tablets, the Company also markets and distributes Unithroid tablets, a branded version of Levothyroxine Sodium tablets, which is produced and marketed with eleven different potencies. Both Levothyroxine Sodium products are manufactured by JSP. Lannett began buying generic Levothyroxine Sodium tablets from JSP and selling it to its customers in April 2003. In September 2003, the Company began buying the branded Unithroid tablets from JSP and selling it to its customers. Levothyroxine Sodium tablets are used to treat hypothyroidism and other thyroid disorders. It remains one of the most prescribed drugs in the United States with over 13 million patients of various ages and demographic backgrounds. Side effects from Levothyroxine Sodium are rare, but may include allergic reactions, such as rash or hives. In late June of 2004, JSP received a letter from the FDA approving its supplemental application for generic bioequivalence to Levoxyl®. In December 2004, JSP received a letter from the FDA approving its supplemental application for generic bioequivalence to Synthroid®. With its distribution of these products, Lannett competes in a market which is currently controlled by two branded Levothyroxine Sodium tablet products—Abbott Laboratories' Synthroid® and Monarch Pharmaceutical's Levoxyl® as well as generic competition from Mylan Laboratories and Sandoz.

**New Products**

In Fiscal 2008, Lannett received 9 ANDA approvals from the FDA. We received only 1 ANDA approval in Fiscal 2007. The following contains more specific details regarding our latest approvals. Market data is obtained from Wolters Kluwer.

In July 2007, Lannett received a letter from the FDA with approval to market and launch Baclofen 10mg tablets. Baclofen is the generic version of Lioresal® and is a muscle relaxer used to treat symptoms of multiple sclerosis. According to Wolters Kluwer, total sales of generic Baclofen 10mg tablets were $151 million at average wholesale price (AWP) in 2007.

In August 2007, Lannett received two letters from the FDA with approval to market and launch Hydrochlorothiazide 25mg & 50mg tablets. Hydrochlorothiazide is the generic version of Hydrodiuril® and is a thiazide diuretic (water pill) that helps prevent your body from absorbing too much salt. According to Wolters Kluwer, total sales of generic Hydrochlorothiazide 25mg & 50mg tablets was $182 million at AWP in 2007.

In December 2007, Lannett received a letter from the FDA with approval to market and launch Phentermine HCl 30mg capsules. Phentermine HCl is the generic version of Fastin® and is an appetite suppressant. According to Wolters Kluwer, total sales of generic Phentermine HCl 30mg capsules were $37.5 million at AWP in 2007.

In March 2008, Lannett received three letters from the FDA with approval to market and launch Bethanechol Chloride 5mg, 10mg & 25mg tablets. Bethanechol Chloride is the generic version of Urecholine® and is indicated for the treatment of acute postoperative and postpartum non obstructive (functional) urinary retention and for neurogenic atony of the urinary bladder with retention. According to Wolters Kluwer, total sales of generic Bethanechol Chloride 5mg, 10mg & 25mg tablets at AWP was $56 million in 2007.

In March 2008, Lannett received a letter from the FDA with approval to market and launch Rifampin 150mg & 300mg capsules. Rifampin is the generic version of Rifadin® and is used to reduce the number of meningococcal bacteria in the nose and throat. According to Wolters Kluwer, total sales of generic Rifampin 150mg & 300mg capsules at AWP was $35 million in 2007.

In April 2008, Lannett received a letter from the FDA with approval to market and launch Dipyridamole 25mg, 50mg & 75mg tablets. Dipyridamole is the generic version of Persantine® and is used to reduce the formation of blood clots in people who have had heart valve surgery. According to Wolters Kluwer, total sales of generic Dipyridamole 25mg, 50mg & 75mg tablets at AWP was $45 million in 2007.

Additional products are currently under development. These products are either orally administered, solid-dosage products (i.e. tablet/capsule) or oral solutions, topicals or parentarels designed to be generic equivalents to brand named innovator drugs. The Company's 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 currently under development is dependent on numerous factors not limited to the following: the complexity of the active ingredient's chemical characteristics, the price of the raw materials, the FDA-mandated requirement of bioequivalence studies—depending on the FDA's Orange Book classification and other developmental factors. The estimated cost to develop a new generic product ranges from $100,000 to $1 million.

In addition, as one of the oldest generic drug manufacturers in the country formed in 1942, Lannett currently owns several ANDAs that are dormant on the Company's records for products which it does not manufacture and market. Occasionally, the Company reviews such ANDAs to determine if the market potential for any of these older drugs has recently changed to make it attractive for Lannett to reconsider manufacturing and selling them. If the Company decides to introduce one of these products into the consumer market, it must review the ANDA and related documentation to ensure that the approved product specifications, formulation and other factors meet current FDA requirements for the marketing of that drug. Generally, in these situations, the Company must 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. The Company 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 its internal product development group, Lannett has 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 are orally administered solid dosage products intended to treat a diverse range of medical indications. It is the Company's intention to ultimately transfer the formulation technology and manufacturing process for all of these R&D products to the Company's own commercial manufacturing sites. The Company initiated these outsourced R&D efforts to complement the progress of its own internal R&D efforts.

The majority of the Company's R&D projects are being developed in-house under Lannett's direct supervision and with Company personnel. Hence, the Company does not believe that its outside contracts for product development or manufacturing supply are material in nature, nor is the Company substantially dependent on the services rendered by such outside firms. Since the Company has no control over the FDA review process, management is unable to anticipate whether or when it will be able to begin producing and shipping such additional products.

The following table summarizes key information related to the Company's R&D products. 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 filing.

2.) Regulatory Requirement – Defines whether the R&D product is or is expected to be a new ANDA submission, an ANDA supplement, or a grand-fathered product not requiring specific FDA approval.

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.

| Stage of R&D | Regulatory Requirement | Number of Products |
|---|---|---|
| FDA Review | ANDA | 10 |
| FDA Review | ANDA supplement | 3 |
| Clinical Testing | ANDA | 1 |
| Scale-Up | Grand-fathered | 0 |
| Scale-Up | ANDA supplement | 0 |
| Scale-Up | ANDA | 12 |
| Formulation/Method Development | ANDA | 29 |

**Raw Materials and Finished Goods Inventory Suppliers**

The raw materials used by the Company in the production process consist of pharmaceutical chemicals in various forms and are generally available from several sources. FDA approval is required in connection with the process of using most active ingredient suppliers. In addition to the raw materials purchased for the production process, the Company purchases certain finished dosage inventories, including capsule, tablet, and oral liquid products. The Company then sells these finished dosage products directly to its customers along with the finished dosage products internally manufactured. If suppliers of a certain material or finished product are limited, the Company will generally take certain precautionary steps to avoid a disruption in supply, such as finding a secondary supplier or ordering larger quantities.

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 approximately 71% of the Company's inventory purchases in Fiscal 2008, 63% in Fiscal 2007 and 76% in Fiscal 2006. 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 four million (4,000,000) shares of the Company's common stock. The JSP products covered under the agreement included Butalbital, Aspirin, Caffeine with Codeine Phosphate capsules, Digoxin tablets and Levothyroxine Sodium tablets, sold generically and under the brand name Unithroid®. The term of the agreement is ten years, beginning on March 23, 2004 and continuing through March 22, 2014. Refer to the Materials Contract footnote to our consolidated financial statements for more information on the terms, conditions, and financial impact of this agreement.

During the term of the agreement, the Company is required to use commercially reasonable efforts to purchase minimum dollar quantities of JSP's products being distributed by the Company. The minimum quantity to be purchased in the first year of the agreement was $15 million. Thereafter, the minimum purchase quantity increases by $1 million per year up to $24 million for the last year of the ten-year contract. The Company has met the minimum purchase requirement for the first four years of the contract, but there is no guarantee that the Company will be able to continue to do so in the future. If the Company does not meet the minimum purchase requirements, JSP's sole remedy is to terminate the agreement.

In August 2005, the Company signed an agreement with a finished goods provider to purchase, at fixed prices, and distribute a certain generic pharmaceutical product in the United States. Purchases of finished goods inventory from this provider accounted for approximately 14% of the Company's costs of purchased inventory in Fiscal 2008, 23% in 2007, and 11% in 2006. The term of the agreement was three years, beginning on August 22, 2005 and continuing through August 21, 2008. Following its expiration on August 21, 2008, the agreement was not renewed.

The Company signed supply and development agreements with Olive Healthcare, Wintac and Unichem of India; Orion Pharma of Finland; Azad Pharma AG of Switzerland, Pharmaseed in Israel and Banner Pharmacaps and Catalent in the United States. The Company is also in negotiations with companies in Israel for similar new product initiatives in which Lannett will market and distribute products manufactured by third parties.

**Customers and Marketing**

The Company sells its products primarily to wholesale distributors, generic drug distributors, mail-order pharmacies, group purchasing organizations, chain drug stores, and other pharmaceutical companies. The industry's largest wholesale distributors, McKesson, Cardinal Health, and Amerisource Bergen, accounted for 6%, 10%, and 6%, respectively, of net sales in Fiscal 2008. The Company's largest chain drug store customer, Walgreens, accounted for 36% of net sales in Fiscal 2008. The Company performs ongoing credit evaluations of its customers' financial condition, and has experienced no significant collection problems to date. Generally, the Company requires no collateral from its customers.

Sales to these 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." Lannett enters into agreements with its indirect customers to establish pricing for certain products. The indirect customers then independently select a wholesaler from which to actually purchase the products at these agreed-upon prices. Lannett will provide credit to the wholesaler for the difference between the agreed-upon price with the indirect customer and the wholesaler's invoice price. This credit is called a chargeback. For more information on chargebacks, refer to the section entitled "Chargebacks" 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 Lannett's books as sales to the wholesale customers.

The Company believes 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, the Company believes that consumer demand will be fulfilled by other wholesale or retail sources of supply. As such, Lannett attempts 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 the Company's products through whatever channel the consumer prefers. Although the Company has agreements with customers governing the transaction terms of its sales, there are no minimum purchase quantities with these agreements.

The Company promotes its products through direct sales, trade shows, trade publications, and bids. The Company also markets its products through private label arrangements, under which Lannett produces its products with a label containing the name and logo of a customer. This practice is commonly referred to as private label business. It allows the Company to leverage its internal sales efforts by using the marketing services from other well-respected pharmaceutical dosage suppliers. The focus of the Company's sales efforts is the relationships it creates with its customer accounts. Strong customer relationships have created a positive platform for Lannett to increase its sales volumes. Advertising in the generic pharmaceutical industry is generally limited to trade publications, read by retail pharmacists, wholesale purchasing agents and other pharmaceutical decision-makers. Historically and in Fiscal 2008, 2007, and 2006, the Company's advertising expenses were immaterial. When the customer and the Company's sales representatives make contact, the Company will generally offer to supply the customer its 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 the Company's supply of product, the customer typically expects a high standard of service, including shipping product in a timely manner, maintaining convenient and effective customer service functions, and retaining a mutually beneficial dialogue of communication. The Company believes that although the generic pharmaceutical industry is a commodity industry where price is the primary factor for sales success, these additional service standards are also important to the customers that rely on a consistent source of supply.

**Competition**

The manufacture and distribution of generic pharmaceutical products is a highly competitive industry. Competition is based primarily on price, service and quality. Our competitive advantage is based on our ability to provide superior customer service (fulfilling customer's in critical need of inventory, carrying excess finished goods inventory and providing added value) by insuring the Company's 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.

The Company competes with other manufacturers and marketers of generic and brand drugs. Each product manufactured and/or sold by Lannett has a different set of competitors. The list below identifies the companies with which Lannett primarily competes for each of its major products.

| Product | Primary Competitors |
|---|---|
| Butalbital with Aspirin and Caffeine, with and without Codeine Phosphate Capsules ...................... | Watson Pharmaceuticals, Breckenridge Pharmaceutical (manufactured by Anabolic Laboratories) |
| Digoxin Tablets ...................................................... | GlaxoSmithKline, Caraco Pharmaceutical Laboratories, Westward Pharmaceuticals |
| Doxycycline............................................................ | Par Pharmaceuticals, Ranbaxy Laboratories |
| Levothyroxine Sodium Tablets................................ | Abbott Laboratories, Monarch Pharmaceuticals, Mylan Laboratories, Sandoz, Forest Laboratories |
| Primidone Tablets................................................... | Watson Pharmaceuticals, Qualitest Pharmaceuticals, URL, Westward Pharmaceuticals, Amneal Pharmaceuticals, Impax Labs |
| Sulfamethoxazole w/ Trimethoprim ........................ | URL/Mutual Pharmaceuticals, Sandoz, Vista, Teva |
| Unithroid Tablets.................................................... | Abbott Laboratories, Monarch Pharmaceuticals, Mylan Laboratories, Sandoz |

**Government Regulation**

Pharmaceutical manufacturers are subject to extensive regulation by the federal government, principally by the FDA and the Drug Enforcement Agency (DEA) and to a lesser extent, by other federal regulatory bodies and state governments. The Federal Food, Drug and Cosmetic Act, the Controlled Substance Act, and other federal statutes and regulations govern or influence the testing, manufacture, safety, labeling, storage, record keeping, approval, pricing, advertising, and promotion of the Company's generic drug products. Noncompliance with applicable regulations can result in fines, recall 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 products.

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 as a new medical treatment. 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 may be used for generic equivalents. Typically, the investment required to develop a generic drug is less costly than the brand 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 paragraphs is available, a manufacturer must conduct and submit to the FDA complete clinical studies to establish a drug's safety and efficacy.

- ***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. In addition to establishing a new ANDA procedure, this 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.

Additionally, the Hatch-Waxman Act extends for up to five years the term of a product or use patent covering a drug to compensate the patent holder for the reduction of the effective market life of a patent due to federal regulatory review. With respect to certain drugs not covered by patents, the act sets specified time periods of two to ten years during which ANDAs for generic drugs cannot become effective or, under certain circumstances, cannot be filed if the branded drug was approved after December 31, 1981. Lannett, like most other generic drug companies, uses the ANDA process for the submission of its developmental generic drug candidates.

- ***Paper New Drug Applications (Paper NDA also known as a 505(b)(2))****:* For a drug that is identical to a drug first approved after 1962, 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. 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 bioeqivalency testing were undertaken and approved by FDA. Moreover, the utility of Paper NDAs has been further diminished by the recently broadened availability of the ANDA process, as described above.

Among the requirements for new drug approval is the requirement that the prospective manufacturer's methods conform to the FDA's current Good Manufacturing Practice. The cGMP Regulations must be followed at all times during which the approved drug is manufactured. In complying with the standards set forth in the cGMP Regulations, the Company must continue to expend time, money, and effort in the areas of production and quality control to ensure full technical compliance. Failure to comply with the cGMP Regulations risks possible FDA action, including but not limited to, the seizure of noncomplying drug products or, through the Department of Justice, enjoining the manufacture of such products.

The Company is also subject to federal, state, and local laws of general applicability, such as laws regulating working conditions and the storage, transportation, or discharge of items that may be considered hazardous substances, hazardous waste, or environmental contaminants. The Company monitors its compliance with all environmental laws. The Company is in substantial compliance with all regulatory bodies.

As a publicly traded company we are also subject to significant regulations, including 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.

Lannett operates in a highly regulated environment and is responsible for maintaining compliance with many regulatory requirements. The U.S. Department of Justice, acting on behalf of the U.S. Drug Enforcement Administration ("DEA"), recently issued a letter to the Company requesting additional information on certain record keeping matters regarding a DEA inspection of Lannett's facilities. The Company intends to fully comply with this and all requests for information that occur from time to time as a normal course of business

**Research and Development**

The Company incurred research and development (R&D) expenses of approximately $5,173,000 in 2008, $7,459,000 in 2007, and $8,102,000 in 2006. The R&D spending includes spending on bioequivalence studies, internal development resources, as well as outsourced development. While the Company manages all R&D from our offices in Philadelphia, we have also been taking advantage of favorable development costs in other countries. We have alliances with various companies that either act as contract research organizations or active pharmaceutical ingredient suppliers as well as dosage form manufacturers. In addition, US based Clinical Research Organizations have been engaged for product development to enhance our internal development. Fixed payment arrangements are established with these development partners, and can range from $150,000 to $250,000 to develop a drug. Development payments are normally scheduled in advance, based on milestones.

**Employees**

The Company currently has 187 employees at Lannett and an additional 35 employees at Cody.

**Securities Exchange Act Reports**

The Company maintains an Internet website at the following address: www.lannett.com. The Company makes available on or through its Internet website certain reports and amendments to those reports that are filed with the Securities and Exchange Commission (SEC) in accordance with the Securities Exchange Act of 1934. These 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 the Company's website free of charge as soon as reasonably practicable after the Company electronically files the information with, or furnishes it to, the SEC. The contents of the Company's website are not incorporated by reference in this Form 10-K and shall not be deemed "filed" under the Securities Exchange Act of 1934.

## ITEM 1A. RISK FACTORS

We operate in a rapidly changing environment that involves a number of risks, some of which are beyond our control. The following discussion highlights some of these risks and others are discussed elsewhere in this report. These and other risks could materially and adversely affect our business, financial condition, operating results or cash flows.

**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 active pharmaceutical ingredients 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 issued and been listed with the FDA after the key chemical patent on the branded 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.

**If KV were to prevail in its countersuit against us, and the Company were subject to paying damages or were prohibited from selling the Prenatal Multivitamin in the future, it could have an adverse impact on the Company**.

In early June 2008, the Company filed a declaratory judgment suit against KV Pharmaceuticals, DrugTech Corp., and Ther-Rx Corp (collectively "KV"). The complaint sought declaratory judgment for non-infringement and invalidity of certain patents owned by KV. The complaint further sought declaratory judgment of anti-trust violations and federal and state unfair competition violations for actions taken by KV in securing and enforcing these patents. After the complaint was filed, KV countered with a motion for a Temporary Restraining Order ("TRO") to prevent the Company from launching its Multivitamin with Mineral Capsules ("MMCs"), due to alleged patent and trademark infringement issues. The TRO was heard and, ultimately, resulted in a conclusion by the court that the Company's product label on the MMCs should be modified. KV also countered with claims of infringement by the Company of KV's patents seeking the Company's profits for sales of MMCs or other monetary relief, preliminary and permanent injunctive relief, attorney's fees and a finding of willful infringement. The case is currently in its discovery phase with a hearing expected in January 2009. The Company believes that it has meritorious defenses with respect to the claims asserted against it and intends to vigorously defend its position.

**The 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, 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.

**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 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 amount 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.

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

Many branded 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 branded 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 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 branded product is expiring, an area where infringement litigation is prevalent, and in the case of new branded 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. 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.

**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 could negatively impact profitability.**

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

**The loss of our 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 key personnel. 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 of our senior executive officers.

**Significant balances of intangible assets, including product rights acquired, are subject to impairment testing and may result in impairment charges, which will adversely affect our results of operations and financial condition.**

Our acquired contractual rights to market and distribute products are stated at cost, less accumulated amortization and related impairment charges identified to date. We determined the initial cost by referring to the original fair value of the assets exchanged. Future amortization periods for product rights are based on our assessment of various factors impacting estimated useful lives and cash flows of the acquired products. Such factors include the product's position in its life cycle, the existence or absence of like products in the market, various other competitive and regulatory issues and contractual terms. Significant changes to any of these factors would require us to perform an additional impairment test on the affected asset and, if evidence of impairment exists, we would be required to take an impairment charge with respect to the asset. Such a charge would adversely affect our results of operations and financial condition.

**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, principally the FDA and to a lesser extent by the DEA, and state government agencies. The Federal Food, Drug and Cosmetic Act, the Controlled Substances Act and other federal statutes and regulations govern or influence the testing, manufacturing, packing, labeling, storing, record keeping, safety, approval, advertising, promotion, sale and distribution of our products.

Under these regulations, we are subject to periodic inspection of our facilities, procedures and operations and/or the testing of our products by the FDA, the DEA and other authorities, which conduct periodic inspections to confirm that we are in compliance with all applicable regulations. In addition, the FDA conducts pre-approval and post-approval reviews and plant inspections to determine whether our systems and processes are in compliance with current Good Manufacturing Practice, or cGMP, and other FDA regulations. Following such inspections, the FDA may issue notices on Form 483 that could cause us 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. FDA guidelines specify that a "Warning Letter" is issued only for violations of "regulatory significance" for which the failure to adequately and promptly achieve correction may be expected to result in an enforcement action. Any such sanctions, if imposed, could materially harm our operating results and financial condition. Under certain circumstances, the FDA also has the authority to revoke previously granted drug approvals. Similar sanctions as detailed above may be available to the FDA under a consent decree, depending upon the actual terms of such decree. 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. Certain of our vendors are subject to similar regulation and periodic inspections.

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. 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.

**Federal regulation of arrangements between manufacturers of branded 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 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 branded drugs. This new requirement could affect the manner in which generic drug manufacturers resolve intellectual property litigation and other disputes with branded 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.

**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.

For the year ended June 30, 2008, our three largest customers accounted for 36%, 10% and 6% respectively, of our net sales. 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 has no long-term supply agreements with its customers which would require them to purchase our products.

## ITEM 2. DESCRIPTION OF PROPERTY

Lannett owns two facilities in Philadelphia, Pennsylvania. The administrative offices, quality control laboratory, and manufacturing and production facilities are located in a 38,000 square foot facility at 9000 State Road in Philadelphia. The second facility consists of 65,000 square feet, and is located within 1 mile of the State Road location, 9001 Torresdale Avenue in Philadelphia. Our research laboratory, package, warehousing and distribution operations, sales and accounting departments are located in the second building.

In June 2006, Lannett signed a lease agreement on a 66,000 square foot facility in Philadelphia. An additional agreement which gives us the option to buy the facility was also signed. This new facility is initially going to be used for warehouse space with the expectation of making this facility our headquarters in addition to manufacturing and warehousing. The other Philadelphia locations will continue to be utilized as manufacturing, packaging, and as a research laboratory. This gives Lannett the space to fit its desire to expand.

Cody, a subsidiary of Lannett, leases a 73,000 square foot facility in Cody, Wyoming. This location houses Cody's manufacturing and production facilities. Cody leases the facility from Cody LCI Realty, LLC, Wyoming, which is 50% owned by Lannett and 50% by an affiliate of Cody Labs.

## ITEM 3. LEGAL PROCEEDINGS

In early June 2008, the Company filed a declaratory judgment suit against KV Pharmaceuticals, DrugTech Corp., and Ther-Rx Corp (collectively "KV"). The complaint sought declaratory judgment for non-infringement and invalidity of certain patents owned by KV. The complaint further sought declaratory judgment of anti-trust violations and federal and state unfair competition violations for actions taken by KV in securing and enforcing these patents. After the complaint was filed, KV countered with a motion for a Temporary Restraining Order ("TRO") to prevent the Company from launching its Multivitamin with Mineral Capsules ("MMCs"), due to alleged patent and trademark infringement issues. The TRO was heard and, ultimately, resulted in a conclusion by the court that the Company's product label on the MMCs should be modified. KV also countered with claims of infringement by the Company of KV's patents seeking the Company's profits for sales of MMCs or other monetary relief, preliminary and permanent injunctive relief, attorney's fees and a finding of willful infringement. The case is currently in its discovery phase with a hearing expected in January 2009. The Company believes that it has meritorious defenses with respect to the claims asserted against it and intends to vigorously defend its position.

In or about July 2008, Albion International and Albion, Inc. filed suit against Lannett asserting claims for patent and trademark infringement, as well as unfair competition, arising out of Lannett's use of product that it purchased from Albion and used as an ingredient in its MMC. Lannett filed a motion to dismiss the complaint on the basis that it purchased the product from Albion and, as such, was authorized to use the product in its MMC. The Court has not ruled on the motion. Lannett is no longer purchasing product from Albion. If Albion were to prevail on its claims, it may be entitled to a reasonable royalty on the Lannett product that contained the Albion ingredient. The Company believes that Albion's claims have no merit and Lannett intends to vigorously defend the suit.

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

No matters have been submitted to a vote of the Company's security holders during the quarter ended June 30, 2008.

# PART II

## ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

### Market Information

On April 15, 2002, the Company's common stock began trading on the American Stock Exchange. Prior to this, the Company's common stock traded in the over-the-counter market through the use of the inter-dealer "pink-sheets" published by Pink Sheets LLC. The following table sets forth certain information with respect to the high and low daily closing prices of the Company's common stock during Fiscal 2008 and 2007, as quoted by the American Stock Exchange. Such quotations reflect inter-dealer prices without retail mark-up, markdown, or commission and may not represent actual transactions.

**Fiscal Year Ended June 30, 2008**

| | High | Low |
|---|---|---|
| First quarter | $ 6.20 | $ 3.65 |
| Second quarter | $ 5.14 | $ 3.05 |
| Third quarter | $ 3.55 | $ 2.34 |
| Fourth quarter | $ 4.80 | $ 2.05 |

**Fiscal Year Ended June 30, 2007**

| | High | Low |
|---|---|---|
| First quarter | $ 6.38 | $ 4.55 |
| Second quarter | $ 6.94 | $ 5.28 |
| Third quarter | $ 6.83 | $ 5.09 |
| Fourth quarter | $ 7.15 | $ 5.08 |

### Holders

As of September 25, 2008, there were approximately 258 holders of record of the Company's common stock.

### Dividends

The Company did not pay cash dividends in Fiscal 2008 or Fiscal 2007. 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 shareholders expect to receive, cash dividends in the foreseeable future.

## ITEM 6. SELECTED FINANCIAL DATA

The following financial information as of and for the five years ended June 30, 2008, has been derived from the Company's Consolidated Financial Statements. This information should be read in conjunction with the Consolidated Financial Statements and related notes thereto included elsewhere herein.

The comparability of information is affected by the write-off of a portion of a note receivable due from Cody Labs, and the subsequent acquisition of Cody Labs (a provider of active pharmaceutical ingredients ("API")) in Fiscal 2007. Approximately $7.8 million of notes were written-off prior to the Cody Labs acquisition, representing the excess of the note receivable over the fair value of assets received of approximately $4.4 million.

Statement of Financial Accounting Standards (SFAS) 123(R), *"Share-Based Payment,"* was adopted on July 1, 2005 using the modified prospective transition method. Because the modified prospective transition method was elected, results for prior periods have not been restated to include share-based compensation expense for stock options or the Company's Employee Stock Purchase Plan. See Note 1 to the financial statements in Item 8 for more information.

In Fiscal 2005, the Company determined that an intangible asset related to acquired product rights was impaired. At that time, the Company determined that this intangible was impaired and a $46.1 million impairment charge was recorded.

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

| As of and for the Fiscal Year Ended June 30, | 2008 | 2007 | 2006 | 2005 | 2004 |
|---|---|---|---|---|---|
| ***Operating Highlights*** | | | | | |
| Net Sales | $ 72,403,283 | $ 82,577,591 | $ 64,060,375 | $ 44,901,645 | $ 63,781,219 |
| Gross Profit | $ 16,301,071 | $ 21,424,987 | $ 28,375,665 | $ 7,968,320 | $ 35,609,834 |
| Operating (Loss)/Income | $ (5,430,534) | $ (5,964,409) | $ 8,453,918 | $ (53,639,658) | $ 20,830,969 |
| Net (Loss)/Income | $ (2,318,059) | $ (6,929,008) | $ 4,968,922 | $ (32,779,596) | $ 13,215,454 |
| Basic (Loss)/Earnings Per Share | $ (0.10) | $ (0.29) | $ 0.21 | $ (1.36) | $ 0.63 |
| Diluted (Loss)/Earnings Per Share | $ (0.10) | $ (0.29) | $ 0.21 | $ (1.36) | $ 0.63 |
| ***Balance Sheet Highlights*** | | | | | |
| Total Assets | $ 116,858,608 | $ 104,656,100 | $ 105,992,064 | $ 94,917,060 | $ 131,904,084 |
| Total Debt | $ 8,978,834 | $ 9,679,965 | $ 8,196,692 | $ 9,532,448 | $ 10,092,857 |
| Long Term Debt | $ 8,186,922 | $ 8,987,846 | $ 7,649,806 | $ 7,262,672 | $ 8,104,141 |
| Total Stockholders' Equity | $ 69,271,480 | $ 70,183,175 | $ 75,755,916 | $ 69,249,244 | $ 102,246,991 |

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

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 2009, and any current reports on Form 8-K filed by the Company.

### Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties and potentially result in materially different results under different assumptions and conditions. We believe that our critical accounting policies include those described below. For a detailed discussion on the application of these and other accounting policies, refer to Note 1 in the Notes to the Consolidated Financial Statements included herein.

**Consolidation of Variable Interest Entity** – The Company consolidates any Variable Interest Entity ("VIE") of which we are the primary beneficiary. The liabilities recognized as a result of consolidating a VIE do not represent additional claims on our general assets; rather, they represent claims against the specific assets of the consolidated VIE. Conversely, assets recognized as a result of consolidating a VIE do not represent additional assets that could be used to satisfy claims against our general assets. Reflected in the June 30, 2008 and 2007 balance sheets are consolidated VIE assets of $1.9 and $1.8 million, respectively, which is comprised mainly of land and a building. VIE liabilities consist of a mortgage on that property in the amount of $1.7 and $1.8 million at June 30, 2008 and 2007, respectively. This VIE was initially consolidated by Cody, as Cody has been the primary beneficiary. Cody has then been consolidated within Lannett's financial statements since its acquisition in April 2007.

**Revenue Recognition** – The Company recognizes revenue when its products are shipped. At this point, title and risk of loss have transferred to the customer and provisions for rebates, promotional adjustments, price adjustments, returns, chargebacks, and other potential adjustments are reasonably determinable. Accruals for these provisions are presented in the consolidated financial statements as rebates, chargebacks and returns payable and as reductions to net sales. The change in the reserves for various sales adjustments may not be proportionally equal to the change in sales because of changes in both the product and the customer mix. Increased sales to wholesalers will generally require additional accruals as they are the primary recipient of chargebacks and rebates. Incentives offered to secure sales vary from product to product. Provisions for estimated rebates and promotional credits are estimated based upon contractual terms. Provisions for other customer credits, such as price adjustments, returns, and chargebacks, require management to make subjective judgments on customer mix. Unlike branded innovator drug companies, Lannett does not use information about product levels in distribution channels from third-party sources, such as IMS and Wolters Kluwer, in estimating future returns and other credits. Lannett calculates a chargeback/rebate rate based on contractual terms with its customers and applies this rate to customer sales. The only variable is customer mix, and this assumption is based on historical data and sales expectations. The chargeback/rebate reserve is reviewed on a monthly basis by management using several ratios and calculated metrics. As we continue to obtain additional information about our historical experience for chargebacks, rebates and returns, we also update our estimates of the required reserves.

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

***Rebates –*** Rebates are offered to the Company's key chain drug store and wholesaler customers to promote customer loyalty and increase product sales. These rebate programs provide customers with rebate credits upon attainment of pre-established volumes or attainment of net sales milestones for a specified period. Other promotional programs are incentive programs offered to the customers. At the time of shipment, the Company estimates reserves for rebates and other promotional credit programs based on the specific terms in each agreement. The reserve for rebates increases as sales to rebate-eligible customers are recognized and decreases when actual rebate payments are made. However, since 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 certain customers to return product within a specified period prior to and subsequent to the product's lot expiration date in exchange for a credit to be applied to future purchases. The Company's policy requires that the customer obtain pre-approval from the Company for any qualifying return. The Company estimates its provision for returns based on historical experience, adjusted for any changes in business practices or conditions that would cause management to believe that future product returns may differ from those returns assumed in the establishment of reserves. Generally, the reserve for returns increases as sales increase and decrease when credits are issued or payments are made for actual returns received. The reserve for returns is included in the rebates and chargebacks payable account on the balance sheet.

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

The following tables identify the reserves for each major category of revenue allowance and a summary of the activity for the fiscal years ended June 30, 2008, 2007 and 2006. Unless we have specific information to indicate otherwise, actual credits issued in a given year are assumed to be related to sales recorded in prior years based on the Company’s returns policy. The following tables have been revised to conform to this assumption.

**For the Year Ended June 30, 2008**

| Reserve Category | Chargebacks | Rebates | Returns | Other | Total |
|---|---|---|---|---|---|
| Reserve Balance as of June 30, 2007 | $ 4,649,478 | $ 871,339 | $ 113,313 | $ 52,234 | $ 5,686,364 |
| Actual credits issued related to sales recorded in prior fiscal years | (4,556,488) | (1,741,804) | (4,909,659) | — | (11,207,951) |
| Reserves or (reversals) charged during Fiscal 2008 related to sales in prior fiscal years | — | 870,465 | 5,892,805 | (50,000) | 6,713,270 |
| Reserves charged to net sales during Fiscal 2008 related to sales recorded in Fiscal 2008 | 26,126,995 | 7,999,232 | 12,546,130 | 473,423 | 47,145,780 |
| Actual credits issued related to sales recorded in Fiscal 2008 | (22,170,578) | (7,366,918) | — | (473,550) | (30,011,046) |
| Reserve Balance as of June 30, 2008 | $ 4,049,407 | $ 632,314 | $ 13,642,589 | $ 2,107 | $ 18,326,417 |

| Reserve Category | Chargebacks | Rebates | Returns | Other | Total |
|---|---|---|---|---|---|
| Reserve Balance as of June 30, 2006 | $10,137,400 | $2,183,100 | $416,000 | $275,600 | $13,012,100 |
| Actual credits issued related to sales recorded in prior fiscal years | (10,170,000) | (1,800,000) | (5,578,000) | (250,000) | (17,798,000) |
| Reserves or (reversals) charged during Fiscal 2007 related to sales recorded in prior fiscal years | — | (300,000) | 3,572,313 | — | 3,272,313 |
| Reserves charged to net sales in fiscal 2007 related to sales recorded in fiscal 2007 | 28,034,000 | 9,562,000 | 1,703,000 | 1,044,800 | 40,343,800 |
| Actual credits issued related to sales in fiscal 2007 | (23,351,922) | (8,773,761) | — | (1,018,166) | (33,143,849) |
| Reserve Balance as of June 30, 2007 | $4,649,478 | $871,339 | $113,313 | $52,234 | $5,686,364 |

**For the Year Ended June 30, 2006**

| Reserve Category | Chargebacks | Rebates | Returns | Other | Total |
|---|---|---|---|---|---|
| Reserve Balance as of June 30, 2005 | $ 7,999,700 | $ 1,028,800 | $ 1,692,000 | $ 29,500 | $ 10,750,000 |
| Actual credits issued related to sales recorded in prior fiscal years | (7,920,500) | (1,460,500) | (1,273,300) | (59,300) | (10,713,600) |
| Reserves or (reversals) charged during Fiscal 2006 related to sales recorded in prior fiscal years | — | 500,000 | (500,000) | — | — |
| Reserves charged to net sales in fiscal 2006 related to sales recorded in fiscal 2006 | 28,237,000 | 5,688,500 | 497,300 | 1,298,200 | 35,721,000 |
| Actual credits issued related to sales in fiscal 2006 | (18,178,800) | (3,573,700) | 0 | (992,800) | (22,745,300) |
| Reserve Balance as of June 30, 2006 | $ 10,137,400 | $ 2,183,100 | $ 416,000 | $ 275,600 | $ 13,012,100 |

**Reserve Activity 2008 vs. 2007**

The total reserve for chargebacks, rebates, returns and other adjustments increased from $5,686,364 at June 30, 2007 to $18,326,415 at June 30, 2008. The increase in the reserve balance was primarily the result of our decision to record during the fourth quarter of Fiscal 2008 a $10,536,000 provision for the expected return of 100% of the shipments of Prenatal Multivitamin. Our expectation that all of the product would be returned was based on our inability to have the product specified as a brand equivalent, and information from our customers regarding their intentions to return the product. Also during our fiscal year 2008 we increased our estimated returns reserve by approximately $3.0 million, based on an analysis of our historical returns experience, the average lag time between sales and returns and our understanding of the buying patterns and inventory practices of both our direct and indirect customers. This change in estimate incorporated new information that has allowed us to better estimate the average length of time between product sales and returns. As this change resulted from new information that has allowed us to better estimate the average length of time between product sales and returns, we consider it to be a change in estimate as defined in SFAS 154: *Accounting Changes and Error Corrections – A Replacement of APB Opinion No. 20 and FASB Statement No. 3.*

During fiscal year 2008, we also experienced an unanticipated increase in our returns compared to historical experience that required us to record a provision of approximately $3.0 million in fiscal year 2008 for returns related to sales in prior years. We believe, however, that this increase in return was largely related to certain specific nonrecurring events.

The decline in chargeback and rebate reserves between June 30, 2007 and June 30, 2008 was due in part to a change in our sales mix away from wholesalers and toward the chain drug stores as well as a decrease in inventory levels at wholesaler distribution centers. The following tables compare the year-end reserve balances in fiscal 2008 and 2007 and the sales mix in fiscal 2008 and fiscal 2007.

| | Fiscal Year Ended June 30, | | | |
|---|---|---|---|---|
| | 2008 | % | 2007 | % |
| Chargeback reserve | $ 4,049,407 | 22% | $ 4,649,478 | 82% |
| Rebate reserve | 632,314 | 3% | 871,339 | 15% |
| Return reserve | 13,642,589 | 74% | 113,313 | 2% |
| Other reserve | 2,107 | 0% | 52,234 | 1% |
| | $ 18,326,417 | 100% | $ 5,686,364 | 100% |

| | Fiscal Year ended June 30, | | Fiscal Fourth Quarter | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Chain drug stores | 34% | 24% | 35% | 34% |
| Mail Order | 3% | 4% | 4% | 4% |
| Wholesalers | 62% | 72% | 61% | 62% |
| Private Label | 0% | 0% | 0% | 0% |
| | 100% | 100% | 100% | 100% |

**Reserve Activity 2007 vs. 2006**

The total reserves for chargebacks, rebates, returns and other adjustments decreased from $13,012,100 at June 30, 2006 to $5,686,364 at June 30, 2007 The decrease reflected a change in customer sales mix away from wholesalers and toward the chain drug stores which reduces total chargebacks because wholesalers are typically the only customers who are eligible for chargebacks and rebates,. The decrease in rebate reserve to $871,339 from $2,183,100 at June 30, 2006 was also due to the decrease in sales to wholesalers as well as a decrease in sales in the fourth quarter of Fiscal 2007. There was a large rebate reserve as of June 30, 2006 as direct customers (only direct customers are eligible to receive rebates) represented a larger-than-usual percentage of sales in the month of June.

The following tables compare the year-end reserve balances for fiscal 2007 and 2006, and the customer sales mix in Fiscal 2007 and Fiscal 2006.

| | Fiscal Year Ended 6/30, | | | |
|---|---|---|---|---|
| | 2007 | % | 2006 | % |
| Chargeback reserve | $ 4,649,478 | 82% | $ 10,137,400 | 78% |
| Rebate reserve | 871,339 | 15% | 2,183,100 | 17% |
| Return reserve | 113,313 | 2% | 416,000 | 3% |
| Other reserve | 52,234 | 1% | 275,600 | 2% |
| | $ 5,686,364 | 100% | $ 13,012,100 | 100% |

| | Fiscal Year ended June 30, | | Fiscal Fourth Quarter | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Chain drug stores | 24% | 13% | 34% | 10% |
| Mail Order | 4% | 7% | 4% | 6% |
| Wholesalers | 72% | 78% | 62% | 82% |
| Private Label | 0% | 2% | 0% | 2% |
| | 100% | 100% | 100% | 100% |

Other reserves have decreased since June 30, 2006, due to an unusually high level of shelf stock adjustments required in the prior year. Changes in competition in the Primidone 50 market required Lannett to give more of this type of credit in the prior year.

During the year, the Company began to implement improvements to separately calculate the provisions, credits and reserves for chargebacks, rebates and returns including the performance of several types of analysis to ensure reserves are reasonable. These included analysis of wholesaler versus direct (or retail) sales mix; revenue reserve relative to gross sales; comparison of net receivables to net sales; comparison of gross receivables to gross sales; and recalculation of wholesaler inventory levels. Because we were unable to independently verify product sales levels at the final customer, wholesaler inventory reports were used to calculate potential chargebacks and rebates based on known contracted rebate and chargeback rates.

The decrease in the chargeback reserve to $4,649,478 at June 30, 2007 from $10,137,400 at June 30, 2006 is due to the decrease in sales to wholesalers. The decrease in rebate reserve to $871,339 from $2,183,100 at June 30, 2006 is also due to the decrease in sales to wholesalers plus the decrease in overall sales in the fourth quarter of Fiscal 2007. There was a large rebate reserve as of June 30, 2006 as direct customers (those who receive the only rebates) were a larger than usual portion of sales in the month of June – 58%, typically 50%.

During the Fiscal year ended June 30, 2007, the Company began to implement improvements to separately calculate the chargebacks and reserves. Management is continuing to make improvements to the calculation and reconciliation of these amounts. Management performs several types of analysis to ensure reserves are reasonable. This includes ratio analysis of: 1) wholesaler versus direct (or retail) sales mix, 2) revenue reserve to gross sales, 3) comparison of net receivables to net sales, 4) comparison of gross receivables to gross sales and 5) recalculation of wholesaler inventory levels.

The return and other reserves have decreased since June 30, 2006, due to an unusually high level of shelf stock adjustments required in the prior year. Changes in the competition in the Primidone 50 market required Lannett to give more of this type of credit in the prior year.

Fluctuations in the amount of sales through the wholesaler channel will have an impact on the amount of reserve being charged. Due to the fact that wholesale sales result in greater chargebacks, a change in wholesale sales will directly correlate to change in the chargebacks required. For the first, second, third and fourth quarters of Fiscal 2007, reserves recorded against sales amounted to $12.0 million, $10.5 million, $12.7 million and $4.7 million, respectively. Wholesaler sales were $16.2 million, $12.4 million, $12.8 million and $8.7 million, respectively. The decrease in the dollar value of the reserves corresponds to the increase in wholesale sales, most significantly in the fourth quarter. For the first, second, third and fourth quarters of Fiscal 2006, reserves recorded against sales amounted to $7.1 million, $7.4 million, $12.0 million and $9.7 million, respectively. Wholesaler sales were $9.3 million, $9.9 million, $16.7 million and $15.8 million, respectively. This third quarter increase in sales and reserves during Fiscal 2006 is a result of increased demand for Levothyroxine Sodium, for which the reserve rebate and chargeback reserve remains consistent, but is higher than most other products. This drug's reserves are higher than other drugs because of the number of competitors in the market. This may change if the number of competitors decline because low prices will force some competitors out of the market, which in turn may lead to higher prices. Fourth quarter sales to wholesalers dropped off slightly from the third quarter. The reserves in the fourth quarter also declined because of the product mix, but were consistent with reserves in the first and second quarters.

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

The Company also regularly monitors accounts receivable ("AR") balances by reviewing both net and gross day's sales outstanding ("DSO"). Net DSO is calculate by dividing gross accounts receivable less the reserve for rebates, chargebacks, returns and other adjustments by the average daily net sales for the period. Gross DSO shows the result of the same calculation without regard to rebates, chargebacks, returns and other adjustments.

The Company monitors both net DSO and gross DSO as an overall check on collections and to assess the reasonableness of the reserves. Gross DSO provides management with an understanding of the frequency of customer payments, and the ability to process customer payments and deductions. The net DSO calculation provides management with an understanding of the relationship of the A/R balance net of the reserve liability compared to net sales after charges to the reserves during the period. Standard payment terms offered to customers are consistent with industry practice at 60 days. Net DSO provides us with an understanding of the relationship of the A/R balance net of the reserve liability compared to net sales after reserves charged during the period. It eliminates the effect of timing of processing, which is inherent in the gross DSO calculation.

The following table shows the results of these calculations for the fiscal years ended June 30, 2008, 2007 and 2006:

| Fiscal Year Ended June 30, | 2008 | 2007 | 2006 |
|---|---|---|---|
| Net DSO (in days) .......................................... | 65 | 72 | 56 |
| Gross DSO (in days)....................................... | 70 | 74 | 77 |

The level of both net and gross DSO at June 30, 2008 is consistent with the Company's expectation that DSO will be in the 60 to 70 day range, based on 60 day payment terms for most customers

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

***New Accounting Pronouncements -***.

In July 2006, the FASB issued FIN 48, which addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based solely on position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. FIN 48 also provides guidance on derecognition, classification, interest and penalties on income taxes, accounting in interim periods and requires increased disclosures. FIN 48 is effective for fiscal years beginning after December 15, 2006. We adopted the provisions of FIN 48 on July 1, 2007. See Note 16.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" (SFAS 157). This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice. In February, 2008, the FASB issued FASB Staff Position 157-1, Application of FASB Statement No. 157 to FASB Statement 13 and Other Accounting Pronouncements That Address Fair value Measurements for Purposes of Lease Classification and Measurement under Statement 13 (FSP FAS 157-1) and FASB Staff Position 157-2, Effective Date of FASB Statement No. 157 (FSP FAS 157-2). FSP FAS 157-1 amends SFAS 157 to remove certain leasing transactions from its scope. FSP FAS 157-2 defers the effective date of SFAS No. 157 for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. We adopted the guidance of SFAS 157 as it applies to our financial instruments on July 1, 2008 and do not expect the adoption will have a significant impact on our consolidated financial statements

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115* (SFAS No. 159), which allows companies to choose, at specific election dates, to measure eligible financial assets and liabilities at fair value that are not otherwise required to be measured at fair value. If a company elects the fair value option for an eligible item, changes in that item's fair value in subsequent reporting periods must be recognized in current earnings. SFAS 159 is effective for our fiscal year beginning July 1, 2008. We do not expect the adoption of SFAS 159 will have a significant impact on our consolidated financial statements as we have not elected to apply the fair value option to any of our financial assets and liabilities.

In June 2007, the EITF reached a final consensus on EITF Issue No. 07-3, "Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities" ("EITF 07-3"). EITF 07-3 is effective for our fiscal year beginning July 1, 2008. EITF 07-3 requires non-refundable advance payments for future research and development activities to be capitalized until the goods have been delivered or related services have been performed. As the guidance in EITF 07-03 is consistent with our existing policy we do not believe EITF 07-03 will have any impact on our financial statements or related disclosures.

In November 2007, the EITF reached a final consensus on EITF Issue No. 07-1, "Accounting for Collaborative Arrangements Related to the Development and Commercialization of Intellectual Property" ("EITF 07-1"). EITF 07-1 will be effective for our fiscal year beginning July 1, 2009 and interim periods within that fiscal year. Adoption is on a retrospective basis to all prior periods presented for all collaborative arrangements existing as of the effective date. We are currently evaluating the impact of adopting EITF 07-1 on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations" ("SFAS 141(R)"). SFAS 141(R) will significantly change the accounting for business combinations in a number of areas including the treatment of contingent consideration, contingencies, acquisition costs, in-process research and development and restructuring costs. In addition, under SFAS 141(R), changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact income tax expense. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the fiscal year beginning July 1, 2009. Early application is not permitted. The effect of SFAS 141(R) on our consolidated financial statements will depend on the nature and terms of any business combinations that occur after its effective date.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements" ("SFAS 160"). SFAS 160 amends Accounting Research Bulletin No. 51 to establish accounting and reporting standards for the noncontrolling (minority) interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements and establishes a single method of accounting for changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation. SFAS 160 is effective for our fiscal year beginning July 1, 2009. We are currently evaluating the impact the adoption of SFAS 160 will have our consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities" ("SFAS 161"). The new standard is intended to help investors better understand how derivative instruments and hedging activities affect an entity's financial position, financial performance and cash flows through enhanced disclosure requirements. The new standard is effective for our fiscal year beginning July 1, 2009 and for all interim periods within that fiscal year. Early adoption is encouraged. We do not expect the adoption of SFAS 161 to have a significant impact on our consolidated financial statements as we do not currently have any derivatives within the scope of SFAS 161.

In April 2008, the FASB issued FASB Staff Position No. FAS 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP FAS 142-3"). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, "Goodwill and Other Intangible Assets". The FSP is intended to improve the consistency between the useful life of a recognized intangible asset under Statement 142 and the period of expected cash flows used to measure the fair value of the asset under

SFAS 141(R) and other U.S. generally accepted accounting principles. The new standard is effective for our financial statements issued for fiscal years and interim periods beginning July 1, 2009. We are currently evaluating the impact of FSP FAS 142-3.

**Results of Operations – Fiscal 2008 compared to Fiscal 2007**

Net sales decreased 12% from $82,577,591 in Fiscal 2007 to $72,403,283 in Fiscal 2008. The decrease reflected increased competition in the generic drug market which adversely affected Lannett's sales of certain antibacterial drugs as well as sales of drugs used in the treatment of epilepsy. Prices of antibiotic drugs declined 34% from prior year levels due to increased competition, which partly offset higher sales volumes. Prices of Lannett's heart failure drugs increased slightly from prior year levels and sales volumes increased 49% from the prior year level, largely due to the impact of a product recall of one of Lannett's competitors during the quarter ended June 30, 2008. Thyroid medication, our largest product in terms of sales, showed continued growth in both volume and in price. The following table presents the percentage changes in prices and volumes for the Company's products, by medical indication.

| Medical indication | Sales volume change % | Sales price change % |
|---|---|---|
| Migraine Headache | 18% | (17)% |
| Antibiotics | 136% | (34)% |
| Epilepsy | (20)% | (36)% |
| Heart Failure | 49% | 8% |
| Thyroid | 5% | 4% |

We plan to continue to increase the number of products available for sale to our customers, although FDA approvals are needed to achieve this growth.

The Company sells its products to customers in various categories. The table below presents the Company's net sales to each category.

| Customer Category | Fiscal 2008 Net Sales | Fiscal 2007 Net Sales |
|---|---|---|
| Wholesaler/Distributor | $30.5 million | $49.4 million |
| Retail Chain | $37.1 million | $27.9 million |
| Mail-Order Pharmacy | $4.5 million | $5.1 million |
| Private Label | $0.3 million | $0.2 million |
| Total | $72.4 million | $82.6 million |

Wholesaler/Distributor sales decreased as a result of one of Lannett's major wholesalers withdrawing from the one-stop program which used Lannett as a first call supplier. Retail chain sales increased significantly as a result of an increase in the number of products available for sale and a significant increase in the number of retail stores of one of our customers. Mail order pharmacy sales decreased from the prior year due mainly to the market shift toward retail chains at the expense of mail order pharmacy sales. Private label sales increased slightly from the prior year, although this channel is not expected to contribute significantly to Lannett's sales in the future as we have decided not to actively pursue additional private label customers because of the lower margins for this business.

In 2006, prior to its acquisition by Lannett, Cody received an FDA warning letter, and stopped operations to remediate their facility. This remediation occurred from the months of August 2006 through February 2007. Upon completion of the remediation, Cody requested an FDA inspection. Subsequent FDA inspection resulted in relatively minor Form 483 observations, which have since been remediated. In March 2008 Cody Labs recommenced manufacturing operations after management concluded that certain regulatory deficiencies identified by the FDA prior to Lannett's acquisition were substantially remediated.

Cost of sales (excluding amortization of intangible assets) decreased 6%, from $57,394,751 in Fiscal 2007 to $54,080,947 in Fiscal 2008. The decrease reflected the 12% decrease in net sales, partly offset by the impact of normal inflationary pressures on labor and material costs and expenses related to the Company's prenatal vitamin with mineral product.

The amortization expense relates to the March 23, 2004 exclusive marketing and distribution rights agreement with Jerome Stevens Pharmaceutical. For the remaining six years of the contract, the Company will incur annual amortization expense of approximately $1,785,000.

Gross profit as a percent of net sales declined to 23% in Fiscal 2008 from 26% in Fiscal 2007, due in part to expenses related to the prenatal multivitamin with mineral product, and price erosion for antibiotics, heart failure products and epilepsy medications. While the Company is continuously striving to keep product costs low, there can be no guarantee that profit margins will decline in future periods due to pricing pressure from competitors and costs of producing or purchasing new drugs. Changes in the product mix may also occur which also affect gross could profit as a percent of sales in future periods. The Company has changed the presentation of amortization of intangibles and product royalty expenses, in an effort to comply with the SEC's Staff Accounting Bulletin Topic 11-B (SAB 11-B). Accordingly, amortization of intangible assets and product royalty expense is now presented before gross profit in order to align the financial reporting with this SEC guidance, and prior periods have been reclassified on order to be consistent with the current presentation.

Research and development ("R&D") expenses decreased 31% to $5,172,715 in Fiscal 2008 from $7,459,432 in Fiscal 2007. The decrease was primarily due to a decrease in the production of drugs in development and preparation for submission to the FDA. 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 planned submissions to the FDA.

Selling**,** general and administrative expenses increased 36% to $16,552, 859 in Fiscal 2008 from $12,161,187 in Fiscal 2007, primarily due to the inclusion of a full year of general and administrative expenses of Cody, which was acquired in the fourth quarter of Fiscal 2007. The remaining increase in expense reflects increased legal expenses and higher professional fees. While the Company is focused on controlling costs, increases in personnel costs may have an ongoing impact on the administrative cost structure. Other costs are being incurred to facilitate improvements in the Company's infrastructure.

On March 31, 2007, the Company recorded an impairment charge of $7,775,890 on a note receivable owed by Cody. On April 10, 2007, it was decided to complete the acquisition of Cody by forgiving the remaining balance of the receivable. See discussion below in *Results of Operations – Fiscal 2007 compared to Fiscal 2006*.

Interest expense increased to $383,267 in Fiscal 2008 from $273,633 in Fiscal 2007, reflecting full year impact of the interest expense on a mortgage held by Cody Realty LLC. Effective with the acquisition of Cody labs on April 10, 2007, the Company consolidated the operations of Lannett Realty LLC, a variable interest entity that had been fully consolidated by Cody Labs (see Note 13).

The Company recorded an income tax benefit of $3,376,011 in Fiscal 2008 on a pretax loss after minority interest of $5,694,070 as compared to tax expense of $1,007,929 in Fiscal 2007 on a pretax loss of $5,921,079. The inclusion of state income taxes, federal income tax credits, and a reduction in the valuation allowance for deferred tax assets were the principal reasons for the effective tax rate of $59.3% in fiscal 2008.

At June 30, 2008, the Company has recognized a net deferred tax asset of $21,198,706. The net deferred tax asset is net of a valuation allowance of $2,314,498 for the specific total tax asset of $2,106,798 related to the Cody notes receivable impairment incurred in conjunction with the acquisition of Cody Labs and the $207,700 tax benefit associated with the state income tax net operating loss carryforwards. 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 valuation allowance related to the tax benefit of the state operating loss carryforwards has been established as the Company does not expect these carryforwards to be utilized due to the Company's tax planning strategies at the state and local levels. 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.

The Company reported a net loss of $2,318,059 for Fiscal 2008, or $0.10 basic and diluted loss per share, compared to net loss of $6,929,008 for Fiscal 2007, or $0.29 basic and diluted loss per share.

**Results of Operations – Fiscal 2007 compared to Fiscal 2006**

Net sales increased by 29% from $64,060,375 in Fiscal 2006 to $82,577,591 in Fiscal 2007. The increase was due in part from continued improvement in sales of Levothyroxine Sodium (Levo), which increased $18.1 million, or 121% over the prior year sales, and Sulfamethoxazole with Trimethoprim (SMZ) which increased $14.9 million, a 570% increase. These increases were offset partially by decreases in other existing products, most significantly Primidone tablets, of which sales declined $5,152,000. The Company is working to offset continued declines in existing products through new product offerings. The increase in Levo sales was due entirely to an increase in the quantity of bottles sold. The increase in SMZ was due to quantity increases of nearly 390% and price increases of 180%.

Overall, product sales quantities increased 100% (including new products), leading to increased sales. Pricing pressure, due to increased competition and new customer demands for lower prices offset the volume increase, resulting in the 29% sales increase over Fiscal 2006. SMZ pricing benefited from the departure of a competitor from the market. Such pricing changes due to competition are not predictable. For that reason, the Company must maintain its focus on developing new products every year to expand the number of products available to supply to customers. Net sales of new products are often impacted by greater incentives to wholesalers. Excluding sales of SMZ in Fiscal 2007, the Company experienced a decline in new product net sales in the year. This is due to the Company receiving fewer approvals from the FDA during the year. At June 30, 2007, the Company had 18 products, as ANDA and ANDA supplements, awaiting approval from the FDA as compared to 10 at June 30, 2006.

The Company sells its products to customers in various categories. The table below identifies the Company's net sales to each category.

| **Customer Category** | **Fiscal 2007 Net Sales** | **Fiscal 2006 Net Sales** |
|---|---|---|
| Wholesaler/Distributor .......... | $49.4 million | $44.0 million |
| Retail Chain .......................... | $27.9 million | $10.6 million |
| Mail-Order Pharmacy ............ | $5.1 million | $7.0 million |
| Private Label......................... | $0.2 million | $2.5 million |
| Total...................................... | $82.6 million | $64.1 million |

Wholesaler/distributor sales increased due to a rebound in Levothyroxine Sodium sales and sales of new products. Levo and SMZ sales increased as wholesalers began to reorder the product in larger volumes in Fiscal 2006. Retail Chain sales increased significantly due to a new significant customer agreement signed during Fiscal 2007. Mail order pharmacy sales decreased slightly from the prior year. Private label sales decreased due to our largest private label customer, Qualitest, receiving FDA approval in late November 2005 to manufacture its own Primidone 50mg. As disclosed previously, private label sales have continued to decline, as Lannett does not actively pursue additional private label customers because of the lower margins and product label inventories required to service the category.

Cost of sales (excluding amortization of intangible assets) increased 69%, from $33,900,045 in Fiscal 2006 to $57,394,751 in Fiscal 2007. This increase is due in part to higher production volumes to meet increased sales demand, and increased purchases of finished products for sale. Gross margins were 30% in 2007, a decline from 47% in 2006. In spite of the significant increase in net sales, the Company has increasing sales of drugs made by other companies, and distributed by Lannett. The margins on these drugs are typically lower than margins on produced drugs. The Company also launched a greater amount of new drugs in the prior year, and was able to take advantage of its new products and the higher margin on these products in 2006. Depending on future market conditions for each of the Company's products, changes in the future sales product mix may occur. New drug approvals may increase in future years. Currently, there are 18 products at the FDA review stage. These changes may affect the gross profit percentage in future periods.

Research and development ("R&D") expenses decreased by $643,033 or 8%. The decrease in R&D was primarily due to a decrease in raw material consumption for production of experimental batches.

Selling, general and administrative expenses increased $2,334,382, or 20% from the prior year. A significant portion of the increase is due to expenses incurred in Fiscal 2007 that relate to marketing agreements tied to sales of new generic products.

The amortization expense relates to the March 23, 2004 exclusive marketing and distribution rights agreement with JSP. For the remaining seven years of the contract, the Company will incur annual amortization expense of approximately $1,785,000.

On March 31, 2007, the Company wrote down $7,775,890 of a note receivable owed by Cody Laboratories, Inc. The Company determined that the value of the note receivable was impaired, and on April 10, 2007, it was decided to complete the acquisition of Cody by forgiving a portion of the loan. At that point, Cody owed Lannett approximately $11.7 million, in the form of notes receivable and prepayments on products and services. The remaining value of the amounts owed, or $4.4 million was approximately the net asset value of Cody at the time of the acquisition.

The Note was determined to be uncollectible due to FDA reviews and operational delays by Cody to return to operation. In 2006, Cody received an FDA warning letter, and stopped operations to remediate their facility. This remediation occurred from the months of August 2006 through February 2007. Upon completion of the remediation, Cody requested a future FDA inspection. The timing of that inspection was, at that time, unknown, and Cody management was unable to conclude as to the outcome of that inspection. With such a limited outlook, Cody management suggested that the full note was not likely to be satisfied, and Lannett management was not willing to loan further funds to Cody to keep it in operation. Both companies agreed to complete the acquisition for the value of the Cody's net assets. The uncollected portion of debt was extinguished prior to the acquisition.

Upon acquisition, the fair value of Cody's assets was added to the Company's Consolidated Balance Sheets, and the results of operations were included in the Consolidated Statements of Operations from the acquisition date forward. Due to the fact that most of the value of Cody consisted of physical assets that were recently acquired as part of the remediation, the fair value closely approximated the book value of net assets. In accordance with the Financial Accounting Standards Board Statement No. 141, "Business Combinations," measurement is based on the fair value of the consideration given or the fair value of the asset (or net assets) acquired, whichever is more clearly evident and, thus, more reliably measurable.

The Company's net loss for Fiscal 2007 includes an income tax expense of $1,007,929, as compared to an expense of $3,561,175 in Fiscal 2006. The Company has set up a valuation allowance on the tax benefit from the write-off of a portion of the Cody loan described above in Fiscal 2007. This has led to an income tax expense despite of the net loss from operations.

The Company reported net loss of $6,929,008 for Fiscal 2007, or $.29 basic and diluted loss per share, compared to net income of $4,968,922 for Fiscal 2006, or $.21 basic and diluted earnings per share.

**Liquidity and Capital Resources**

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, 2008, working capital was $25,590,468, as compared to $22,034,947 at June 30, 2007, an increase of $3,555,521.

Net cash provided by operating activities of $3,118,222 for the Fiscal year ended June 30, 2008 reflected cash provided from changes in operating assets and liabilities of $3,855,513, partly offset by a net loss of $1,580,768 after adjusting for non-cash items of $737,291. Significant changes in operating assets and liabilities are comprised of:

1. An increase in trade accounts receivable (excluding the receivables related to the sales of prenatal multivitamins with minerals) of $2,000,951 was due to a higher level of sales at the end of Fiscal 2008, compared to the end of Fiscal 2007.
2. A decrease in inventory of $2,901,226 due to higher-than-usual inventories at June 30, 2007 reflecting purchases from Jerome Stevens Pharmaceutical in the quarter ended June 30, 2007in response to strong demand for Levothyroxine Sodium, Butalbital and Digoxin products.
3. A decrease in prepaid taxes of $1,594,748 due to the application of an overpayment of taxes in Fiscal 2007 to taxes owed in Fiscal 2008.
4. An increase in accounts payable of $4,779,328 is due to the timing of payments at the end of the month combined with increased spending on products for resale, primarily Levothyroxine Sodium tablets.
5. A decrease in accrued expenses of $2,693,834 was due to a high level of accrual for materials received at the end of Fiscal 2007 primarily related to distributed products.

Net cash used in investing activities of $1,391,766 for the twelve months ended June 30, 2008 reflected the purchase of property, plant and equipment of $2,295,817, partially offset by $882,671 of net proceeds related to the sale of the Company's marketable securities.

Net cash used in financing activities for the year ending June 30, 2008 was $662,085 primarily due to scheduled debt repayments of $701,131, partially offset by $113,422 of proceeds from the issuance of stock in connection with the

Company’s Employee Stock Purchase Plan. In addition, the Company withheld the issuance of shares of stock with a fair value of $74,376 in connection with the payment of withholding taxes owed by certain employees for vested restricted stock.

During Fiscal 2008, the Company issued restricted stock with a fair value of $300,090 to settle a liability for employee bonuses that had been earned during Fiscal 2007. This represented a non-cash transaction and is therefore not included on the Consolidated Statement of Cash Flows for Fiscal 2008.

The Company has entered into agreements with various government agencies and financial institutions to provide additional cash to help finance the Company’s operations. These borrowing arrangements as of June 30, 2008 are as follows.

The Company had a $3,000,000 million line of credit from Wachovia Bank, N.A. that bears interest at the prime interest rate less 0.25% (4.75% at June 30, 2008). The Company had $2,912,247 available under this line of credit at June 30, 2008. The line of credit was renewed and extended to November 30, 2009. The Company also entered into a letter of credit in the amount of $917,000 of which $87,753 is outstanding as of June 30, 2008.

The Company borrowed $4,500,000 from the Philadelphia Industrial Development Corporation (PIDC). The Company will pay a bi-annual interest payment at a rate equal to two and one-half percent per annum. The outstanding principal balance shall be due and payable 60 months from January 1, 2006.

The Company borrowed $1,250,000 through the Pennsylvania Industrial Development Authority (PIDA). The Company is required to make equal payments each month for 180 months starting February 1, 2006 with interest of two and three-quarter percent per annum. The PIDA Loan has $1,075,732 outstanding as of June 30, 2008 with $73,132 currently due.

The Company had borrowed $500,000 from the Pennsylvania Department of Community and Economic Development Machinery and Equipment Loan Fund. The Company is required to make equal payments for 60 months starting May 1, 2006 with interest of two and three quarter percent per annum. As of June 30, 2008, $283,475 is outstanding and $100,614 is currently due.

In April 1999, the Company entered into a loan agreement with the Philadelphia Authority for Industrial Development (the “Authority” or “PAID”), to finance future construction and growth projects of the Company. The Authority issued $3,700,000 in tax-exempt variable rate demand and fixed rate revenue bonds to provide the funds to finance such growth projects pursuant to a trust indenture (“the Trust Indenture”). A portion of the Company’s proceeds from the bonds was used to pay for bond issuance costs of approximately $170,000. The Trust Indenture requires that the Company repay the Authority loan through installment payments beginning in May 2003 and continuing through May 2014, the year the bonds mature. The bonds bear interest at the floating variable rate determined by the organization responsible for selling the bonds (the “remarketing agent”). The interest rate fluctuates on a weekly basis. The effective interest rate at June 30, 2008 was 1.67%. At June 30, 2008, the Company has $795,000 outstanding on the Authority loan, of which $115,000 is classified as currently due. The remainder is classified as a long-term liability. In April 1999, an irrevocable letter of credit of $3,770,000 was issued by Wachovia Bank, National Association (Wachovia) to secure payment of the Authority Loan and a portion of the related accrued interest. At June 30, 2008, no portion of the letter of credit has been utilized.

The Company entered into agreements (the “2003 Loan Financing”) with Wachovia to finance the purchase of the Torresdale Avenue facility, the renovation and setup of the building, and other anticipated capital expenditures. The Company, as part of the 2003 Loan Financing agreement, is required to make equal payments of principal and interest. The only portion of the loan that remains outstanding at June 30, 2008 was the Equipment Loan which consists of a term loan with a term of five years and had an outstanding balance of $400,653. The terms of the Equipment loan require that the Company meet certain financial covenants and reporting standards, including the attainment of specific financial liquidity and net worth ratios. As of June 30, 2008, the Company was not in compliance with one of these covenants, but received a waiver from its lending institution with respect to that covenant as of June 30, 2008. The Company shall maintain and comply with a debt service coverage ratio of not less than 2 to 1 (to be measured quarterly). Debt service coverage is defined as the ratio of earnings before interest, taxes, depreciation and amortization (EBITDA) to the sum of interest expenses plus scheduled current maturities of long-term debt and current capitalized lease obligations. The terms of the waiver require the Company shall at all times maintain deposit balances in excess of $3,500,000 with the Bank. Additionally, the Company shall now pay to the Bank an availability fee equal to 0.50% per annum calculated daily, on the available but unused balance of the line of credit instead of the previous 0.25% per annum rate. The financing facilities under the 2003 Loan Financing bear interest at a variable rate equal to the LIBOR rate plus 150 basis points. We believe that it is possible that we may not be able to comply with all of the covenants at each measurement date during the twelve month period ending June 30, 2009; therefore we reclassified the $80,132 long-term portion of the debt to current portion of long-term debt. As of June 30, 2008, the interest rate for the 2003 Loan Financing (of which only the Equipment loan remains) was 3.89%.

The Company has executed Security Agreements with Wachovia, PIDA and PIDC in which the Company has agreed to use substantially all of its assets to collateralize the amounts due.

As part of the acquisition of Cody Laboratories, the Company assumed the debt owed to the Small Business Administration ("SBA"). The loan requires fixed monthly payments through July 31, 2012.

The effective interest rate at June 30, 2008 was 8.75%. As of June 30, 2008, $183,750 is outstanding under the SBA loan, of which $54,025 is classified as currently due. Cody has pledged inventory, accounts receivable and equipment as collateral for this loan.

Also as a result of the acquisition of Cody, the Company must now consolidate Cody LCI Realty, LLC, a variable interest entity ("VIE"), for which Cody Labs is the primary beneficiary. See Note 13 for "Consolidation of Variable Interest Entities." A mortgage loan with First National Bank of Cody related to the purchase of land and building by the VIE has also been consolidated in the Company's consolidated balance sheets. The mortgage has approximately 18 years of principal and interest payments remaining, with monthly payments of $14,782, at a fixed rate of 7.5%, to be made through June 2026. As of June 30, 2008, the Company has $1,740,224 outstanding under the mortgage loan, of which $48,488 is classified as currently due.

In July 2004, the Company received $500,000 of grant funding from the Commonwealth of Pennsylvania, acting through the Department of Community and Economic Development. The grant funding program requires the Company to use the funds for machinery and equipment located at their Pennsylvania locations, hire an additional 100 full-time employees by June 30, 2006, operate its Pennsylvania locations a minimum of five years and meet certain matching investment requirements. If the Company fails to comply with any of the requirements above, the Company would be liable to repay the full amount of the grant funding ($500,000). The Company has recorded the unearned grant funds as a liability until the Company complies with all of the requirements of the grant funding program As of June 30, 2008, the Company has had preliminary discussions with the Commonwealth of Pennsylvania to determine whether it will be required to repay any of the funds provided under the grant funding program. Based on information available at June 30, 2008, the Company has recorded the grant funding as a long-term liability under the caption of Unearned Grant Funds.

The following table represents annual contractual obligations as of June 30, 2008:

| | Total | Less than 1 year | 1-3 years | 3-5 years | more than 5 years |
|---|---|---|---|---|---|
| Long-Term Debt | $ 8,978,834 | $ 711,780 | $ 5,401,420 | $ 562,026 | $ 2,303,608 |
| Operating Leases | 1,105,014 | 492,939 | 596,853 | 15,222 | — |
| Purchase Obligations | 124,250,000 | 19,250,000 | 41,500,000 | 45,500,000 | 18,000,000 |
| Interest on Obligations | 2,114,548 | 336,276 | 583,802 | 299,993 | 894,477 |
| Total | $ 136,448,396 | $ 20,790,995 | $ 48,082,075 | $ 46,377,241 | $ 21,198,085 |

The amount of long-term debt due in less than one year in the above table is $80,132 less than the current portion of long-term debt in the consolidated balance sheet at June 30, 2008 because of our decision, as explained above, to classify that amount as current.

Purchase obligations relate to the Company's agreement with Jerome Stevens Pharmaceuticals, Inc. See further description in the Notes to the Consolidated Financial Statements.

**Prospects for the Future**

The Company has several generic products under development. These products are all orally-administered, topical and parenteral products designed to be generic equivalents to brand named innovator drugs. The Company's developmental drug products are intended to treat a diverse range of indications. As the oldest generic drug manufacturer in the country, formed in 1942, Lannett currently owns several ANDAs for products which it does not manufacture and market. These ANDAs are simply dormant on the Company's records. Occasionally, the Company reviews such ANDAs to determine if the market potential for any of these older drugs has recently changed, so as to make it attractive for Lannett to reconsider manufacturing and selling it. If the Company makes the determination to introduce one of these products into the consumer marketplace, it must review the ANDA and related documentation to ensure that the approved product specifications, formulation and other factors meet current FDA requirements for the marketing of that drug. The Company would then redevelop the product and submit it to the FDA for supplemental approval. The FDA's approval process for ANDA supplements is similar to that of a new ANDA. Generally, in these situations, the Company must file a supplement to the FDA for the applicable ANDA, informing the FDA of any significant changes in the manufacturing process, the formulation, or the raw material supplier of the previously-approved ANDA.

A majority of the products in development represent either previously approved ANDAs that the Company is planning to reintroduce (ANDA supplements), or new formulations (new ANDAs). The products under development are at various stages in the development cycle—formulation, scale-up, and/or clinical testing. Depending on the complexity of the active ingredient's chemical characteristics, the cost of the raw material, the FDA-mandated requirement of bioequivalence studies, the cost of such studies and other developmental factors, the cost to develop a new generic product varies and can range from $100,000 to $1 million. Some of Lannett's developmental products will require bioequivalence studies, while others will not—depending on the FDA's Orange Book classification. Since the Company has no control over the FDA review process, management is unable to anticipate whether or when it will be able to begin producing and shipping additional products.

In addition to the efforts of its internal product development group, Lannett has 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 are orally-administered solid dosage products intended to treat a diverse range of medical indications. It is the Company's intention to ultimately transfer the formulation technology and manufacturing process for all of these R&D products to the Company's own commercial manufacturing sites. The Company initiated these outsourced R&D efforts to complement the progress of its own internal R&D efforts.

Occasionally, the Company will work on developing a drug product that does not require FDA approval. Certain prescription drugs do not require prior FDA approval before marketing. For instance, drugs listed as DESI drugs (Drug Efficacy Study implementation) which are under evaluation by FDA, Grandfathered Drugs, and prescription multivitamin drugs. A generic manufacturer may sell products which are chemically equivalent to innovator drugs, under FDA rules by simply performing and internally documenting the normal research and development involved in bringing a new product to market. Under this scenario, a generic company can forego the time required for FDA ANDA approval.

More specifically, certain products, marketed prior to the Federal Food, Drug, and Cosmetic Act (FFDCA) 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 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."

The Company signed supply and development agreements with Olive Healthcare, of India; Orion Pharma, of Finland; Azad Pharma AG, of Switzerland, Unichem Inc. of India, Wintac Limited of India, Pharmaseed of Israel and Banner Pharmacaps and Catalent of the United States, and is in negotiations with companies in Israel and China for similar new product initiatives, in which Lannett will market and distribute products manufactured by Lannett or by third parties. Lannett intends to use its strong customer relationships to build its market share for such products, and increase future revenues and income.

The majority of the Company's R&D projects are being developed in-house under Lannett's direct supervision and with Company personnel. Hence, the Company does not believe that its outside contracts for product development and manufacturing supply are material in nature, nor is the Company substantially dependent on the services rendered by such outside firms. Since the Company has no control over the FDA review process, management is unable to anticipate whether or when it will be able to begin producing and shipping such additional products.

Lannett may increase its focus on certain specialty markets in the generic pharmaceutical industry. Such a focus is intended to provide Lannett customers with increased product alternatives in categories with relatively few market participants. While there is no guarantee that Lannett has the market expertise or financial resources necessary to succeed in such a market specialty, management is confident that such future focus will be well received by Lannett customers and increase shareholder value in the long run.

The Company plans to enhance relationships with strategic business partners, including providers of product development research, raw materials, active pharmaceutical ingredients as well as finished goods. Management believes that mutually beneficial strategic relationships in such areas, including potential financing arrangements, partnerships, joint ventures or acquisitions, could allow for potential competitive advantages in the generic pharmaceutical market. The Company plans to continue to explore such areas for potential opportunities to enhance shareholder value.

As disclosed in Item 3. Legal Proceedings, the Company filed in June 2008 a declaratory judgment suit against KV Pharmaceuticals, DrugTech Corp., and Ther-Rx Corp (collectively "KV"). The complaint sought declaratory judgment for non-infringement and invalidity of certain patents owned by KV. The complaint further sought declaratory judgment of anti-trust violations and federal and state unfair competition violations for actions taken by KV in securing and enforcing these patents. If KV were to prevail in the litigation and the Company were subject to paying damages or were prohibited from selling the Prenatal Multivitamin in the future, it could have an adverse impact on the Company. Any requirement to pay damages could adversely impact the company's cash flow and results of operations.

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The Consolidated Financial Statements and Report of the Independent Registered Public Accounting Firm filed as a part of this Form 10-K are listed in the Exhibit Index filed herewith.

## 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, 2008. 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*

Our management 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 Exchange Act as a process designed by, or under the supervision of, the chief executive officer and chief financial officer and effected by the board of directors and management 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 and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;

- 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 our management and board of directors;

- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our 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. Projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting as of June 30, 2008. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework.*

Based on our assessment, our management believes that, as of June 30, 2008, our internal control over financial reporting is effective.

## ITEM 9B. OTHER INFORMATION

None.

# PART III

## ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS AND CORPORATE GOVERANCE

### Directors and Executive Officers

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

| | Age | Position |
|---|---|---|
| Directors: | | |
| William Farber | 76 | Chairman of the Board |
| Ronald A. West | 74 | Vice Chairman of the Board, Director |
| Arthur P. Bedrosian | 62 | Director |
| Jeffrey Farber | 48 | Director, Interim Chairman of the Board |
| Kenneth Sinclair | 62 | Director |
| Albert Wertheimer | 66 | Director |
| Myron Winkelman | 70 | Director |
| Officers: | | |
| Arthur P. Bedrosian | 62 | President and Chief Executive Officer |
| Brian J. Kearns | 42 | Vice President of Finance, Treasurer, Secretary and Chief Financial Officer |
| Bernard Sandiford | 79 | Vice President of Operations |
| William Schreck | 58 | Vice President of Logistics |
| Kevin Smith | 48 | Vice President of Sales and Marketing |
| Ernest Sabo | 60 | Vice President of Regulatory Affairs and Chief Compliance Officer |

**William Farber, R.Ph.,** was elected as Chairman of the Board of Directors in August 1991. On September 10, 2008, the Company announced that William Farber has taken a temporary medical leave of absence for health reasons. Jeffrey Farber has been appointed to serve as interim chairman of the board. 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 is a registered pharmacist in the State of Michigan.

**Ronald A. West** was elected a Director of the Company in January 2002. In September 2004, Mr. West was elected Vice Chairman of the Board of Directors. Mr. West is currently a Director of Beecher Associates, an industrial real estate investment company. Prior to this, from 1983 to 1987, Mr. West, member of the audit committee at Lannett, served as Chairman and Chief Executive Officer of Dura Corporation, an original equipment manufacturer of automotive products and other engineered equipment components. In 1987, Mr. West sold his ownership position in Dura Corporation, at which time he retired from active management positions. Mr. West was employed at Dura Corporation since 1969. Prior to this, he served in various financial management positions with TRW, Inc., Marlin Rockwell Corporation and National Machine Products Group, a division of Standard Pressed Steel Company. Mr. West studied Business Administration at Michigan State University and the University of Detroit.

**Jeffrey Farber** was elected a Director of the Company in May 2006. On September 10, 2008, the Company announced that William Farber has taken a temporary medical leave of absence for health reasons. Jeffrey Farber has been appointed to serve as interim chairman of the board. Jeffrey Farber joined the Company in August 2003 as Secretary. For the past 13 years, 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 of the Board of Directors and the principal shareholder of the Company.

**Kenneth Sinclair, Ph.D.**, was elected a Director of the Company in September 2005. Dr. Sinclair is currently Professor of Accounting and Senior Advisor to the College of Business and Economics Dean at Lehigh University, where he began his academic career in 1972. Dr. Sinclair has been recognized for his teaching innovation, held leadership positions with professional accounting organizations and served on numerous academic and advisory committees. He has received a number of awards and honors for teaching and service, and has researched and written on a myriad of subjects related to accounting. Dr. Sinclair earned a Bachelor of Business Administration degree in Accounting, a Master of Science degree in accounting and a Doctorate Degree in Business Administration from the University of Massachusetts.

**Albert I. Wertheimer, Ph.D.,** was elected a Director of the Company in September 2004. Dr. Wertheimer has a long and distinguished career in various aspects of pharmacy, health care, education and pharmaceutical research. Since 2000, Dr. Wertheimer has been a professor at the School of Pharmacy at Temple University, and director of its Center for Pharmaceutical Health Services Research. From 1997 to 2000, Dr. Wertheimer was Director of Outcomes Research and Management at Merck & Co., Inc. In addition to his academic responsibilities, he is the author of 26 books and more than 380 journal articles. Dr. Wertheimer also provides consulting services to institutions in the pharmaceutical industry. Dr. Wertheimer's academic experience includes professorships and other faculty and administrative positions at several educational institutions, including the Medical College of Virginia, St. Joseph's University, Philadelphia College of Pharmacy and Science and the University of Minnesota. Dr. Wertheimer's previous professional experience includes pharmacy services in commercial and non-profit environments. Professor Wertheimer is a licensed pharmacist in five states, and is a member of several health associations, including the American Pharmacists Association and the American Public Health Association. Dr. Wertheimer is the editor of the "Journal of Pharmaceutical Finance, Economic and Policy"; and he has been on the editorial board of the Journal of Managed Pharmaceutical Care, Medical Care, and other healthcare journals. Dr. Wertheimer has a Bachelor of Science Degree in Pharmacy from the University of Buffalo, a Master of Business Administration from the State University of New York at Buffalo, a Doctorate from Purdue University and a Post Doctoral Fellowship from the University of London, St. Thomas' Medical School.

**Myron Winkelman, R.Ph.,** was elected a Director of the Company in June 2003. Mr. Winkelman has significant career experience in various aspects of pharmacy and health care. He is currently President of Winkelman Management Consulting (WMC), which provides consulting services to both commercial and governmental clients. He has served in this position since 1994. Mr. Winkelman has recently managed multi-state drug purchasing initiatives for both Medicaid and state entities. Prior to creating WMC, he was a senior executive with ValueRx, a large pharmacy benefits manager, and served for many years as a senior executive for the Revco, Rite Aid and Perry Drug chains. While at ValueRx, Mr. Winkelman served on the Board of Directors of the Pharmaceutical Care Management Association. He belongs to a number of pharmacy organizations, including the Academy of Managed Care Pharmacy and the Michigan Pharmacy Association. Mr. Winkelman is a registered pharmacist and holds a Bachelor of Science Degree in Pharmacy from Wayne State University.

**Arthur P. Bedrosian, J.D.** was promoted to President of the Company in May 2002 and CEO in January of 2006. Prior to this, 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 generic drugs and Interal 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.

**Brian J. Kearns** joined the Company in March 2005 as Vice President of Finance, Treasurer and Chief Financial Officer of the Company and was appointed Secretary in May 2005. Prior to joining the Company, Mr. Kearns served as the Executive Vice President, Treasurer and Chief Financial Officer of MedQuist Inc., a healthcare information management company, from 2000 through 2004. Prior to joining MedQuist, Mr. Kearns was Vice President and Senior Health Care IT analyst at Banc of America Securities from 1999 trough 2000. Mr. Kearns also held various positions with Salomon Smith Barney from 1994 through 1998, including Senior Analyst of Business Services Equity Research. Prior to that, Mr. Kearns held several financial management positions during his seven years at Johnson & Johnson. Mr. Kearns holds a Bachelor of Science degree in Finance from Lehigh University and a Master of Business Administration degree from Rider University, where he matriculated with distinction.

**Bernard Sandiford** joined the Company in November 2002 as Vice President of Operations. Prior to this, from 1998 to 2002, he was the President of Sandiford Consultants, a firm specializing in providing consulting services to drug manufacturers for Good Manufacturing Practices and process validations. His previous employment included senior operating positions with Halsey Drug Company, Barr Laboratories, Inc., Duramed Pharmaceuticals, Inc., and Revlon Health Care Group. In addition to these positions, Mr. Sandiford performed various consulting assignments regarding Good Manufacturing Practices for several companies in the pharmaceutical industry. Mr. Sandiford has a Bachelor of Science Degree in Chemistry from Long Island University.

**William Schreck** joined the Company in January 2003 as Materials Manager. In May 2004, he was promoted to Vice President of Logistics. 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 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 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 Sabo** joined Lannett in March 2005 as Director of Quality Assurance. In May 2008, Mr. Sabo was promoted to Vice President of Regulatory Affairs and Corporate 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 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 New Jersey State College.

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.

**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 2008, 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, except that Form 4s with respect to the September 18, 2007 restricted stock and option grants to the named executive officers Directors were filed late, and Form 4s with respect to a June 9, 2008 gift of stock from William Farber and his wife Audrey Farber to their grandchildren was filed late.

**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, Chief Financial Officer, and Corporate Controller, and other finance organization employees. The code of ethics is publicly available on our website at www.lannett.com. If the Company makes any substantive amendments to the finance 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 Corporate Controller, 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. West, current director of Lannett as well as director of Beecher Associates, an industrial real estate investment company, R&M Resources, an investment and consulting services company and North East Staffing, Inc., an employee services company and previously the Chief Executive Officer of Dura Corporation, is the audit committee financial expert as defined in section 3(a)(58) of the Exchange Act and the related rules of the Commission.

## ITEM 11. EXECUTIVE COMPENSATION

The following table summarizes all compensation paid to or earned by the named executive officers of the Company for Fiscal 2008, Fiscal 2007 and Fiscal 2006.

| Name and Principal Position (a) | Fiscal Year (b) | Salary (c) | Stock Award s (e) | Option Awards (f) | Non-equity incentive pla n compensatio n (g) | All Other Compensatio n (i) | Total (j) |
|---|---|---|---|---|---|---|---|
| Arthur P. Bedrosian (1) President and Chief Executive Officer | 2008 | $ 324,825 | $ — | $ 42,381 | $ — | $ 22,099 | $ 389,305 |
| | 2007 | 301,016 | 122,234 | 158,303 | 43,358 | 34,159 | 659,070 |
| | 2006 | 264,267 | — | 222,465 | 338,880 | 17,834 | 843,446 |
| Brian Kearns Chief Financial Officer, Treasurer | 2008 | 210,361 | — | 28,254 | — | 18,460 | $ 257,075 |
| | 2007 | 202,678 | 83,021 | 161,830 | 27,719 | 22,841 | 498,089 |
| | 2006 | 185,480 | — | — | 240,000 | 9,685 | 435,165 |
| Bernard Sandiford Vice President of Operations | 2008 | 166,547 | — | 2,825 | — | 17,493 | $ 186,865 |
| | 2007 | 154,525 | 64,799 | 161,830 | 16,628 | 41,888 | 439,670 |
| | 2006 | 143,016 | — | 34,877 | 145,000 | 41,014 | 363,907 |
| William Schreck Vice President of Logistics | 2008 | 170,670 | — | 22,603 | — | 18,044 | $ 211,317 |
| | 2007 | 162,871 | 68,021 | 161,830 | 16,724 | 25,334 | 434,780 |
| | 2006 | 157,192 | — | 34,877 | 160,000 | 18,819 | 370,888 |
| Kevin Smith Vice President of Sales and Marketing | 2008 | 192,005 | — | 22,603 | — | 21,495 | $ 236,103 |
| | 2007 | 183,230 | 61,490 | 161,830 | 18,814 | 24,076 | 449,440 |
| | 2006 | 175,853 | — | 34,877 | 180,000 | 22,269 | 412,999 |

(1) Mr. Bedrosian was promoted to President and Chief Executive Officer on January 3, 2006.

**(i) Supplemental All Other Compensation Table**

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

| Name and Principal Position | Fiscal Year | Company Matched Contributions to 401(k) Plan | Auto Allowance | Pay in Lieu of Vacation | Housing Allowance | Excess Life Insurance | Total |
|---|---|---|---|---|---|---|---|
| Arthur P. Bedrosian | 2008 | $ 8,195 | $ 13,500 | $ — | $ — | $ 404 | $ 22,099 |
| President and Chief | 2007 | 10,935 | 13,265 | 9,540 | — | 419 | 34,159 |
| Executive Officer | 2006 | 3,003 | 10,888 | 3,486 | — | 457 | 17,834 |
| Brian Kearns | 2008 | 7,590 | 10,800 | — | — | 70 | 18,460 |
| Chief Financial | 2007 | 12,222 | 10,559 | — | — | 60 | 22,841 |
| Officer, Treasurer | 2006 | 1,526 | 8,091 | — | — | 68 | 9,685 |
| Bernard Sandiford | 2008 | 6,693 | 10,800 | — | — | — | 17,493 |
| Vice President of | 2007 | 9,212 | 10,601 | 11,258 | 10,817 | — | 41,888 |
| Operations | 2006 | 5,146 | 10,214 | 5,226 | 20,428 | — | 41,014 |
| William Schreck | 2008 | 6,872 | 10,800 | — | — | 372 | 18,044 |
| Vice President of | 2007 | 9,382 | 10,589 | 5,095 | — | 268 | 25,334 |
| Logistics | 2006 | 6,604 | 9,000 | 2,942 | — | 273 | 18,819 |
| Kevin Smith | 2008 | 7,889 | 13,500 | — | — | 106 | 21,495 |
| Vice President of | 2007 | 9,309 | 13,188 | 1,486 | — | 93 | 24,076 |
| Sales and Marketing | 2006 | 6,212 | 13,062 | 2,895 | — | 100 | 22,269 |

## Aggregated Options/SAR Exercises and Fiscal Year-end Options/SAR Values

### GRANTS OF PLAN-BASED AWARDS

| | | Estimated Future Payouts Under Non-Equity Incentive Plan Awards | | | Estimated Future Payouts Under Equity Incentive Plan Awards | | | All Other Stock Awards: Number of Shares of Stocks or | All Other Option Awards: Number of Securities Underlying | Exercise or Base Price of Option Awards | Grant Date Fair Value of Stock an d Options |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Name (a) | Grant Date (b) | Threshold ($) (c) | Target ($) (d) | Maximum ($) (e) | Threshol d (f) | Target (g) | Maximu m (h) | Units (#) (i) | Options (#) (j) | ($/sh) (k) | Awards (i) |
| Arthur P. Bedrosian President and Chief Executive Officer | 9/18/2007 | | | | | | | | 50,000 | $ 4.03 | $ 105,535 |
| | 9/18/2007 | | | | | | | | 25,000 | $ 4.03 | $ 52,768 |
| | 9/18/2007 | | | | | | | 16,600 | | | $ 66,898 |
| Brian Kearns Chief Financial Officer and Treasurer | 9/18/2007 | | | | | | | | 25,000 | $ 4.03 | $ 52,768 |
| | 9/18/2007 | | | | | | | | 25,000 | $ 4.03 | $ 52,768 |
| | 9/18/2007 | | | | | | | 9,300 | | | $ 37,479 |
| Bernard Sandiford Vice President of Operations | 9/18/2007 | | | | | | | | 25,000 | $ 4.03 | $ 52,768 |
| | 9/18/2007 | | | | | | | | 25,000 | $ 4.03 | $ 52,768 |
| | 9/18/2007 | | | | | | | 9,300 | | | $ 37,479 |
| William Schreck Vice President of Logistics | 9/18/2007 | | | | | | | | 25,000 | $ 4.03 | $ 52,768 |
| | 9/18/2007 | | | | | | | | 25,000 | $ 4.03 | $ 52,768 |
| | 9/18/2007 | | | | | | | 9,300 | | | $ 37,479 |
| Kevin Smith Vice President of Sales and Marketing | 9/18/2007 | | | | | | | | 25,000 | $ 4.03 | $ 52,768 |
| | 9/18/2007 | | | | | | | | 25,000 | $ 4.03 | $ 52,768 |
| | 9/18/2007 | | | | | | | 9,300 | | | $ 37,479 |

## Employment Agreements

The Company has entered into employment agreements with Arthur P. Bedrosian, President and Chief Executive Officer, Brian Kearns, Chief Financial Officer and Treasurer, Kevin Smith, Vice President of Sales and Marketing, and William Schreck, Vice President of Logistics, (the “Named Executives”). Each of the agreements provide for an annual base salary and eligibility to receive a bonus. The salary and bonus amounts of the Named Executives are determined by the Board of Directors.

Additionally, the Named Executives are eligible to receive stock options, which are granted at the discretion of the Board of Directors, and in accordance with the Company’s policies regarding stock option grants.

Under the agreements, the Named Executive employees may be terminated at any time with or without cause, or by reason of death or disability. In certain termination situations, the Company is liable to pay severance compensation to the Named Executive of between one year and three years.

**Compensation of Directors**

**DIRECTOR COMPENSATION**

| Name (a) | Fees Earned ($) (b) | Stock Awards ($) (c) | Options Awards ($) (d) | Non-Equity Incentive Plan Compensation ($) (e) | Change in Pension Value and Nonqualified Deferred Compensation ($) (f) | All Other Compensation ($) (g) | Total ($) (h) |
|---|---|---|---|---|---|---|---|
| William Farber | $ 6,000 | $ 5,000 | $ 5,942 | $ — | $ — | $ — | $ 16,942 |
| Ronald A. West | 26,500 | 5,000 | 5,942 | — | — | — | 37,442 |
| Jeffrey Farber | 9,000 | 5,000 | 21,897 | — | — | — | 35,897 |
| Kenneth Sinclair | 24,500 | 5,000 | 21,897 | — | — | — | 51,397 |
| Albert Wertheimer | 28,000 | 5,000 | 18,839 | — | — | — | 51,839 |
| Myron Winkelman | 16,000 | 5,000 | 5,942 | — | — | — | 26,942 |

## COMPENSATION DISCUSSION AND ANALYSIS

**Overview of Our Compensation Program**

A fundamental goal of our compensation program is to maximize stockholder value. In order to accomplish this goal, we must attract and retain talented and capable executives, and we must provide those executives with incentives that motivate and reward them for achieving Lannett's short and longer-term goals. To this end, our executive compensation is guided by the following key principles:

- that executive compensation should depend upon group and individual performance factors;
- that the interests of executives should be closely aligned with those of stockholders through equity-based compensation; and
- that compensation should be appropriate and fair in comparison to the compensation provided to similarly situated executives within the pharmaceutical industry and within other publicly-traded companies similar in market capitalization to Lannett's.

Important to our compensation program are the decisions of, and guidance from, the Compensation Committee of our Board of Directors. The Compensation Committee (which we refer to, for purposes of this analysis, as "the Committee") is composed entirely of directors who are independent of Lannett under the independence standards established by the American Stock Exchange, the securities exchange where our common stock is traded. The Committee operates pursuant to a written charter adopted by the Board. If you would like to review the Committee's charter, it is available to any stockholder who requests a copy from our Chief Financial Officer, at 9000 State Road, Philadelphia, Pennsylvania 19136.

The Committee has the authority and responsibility to establish and periodically review our executive compensation principles, described above. Importantly, the Committee also has sole responsibility for approving the corporate goals and objectives upon which the compensation of the chief executive officer (the "CEO") is based, for evaluating the CEO's performance in light of these goals and objectives, and for determining the CEO's compensation, including his equity-based compensation.

The Committee also reviews and approves the recommendations of the CEO with regard to the compensation and benefits of other executive officers. In accomplishing this responsibility, the Committee meets regularly with the CEO, approves cash and equity incentive objectives of the executive officers, reviews with the CEO the accomplishment of these objectives and approves the base salary and other elements of compensation for the executive officers. The Committee has full discretion to modify the recommendations of the CEO in the course of its approval of executive officer compensation.

The Committee also annually reviews recommendations from their consultant, and makes recommendations to the Board about, the compensation of non-employee directors.

During Fiscal 2007, the Committee recommended the adoption of a new Incentive Plan to supplement our existing stock option plans. The Incentive Plan was approved by our stockholders in January 2007. The Incentive Plan provides for the grant of various equity awards, including stock options and restricted stock, to Lannett employees and directors. The Committee is responsible for administering this Plan and it has sole authority to make grants to the CEO or any other executive officer.

In conjunction with its responsibilities related to executive compensation, the Committee also oversees the management development process, reviews plans for executive officer succession and performs various other functions.

The Committee consults as needed with an outside compensation consulting firm retained by the Committee. As it makes decisions about executive compensation, the Committee obtains data from its consultant regarding current compensation practices and trends among United States companies in general and pharmaceutical companies in particular, and reviews this information with its consultant. During Fiscal 2007, the Committee was advised by Mercer Human Resources Consulting, a global human resources consulting firm. In the future, the Committee is expected to use Mercer or a similar firm as a consultant as needed. In addition, the Chairman of the Committee is in contact with management outside of Committee meetings regarding matters being considered or expected to be considered by the Committee.

The individuals who served as Chief Executive Officer and Chief Financial Officer during Fiscal 2008, as well as the other individuals included in the Summary Compensation Table on page 48, are referred to as the "named executive officers."

**Our Fiscal 2008 Compensation Program**

In Fiscal 2008, the Committee's approach to compensation was intended to focus our executives on accomplishing our short and longer-term objectives, and it had as its ultimate object sustained growth in stockholder value. This approach was intended to compensate executives at levels at or near the median levels of compensation offered by other pharmaceutical companies similar in size to Lannett and with whom we compete.

In making decisions about the elements of Fiscal 2008 compensation, the Committee not only considered available market information about each element but also considered aggregate compensation for each executive. Base salary provided core compensation to executives, but it was accompanied by:

- the potential for incentive-based cash compensation based upon our attainment of Fiscal 2008 operating income, other targeted corporate goals and individual or departmental objectives,
- various forms of equity compensation, including some grants based upon Fiscal 2008 sales growth results and upon our return on invested capital results,
- various benefits and perquisites, and
- the potential for post-termination compensation under certain circumstances.

***Summary of Fiscal 2008 Compensation Elements***

The table below provides detailed information regarding each element of the Fiscal 2007 compensation program.

| | Compensation Element Overview | Purpose of the Compensation Element |
|---|---|---|
| **Base Salary** ... | Base salary pays for competence in the executive role. An executive's salary level depends on the decision making responsibilities, experience, work performance, achievement of key goals and team building skills of each position, and the relationship to amounts paid to other executives at peer companies. | To provide competitive fixed compensation based on sustained performance in the executive's role and competitive market practice. |
| **Short- Term Incentives**...... | **Annual Incentive Bonus Plan (AIBP)** The AIBP program rewards with cash awards for annual achievement of overall corporate objectives, and specific individual or departmental operational objectives. In Fiscal 2008, objectives for the Officers were tied to Lannett's achievement of operating income targets, other targeted corporate goals and individual objectives. | To motivate and focus our executive team on the achievement of our annual performance goals. |

| | Compensation Element Overview | Purpose of the Compensation Element |
|---|---|---|
| **Long- Term Incentives**....... | **Stock Options**<br>Stock options reward sustained stock price appreciation and encourage executive retention during a three-year vesting term and a ten-year option life.<br><br>**Restricted Stock**<br>Restricted stock rewards sustained stock price appreciation and encourages executive retention during its three-year vesting term.<br><br>The value of participants' restricted stock increases and decreases according to Lannett's stock price performance during the vesting period and thereafter. | We strive to deliver a balanced long- term incentive portfolio to executives, focusing on (a) share price appreciation, (b) retention, and (c) internal financial objectives.<br><br>The primary objectives of the overall design are:<br><br>to align management interests with those of stockholders<br><br>to increase management's potential for stock ownership opportunities (all awards are earned in shares)<br><br>to attract and retain excellent management talent, and<br><br>to reward growth of the business, increased profitability, and sustained stockholder value. |

| | Compensation Element Overview | Purpose of the Compensation Element |
|---|---|---|
| **Benefits** .......... | **In General**<br>Executives participate in employee benefit plans available to all employees of Lannett, including health, life insurance and disability plans. The cost of these benefits is partially borne by the employee, but mostly paid by the Company. | These benefits are designed to attract and retain employees and provide security for their health and welfare needs. We believe that these benefits are reasonable, competitive and consistent with Lannett's overall executive compensation program. |

| | | |
|---|---|---|
| | **401(k) Plan**<br>Executives may participate in Lannett's 401(k) retirement savings plan, which is available to all employees. In calendar 2006, the Company matched employees' contributions to the plan, on a dollar for dollar basis, up to 3% of their base salary, subject to regulatory limits. Beginning in calendar 2007, Lannett began matching contributions, at a rate of $.50 on the dollar up to 8% of base salary.<br><br>**Life Insurance**<br>Lannett provides life insurance benefits to all employees. The coverage amount for executives is one times base compensation up to a limit of $115,000 and premiums paid for coverage above $50,000 are treated as imputed income to the executive.<br><br>**Disability Insurance**<br>Lannett provides short-term and long-term disability insurance to employees which would, in the event of disability, pay an employee 60% of his or her base salary with limits. | |

| | Compensation Element Overview | Purpose of the Compensation Element |
|---|---|---|
| **Perquisites** . . | Lannett does not utilize perquisites or personal benefits extensively. The few perquisites that are provided complement other compensation vehicles and enable the Company to attract and retain key executives. These perquisites include automobile allowances in various amounts to key executives. | We believe these benefits better allow us to attract and retain superior employees for key positions. |

| | Compensation Element Overview | Purpose of the Compensation Element |
|---|---|---|
| **Post-Termination Pay**................. | **Severance Plan**<br>Lannett's Severance Pay Plan is designed to pay severance benefits to an executive for a qualifying separation. For the Chief Executive Officer, the Severance Pay Plan provides for a payment of three times the sum of 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 named executive officers, the Severance Pay Plan provides for a payment of eighteen months of base salary plus a pro rated annual cash bonus for the current year calculated as if all targets and goals are achieved. | The Severance Pay Plan is intended (1) to allow executives to concentrate on making decisions in the best interests of Lannett (or any successor organization in the event that a change of control is to occur), and (2) generally alleviate an executive's concerns about the loss of his or her position without cause. |

The use of the above compensation tools enables Lannett to reinforce its pay for performance philosophy as well as to strengthen its ability to attract and retain high-performing executive officers. The Committee believes that this combination of programs provides an appropriate mix of fixed and variable pay, balances short-term operational performance with long-term stockholder value creation, and encourages executive recruitment and retention in a high-performance culture.

***Market Data and Our Peer Group***

In determining 2008 compensation for the named executive officers, the Committee relied on market data provided by its consultant. This information was principally related to a group of 13 peer companies similar in size to Lannett with median revenues of $40 million to $133 million (we refer to this group of companies as the "Peer Group"). Information on these companies was derived from two sources: (1) the consultant and broader market survey data analysis, and (2) publicly-available information appearing in the proxy statements of these companies. The members of the Peer Group were:

Bradley Pharmaceutical

Savient Pharm. Inc.

Hi Tech Pharm. Co. Inc.

Quigley Corp.

Noven Pharmaceuticals Inc.

Viropharma Inc.

Balchem Corp.

Orasure Technologies Inc.

Interpharm Holdings Inc

Able Laboratories Inc

Caraco Pharm. Labs

Neogen Corp.

Akorn Inc.

The Committee plans to evaluate the Peer Group periodically and revise it as necessary to ensure that it continues to be appropriate for benchmarking our executive compensation program.

*Base Salary*

Base salaries for the named executive officers are intended, in general, to approach median salaries for similarly situated executives among Peer Group companies. A number of additional factors are considered, however, in determining base salary, such as the executive's individual performance, his or her experience, competencies, skills, abilities, contribution and tenure, internal compensation consistency, the need to attract new, talented executives, and the Company's overall annual budget. Base salaries are generally reviewed on an annual basis.

* The 2008 salaries for Arthur Bedrosian, Lannett's CEO, and for Brian Kearns, Lannett's CFO, were lower than the median for comparable positions among members of the Peer Group and the survey data. Base salaries for all remaining named executive officers were lower than the median for comparable positions among members of the Peer Group, but higher than the median for the survey data.

Base salary increases were granted to Mr. Bedrosian for $14,310 effective on January 1, 2008, Mr. Kearns for $8,742 effective on September 2, 2007, Mr. Smith for $9,935 effective on September 2, 2007, Mr. Schreck for $8,831 effective on September 2, 2007, and Mr. Sandiford for $4,878 effective on September 2, 2007, based on their performance.

***Fiscal 2008 Annual Incentive Bonus Plan***

**Design**

In November 2006, the Committee approved the 2007 Annual Incentive Bonus Plan (or "AIBP") program. This program allowed executive officers the opportunity to earn cash awards upon the accomplishment of the Fiscal 2008 operating income goal, other targeted corporate goals and a number of individual objectives. The relative weighting of these objectives for each executive was fifty percent (50%) for operating income, twenty-five percent (25%) for other targeted corporate goals, twenty percent (20%) for individual objectives and five percent (5%) based on CEO and Committee discretion. For the CEO, the five percent (5%) discretionary portion will be determined by the Committee.

Based on market data provided by its consultant, and considering the relatively low base salaries of the named executive officers, the Committee formulated potential AIBP awards which exceeded the 50th percentile among Peer Group companies, expressed as percentages of base salary. Actual payouts depended upon the degree to which objectives were accomplished as well as the weight accorded to each objective, as described above. The table below shows the potential payout amounts for each of the named executive officers, expressed as percentages of base salary.

| Performance Level | Arthur Bedrosian | Brian Kearns | Bernard Sandiford | William Schreck | Kevin Smith |
|---|---|---|---|---|---|
| Superior Level | 120-150% | 120-150% | 100-125% | 100-125% | 100-125% |
| Goal Level | 100-120% | 100-120% | 75-100% | 75-100% | 75-100% |
| Threshold Level | 50-100% | 50-100% | 30-75% | 30-75% | 30-75% |

The Committee also determined that, if results for any objectives were between the minimum and maximum of the ranges, the Committee would determine appropriate payout percentage.

As discussed above, each named executive officer's objectives for Fiscal 2008 included Company operating income targets and other targeted corporate goals. The Committee reviewed and approved these targets following discussions with management, a review of our historical results, consideration of the various circumstances facing the Company during Fiscal 2008 and taking into account the expectations of our annual plan. The Fiscal 2008 operating income and other corporate goals AIBP targets approved by the Committee are detailed in the table below.

| Objective | Superior | Goal | Target |
|---|---|---|---|
| Operating Income* | $3.5 M | $3.0 M | $2.5 M |
| R&D Submissions | 11 | 10 | 9 |
| R&D Acceptances | 9 | 8 | 7 |
| R&D Launches | 8 | 7 | 6 |

* For purposes of determining achievement of the AIBP targets, these measures exclude certain categories of non-recurring items that the Committee believes do not reflect the performance of Lannett's core continuing operations.

Operational objectives for Mr. Bedrosian related to finalizing a production and sales contract with acceptable returns and a successful launch of a specific new product. Mr. Kearns's objectives related to achieving cash flow targets, establishing internal controls, developing and achieving SAP implementation. Objectives for Mr. Smith included achieving sales targets and margin targets in addition to obtaining new customers in new channels and reducing short dated goods in inventory. For Mr. Schreck, the objectives included reducing obsolete inventory and utilizing SAP more efficiently along with the warehouse relocation. Mr. Sandiford's objectives related to assisting Cody achieve Divisional goals, zero 483 deficiencies and no batch rejections.

All payouts to executive officers under the 2008 AIBP were contingent upon the Committee's review and certification of the degree to which Lannett achieved the 2008 AIBP objectives, and upon the Committee's certification of the degree to which individual objectives had been achieved. The program provided that payout for any objective would be limited to 20% of the actual operating income attained by Lannett.

The 2008 AIBP program provided that the Committee could, in its discretion: modify, amend, suspend or terminate the Plan at any time. The Committee did not take any of these actions in connection with the 2008 AIBP program.

***Results***

In September 2008, the Committee reviewed and certified Lannett's Fiscal 2008 results for purposes of the AIBP program, determining that the objectives for operating income and other corporate objectives were not met at the goal level. The Committee also reviewed and certified the performance of the executive officer individual objectives, determining that these objectives were achieved to varying degrees. The named executive officers received no awards in connection with the 2008 AIBP program.

### *2008 Long Term Incentive Awards (LTIA)*

### *Design*

The Committee believes that long-term equity incentives are an important part of a complete compensation package because they focus executives on: increasing the value of the assets that are entrusted to them by the stockholders, achieving Lannett's long-term goals, aligning the interests of executives with those of stockholders, encouraging sustained stock performance and helping to retain executives.

Prior to the approval of the Incentive Plan by stockholders in 2007, Lannett's equity grants consisted only of stock options. The Incentive Plan expanded the types of equity vehicles which the Committee could grant to executives by including restricted stock. In September 2008, the Committee granted both stock options and restricted stock to executives, each designed to emphasize particular elements of the Company's immediate and long-term objectives and to retain key executives. We refer to these grants collectively as the 2008 Long Term Incentive Awards (LTIA). The types of grants were:

- stock options, becoming exercisable over three years (approximately one-third increments on each anniversary) from the date of the grant and having a total term of ten years,

- shares of restricted stock, vesting over three years (approximately one-third increments on each anniversary) from the date of grant,

The Committee assessed the appropriate overall value of these equity grants to executives by reviewing survey results and other market data provided by its consultant. This information included the value of equity grants made to similarly situated executives among the Peer Group. The overall value of LTIA grants for each executive was determined by the Committee with assistance from their consultant.

In determining the overall value of LTIA grants, the Committee also considered the potential value of equity compensation relative to other elements of compensation for each named executive officer. It likewise assessed the appropriate distribution of equity value among the grant types, as well as the corporate objectives each type of grant was intended to encourage.

### *Stock Options and Restricted Stock*

The stock options and restricted stock granted as part of the 2008 LTIA were designed to reward sustained stock price appreciation and to encourage executive retention during a three-year vesting term and, in the case of stock options, a ten-year option life. Stock option and restricted stock awards are intended to align executives' motivation with stockholders' best interests. Grants of stock options were not contingent upon any conditions. They are to be granted independent of organizational performance. Stock options become exercisable approximately in one-third increments on the first three anniversaries of the date of grant. Restricted stock was contingent upon Lannett achieving annual sales growth and return on invested capital goals. Restricted stock will vest in approximately one-third increments on the first three anniversaries of the date of the grant. The Committee determined for each executive officer a target number of options and restricted shares and those targets appear in the tables below.

Restricted Stock Targets:

| Performance Level | Bedrosian | Kearns | Sandiford | Schreck | Smith |
|---|---|---|---|---|---|
| Superior | 16,600 | 8,300 | 8,300 | 8,300 | 8,300 |
| Goal | 12,500 | 6,600 | 6,600 | 6,600 | 6,600 |
| Threshold | 8,300 | 5,000 | 5,000 | 5,000 | 5,000 |

Stock Option Targets:

| Range | Bedrosian | Kearns | Sandiford | Schreck | Smith |
|---|---|---|---|---|---|
| High | 50,000 | 25,000 | 25,000 | 25,000 | 25,000 |
| Medium | 37,500 | 20,000 | 20,000 | 20,000 | 20,000 |
| Low | 25,000 | 15,000 | 15,000 | 15,000 | 15,000 |

***Results***

In September 2008, the Committee reviewed and certified the Fiscal 2008 financial results for purposes of the Restricted Share Grants and determined that the performance levels required for award grant purposes had not been achieved and therefore no Restricted Share Grants would be awarded. The Lannett Long Term Incentive Plan includes a provision for the granting of Stock Options, on a Committee discretionary basis, as an executive retention and incentive instrument. As a result of the Committee's review, the Committee granted stock options totaling 100,000 shares to be apportioned in the following manner;

Stock Option Awards:

| Awards | Bedrosian | Kearns | Sandiford | Schreck | Smith |
|---|---|---|---|---|---|
| Options.................................. | 30,000 | 20,000 | 2,000 | 16,000 | 16,000 |
| Restricted Shares .................. | — | — | — | — | — |

***Perquisites and Other Benefits***

We provide named executive officers with perquisites and other personal benefits that we believe are reasonable and consistent with our overall compensation program to better enable us to attract and retain superior employees for key positions. The Committee periodically reviews the levels of perquisites and other personal benefits provided to named executive officers.

During calendar year 2006, Lannett matched employees' contributions to the Lannett Company, Inc. 401(k) Retirement Savings Plan on a dollar for dollar basis up to 3% of an employee's base salary, subject to regulatory limits. Contributions by the named executive officers were matched in this way, subject to the limitations of the Plan and applicable law. Beginning in calendar year 2007 and continuing to present, Lannett matched contributions to the 401(k) plan on a fifty cents on the dollar basis up to 8% of the contributing employee's base salary. The named executive officers are also provided with car allowances, for which the taxes are also paid by the Company.

Lannett provides life insurance for executive officers 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 to the executive. Lannett also provides short-term and long-term disability insurance which would, in the event of disability, pay the executive officer sixty percent (60%) of his base salary up to the plan limits of $2,000/week for short term disability and $10,000/month for long term disability. Executive officers participate in other qualified benefit plans, such as medical insurance plans, in the same manner as all other employees.

Attributed costs of the personal benefits available to the named executive officers for the fiscal year ended June 30, 2008, are included in column (i) of the Summary Compensation Table on page 48.

**Severance and Change of Control Benefits**

We believe 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 such executives to find comparable employment within a short period of time, and are designed to alleviate an executive's concerns about the loss of his or her position without cause. We also believe that a change in control arrangement will provide an executive security that will likely reduce the reluctance of an executive to pursue a change in control transaction that could be in the best interests of our stockholders. Lannett's Severance Pay Plan is designed to pay severance benefits to an executive for a qualifying separation. For the Chief Executive Officer, the Severance Pay Plan provides for a payment of three times the sum of 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 named executive officers, the Severance Pay Plan provides for a payment of eighteen months of base salary plus a pro rated annual cash bonus for the current year calculated as if all targets and goals are achieved.

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

The Committee typically holds four regular meetings each year, and the timing of these meetings is generally 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 September of each year. Individual grants (for example, associated with the hiring of a new executive officer or promotion to an executive officer position) may occur at any time of year. We expect to coordinate the timing of equity award grants to be made within thirty (30) days of Lannett's earnings release announcement following the completion of the fiscal year. The exercise price of each stock option and restricted share awarded to our executive officers is the closing price of our common stock on the date of grant.

**Tax and Accounting Implications**

*Deductibility of Executive Compensation*

Section 162(m) of the Internal Revenue Code of 1986, as amended, precludes the deductibility of an executive officer's compensation that exceeds $1.0 million 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 Section 162(m) through, for example, the use of our Incentive Plan. However, to maintain flexibility in compensating executive officers in a manner that attracts, rewards and retains high quality individuals, the Committee may elect to provide compensation outside of 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 and discussed the Compensation Discussion and Analysis set forth above with management. Taking this review and discussion into account, the undersigned Committee members recommended to the Board of Directors that the Compensation Discussion and Analysis be included in this annual report on Form 10-K.

**The Compensation Committee**

Ronald West (Chair)
Albert Wertheimer
Myron Winkelman

## ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table sets forth, as of June 30, 2008, 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:

| | | Excluding Options | | Including Options (*) | |
|---|---|---|---|---|---|
| **Name and Address of Benefical Owner** | **Office** | **Number of Shares** | **Percent of Class** | **Number of Shares** | **Percent of Class** |
| **Directors/Executive Officers**: | | | | | |
| William Farber<br>9000 State Road<br>Philadelphia, PA 19136 | Chairman of the Board | **8,605,029(1)** | **35.44%** | **8,694,196(2)** | **34.73%** |
| Ronald A. West<br>9000 State Road<br>Philadelphia, PA 19136 | Vice Chairman of the Board, Director | **7,310** | **0.03%** | **58,925(3)** | **0.24%** |
| Jeffrey Farber<br>9000 State Road<br>Philadelphia, PA 19136 | Interim Chairman of the Board, Director | **5,157,920(4)** | **21.24%** | **5,195,420(5)** | **20.75%** |
| Kenneth Sinclair<br>9000 State Road<br>Philadelphia, PA 19136 | Director | **0** | **0.00%** | **15,000(6)** | **0.06%** |
| Albert Wertheimer<br>9000 State Road<br>Philadelphia, PA 19136 | Director | **1,000** | **0.00%** | **22,667(7)** | **0.09%** |
| Myron Winkelman<br>9000 State Road<br>Philadelphia, PA 19136 | Director | **1,000** | **0.00%** | **37,667(8)** | **0.15%** |
| Arthur Bedrosian<br>9000 State Road<br>Philadelphia, PA 19136 | President and Chief Executive Officer | **507,783(9)** | **2.09%** | **712,349(10)** | **2.85%** |
| Brian Kearns<br>9000 State Road<br>Philadelphia, PA 19136 | Chief Financial Officer | **6,727** | **0.03%** | **111,727(11)** | **0.45%** |
| Bernard Sandiford<br>9000 State Road<br>Philadelphia, PA 19136 | Vice President of Operations | **4,388** | **0.02%** | **55,268(12)** | **0.22%** |
| William Schreck<br>9000 State Road<br>Philadelphia, PA 19136 | Vice President of Logistics | **4,584** | **0.02%** | **35,329(13)** | **0.14%** |
| Kevin Smith<br>9000 State Road<br>Philadelphia, PA 19136 | Vice President of Sales and Marketing | **3,933** | **0.02%** | **88,693(14)** | **0.35%** |
| David Farber<br>6884 Brook Hollow Ct<br>West Bloomfield, MI 48322 | | **5,167,408(15)** | **21.28%** | **5,189,908(16)** | **20.73%** |
| Farber Properties<br>1775 John R Road<br>Troy, MI 48083 | | **5,000,000(17)** | **20.59%** | **5,000,000** | **19.97%** |
| All directors and executive officers as a group (11 persons) | | **14,450,882** | **59.51%** | **15,049,741** | **60.12%** |

(1) Includes 207,870 shares owned jointly by William Farber and his spouse Audrey Farber.

(2) Includes 37,500 vested options to purchase common stock at an exercise price of $7.97 per share, 25,000 vested options to purchase common stock at an exercise price of $17.36, 25,000 vested options to purchase common stock at an exercise price of $16.04 and 1,667 vested options to purchase common stock at an exercise price of $6.89.

(3) Includes 9,948 vested options to purchase common stock at an exercise price of $7.97 per share, 15,000 vested options to purchase common stock at an exercise price of $17.36 per share, 25,000 vested options to purchase common stock at an exercise price of $16.04 and 1,667 vested options to purchase common stock at an exercise price of $6.89.

(4) Includes 5,000,000 shares held by Farber Properties Group LLC. Farber Properties Group, LLC is managed and jointly owned by Jeffrey Farber and David Farber. Also includes 10,800 shares owned by Jeffrey Farber's children. Jeffrey Farber disclaims beneficial ownership of these shares.

(5) Includes 10,000 vested options to purchase common stock at an exercise price of $17.36 per share, 12,500 vested options to purchase common stock at an exercise price of $16.04, 13,334 vested options to purchase common stock at an exercise price of $4.55, and 1,666 vested options to purchase common stock at an exercise price of $6.89.

(6) Includes 13,333 vested options to purchase common stock at an exercise price of $4.55 per share and 1,667 vested options to purchase common stock at an exercise price of $6.89 per share.

(7) Includes 20,000 vested options to purchase common stock at an exercise price of $9.02 per share and 1,667 vested options to purchase common stock at an exercise price of $6.89 per share.

(8) Includes 15,000 vested options to purchase common stock at an exercise price of $17.36, 20,000 vested options to purchase common stock at an exercise price of $16.04 and 1,667 vested options to purchase common stock at an exercise price of $6.89 per share.

(9) Includes 33,150 shares owned by Arthur Bedrosian's wife, Shari, and 19,602 shares owned by his daughter Talin. Mr. Bedrosian disclaims beneficial ownership of these shares.

(10) Includes 18,000 vested options to purchase common stock at an exercise price of $4.63 per share, 96,900 vested options to purchase common stock at an exercise price of $7.97 per share, 33,000 vested options to purchase common stock at an exercise price of $17.36, 30,000 vested options to purchase common stock at an exercise price of $16.04, 16,666 vested options to purchase common stock at an exercise price of $8.00 per share and 10,000 vested options to purchase common stock at an exercise price of $4.03 per share.

(11) Includes 100,000 vested options to purchase common stock at an exercise price of $6.75 per share and 5,000 vested options to purchase common stock at an exercise price of $6.89 per share.

(12) Includes 38,760 vested options to purchase common stock at an exercise price of $7.97 per share, 13,000 vested options to purchase common stock at an exercise price of $17.36 per share, 20,000 vested options to purchase common stock at an exercise price of $16.04 per share, 8,000 vested options to purchase common stock at an exercise price of $5.18 per share and 5,000 vested options to purchase common stock at an exercise price of $6.89 per share.

(13) Includes 17,745 vested options to purchase common stock at an exercise price of $11.27 per share, 8,000 vested options to purchase common stock at an exercise price of $5.18 per share and 5,000 vested options to purchase common stock at an exercise price of $6.89 per share.

(14) Includes 15,380 vested options to purchase common stock at an exercise price of $11.27 per share, 10,000 vested options to purchase common stock at an exercise price of $17.36 per share, 12,500 vested options to purchase common stock at an exercise price of $16.04 per share, 8,000 vested options to purchase common stock at an exercise price of $5.18 per share and 5,000 vested options to purchase common stock at an exercise price of $6.89 per share.

(15) Indirect shares total includes 23,688 shares held as custodian for David Farber's children and 2,850 shares held by David Farber's spouse. David Farber disclaims beneficial ownership of these shares. Indirect share total also includes 5,000,000 shares held by Farber Properties Group LLC. Farber Properties Group, LLC is managed and jointly owned by Jeffrey Farber and David Farber.

(16) Includes 10,000 vested options to purchase common stock at an exercise price of $17.36 per share and 12,500 vested options to purchase common stock at an exercise price of $16.04 per share.

(17) Farber Properties Group, LLC is managed and jointly owned by Jeffrey Farber and David Farber.

* Assumes that all options exercisable within sixty days have been exercised, which results in 25,034,030 shares outstanding.

**Equity Compensation Plan Information**

The following table summarizes the equity compensation plans as of June 30, 2008:

| Plan Category | Number of securities to be issued upon exercise of outstanding options, warrants and rights (a) | | Weighted average exercise price of outstanding options, warrants and rights (b) | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c) |
|---|---|---|---|---|
| Equity Compensation plans approved by security holders | 1,694,331 | $ | 7.59 | 3,146,338 |
| Equity Compensation plans not approved by security holders | — | | — | — |
| Total | 1,694,331 | $ | 7.59 | 3,146,338 |

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

The Company had sales of approximately $787,000, $763,000, and $1,143,000 during the fiscal years ended June 30, 2008, 2007 and 2006, respectively, to a generic distributor, Auburn Pharmaceutical Company. Jeffrey Farber (the "related party"), a board member and the son of the Chairman of the Board of Directors and principal shareholder of the Company, William Farber, is the owner of Auburn Pharmaceutical Company. Accounts receivable includes amounts due from the related party of approximately $305,000 and $109,000 at June 30, 2008 and 2007, respectively. In the Company's opinion, the terms of these transactions were not more favorable to the related party than would have been to a non-related party.

In January 2005, Lannett Holdings, Inc. entered into an agreement in which the Company purchased for $100,000 and future royalty payments the proprietary rights to manufacture and distribute a product for which Pharmeral, Inc. owned the ANDA. In Fiscal 2008, the Company obtained FDA approval to use the proprietary rights. Accordingly, the Company has capitalized this purchased product right as an indefinite lived intangible asset and will test this asset for impairment on a quarterly basis. Arthur Bedrosian, President of the Company, Inc. was formerly the President and Chief Executive Officer of Phameral Inc. and currently owns 100% of Pharmeral, Inc. This transaction was approved by the Board of Directors of the Company and in their opinion the terms were not more favorable to the related party than they would have been to a non-related party.

At June 30, 2008, the Company had approximately $983,000 of deferred revenue as a result of prepayments on inventory received from Provell Pharmaceuticals, LLC ("Provell"). The Company recognized revenues of approximately $141,000 during the fiscal year ended June 30, 2008. Accounts receivable includes amounts due from Provell of approximately $60,000 at June 30, 2008. Provell is a joint venture to distribute pharmaceutical products through mail order outlets. In exchange for access to Lannett's drug providers, Lannett received a 33% ownership of this venture. After June 30, 2008, Lannett's ownership portion of this venture decreased to 25% due to outside investment in the venture from a third party. The investment is valued at zero, due to losses incurred to date by Provell.

## ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Grant Thornton LLP served as the independent auditors of the Company during Fiscal 2008, 2007 and 2006. 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 2008, 2007 and 2006.

| | | Audit Fees | | Audit-Related (1) | | Tax Fees (2) | | All Other Fees (3) | | Total Fees |
|---|---|---|---|---|---|---|---|---|---|---|
| Fiscal 2008: | $ | 335,894 | $ | 5,900 | $ | 78,880 | $ | 49,964 | $ | 470,638 |
| Fiscal 2007: | $ | 338,660 | $ | — | $ | 36,528 | $ | 70,300 | $ | 445,460 |
| Fiscal 2006: | $ | 180,418 | $ | — | $ | 52,942 | $ | 135,248 | $ | 368,608 |

(1) Audit-related fees include fees paid for preparation of S-8 filing.

(2) Tax fees include fees paid for preparation of annual federal, state and local income tax returns, quarterly estimated income tax payments, Cody tax issues, sales and use tax review and various tax planning services. Fiscal 2006 fees paid to Grant Thornton for services rendered during an IRS audit.

(3) Other fees include:

Fiscal 2008 – Fees paid for review of various SEC correspondences.

Fiscal 2007 – Fees paid for review of various SEC correspondences, disclosures, and fixed asset review.

Fiscal 2006 – Fees paid for services rendered in connection with quarterly reviews of the Company's SEC filings, fixed asset review, a cost segregation study and review of various SEC correspondence.

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.

## PART IV

## ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Consolidated Financial Statements and Supplementary Data

(1) The following financial statements are included herein:

Consolidated Balance Sheets as of June 30, 2008 and 2007
Consolidated Statements of Operations for each of the three years in the period ended June 30, 2008
Consolidated Statements of Changes in Shareholders' Equity for each of the three years in the period ended June 30, 2008
Consolidated Statements of Cash Flows for each of the three years in the period ended June 30, 2008
Supplementary Data

(2) The following financial statement schedule is included herein

Schedule II – Valuation and Qualifying Accounts

(b) A list of the exhibits required by Item 601 of Regulation S-K to be filed as of this Form 10-K is shown on the Exhibit Index filed herewith. All other schedules have been omitted because they are not applicable or not required, or because the required information is included in the Consolidated Financial Statements or Notes thereto.

## 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: September 29, 2008

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

Date: September 29, 2008

By: / s / Brian Kearns
Brian Kearns,
Vice President of Finance, Treasurer, and
Chief Financial 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: September 29, 2008

By: / s / William Farber
William Farber,
Chairman of the Board of Directors

Date: September 29, 2008

By: / s / Ronald West
Ronald West,
Director, Vice Chairman of the Board,
Chairman of Compensation Committee

Date: September 29, 2008

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

Date: September 29, 2008

By: / s / Jeffrey Farber
Jeffrey Farber,
Director

Date: September 29, 2008

By: / s / Kenneth Sinclair
Kenneth Sinclair,
Director, Chairman of Audit Committee

Date: September 29, 2008

By: / s / Albert Wertheimer
Albert Wertheimer,
Director

Date: September 29, 2008

By: / s / Myron Winkelman
Myron Winkelman,
Director, Chairman of Strategic Plan Committee

## Exhibit Index

| Exhibit Number | Description | Method of Filing |
|---|---|---|
| 3.1 | Articles 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. |
| 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 | Terms of Employment Agreement with Kevin Smith | Incorporated by reference to Exhibit 10.6 to the Annual Report on 2003 Form 10-KSB |
| 10.7 | Terms of Employment Agreement with Arthur Bedrosian | Incorporated by reference to Exhibit 10 to the Quarterly Report on Form 10-Q dated May 12, 2004. |
| 10.8 | Terms of Employment Agreement with Brian Kearns | Incorporated by reference to Exhibit 10.1 of the Form 8-K dated March 21, 2005. |
| 10.9 (Note A) | Agreement between Lannett | Incorporated by reference to Exhibit 10.9 to |

| Exhibit Number | Description | Method of Filing |
|---|---|---|
| | Company, Inc and Siegfried (USA), Inc. | the Annual Report on 2003 Form 10-KSB |
| 10.10 (Note A) | 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 |
| 13 | Annual Report on Form 10-K | Filed Herewith |
| 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 |

**Exhibit 13**

**Annual Report on Form 10-K**

**Report of Independent Registered Public Accounting Firm**

Board of Directors and Shareholders
Lannett Company, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Lannett Company, Inc. (a Pennsylvania corporation) and Subsidiaries (collectively, the Company) as of June 30, 2008 and 2007, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended June 30, 2008. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements 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 consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated 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 consolidated financial position of Lannett Company, Inc. and Subsidiaries as of June 30, 2008 and 2007, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2008 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Notes 2 and 16 to the consolidated financial statements, the Company has adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Tax Positions*, in 2008.

/s/ Grant Thornton, LLP
Philadelphia, Pennsylvania
September 29, 2008

# LANNETT COMPANY, INC. AND SUBSIDIARIES
# CONSOLIDATED BALANCE SHEETS

| | June 30,2008 | June 30,2007 |
|---|---|---|
| **ASSETS** | | |
| *Current Assets* | | |
| Cash | $ 6,256,712 | $ 5,192,341 |
| Trade accounts receivable (net of allowance of $207,151 and $250,000, respectively) | 34,114,982 | 19,473,978 |
| Inventories | 11,617,258 | 14,518,484 |
| Interest receivable | 51,781 | 36,260 |
| Prepaid taxes | 1,598,937 | 3,193,685 |
| Deferred tax assets | 6,997,935 | 1,258,930 |
| Other current assets | 591,415 | 611,512 |
| **Total Current Assets** | 61,229,020 | 44,285,190 |
| Property, plant and equipment | 39,996,008 | 39,260,689 |
| Less accumulated depreciation | (15,261,905) | (11,817,528) |
| | 24,734,103 | 27,443,161 |
| Construction in progress | 458,046 | 176,003 |
| Investment securities - available for sale | 2,500,135 | 3,320,632 |
| Intangible asset (product rights) - net of accumulated amortization | 10,361,835 | 12,046,502 |
| Deferred tax assets | 17,380,115 | 17,150,174 |
| Other assets | 195,354 | 234,438 |
| **Total Assets** | $ 116,858,608 | $ 104,656,100 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| **LIABILITIES** | | |
| *Current Liabilities* | | |
| Accounts payable | $ 11,793,312 | $ 7,013,985 |
| Accrued expenses | 3,744,243 | 6,719,782 |
| Deferred revenue | 982,668 | 1,637,993 |
| Unearned grant funds | — | 500,000 |
| Current portion of long term debt | 791,912 | 692,119 |
| Rebates, chargebacks and returns payable | 18,326,417 | 5,686,364 |
| **Total Current Liabilities** | 35,638,552 | 22,250,243 |
| Long term debt, less current portion | 8,186,922 | 8,987,846 |
| Deferred tax liabilities | 3,179,344 | 3,202,835 |
| Unearned grant funds | 500,000 | — |
| Other long term liabilities | 32,001 | 32,001 |
| **Total Liabilities** | 47,536,819 | 34,472,925 |
| Commitment and Contingencies, See notes 9 and 10 | | |
| Minority Interest in Cody LCI Realty, LLC, net of taxes | 50,309 | — |
| **SHAREHOLDERS' EQUITY** | | |
| Common stock - authorized 50,000,000 shares, par value $0.001; issued and outstanding, 24,283,963 and 24,171,217 shares, respectively | 24,284 | 24,171 |
| Additional paid in capital | 74,497,100 | 73,053,778 |
| Accumulated deficit | (4,790,680) | (2,472,621) |
| Accumulated other comprehensive income (loss) | 9,722 | (27,583) |
| | 69,740,426 | 70,577,745 |
| Less: Treasury stock at cost - 74,970 and 50,900 shares, respectively | (468,946) | (394,570) |
| **TOTAL SHAREHOLDERS' EQUITY** | 69,271,480 | 70,183,175 |
| **TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY** | $ 116,858,608 | $ 104,656,100 |

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

**LANNETT COMPANY, INC. AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF OPERATIONS**

| | Fiscal Year Ended June 30, | | |
|---|---|---|---|
| | 2008 | 2007 | 2006 |
| Net sales | $ 72,403,283 | $ 82,577,591 | $ 64,060,375 |
| Cost of sales | 54,080,947 | 57,394,751 | 33,900,045 |
| Amortization of intangible assets | 1,784,664 | 1,784,664 | 1,784,665 |
| Product royalties | 236,601 | 1,973,189 | — |
| Gross profit | 16,301,071 | 21,424,987 | 28,375,665 |
| Research and development expenses | 5,172,715 | 7,459,432 | 8,102,465 |
| Selling, general, and administrative expenses | 16,552,859 | 12,161,187 | 11,799,994 |
| Loss on impairment | — | 7,775,890 | — |
| Loss on sale of investments | 4,338 | — | — |
| (Gain) loss on sale of assets | 1,693 | (7,113) | 19,288 |
| Operating (loss) income | (5,430,534) | (5,964,409) | 8,453,918 |
| OTHER INCOME(EXPENSE): | | | |
| Interest income | 170,040 | 316,963 | 437,470 |
| Interest expense | (383,267) | (273,633) | (361,291) |
| | (213,227) | 43,330 | 76,179 |
| (Loss) income before income tax (benefit) expense and minority interest | (5,643,761) | (5,921,079) | 8,530,097 |
| Income tax (benefit) expense | (3,376,011) | 1,007,929 | 3,561,175 |
| Minority interest in Cody LCI Realty, LLC | 50,309 | — | — |
| Net (loss) income | $ (2,318,059) | $ (6,929,008) | $ 4,968,922 |
| Basic (loss) earnings per common share | $ (0.10) | $ (0.29) | $ 0.21 |
| Diluted (loss) earnings per common share | $ (0.10) | $ (0.29) | $ 0.21 |
| Basic weighted average number of shares | 24,227,181 | 24,159,251 | 24,130,224 |
| Diluted weighted average number of shares | 24,227,181 | 24,159,251 | 24,156,889 |

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

# LANNETT COMPANY, INC. AND SUBSIDIARIES
# CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

| | Common Stock | | Additional | | | | |
|---|---|---|---|---|---|---|---|
| | Shares Issued | Amount | Paid-in Capital | Accumulated Deficit | Treasury Stock | Accum. Other Comp. Income (Loss) | Shareholders' Equity |
| **Balance, June 30, 2005** | 24,111,140 | $ 24,111 | $ 70,157,431 | $ (512,535) | $ (394,570) | $ (25,193) | $ 69,249,244 |
| Exercise of Stock Options | 1,000 | 1 | 4,632 | — | — | — | 4,633 |
| Shares issued in connection with employee stock purchase plan | 29,185 | 29 | 139,628 | — | — | — | 139,657 |
| Share based compensation | | | | | | | — |
| Stock options | | — | 1,440,711 | — | — | — | 1,440,711 |
| Other comprehensive income, net of income tax | — | — | — | — | — | (47,251) | (47,251) |
| Net income | — | — | — | 4,968,922 | — | — | 4,968,922 |
| **Balance, June 30, 2006** | 24,141,325 | $ 24,141 | $ 71,742,402 | $ 4,456,387 | $ (394,570) | $ (72,444) | $ 75,755,916 |
| Exercise of Stock Options | 375 | | 281 | — | — | — | 281 |
| Shares issued in connection with employee stock purchase plan | 29,517 | 30 | 134,860 | — | — | — | 134,890 |
| Share based compensation | | | | | | | |
| Stock options | — | — | 1,176,235 | — | — | — | 1,176,235 |
| Other comprehensive income, net of income tax | — | — | — | — | — | 44,861 | 44,861 |
| Net loss | — | — | — | (6,929,008) | — | — | (6,929,008) |
| **Balance, June 30, 2007** | 24,171,217 | $ 24,171 | $ 73,053,778 | $ (2,472,621) | $ (394,570) | $ (27,583) | $ 70,183,175 |
| Shares issued in connection with employee stock purchase plan | 38,282 | 38 | 138,592 | — | — | — | 138,630 |
| Share based compensation | | | | | | | — |
| Restricted stock | — | — | 134,794 | — | — | — | 134,794 |
| Stock options | — | — | 869,921 | — | — | — | 869,921 |
| Shares issued in connection with restricted stock grant | 74,464 | 75 | 300,015 | | | | 300,090 |
| Purchase of treasury stock | — | | | | (74,376) | | (74,376) |
| Other comprehensive income, net of income tax | — | — | — | — | — | 37,305 | 37,305 |
| Net loss | — | — | — | (2,318,059) | — | — | (2,318,059) |
| **Balance, June 30, 2008** | 24,283,963 | $ 24,284 | $ 74,497,100 | $ (4,790,680) | $ (468,946) | $ 9,722 | $ 69,271,480 |

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

**LANNETT COMPANY, INC. AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

| | Fiscal Year Ended June 30, | | |
|---|---|---|---|
| | 2008 | 2007 | 2006 |
| OPERATING ACTIVITIES: | | | |
| Net (loss) income | $ (2,318,059) | $ (6,929,008) | $ 4,968,922 |
| Adjustments to reconcile net (loss) income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 5,229,358 | 4,465,393 | 3,967,128 |
| Deferred tax (benefit) expense | (4,743,854) | 1,779,843 | 2,738,418 |
| Stock compensation expense | 1,029,923 | 1,176,235 | 1,440,711 |
| Loss (gain) on disposal/impairment of assets | — | 7,774,098 | (5,945) |
| Loss on sale of assets | 1,693 | — | — |
| Other noncash expenses | 13,339 | — | — |
| Interest income accrued on note | — | (267,672) | — |
| Minority interest in Cody LCI Realty, LLC, net of taxes | 50,309 | — | — |
| Changes in assets and liabilities which provided (used) cash: | | | |
| Trade accounts receivable | (2,000,951) | (1,878,027) | (11,924,058) |
| Inventories | 2,901,226 | (2,716,610) | (1,487,734) |
| Prepaid taxes | 1,594,748 | 18,826 | 745,482 |
| Prepaid expenses and other assets | (69,679) | 140,195 | (18,827) |
| Accounts payable | 4,779,328 | 5,991,581 | (444,404) |
| Accrued expenses | (2,693,834) | 1,482,473 | 3,550,257 |
| Deferred revenue | (655,325) | 1,637,993 | — |
| Net cash provided by operating activities | 3,118,222 | 12,675,320 | 3,529,949 |
| INVESTING ACTIVITIES: | | | |
| Cash paid for acquisition of business, net cash received | — | 167,728 | — |
| Purchases of property, plant and equipment | (2,295,817) | (2,465,075) | (5,073,076) |
| Proceeds from sale of asset | 21,380 | 10,000 | — |
| Proceeds from sale of investment securities - available for sale | 2,023,616 | 1,845,838 | 2,219,848 |
| Purchase of investment securities - available for sale | (1,140,945) | — | — |
| Issuance of note receivable | — | (7,059,567) | (3,182,498) |
| Net cash used in investing activities | (1,391,766) | (7,501,076) | (6,035,726) |
| FINANCING ACTIVITIES: | | | |
| Repayments of debt | (701,131) | (585,433) | (7,585,755) |
| Proceeds from debt, net of restricted cash released | — | — | 6,250,000 |
| Proceeds from issuance of stock | 113,422 | 135,171 | 144,290 |
| Treasury stock transactions | (74,376) | — | — |
| Net cash used in financing activities | (662,085) | (450,262) | (1,191,465) |
| NET INCREASE (DECREASE) IN CASH | 1,064,371 | 4,723,982 | (3,697,242) |
| CASH, BEGINNING OF PERIOD | 5,192,341 | 468,359 | 4,165,601 |
| CASH, END OF PERIOD | $ 6,256,712 | $ 5,192,341 | $ 468,359 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION - | | | |
| Interest paid | $ 270,691 | $ 194,656 | $ 321,277 |
| Income taxes paid | $ — | $ 684,670 | $ 50,000 |

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

**LANNETT COMPANY, INC. AND ITS SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

## Note 1. Summary of Significant Accounting Policies

Lannett Company, Inc., a Delaware corporation, and subsidiaries (the "Company"), develops, manufactures, packages, markets and distributes pharmaceutical products sold under generic chemical names.

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

***Use of Estimates*** - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. As applicable to these consolidated financial statements, the most significant estimates and assumptions relate to sales reserves and allowances, income taxes, inventories, contingencies and valuation of intangible assets.

***Principles of Consolidation*** - The consolidated financial statements include the accounts of the operating parent company, Lannett Company, Inc., its wholly owned subsidiaries, Lannett Holdings, Inc. and Cody Laboratories, Inc. Cody Laboratories, Inc includes the consolidation of Cody LCI Realty, LLC, a variable interest entity, as a result of the acquisition of Cody Laboratories, Inc. See Note 13 regarding the consolidation of this variable interest entity. All intercompany accounts and transactions have been eliminated.

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

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

***Rebates*** – Rebates are offered to the Company's key chain drug store and wholesaler customers to promote customer loyalty and increase product sales. These rebate programs provide customers with rebate credits upon attainment of pre-established volumes or attainment of net sales milestones for a specified period. Other promotional programs are incentive programs offered to the customers. At the time of shipment, the Company estimates reserves for rebates and other promotional credit programs based on the specific terms in each agreement. The reserve for rebates increases as sales to certain wholesale and retail customers increase. However, since these rebate programs are not identical for all customers, the size of the reserve will depend on the mix of customers that are eligible to receive rebates.

***Returns –*** Consistent with industry practice, the Company has a product returns policy that allows customers to return product within a specified period before and after the product's lot expiration date in exchange for a credit to be applied to future purchases. The Company's policy requires that the customer obtain pre-approval from the Company for any qualifying return. The Company estimates its provision for returns based principally on historical experience. However, the Company continually monitors the provisions for returns and makes adjustments when management believes that future product returns may differ from historical experience. Generally, the reserve for returns increases as net sales increase. During our fiscal year 2008 we increased our estimated returns reserve approximately $3.0 million, of which $1.5 million occurred in the fourth quarter, This adjustment was based on an analysis of our historical returns experience, the average lag time between sales and returns and an evaluation of changing buying and inventory trends of both our direct and indirect customers. As this change resulted from new information that has allowed us to better estimate the average length of time between product sales and returns, we consider it to be a change in estimate as defined in SFAS 154: *Accounting Changes and Error Corrections – A Replacement of APB Opinion No. 20 and FASB Statement No. 3.* The reserve for returns is included in the rebates and chargebacks payable account on the balance sheet.

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

The following tables identify the reserves for each major category of revenue allowance and a summary of the activity for the fiscal years ended June 30, 2008, 2007 and 2006:

**For the Year Ended June 30, 2008**

| Reserve Category | Chargebacks | Rebates | Returns | Other | Total |
|---|---|---|---|---|---|
| Reserve Balance as of June 30, 2007 .................... | $ 4,649,478 | $ 871,339 | $ 113,313 | $ 52,234 | $ 5,686,364 |
| Actual credits issued related to sales recorded in prior fiscal years .............................................. | (4,556,488) | (1,741,804) | (4,909,659) | — | (11,207,951) |
| Reserves or (reversals) charged during Fiscal 2008 related to sales in prior fiscal years ................... | — | 870,465 | 5,892,805 | (50,000) | 6,713,270 |
| Reserves charged to net sales during Fiscal 2008 related to sales recorded in Fiscal 2008 ............ | 26,126,995 | 7,999,232 | 12,546,130 | 473,423 | 47,145,780 |
| Actual credits issued related to sales recorded in Fiscal 2008 ....................................................... | (22,170,578) | (7,366,918) | — | (473,550) | (30,011,046) |
| Reserve Balance as of June 30, 2008 .................... | $ 4,049,407 | $ 632,314 | $ 13,642,589 | $ 2,107 | $ 18,326,417 |
| Reserve Balance as of June 30, 2006 .................... | $ 10,137,400 | $ 2,183,100 | $ 416,000 | $ 275,600 | $ 13,012,100 |
| Actual credits issued related to sales recorded in prior fiscal years .............................................. | (10,170,000) | (1,800,000) | (5,578,000) | (250,000) | (17,798,000) |
| Reserves or (reversals) charged during Fiscal 2007 related to sales recorded in prior fiscal years ..... | — | (300,000) | 3,572,313 | — | 3,272,313 |
| Reserves charged to net sales in fiscal 2007 related to sales recorded in fiscal 2007 ......................... | 28,034,000 | 9,562,000 | 1,703,000 | 1,044,800 | 40,343,800 |
| Actual credits issued related to sales in fiscal 2007 ......................................................................... | (23,351,922) | (8,773,761) | — | (1,018,166) | (33,143,849) |
| Reserve Balance as of June 30, 2007 .................... | $ 4,649,478 | $ 871,339 | $ 113,313 | $ 52,234 | $ 5,686,364 |

| Reserve Category | Chargebacks | Rebates | Returns | Other | Total |
|---|---|---|---|---|---|
| Reserve Balance as of June 30, 2005 ................. | $ 7,999,700 | $ 1,028,800 | $ 1,692,000 | $ 29,500 | $ 10,750,000 |
| Actual credits issued related to sales recorded in prior fiscal years ............................................ | (7,920,500) | (1,460,500) | (1,273,300) | (59,300) | (10,713,600) |
| Reserves or (reversals) charged during Fiscal 2006 related to sales recorded in prior fiscal years ............................................................... | — | 500,000 | (500,000) | — | 0 |
| Reserves charged to net sales in fiscal 2006 related to sales recorded in fiscal 2006 .......... | 28,237,000 | 5,688,500 | 497,300 | 1,298,200 | 35,721,000 |
| Actual credits issued related to sales in fiscal 2006 ............................................................... | (18,178,800) | (3,573,700) | 0 | (992,800) | (22,745,300) |
| Reserve Balance as of June 30, 2006 ................. | $ 10,137,400 | $ 2,183,100 | $ 416,000 | $ 275,600 | $ 13,012,100 |

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

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

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

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

***Property, Plant and Equipment*** - Property, plant and equipment are stated at cost. Depreciation is provided for by the straight-line method for financial reporting purposes over the estimated useful lives of the assets. Depreciation expense for the fiscal years ended June 30, 2008, 2007, and 2006 was approximately $3,444,000, $2,765,000 and $2,182,000, respectively.

***Investment Securities*** – The Company's investment securities consist of marketable debt securities, primarily in U.S. government and agency obligations. All of the Company's marketable debt securities are classified as available-for-sale and recorded at fair value, based on quoted market prices. Unrealized holding gains and losses are recorded, net of any tax effect, as a separate component of accumulated other comprehensive loss. No gains or losses on marketable debt securities are realized until they are sold or a decline in fair value is determined to be other-than-temporary. In accordance with Financial Accounting Standards Board ("FASB") Staff Position Nos. FAS 115-1 and FAS 124-1 "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" ("FSP 115-1"), the Company periodically reviews its marketable securities and determines whether the investments are other-than-temporarily impaired. If the investments are deemed to be other-than-temporarily impaired, the investments are written down to their then current fair market value with a new cost basis being established. There were no securities determined by management to be other-than-temporarily impaired for the twelve month periods ended June 30, 2008, 2007 and 2006.

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

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

***Intangible Assets –*** In January 2005, Lannett Holdings, Inc. entered into an agreement in which the Company purchased for $100,000 and future royalty payments the proprietary rights to manufacture and distribute a product for which Pharmeral, Inc. owned the ANDA. In Fiscal 2008, the Company obtained FDA approval for the ANDA. The Company has recognized the payment for these rights as an indefinite lived intangible asset and tests this asset for impairment at least on an annual basis. See Note 17.

In March 2004, the Company entered into an agreement with Jerome Stevens Pharmaceuticals, Inc. (JSP) for the exclusive marketing and distribution rights in the United States to the current line of JSP products in exchange for four million (4,000,000) shares of the Company's common stock. As a result of the JSP agreement, the Company recorded an intangible asset of $67,040,000 for the exclusive marketing and distribution rights obtained from JSP. The intangible asset was recorded based upon the fair value of the four million (4,000,000) shares at the time of issuance to JSP. During the quarter ended March 31, 2005, the Company recorded a non-cash impairment loss of approximately $46,093,000 in accordance with SFAS 144, *Accounting for Impairment or Disposal of Long-lived Assets* to reduce the carrying value of the intangible asset to its fair value of approximately $16,062,000 as of the date of the impairment. As of June 30, 2008, management concluded the intangible asset was correctly stated at fair value and, therefore, no impairment was required.

The Company will incur annual amortization expense of approximately $1,785,000 for the intangible asset over the remaining term of the agreement. For the 12 month periods ending June 30, 2008, 2007 and 2006, the Company incurred amortization expense of $1,785,000, $1,785,000, and $1,785,000, respectively.

Future annual amortization expense of the JSP intangible asset consists of the following:

| Fiscal Year Ending June 30, | Annual Amortization Expense |
|---|---|
| 2009 | $ 1,785,000 |
| 2010 | 1,785,000 |
| 2011 | 1,785,000 |
| 2012 | 1,785,000 |
| 2013 | 1,785,000 |
| Thereafter | 1,337,000 |
| | $ 10,262,000 |

***Advertising Costs*** - The Company charges advertising costs to operations as incurred. Advertising expense for the fiscal years ended June 30, 2008, 2007 and 2006 was approximately $9,000, $75,000, and $165,000, respectively.

***Income Taxes*** - The Company uses the liability method specified by Statement of Financial Accounting Standards No. 109 (FAS), *Accounting for Income Taxes.* Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities as measured by the enacted tax rates which will be in effect when these differences reverse. Deferred tax expense/ (benefit) is the result of changes in deferred tax assets and liabilities.

***Segment Information*** – The Company reports segment information in accordance with Statement of Financial Accounting Standard No. 131 (FAS 131), *Disclosures about Segments of an Enterprise and Related Information*. The Company operates one business segment - generic pharmaceuticals, accordingly the Company has one reporting segment. In accordance with FAS 131, the Company aggregates its financial information for all products and reports as one operating segment. The following table identifies the Company's approximate net product sales by medical indication for the fiscal years ended June 30, 2008, 2007 and 2006:

| Medical Indication | For the Fiscal Year Ended June 30, 2008 | 2007 | 2006 |
|---|---|---|---|
| Migraine Headache | $ 10,302,868 | $ 10,738,109 | $ 11,666,330 |
| Epilepsy | 3,811,963 | 7,593,547 | 12,815,637 |
| Heart Failure | 7,574,240 | 4,728,907 | 7,214,182 |
| Thyroid Deficiency | 38,429,663 | 35,350,388 | 17,931,743 |
| Antibiotic | 3,449,429 | 3,095,241 | 4,669,992 |
| Other | 8,835,120 | 21,071,399 | 9,762,491 |
| Total | $ 72,403,283 | $ 82,577,591 | $ 64,060,375 |

***Concentration of Market and Credit Risk –*** Six of the Company's products, defined as generics containing the same active ingredient or combination of ingredients, accounted for approximately 53%, 10%, 9%, 7%, 7%, and 5% of net sales for the fiscal year ended June 30, 2008. Those same products accounted for 43%, 6%, 21%, 7%, 6%, and 9%, respectively, of net sales for the fiscal year ended June 30, 2007, and 28%, 11%, 4%, 10%, 7%, and 20%, respectively, for the fiscal year ended June 30, 2006.

Four of the Company's customers accounted for 36%, 10%, 6%, and 6%, respectively, of net sales for the fiscal year ended June 30, 2008; 15%, 12%, 24%, and 6%, respectively, of net sales for the fiscal year ended June 30, 2007; and 4%, 15%, 17%, and 5%, respectively, of net sales for the fiscal year ended June 30, 2006.

Credit terms are offered to customers based on evaluations of the customers' financial condition. Generally, collateral is not required from customers. Accounts receivable payment terms vary and are stated in the financial statements at amounts due from customers net of an allowance for doubtful accounts. Accounts remaining outstanding longer than the payment terms are considered past due. The Company determines its allowance by considering a number of factors, including the length of time trade accounts receivable are past due, the Company's previous loss history, the customer's current ability to pay its obligation to the Company, and the condition of the general economy and the industry as a whole. The Company writes-off accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for doubtful accounts.

***Share-based Payments*** - The Company follows the guidance in Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 123 (R), "Share-Based Payment" (SFAS 123(R)). This standard is a revision of SFAS 123, "Accounting for Stock-Based Compensation" and supersedes Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees." SFAS 123(R) addresses the accounting for share-based compensation in which we receive employee services in exchange for our equity instruments. Under the standard, we recognize compensation cost for share-based compensation issued to or purchased by employees, net of estimated forfeitures, under share-based compensation plans using a fair value method. Compensation cost related to share-based payments is included in the income statement in the same line item as the related other compensation costs.

At June 30, 2008, the Company had three stock-based employee compensation plans (the "Old Plan," the "2003 Plan," and the "Long-term Incentive Plan," or "LTIP"). During the fiscal year ended June 30, 2008, the Company awarded 209,264 shares of restricted stock under the LTIP of which, 74,464 of these shares vested 100% on January 1, 2008, the remainder vest in equal portions on September 18, 2008, 2009 and 2010. Stock compensation expense of $134,794 was recognized during the fiscal year ended June 30, 2008, related to these shares of restricted stock.

The Company is required to record compensation expense for all awards granted after the date of adoption of SFAS 123(R) and for the unvested portion of previously granted awards that remain outstanding as of the beginning of the period of adoption. 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 years ended June 30 and the estimated annual forfeiture rates used to recognize the associated compensation expense:

| | Incentive Stock Options FY 2008 | Non-qualified Stock Options FY 2008 | Incentive Stock Options FY 2007 | Non- qualified Stock Options FY 2007 | Incentive Stock Options FY 2006 | Non-qualified Stock Options FY 2006 |
|---|---|---|---|---|---|---|
| Risk-free interest rate.......... | 4.15% | 4.21% | 4.71% | 4.79% | 4.59% | 4.13% |
| Expected volatility............. | 56% | 56% | 59% | 59% | 61% | 61% |
| Expected dividend yield...... | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| Forfeiture rate .................... | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% |
| Expected term (in years)..... | 5.0 years | 5.0 years | 5.0 years | 5.0 years | 5.0 years | 5.0 years |
| Weighted average fair value............................... | $ 2.11 | $ 2.11 | $ 3.36 | $ 3.20 | $ 3.06 | $ 3.77 |

Approximately 582,000 options were issued under the LTIP during the year ended June 30, 2008. This compares to approximately 354,000 options issued during the year ended June 30, 2007 and approximately 109,000 options issued during the year ended June 30, 2006. There were no shares under option that were exercised in the year ended June 30, 2008. Three hundred seventy-five options were exercised in the year ended June 30, 2007, resulting in proceeds of $281 to the Company. 1,000 options were exercised in the year ended June 30, 2006, resulting in proceeds of $4,633 to the Company. At June 30, 2008, there were 1,694,331 options outstanding. Of those, 581,900 were options issued under the LTIP, 901,198 were issued under the 2003 Plan, and 211,233 under the Old Plan. There are no further shares authorized to be issued under the Old Plan. 1,125,000 shares were authorized to be issued under the 2003 Plan, with 7,690 shares under option having already been exercised under that plan. 2,500,000 shares were authorized to be issued under the LTIP, with no shares under options having yet been exercised under that plan.

Expected volatility is based on the historical volatility of the price of our common shares since the date we commenced trading on the AMEX, April 2002, or a historical period equal to the expected term of the option, whichever is shorter. We use historical information to estimate expected term within the valuation model. The expected term of awards represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. Compensation cost is recognized using a straight-line method over the vesting or service period and is net of estimated forfeitures.

The forfeiture rate assumption is the estimated annual rate at which unvested awards are expected to be forfeited during the vesting period. This assumption is based on our historical forfeiture rate. Periodically, management will assess whether it is necessary to adjust the estimated rate to reflect changes in actual forfeitures or changes in expectations. For example, adjustments may be needed if, historically, forfeitures were affected mainly by turnover that resulted from a business restructuring that is not expected to recur. The increase in the forfeiture rate from 3% at June 30, 2006 to 5% at June 30, 2007 is an adjustment made to account for recent turnover at manager levels. As the Company continues to grow, this rate is likely to change to match such changes in turnover and hiring rates. Under the provisions of FAS 123R, the Company will incur additional expense if the actual forfeiture rate is lower than originally estimated. A recovery of prior expense will be recorded if the actual rate is higher than originally estimated.

The following table presents all share-based compensation costs recognized in our statements of income as part of selling, general and administrative expenses:

| | Twelve months ended June 30, | | |
|---|---|---|---|
| **Method used to account for share-based compensation** | **2008 Fair Value** | **2007 Fair Value** | **2006 Fair Value** |
| Share based compensation | | | |
| Stock options ................................................................................... | $ 869,921 | $ 1,142,913 | $ 1,396,736 |
| Employee stock purchase plan....................................................... | $ 25,208 | $ 33,323 | $ 43,975 |
| Restricted stock................................................................................ | $ 134,794 | $ — | $ — |
| Tax benefit at effective rate ................................................................ | $ 108,127 | $ 187,762 | $ 317,400 |

Options outstanding that have vested and are expected to vest as of June 30, 2008 are as follows:

| | Awards | Weighted Average Exercise Price | Aggregate Intrinsic Value | Weighted Average Remaining Contractual Life |
|---|---|---|---|---|
| Options vested | 850,142 | $ 10.50 | $ 6,300 | 5.9 |
| Options expected to vest | 801,979 | $ 4.65 | $ — | 8.9 |
| Total vested and expected to vest | 1,652,121 | $ 7.66 | $ 6,300 | 7.4 |

A summary of nonvested stock award activity as of June 30, 2008 and changes during the twelve months then ended, is presented below:

| | Awards | Weighted Average Grant - date Fair Value |
|---|---|---|
| Nonvested at July 1, 2007 | — | $ — |
| Granted | 209,264 | $ 843,334 |
| Vested | (74,464) | $ (300,090) |
| Forfeited | (10,000) | $ (40,300) |
| Nonvested at June 30, 2008 | 124,800 | $ 502,944 |

A summary of stock option award activity under the Plans as of June 30, 2008, 2007 and 2006 and changes during the twelve months then ended, is presented below:

| | Incentive Stock Options | | | | Nonqualified Stock Options | | | |
|---|---|---|---|---|---|---|---|---|
| | Awards | Weighted Average Exercise Price | Aggregate Intrinsic Value | Weighted Average Remaining Contractual Life | Awards | Weighted Average Exercise Price | Aggregate Intrinsic Value | Weighted Average Remaining Contractual Life |
| Outstanding at July 1, 2007 | 501,349 | $ 7.48 | | | 617,982 | $ 11.00 | | |
| Granted | 496,818 | $ 4.03 | | | 85,082 | $ 4.03 | | |
| Exercised | — | — | | | — | — | | |
| Forfeited or expired | 6,900 | $ 5.67 | | | — | — | | |
| Outstanding at June 30, 2008 | 991,267 | $ 5.76 | $ 6,300 | 8.0 | 703,064 | $ 10.16 | $ — | 6.5 |
| Outstanding at June 30, 2008 and not yet vested | 660,538 | $ 4.54 | — | 9.0 | 183,651 | $ 5.05 | $ — | 8.7 |
| Exercisable at June 30, 2008 | 330,729 | $ 8.21 | $ 6,300 | 6.1 | 519,413 | $ 11.96 | $ — | 5.8 |

| | Incentive Stock Options | | | | Nonqualified Stock Options | | | |
|---|---|---|---|---|---|---|---|---|
| | Awards | Weighted Average Exercise Price | Aggregate Intrinsic Value | Weighted Average Remaining Contractual Life | Awards | Weighted Average Exercise Price | Aggregate Intrinsic Value | Weighted Average Remaining Contractual Life |
| Outstanding at July 1, 2006 | 307,541 | $ 8.47 | | | 484,462 | $ 12.42 | | |
| Granted | 220,263 | $ 6.14 | | | 133,520 | $ 5.84 | | |
| Exercised | 375 | $ 0.75 | $ 2,063 | | — | — | | |
| Forfeited or expired | 26,080 | $ 7.84 | | | — | — | | |
| Outstanding at June 30, 2007 | 501,349 | $ 7.48 | $ 201,763 | 7.8 | 617,982 | $ 11.00 | $ 103,320 | 7.1 |
| Outstanding at June 30, 2007 and not yet vested | 276,222 | $ 6.11 | $ 133,375 | 9.0 | 177,817 | $ 6.16 | $ 99,680 | 8.9 |
| Exercisable at June 30, 2007 | 225,127 | $ 9.16 | $ 68,388 | 6.3 | 440,165 | $ 12.96 | $ 3,640 | 6.4 |

| | Incentive Stock Options | | | | Nonqualified Stock Options | | | |
|---|---|---|---|---|---|---|---|---|
| | Awards | Weighted Average Exercise Price | Aggregate Intrinsic Value | Weighted Average Remaining Contractual Life | Awards | Weighted Average Exercise Price | Aggregate Intrinsic Value | Weighted Average Remaining Contractual Life |
| Outstanding at July 1, 2005 | 321,353 | $ 10.55 | | | 535,755 | $ 12.75 | | |
| Granted | 79,833 | $ 5.47 | | | 28,667 | $ 6.82 | | |
| Exercised | 1,000 | $ 4.63 | $ 2,537 | | — | — | | |
| Forfeited or expired | 92,645 | $ 13.15 | | | 79,960 | $ 12.63 | | |
| Outstanding at June 30, 2006 | 307,541 | $ 8.47 | $ 78,010 | 7.5 | 484,462 | $ 12.42 | $ 6,120 | 7.2 |
| Outstanding at June 30, 2006 and not yet vested | 132,766 | $ 7.20 | $ 36,465 | 8.4 | 165,014 | $ 12.10 | $ 6,120 | 7.3 |
| Exercisable at June 30, 2006 | 174,775 | $ 9.43 | $ 41,545 | 6.8 | 319,448 | $ 12.59 | $ — | 7.2 |

Options with a fair value of approximately $646,000 completed vesting during 2008. As of June 30, 2008, there was approximately $1,790,000 of total unrecognized compensation cost related to nonvested share-based compensation awards granted under the Plans. That cost is expected to be recognized over a weighted average period of 1.5 years. As of June 30, 2007 there was approximately $1,114,000 of total unrecognized compensation cost related to non-vested share-based compensation awards granted under the Plans. The Company issues new shares when stock options are exercised.

***Unearned Grant Funds*** – The Company records all grant funds received as a liability until the Company fulfills all the requirements of the grant funding program.

***Earnings per Common Share*** – SFAS No. 128, *Earnings per Share,* requires a dual presentation of basic and diluted earnings per share on the face of the Company's consolidated statement of income and a reconciliation of the computation of basic earnings per share to diluted earnings per share. Basic earnings per share excludes the dilutive impact of common stock equivalents and is computed by dividing net income by the weighted-average number of shares of common stock outstanding for the period. Diluted earnings per share include the effect of potential dilution from the exercise of outstanding common stock equivalents into common stock using the treasury stock method. Earnings per share amounts for all periods presented have been calculated in accordance with the requirements of SFAS No. 128. A reconciliation of the Company's basic and diluted earnings per share follows:

| | 2008 | | 2007 | | 2006 | |
|---|---|---|---|---|---|---|
| | Net Loss (Numerator) | Shares (Denominator) | Net Loss (Numerator) | Shares (Denominator) | Net Income (Numerator) | Shares (Denominator) |
| Basic (loss)/earnings per share factors | $ (2,318,059) | 24,227,181 | $ (6,929,008) | 24,159,251 | $ 4,968,922 | 24,130,224 |
| Effect of potentially dilutive option plans | — | — | — | — | — | 26,665 |
| Diluted (loss)/earnings per share factors | (2,318,059) | 24,227,181 | (6,929,008) | 24,159,251 | 4,968,922 | 24,156,889 |
| Basic (loss)/earnings per share | $ (0.10) | | $ (0.29) | | $ 0.21 | |
| Diluted (loss)/earnings per share | $ (0.10) | | $ (0.29) | | $ 0.21 | |

Dilutive shares have been excluded in the weighted average shares used for the calculation of earnings per share in periods of net loss because the effect of such securities would be anti-dilutive. 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, 2008, 2007 and 2006 were 1,949,131, 1,119,331, and 726,833, respectively.

As disclosed in Note 12, the Company entered into a Stock Purchase Agreement on April 10, 2007 to acquire Cody Laboratories, Inc. ("Cody") by purchasing all of the remaining shares of common stock of Cody. As part of the consideration, the agreement required Lannett to issue to the sellers 120,000 shares of unregistered common stock of the Company contingent upon the receipt of a license from a regulatory agency. In accordance with paragraph 30 of SFAS 128, these contingently issuable shares were not included in the calculation of diluted EPS because the conditions necessary for the issuance of the shares had not been satisfied at the end of the reporting period. In July, 2008, the license was received form the regulatory agency and the contingent shares will be issued to the sellers in accordance with the Stock Purchase Agreement.

**Note 2. New Accounting Standards**

In July 2006, the FASB issued FIN 48, which addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based solely on position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. FIN 48 also provides guidance on derecognition, classification, interest and penalties on income taxes, accounting in interim periods and requires increased disclosures. FIN 48 is effective for fiscal years beginning after December 15, 2006. We adopted the provisions of FIN 48 on July 1, 2007. See Note 16 herein.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" (SFAS 157). This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice. In February, 2008, the FASB issued FASB Staff Position 157-1, Application of FASB Statement No. 157 to FASB Statement 13 and Other Accounting Pronouncements That Address Fair value Measurements for Purposes of Lease Classification and Measurement under Statement 13 (FSP FAS 157-1) and FASB Staff Position 157-2, Effective Date of FASB Statement No. 157 (FSP FAS 157-2). FSP FAS 157-1 amends SFAS 157 to remove certain leasing transactions from its scope. FSP FAS 157-2 defers the effective date of SFAS No. 157 for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. We adopted the guidance of SFAS 157 as it applies to our financial instruments on July 1, 2008 and do not expect the adoption will have a significant impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115* (SFAS No. 159), which allows companies to choose, at specific election dates, to measure eligible financial assets and liabilities at fair value that are not otherwise required to be measured at fair value. If a company elects the fair value option for an eligible item, changes in that item's fair value in subsequent reporting periods must be recognized in current earnings. SFAS 159 is effective for our fiscal year beginning July 1, 2008. We do not expect the adoption of SFAS 159 will have any impact on our consolidated financial statements as we have not elected to apply the fair value option to any of our financial assets and liabilities.

In June 2007, the EITF reached a final consensus on EITF Issue No. 07-3, "Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities" ("EITF 07-3"). EITF 07-3 is effective for our fiscal year beginning July 1, 2008. EITF 07-3 requires non-refundable advance payments for future research and development activities to be capitalized until the goods have been delivered or related services have been performed. As the guidance in EITF 07-03 is consistent with our existing policy we do not believe EITF 07-03 will have any impact on our financial statements or related disclosures.

In November 2007, the EITF reached a final consensus on EITF Issue No. 07-1, "Accounting for Collaborative Arrangements Related to the Development and Commercialization of Intellectual Property" ("EITF 07-1"). EITF 07-1 will be effective for our fiscal year beginning July 1, 2009 and interim periods within that fiscal year. Adoption is on a retrospective basis to all prior periods presented for all collaborative arrangements existing as of the effective date. We are currently evaluating the impact of adopting EITF 07-1 on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations" ("SFAS 141(R)"). SFAS 141(R) will significantly change the accounting for business combinations in a number of areas including the treatment of contingent consideration, contingencies, acquisition costs, in-process research and development and restructuring costs. In addition, under SFAS 141(R), changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact income tax expense. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the fiscal year beginning July 1, 2009. Early application is not permitted. The effect of SFAS 141(R) on our consolidated financial statements will depend on the nature and terms of any business combinations that occur after its effective date.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements" ("SFAS 160"). SFAS 160 amends Accounting Research Bulletin No. 51 to establish accounting and reporting standards for the noncontrolling (minority) interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements and establishes a single method of accounting for changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation. SFAS 160 is effective for our fiscal year beginning July 1, 2009. We are currently evaluating the impact the adoption of SFAS 160 will have on our consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities" ("SFAS 161"). The new standard is intended to help investors better understand how derivative instruments and hedging activities affect an entity's financial position, financial performance and cash flows through enhanced disclosure requirements. The new standard is effective for our fiscal year beginning July 1, 2009 and for all interim periods within that fiscal year. Early adoption is encouraged. We do not expect the adoption of SFAS 161 to have a significant impact on our consolidated financial statements as we do not currently have any derivatives within the scope of SFAS 161.

In April 2008, the FASB issued FASB Staff Position No. FAS 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP FAS 142-3"). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, "Goodwill and Other Intangible Assets". The FSP is intended to improve the consistency between the useful life of a recognized intangible asset under Statement 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141(R) and other U.S. generally accepted accounting principles. The new standard is effective for our financial statements issued for fiscal years and interim periods beginning July 1, 2009. We are currently evaluating the impact of FSP FAS 142-3.

**Note 3. Inventories**

Inventories at June 30, 2008 and 2007 consist of the following:

| | 2008 | 2007 |
|---|---|---|
| Raw Materials | $ 3,530,951 | $ 3,631,780 |
| Work-in-process | 1,034,360 | 1,008,195 |
| Finished Goods | 6,767,718 | 9,640,106 |
| Packaging Supplies | 284,229 | 238,403 |
| | $ 11,617,258 | $ 14,518,484 |

The preceding amounts are net of inventory obsolescence reserves of $1,642,668 and $923,920 at June 30, 2008 and 2007, respectively.

**Note 4. Property, Plant and Equipment**

Property, plant and equipment at June 30, 2008 and 2007 consist of the following:

| | Useful Lives | 2008 | 2007 |
|---|---|---|---|
| Land | - | $ 918,314 | $ 918,314 |
| Building and improvements | 10 - 39 years | 16,806,057 | 16,229,427 |
| Machinery and equipment | 5 - 10 years | 21,434,375 | 21,275,686 |
| Furniture and fixtures | 5 - 7 years | 837,262 | 837,262 |
| | | $ 39,996,008 | $ 39,260,689 |
| Less accumulated depreciation | | (15,261,905) | (11,817,528) |
| Total | | $ 24,734,103 | $ 27,443,161 |

As of June 30, 2008, substantially all of the Company's property, plant and equipment was pledged as collateral for the Company's loans. See Note 8.

## Note 5. Investment Securities - Available-for-Sale

The amortized cost, gross unrealized gains and losses, and fair value of the Company's available-for-sale securities as of June 30, 2008 and June 30, 2007:

June 30, 2008
Available-for-Sale

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| U.S. Government Agency | $ 2,036,039 | $ 48,059 | $ (9,854) | $ 2,074,244 |
| Asset-Backed Securities | 447,893 | 1,013 | (23,015) | 425,891 |
| | $ 2,483,932 | $ 49,072 | $ (32,869) | $ 2,500,135 |

June 30, 2007
Available-for-Sale

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| U.S. Government Agency | $ 2,474,435 | $ 8,302 | $ (5,525) | $ 2,477,212 |
| Asset-Backed Securities | 892,168 | 18 | (48,766) | 843,420 |
| | $ 3,366,603 | $ 8,320 | $ (54,291) | $ 3,320,632 |

The amortized cost and fair value of the Company's current available-for-sale securities by contractual maturity at June 30, 2008 and June 30, 2007 are summarized as follows:

| | June 30, 2008 Available for Sale | | June 30, 2007 Available for Sale | |
|---|---|---|---|---|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| Due in one year or less | $ 343,638 | $ 354,155 | $ 201,540 | $ 198,750 |
| Due after one year through five years | 1,692,401 | 1,720,089 | 2,491,286 | 2,493,953 |
| Due after five years through ten years | 121,608 | 121,769 | 216,182 | 208,602 |
| Due after ten years | 326,285 | 304,122 | 457,595 | 419,327 |
| | $ 2,483,932 | $ 2,500,135 | $ 3,366,603 | $ 3,320,632 |

The Company uses the specific identification method to determine the cost of securities sold. For the fiscal years ended June 30, 2008, 2007 and 2006, the Company had realized losses of $4,338, $1,095 and $25,233, respectively.

There were no securities held from a single issuer that represented more than 10% of shareholders' equity.

The table below indicates the length of time individual securities have been in a continuous unrealized loss position as of June 30, 2008:

June 30, 2008

| Description of Securities | Number of Securities | Less than 12 months Fair Value | Less than 12 months Unrealized Loss | 12 months or longer Fair Value | 12 months or longer Unrealized Loss | Total Fair Value | Total Unrealized Loss |
|---|---|---|---|---|---|---|---|
| U.S. Government Agency | 5 | $ 433,224 | $ (9,854) | $ — | $ — | $ 433,224 | $ (9,854) |
| Asset-Backed Securities | 6 | 40,853 | (13) | 160,132 | (23,002) | 200,985 | (23,015) |
| Total tempory impaired investment securities | 11 | $ 474,077 | $ (9,867) | $ 160,132 | $ (23,002) | $ 634,209 | $ (32,869) |

The investment securities shown above currently have fair values less than amortized cost and therefore contain unrealized losses. The Company has evaluated these securities and has determined that the decline in value is not related to any company or industry specific event. At June 30, 2008, there were approximately 11 out of 28 investment securities with unrealized losses. The Company anticipates full recovery of amortized costs with respect to these securities at maturity or sooner in the event of a more favorable market interest rate environment.

None of the Company's investment securities was pledged as collateral for borrowings as of June 30, 2008.

**Note 6. Bank Line of Credit**

The Company has a $3 million line of credit from Wachovia Bank, N.A. that bears interest at the prime interest rate less 0.25% (4.75% at June 30, 2008). The Company currently has $2,912,247 available under this line of credit. The Company entered into a letter of credit in the amount of $917,000 of which $87,753 is outstanding as of June 30, 2008. The line of credit was renewed and extended to November 30, 2009. The line of credit is collateralized by substantially all of the Company's assets. The agreement contains covenants with respect to working capital, net worth and certain ratios, as well as other covenants. At June 30, 2008, the Company was not in compliance with one of these covenants, but received a waiver from its lending institution with respect to that covenant as of June 30, 2008. The Company shall maintain and comply with a debt service coverage ratio of not less than 2 to 1 (to be measured quarterly). Debt service coverage is defined as the ratio of earnings before interest, taxes, depreciation and amortization (EBITDA) to the sum of interest expenses plus scheduled current maturities of long-term debt and current capitalized lease obligations. The terms of the waiver require the Company shall at all times maintain deposit balances in excess of $3,500,000 with the Bank. Additionally, the Company shall now pay to the Bank an availability fee equal to 0.50% per annum calculated daily, on the available but unused balance of the line of credit instead of the previous 0.25% per annum rate.

**Note 7. Unearned Grant Funds**

In July 2004, the Company received $500,000 of grant funding from the Commonwealth of Pennsylvania, acting through the Department of Community and Economic Development. The grant funding program requires the Company to use the funds for machinery and equipment located at their Pennsylvania locations, hire an additional 100 full-time employees by June 30, 2006, operate its Pennsylvania locations a minimum of five years and meet certain matching investment requirements. If the Company fails to comply with any of the requirements above, the Company would be liable to repay the full amount of the grant funding ($500,000). The Company has recorded the unearned grant funds as a liability until the Company complies with all of the requirements of the grant funding program As of June 30, 2008, the Company has had preliminary discussions with the Commonwealth of Pennsylvania to determine whether it will be required to repay any of the funds provided under the grant funding program. Based on information available at June 30, 2008, the Company has recorded the grant funding as a long-term liability under the caption of Unearned Grant Funds.

**Note 8. Long-Term Debt**

Long-term debt at June 30, 2008 and 2007 consists of the following:

| | June 30, 2008 | June 30, 2007 |
|---|---|---|
| PIDC Regional Center, LP III loan | $ 4,500,000 | $ 4,500,000 |
| Pennsylvania Industrial Development Authority loan | 1,075,732 | 1,150,212 |
| Pennsylvania Department of Community & Economic Development loan | 283,475 | 388,487 |
| Tax-exempt bond loan (PAID) | 795,000 | 904,422 |
| Equipment loan | 400,653 | 722,266 |
| SBA loan | 183,750 | 231,812 |
| First National Bank of Cody | 1,740,224 | 1,782,766 |
| Total debt | 8,978,834 | 9,679,965 |
| Less current portion | 791,912 | 692,119 |
| Long term debt | $ 8,186,922 | $ 8,987,846 |

Current Portion of Long Term Debt

| | June 30, 2008 | June 30, 2007 |
|---|---|---|
| PIDC Regional Center, LP III loan | $ — | $ — |
| Pennsylvania Industrial Development Authority loan | 73,132 | 70,604 |
| Pennsylvania Department of Community & Economic Development loan | 100,614 | 97,001 |
| Tax-exempt bond loan (PAID) | 115,000 | 109,164 |
| Equipment loan | 400,653 | 320,520 |
| SBA loan | 54,025 | 49,647 |
| First National Bank of Cody | 48,488 | 45,183 |
| Total current portion of long term debt | $ 791,912 | $ 692,119 |

The Company financed $4,500,000 through the Philadelphia Industrial Development Corporation (PIDC). The Company will pay a bi-annual interest payment at a rate equal to two and one-half percent per annum. The outstanding principal balance shall be due and payable 5 years (60 months) from January 1, 2006.

The Company financed $1,250,000 through the Pennsylvania Industrial Development Authority (PIDA). The Company is required to make equal payments each month for 180 months starting February 1, 2006 with interest of two and three-quarter percent per annum.

An additional $500,000 was financed through the Pennsylvania Department of Community and Economic Development Machinery and Equipment Loan Fund. The Company is required to make equal payments for 60 months starting May 1, 2006 with interest of two and three quarter percent per annum.

In April 1999, the Company entered into a loan agreement (the "Agreement") with a governmental authority, the Philadelphia Authority for Industrial Development (the "Authority" or "PAID"), to finance future construction and growth projects of the Company. The Authority issued $3,700,000 in tax-exempt variable rate demand and fixed rate revenue bonds to provide the funds to finance such growth projects pursuant to a trust indenture ("the Trust Indenture"). A portion of the Company's proceeds from the bonds was used to pay for bond issuance costs of approximately $170,000. The Trust Indenture requires that the Company repay the Authority loan through installment payments beginning in May 2003 and continuing through May 2014, the year the bonds mature. The bonds bear interest at the floating variable rate determined by the organization responsible for selling the bonds (the "remarketing agent"). The interest rate fluctuates on a weekly basis. The effective interest rate at June 30, 2008 was 1.67%.

The Company entered into agreements (the "2003 Loan Financing") with Wachovia to finance the purchase of the Torresdale Avenue facility, the renovation and setup of the building, and other anticipated capital expenditures. The Company, as part of the 2003 Loan Financing agreement, is required to make equal payments of principal and interest. The only portion of the loan that remains outstanding at June 30, 2008 was the Equipment Loan which consists of a term loan with a term of five years and had an outstanding balance of $400,653 at June 30, 2008. The terms of the Equipment loan require that the Company meet certain financial covenants and reporting standards, including the attainment of specific financial liquidity and net worth ratios. As of June 30, 2008, the Company was not in compliance with one of these covenants, but received a waiver from its lending institution with respect to that covenant as of June 30, 2008. The Company shall maintain and comply with a debt service coverage ratio of not less than 2 to 1 (to be measured quarterly). Debt service coverage is defined as the ratio of earnings before interest, taxes, depreciation and amortization (EBITDA) to the sum of interest expenses plus scheduled current maturities of long-term debt and current capitalized lease obligations. The terms of the waiver require the Company shall at all times maintain deposit balances in excess of $3,500,000 with the Bank. Additionally, the Company shall now pay to the Bank an availability fee equal to 0.50% per annum calculated daily, on the available but unused balance of the line of credit instead of the previous 0.25% per annum rate. The financing facilities under the 2003 Loan Financing bear interest at a variable rate equal to the LIBOR rate plus 150 basis points. We believe that it is possible that we may not be able to comply with all of the covenants at each measurement date during the twelve month period ending June 30, 2009, therefore we reclassified the $80,132 long-term portion of the debt to current portion of long-term debt.. As of June 30, 2008, the interest rate for the 2003 Loan Financing (of which only the Equipment loan remains) was 3.89%.

The financing facilities under the 2003 Loan Financing, of which only the Equipment Loan is left, bear interest at a variable rate equal to the LIBOR rate plus 150 basis points. The LIBOR rate is the rate per annum, based on a 30-day interest period, quoted two business days prior to the first day of such interest period for the offering by leading banks in the London interbank market of dollar deposits. As of June 30, 2008, the interest rate for the 2003 Loan Financing (of which only the Equipment loan remains) was 3.89%.

The Company has executed Security Agreements with Wachovia, PIDA and PIDC in which the Company has agreed to pledge substantially all of its assets to collateralize the amounts due.

Included in the acquisition of Cody was a loan from the Small Business Administration ("SBA"). The loan requires fixed monthly payments, with an effective interest rate of 8.75%, through July 31, 2012. Cody has pledged inventory, accounts receivable and equipment as collateral.

Also as part of the Cody acquisition, the Company became primary beneficiary to a variable interest entity ("VIE") called Cody LCI Realty, LLC. See Note 13, Consolidation of Variable Interest Entity for additional description. The VIE owns land and a building which is being leased to Cody. A mortgage loan with First National Bank of Cody has been consolidated in the Company's financial statements, along with the related land and building. The mortgage has 18 years remaining. Principal and interest payments of $14,782, at a fixed interest rate of 7.5%, are being made on a monthly basis through June 2026. The mortgage loan is collateralized by the land and building.

Long-term debt amounts are due as follows:

| **Fiscal Year Ending June 30,** | **Amounts Payable to Institutions** |
|---|---|
| 2009 | $ 791,912 |
| 2010 | 414,314 |
| 2011 | 4,906,974 |
| 2012 | 281,178 |
| 2013 | 280,848 |
| Thereafter | 2,303,608 |
| | $ 8,978,834 |

Some of the Company's debt instruments are fixed rate, with a lower interest rate than the prevailing market rates. The Company has been able to obtain favorable rates through Philadelphia and Pennsylvania Industrial Development Authorities.

**Note 9. Contingencies**

In June 2008, the Company filed a declaratory judgment suit against KV Pharmaceuticals, DrugTech Corp., and Ther-Rx Corp (collectively "KV"). The complaint sought declaratory judgment for non-infringement and invalidity of certain patents owned by KV. The complaint further sought declaratory judgment of anti-trust violations and federal and state unfair competition violations for actions taken by KV in securing and enforcing these patents. After the complaint was filed, KV countered with a motion for a Temporary Restraining Order ("TRO") to prevent the Company from launching its Multivitamin with Mineral Capsules ("MMCs"), due to alleged patent and trademark infringement issues. The TRO was heard and, ultimately, resulted in a conclusion by the court that the Company's product label on the MMCs should be modified. KV also countered with claims of infringement by the Company of KV's patents seeking the Company's profits for sales of MMCs or other monetary relief, preliminary and permanent injunctive relief, attorney's fees and a finding of willful infringement. The case is currently in its discovery phase with a hearing expected in January 2009. The Company believes that it has meritorious defenses with respect to the claims asserted against it and intends to vigorously defend its position.

In or about July 2008, Albion International and Albion, Inc. filed suit against Lannett asserting claims for patent and trademark infringement, as well as unfair competition, arising out of Lannett's use of product that it purchased from Albion and used as an ingredient in its Multivitamin product. Lannett filed a motion to dismiss the complaint on the basis that it purchased the product from Albion and, as such, was authorized to use the product in its Multivitamin. The Court has not ruled on the motion. Lannett is no longer purchasing product from Albion. If Albion were to prevail on its claims, it may be entitled to a reasonable royalty on the Lannett product that contained the Albion ingredient. The Company believes that Albion's claims have no merit and Lannett intends to vigorously defend the suit.

## Note 10. Commitments

### *Leases*

In June 2006, Lannett signed a lease agreement on a 66,000 square foot facility located on seven acres in Philadelphia. An additional agreement which gives the Company the option to buy the facility was also signed. This new facility is initially going to be used for warehouse space with the expectation of making this facility the Company's headquarters in addition to manufacturing and warehousing. The other Philadelphia locations will continue to be utilized as manufacturing, packaging, and as a research laboratory.

Lannett's subsidiary, Cody leases a 73,000 square foot facility in Cody, Wyoming. This location houses Cody's manufacturing and production facilities. Cody leases the facility from Cody LCI Realty, LLC, a Limited Liability Company which is 50% owned by Lannett. See Note 13.

In addition to the above, the Company has operating leases, expiring at the end of 2008, for office equipment.

Rental and lease expense for the years ended June 30, 2008, 2007 and 2006 was approximately $449,000, $380,000, and $47,000, respectively.

### *Contractual Obligations*

The following table represents annual contractual obligations as of June 30, 2008:

| | Total | Less than 1 year | 1-3 years | 3-5 years | more than 5 years |
|---|---|---|---|---|---|
| Long-Term Debt........ | $ 8,978,834 | $ 711,780 | $ 5,401,420 | $ 562,026 | $ 2,303,608 |
| Operating Leases ....... | 1,105,014 | 492,939 | 596,853 | 15,222 | — |
| Purchase Obligations . | 124,250,000 | 19,250,000 | 41,500,000 | 45,500,000 | 18,000,000 |
| Interest on Obligations............ | 2,114,548 | 336,276 | 583,802 | 299,993 | 894,477 |
| Total.......................... | $ 136,448,396 | $ 20,790,995 | $ 48,082,075 | $ 46,377,241 | $ 21,198,085 |

The amount of long-term debt due in less than one year in the above table is $80,132 less than the current portion of long-term debt in the consolidated balance sheet at June 30, 2008 because of our decision to classify that amount as current. (See Note 8)

The purchase obligations above are 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. Regardless of which party terminates the purchase agreement, there would be minimal impact on the operating cash flows of the Company from the termination.

### *Employment Agreements*

The Company has entered into employment agreements with Arthur P. Bedrosian, President and Chief Executive Officer, Brian Kearns, Chief Financial Officer and Treasurer, Kevin Smith, Vice President of Sales and Marketing, and William Schreck, Vice President of Logistics, (the "Named Executives"). Each of the agreements provide for an annual base salary and eligibility to receive a bonus. The salary and bonus amounts of the Named Executives are determined by the Board of Directors. Additionally, the Named Executives are eligible to receive stock options, which are granted at the discretion of the Board of Directors, and in accordance with the Company's policies regarding stock option grants.

Under the agreements, the Named Executive employees may be terminated at any time with or without cause, or by reason of death or disability. In certain termination situations, the Company is liable to pay severance compensation to the Named Executive of between one year and three years.

## Note 11. Other Comprehensive (Loss) Income

The Company's other comprehensive loss is comprised of unrealized losses on investment securities classified as available-for-sale. The components of comprehensive income and related taxes consisted of the following as of June 30, 2008, 2007 and 2006:

OTHER COMPREHENSIVE (LOSS) INCOME

| | For Fiscal Year Ended June 30, | | |
|---|---|---|---|
| | 2008 | 2007 | 2006 |
| *Other Comprehensive Loss:* | | | |
| Net (Loss) Income .......................................... | $ (2,318,059) | $ (6,929,008) | $ 4,968,922 |
| Unrealized Holding Gain (Loss) on Securities | 62,174 | 74,769 | (78,751) |
| Add: Tax savings at effective rate .................. | (24,869) | (29,908) | 31,500 |
| Total Other Comprehensive Income (Loss)..... | 37,305 | 44,861 | (47,251) |
| Total Comprehensive (Loss) Income.............. | $ (2,280,754) | $ (6,884,147) | $ 4,921,671 |

## Note 12. Acquisition of Cody Laboratories, Inc.

On March 31, 2007, the Company wrote down $7,775,890 of a note receivable owed by Cody Laboratories, Inc. The Company determined that the value of the note receivable was impaired, and on April 10, 2007, it was decided to complete the acquisition of Cody by forgiving the amount of loans that exceeded the fair value of assets received The remaining value of the amounts owed to Lannett approximated the value of Cody at the acquisition date.

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. The Company initially acquired a 12.5% direct interest in Cody Labs in July 2005. The consideration for the April 10, 2007 acquisition was approximately $4,438,000, which represented the fair value of the tangible net assets acquired. The agreement also required Lannett to issue to the sellers 120,000 shares of unregistered common stock of the Company contingent upon the receipt of a license from a regulatory agency. This license was subsequently received in July 2008.

Cody was a privately owned manufacturer and supplier of bulk active pharmaceutical ingredients (API). The Company acquired all outstanding stock in this supplier in order to expand the breadth of its product offerings, and to maximize the profit margin on these products being offered.

The Company accounted for the transaction by following the guidance under SFAS 15, *Accounting by Debtors and Creditors for Troubled Debt Restructuring* and under the purchase method of accounting as provided in SFAS 141, *Business Combinations.* The operating results of the acquired business have been included in the consolidated statements of operations, financial condition and cash flows from April 10, 2007 (the acquisition date) through June 30, 2008 During the third quarter of Fiscal 2008, the Company adjusted the original purchase price allocation for Cody Labs, as a result of a study and additional analysis of assets acquired. The result of this study was to increase the deferred tax assets by $1,255,000 and decrease the value of Cody Labs' property, plant and equipment by the same amount.

A condensed balance sheet of Cody at the date of acquisition, April 10, 2007, is as follows:

| | |
|---|---|
| Cash | $ 157,962 |
| Inventory | 325,372 |
| Other current assets | 89,445 |
| Total current assets | 572,779 |
| | |
| Property, plant and equipment, net | 3,202,455 |
| Deferred tax asset | 1,255,000 |
| Total assets | $ 5,030,234 |
| | |
| Accounts payable | $ 258,660 |
| Current portion of long-term debt | 48,524 |
| Accrued expenses | 91,476 |
| Total current liabilities | 398,660 |
| | |
| Long term debt, less current portion | 193,417 |
| | |
| Total shareholders' equity | 4,438,157 |
| | |
| Total liabilities and shareholders' equity | $ 5,030,234 |

The following pro forma historical results of operations for the years ended June 30, 2007 and 2006 are presented as if the Company had acquired Cody on July 1, 2005.

Statements of Operations

UNAUDITED

| | Year Ended June 30, | |
|---|---|---|
| | **2007** | **2006** |
| Net Sales | $ 82,578,000 | $ 64,803,000 |
| Net (loss) income | $ (3,197,000) | $ 2,068,000 |
| | | |
| (Loss) earnings per common share - basic and diluted | $ (0.13) | $ 0.09 |
| | | |
| Weighted average common shares outstanding - basic | 24,159,251 | 24,130,224 |
| Weighted average common shares outstanding - diluted | 24,159,251 | 24,156,889 |

The unaudited pro forma financial information is presented for informational purposes only and does not purport to represent what the operating results actually would have been had the acquisition occurred on that date.

**Note 13. Consolidation of Variable Interest Entity**

Lannett consolidates any Variable Interest Entity ("VIE") of which we are the primary beneficiary. The liabilities recognized as a result of consolidating a VIE do not represent additional claims on our general assets; rather, they represent claims against the specific assets of the consolidated VIE. Conversely, assets recognized as a result of consolidating a VIE do not represent additional assets that could be used to satisfy claims against our general assets. Reflected in the June 30, 2008 and 2007 balance sheets are consolidated VIE assets of approximately $1.9 and $1.8 million, respectively, which are comprised mainly of land and building. VIE liabilities consist of a mortgage on that property in the amount of $1.7 and $1.8 million at June 30, 2008 and 2007, respectively.

Cody LCI Realty LLC ("Realty") is the only VIE that is consolidated. Realty has been consolidated by Cody prior to its acquisition by Lannett. Realty is a 50/50 joint venture with a former shareholder of Cody. Its purpose was to acquire the facility used by Cody. Until the acquisition of Cody in April 2007, Lannett had not consolidated the VIE because Cody had been the primary beneficiary of the VIE. The risks associated with our interests in this VIE is limited to a decline in the value of the land and building as compared to the balance of the mortgage note on that property, up to Lannett's 50% share of the venture. Realty owns the land and building, and Cody leases the building and property from Realty for $16,000 per month. All intercompany rent expense is eliminated upon consolidation with Cody.

The Company is not involved in any other VIE of which Lannett is primary beneficiary.

**Note 14. Employee Benefit Plan**

The Company has a defined contribution 401k plan (the "Plan") covering substantially all employees. During calendar year 2006, Lannett matched employees' contributions to the Lannett Company, Inc. 401(k) Retirement Savings Plan on a dollar for dollar basis up to 3% of an employee's base salary, subject to regulatory limits. Beginning in calendar year 2007 and continuing to present, Lannett matched contributions to the 401(k) plan on a fifty cents on the dollar basis up to 8% of the contributing employee's base salary. Contributions to the Plan during the years ended June 30, 2008, 2007 and 2006 were approximately $350,000, $375,000, and $240,000, respectively.

**Note 15. Employee Stock Purchase Plan**

In February 2003, the Company's shareholders 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 1,125,000 shares of the Company's common stock for issuance under the ESPP. As of June 30, 2008, 126,260 shares have been issued under the ESPP. Compensation expense of $25,208, $33,322, and $43,975 was recognized in fiscal years 2008, 2007 and 2006, respectively, relating to the ESPP.

**Note 16. Income Taxes**

The provision (benefit) for income taxes consists of the following for the years ended June 30:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Current Income Taxes | | | |
| Federal | $ 1,367,843 | $ (771,913) | $ 822,617 |
| State and Local Taxes | — | — | — |
| Total | 1,367,843 | (771,913) | 822,617 |
| Deferred Income Taxes | | | |
| Federal | (3,986,449) | 1,503,322 | 2,281,537 |
| State and Local Taxes | (757,405) | 276,520 | 457,021 |
| Total | (4,743,854) | 1,779,842 | 2,738,558 |
| Total | $ (3,376,011) | $ 1,007,929 | $ 3,561,175 |

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

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Federal income tax at statutory rate | 35.0% | 35.0% | 35.0% |
| State and local income tax, net | 2.4% | 0.0% | 3.5% |
| Nondeductible expenses | -3.5% | -4.4% | 3.0% |
| Change in valuation allowance | 6.2% | -45.1% | 0.0% |
| Income tax credits | 15.3% | 0.0% | 0.0% |
| Other | 3.9% | -2.5% | 0.2% |
| Income taxes expense | 59.3% | -17.0% | 41.7% |

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 stock compensation which began in Fiscal 2006. 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. In addition to the deferred tax assets shown in the table below, a $6,482 current deferred tax liability is also included on the balance sheet related to the tax effect of accumulated other comprehensive income at June 30, 2008. A deferred tax asset valuation allowance was established based on the likelihood that 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.

As of June 30, 2008 and 2007, temporary differences which give rise to deferred tax assets and liabilities are as follows:

| | 2008 | 2007 |
|---|---|---|
| Deferred tax assets: | | |
| Accrued expenses | $ 30,550 | $ 38,078 |
| Stock compensation expense | 673,154 | 515,100 |
| Unearned grant funds | 195,000 | 195,000 |
| Reserve for returns | 5,321,431 | — |
| Reserves for accounts receivable and inventory | 1,707,006 | 1,239,241 |
| Intangible impairment | 13,182,667 | 14,381,090 |
| State net operating loss | 207,700 | 560,752 |
| Income tax credit carryforwards | 63,083 | — |
| Federal net operating loss | 1,255,065 | 141,852 |
| Impairment on Cody note receivable | 2,106,798 | 2,106,798 |
| Accumulated amortization on intangible asset | 2,011,146 | 1,898,743 |
| | 26,753,600 | 21,076,654 |
| Valuation allowance | (2,314,498) | (2,667,550) |
| Total | 24,439,102 | 18,409,104 |
| Deferred tax liabilities: | | |
| Prepaid expenses | 54,570 | 73,479 |
| Property, plant and equipment | 3,179,344 | 3,129,356 |
| Net deferred tax asset | $ 21,205,188 | $ 15,206,269 |

On July 1, 2007, we adopted the provisions of FIN 48, Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109 (FIN 48), which provides a financial statement recognition threshold and measurement attribute for a tax position taken or expected to be taken in a tax return. Under FIN 48, we may recognize the tax benefit from an uncertain tax position 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. FIN 48 also provides 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.

The Company did not recognize any additional current or deferred income tax assets or liabilities as a result of the implementation of FIN 48. As a result, the Company has no unrecognized tax positions at June 30, 2008. Should future tax positions or portions thereof not be recognized under FIN 48, the Company will recognize interest accrued on unrecognized tax benefits in interest expense and any related penalties in operating expenses.

The Company files tax returns in the United States federal jurisdiction, Pennsylvania and New Jersey. The Company's tax returns for years prior to 2004 generally are no longer subject to review as such years generally are closed. The Company is not currently involved with any reviews by any taxing authorities. The Company believes that an unfavorable resolution for open tax years would not be material to the financial position of the Company.

In the third quarter of Fiscal 2008, the Company adjusted the original purchase price allocation for Cody, as a result of a study and additional analysis of assets acquired. The result of this study was to increase the deferred tax assets by $1,255,065 and decrease the value of Cody's property, plant and equipment by the same amount. This adjustment was made in accordance with Statement of Financial Accounting Standards No. 141, Business Combinations.

This income tax benefit is related to Cody's federal net operation loss (NOL) carry forwards totaling approximately $ 3,774,000 with $1,902,000 expiring in 2026 and $1,872,000 in 2027. 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.

**Note 17. Related Party Transactions**

The Company had sales of approximately $787,000, $763,000, and $1,143,000 during the years ended June 30, 2008, 2007 and 2006, respectively, to a generic distributor, Auburn Pharmaceutical Company. Jeffrey Farber (the "related party"), who is a current board member and the son of the Chairman of the Board of Directors and principal shareholder of the Company, William Farber, is the owner of Auburn Pharmaceutical Company. Accounts receivable includes amounts due from the related party of approximately $305,000 and 109,000 at June 30, 2008 and 2007, respectively. In the Company's opinion, the terms of these transactions were not more favorable to the related party than would have been to a non-related party.

In January 2005, Lannett Holdings, Inc. entered into an agreement in which the Company purchased for $100,000 and future royalty payments the proprietary rights to manufacture and distribute a product for which Pharmeral, Inc. owned the ANDA. During fiscal 2008, Pharmeral agreed to suspend the requirement to make royalty payments under this agreement. In Fiscal 2008, the Company obtained FDA approval to use the proprietary rights. The Company has capitalized these rights as an indefinite lived intangible asset and will test this asset for impairment at least on an annual basis. Arthur Bedrosian, President of the Company, Inc. was formerly the President and Chief Executive Officer and currently owns 100% of Pharmeral, Inc. This transaction was approved by the Board of Directors of the Company and in their opinion the terms were not more favorable to the related party than they would have been to a non-related party.

As of June 30, 2008, the Company had approximately $983,000 of deferred revenue, representing payments received from Provell Pharmaceuticals, LLC ("Provell") for inventory purchased from Lannett. The Company recognized revenue of approximately $141,000 during the fiscal year ended June 30, 2008. Accounts receivable includes amounts due from the related party of approximately $60,000 at June 30, 2008. Provell is a joint venture to distribute pharmaceutical products through mail order outlets. Lannett was given 33% ownership of this venture in exchange for access to Lannett's drug providers. The investment is valued at zero, due to losses incurred to date by Provell.

**Note 18. Material Contracts with Suppliers**

Jerome Stevens Pharmaceuticals agreement:

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 approximately 71% of the Company's inventory purchases in Fiscal 2008, 63% in Fiscal 2007 and 76% in Fiscal 2006. 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 four million (4,000,000) shares of the Company's common stock. The JSP products covered under the agreement included Butalbital, Aspirin, Caffeine with Codeine Phosphate capsules, Digoxin tablets and Levothyroxine Sodium tablets, sold generically and under the brand name Unithroid®. The term of the agreement is ten years, beginning on March 23, 2004 and continuing through March 22, 2014. 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, the Company is required to use commercially reasonable efforts to purchase minimum dollar quantities of JSP's products being distributed by the Company. The minimum quantity to be purchased in the first year of the agreement is $15.0 million. Thereafter, the minimum quantity to be purchased increases by $1.0 million per year up to 24 million for the last year of the ten-year contract. The Company has met the minimum purchase requirement for the first four years of the contract, but there is no guarantee that the Company will be able to continue to do so in the future. If the Company does not meet the minimum purchase requirements, JSP's sole remedy is to terminate the agreement.

Under the agreement, JSP is entitled to nominate one person to serve on the Company's Board of Directors (the "Board") provided, however, that the Board shall have the right to reasonably approve any such nominee in order to fulfill its fiduciary duty by ascertaining that such person is suitable for membership on the board of a publicly traded corporation. Suitability is determined by, but not limited to, the requirements of the Securities and Exchange Commission, the American Stock Exchange, and other applicable laws, including the Sarbanes-Oxley Act of 2002. As of June 30, 2008, JSP has not exercised the nomination provision of the agreement.

Other agreements:

In August 2005, the Company signed an agreement with a finished goods provider to purchase, at fixed prices, and distribute a certain generic pharmaceutical product in the United States. Purchases of finished goods inventory from this provider accounted for approximately 14% of the Company's costs of purchased inventory in Fiscal 2008, 23% in 2007, and 11% in

2006. The term of the agreement is three years, beginning on August 22, 2005 and continuing through August 21, 2008. Following its expiration on August 21, 2008, the agreement was not renewed.

**Note 19. Fair Value of Financial Instruments**

The Company's financial instruments consist primarily of cash and cash equivalents, accounts receivable, accounts payable, accrued expenses and debt obligations. The carrying values of these assets and liabilities approximate fair value based upon the short-term nature of these instruments. The Company has estimated that the fair value of long-term debt associated with the 20 year mortgage on its land and building in Cody, Wyoming approximates the discounted amount of future payments to the mortgage-holder. There is no market for this type of financial liability.

**Note 20. Quarterly Financial Information (Unaudited)**

Lannett's quarterly consolidated results of operations and market price information are shown below:

| | Fourth Quarter | Third Quarter | Second Quarter | First Quarter |
|---|---|---|---|---|
| **Fiscal 2008** | | | | |
| Net Sales | $ 20,748,799 | $ 16,579,512 | $ 17,534,942 | $ 17,540,030 |
| Cost of Goods Sold | 17,878,596 | 12,682,018 | 13,107,326 | 12,434,272 |
| Gross Profit | 2,870,203 | 3,897,494 | 4,427,616 | 5,105,758 |
| Other Operating Expenses | 5,553,598 | 5,739,007 | 5,201,499 | 5,231,858 |
| Operating (Loss) Income | (2,683,395) | (1,841,513) | (773,883) | (126,100) |
| Other (Expense) Income | (98,691) | (29,786) | (43,647) | (46,746) |
| Income Taxes | (2,554,889) | (615,454) | (159,983) | (45,685) |
| Minority Interest | 50,309 | | | |
| Net (Loss) Income | (277,506) | (1,255,845) | (657,547) | (127,161) |
| Basic (Loss) Earnings Per Share | $ (0.01) | $ (0.05) | $ (0.03) | $ (0.01) |
| Diluted (Loss) Earnings Per Share | $ (0.01) | $ (0.05) | $ (0.03) | $ (0.01) |

| | Fourth Quarter | Third Quarter | Second Quarter | First Quarter |
|---|---|---|---|---|
| **Fiscal 2007** | | | | |
| Net Sales | $ 17,390,842 | $ 20,302,576 | $ 22,916,347 | $ 21,967,826 |
| Cost of Goods Sold | 14,441,928 | 15,090,163 | 17,790,927 | 13,829,586 |
| Gross Profit | 2,948,914 | 5,212,413 | 5,125,420 | 8,138,240 |
| Other Operating Expenses | 5,143,647 | 12,661,477 | 3,577,296 | 6,006,976 |
| Operating (Loss) Income | (2,194,733) | (7,449,064) | 1,548,124 | 2,131,264 |
| Other (Expense) Income | (57,978) | 22,898 | 43,828 | 34,582 |
| Income Taxes | 322,138 | (818,807) | 636,781 | 867,817 |
| Net (Loss) Income | (2,574,849) | (6,607,359) | 955,171 | 1,298,029 |
| Basic (Loss) Earnings Per Share | $ (0.11) | $ (0.27) | $ 0.04 | $ 0.05 |
| Diluted (Loss) Earnings Per Share | $ (0.11) | $ (0.27) | $ 0.04 | $ 0.05 |

| | Fourth Quarter | Third Quarter | Second Quarter | First Quarter |
|---|---|---|---|---|
| **Fiscal 2006** | | | | |
| Net Sales | $ 19,452,896 | $ 15,737,180 | $ 15,228,767 | $ 13,641,532 |
| Cost of Goods Sold | 10,015,296 | 9,850,322 | 8,510,141 | 7,308,951 |
| Gross Profit | 9,437,600 | 5,886,858 | 6,718,626 | 6,332,581 |
| Other Operating Expenses | 7,770,915 | 3,806,703 | 4,625,893 | 3,718,236 |
| Operating Income | 1,666,685 | 2,080,155 | 2,092,733 | 2,614,345 |
| Other Income (Expense) | (8,632) | 30,906 | 13,859 | 40,046 |
| Income Taxes | 808,840 | 856,402 | 842,518 | 1,053,415 |
| Net Income | 849,213 | 1,254,659 | 1,264,074 | 1,600,976 |
| Basic Earnings Per Share | $ 0.04 | $ 0.05 | $ 0.05 | $ 0.07 |
| Diluted Earnings Per Share | $ 0.04 | $ 0.05 | $ 0.05 | $ 0.07 |

On March 31, 2007, the Company wrote down $7,775,890 of a note receivable owed by Cody Laboratories, Inc. The Company determined that the value of the note receivable was impaired, and on April 10, 2007, it was decided to complete the acquisition of Cody by forgiving the amount of loans that exceeded the fair value of assets received. The remaining value of the amounts owed approximated the value of Cody at the time of the acquisition.

Net sales for the fourth quarter of Fiscal 2007 have decreased as a result of change in sales mix and customer mix. The Company was able to increase sales to retail drug stores, however the Company experienced declines in sales to wholesaler customers. This change in mix is a result of purchasing patterns of wholesalers and revised purchase agreements with the wholesalers.

In the fourth quarter of Fiscal 2008 net sales increased largely due to a product recall of one of Lannett's competitors. Overall net sales for Fiscal 2008 decreased over Fiscal 2007 as a result of the increased competition in the generic drug market which adversely affected Lannett's sales of drugs used for the treatment of epilepsy and antibiotic drugs. Retail chain sales increased significantly in Fiscal Year 2008 as a result of an increase in the number of products available for sale and a significant increase in the number of retails stores of one of our customers.

Also during the fourth quarter of Fiscal 2008, we increased our returns reserve by $10.5 million, reflecting our expectation that 100% of the shipments of Prenatal Multivitamin made in the fourth quarter would be returned. Our expectation that all of the product would be returned was based on our inability to have the product specified as a brand equivalent, and information from our customers regarding their intentions to return the product. In addition, we increased the returns reserve in the fourth quarter by approximately $1.5 million based on an analysis of our historical returns experience, the average lag time between sales and returns and an evaluation of changing buying and inventory trends of both our direct and indirect customers. As this change resulted from new information that has allowed us to better estimate the average length of time between product sales and returns, we consider it to be a change in estimate as defined in SFAS 154: *Accounting Changes and Error Corrections – A Replacement of APB Opinion No. 20 and FASB Statement No. 3.*

**Report of Independent Registered Public Accounting Firm**

Board of Directors and Shareholders
Lannett Company, Inc. and Subsidiaries

We have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of Lannett Company, Inc. and Subsidiaries referred to in our report dated September 29, 2008. Our report on the consolidated financial statements includes an explanatory paragraph, which discusses the adoption of Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Tax Positions*. Our audits of the basic financial statements included the financial statement schedule listed in the index appearing under item 15, which is the responsibility of the Company's management. In our opinion, this financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ Grant Thornton LLP
Philadelphia, Pennsylvania
September 29, 2008

**Schedule II -** Valuation and Qualifying Accounts

For the year ended June 30, 2008

| Description | Balance at Beginning of Fiscal Year | Charged to (reduction of) Expense | Deductions | Balance at End of Fiscal Year |
|---|---|---|---|---|
| Allowance for Doubtful Accounts | | | | |
| 2008 | $ 250,000 | $ 48,284 | $ 91,133 | $ 207,151 |
| 2007 | 250,000 | — | — | 250,000 |
| 2006 | 70,000 | 180,000 | — | 250,000 |
| Inventory Valuation | | | | |
| 2008 | $ 923,920 | $ 2,679,902 | $ 1,961,154 | $ 1,642,668 |
| 2007 | 1,054,499 | 1,717,357 | 1,847,936 | 923,920 |
| 2006 | 5,300,000 | (1,515,589) | 2,729,912 | 1,054,499 |

**Exhibit 21**

## Subsidiaries of the Company

The following list identifies the subsidiaries of the Company:

| Subsidiary Name | State of Incorporation |
|---|---|
| Lannett Holdings, Inc. | Delaware |
| Cody Laboratories, Inc. | Wyoming |
| Cody LCI Realty LLC | Wyoming |

**Exhibit 23.1**

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We have issued our reports dated September 29, 2008 with respect to the consolidated financial statements and schedule in the Annual Report of Lannett Company, Inc. and Subsidiaries on Form 10-K for the year ended June 30, 2008. We hereby consent to the incorporation by reference of said reports in the Registration Statements of Lannett Company, Inc. and Subsidiaries on Form S-3 (File No. 333-115746, effective May 21, 2004) and on Forms S-8 (File No. 33-79258, effective May 23, 1994, File No. 001-31298, effective April 9, 2002, File No. 33-103235, effective February 14, 2003, File No. 33-103236, effective February 14, 2003, and File No. 33-147410, effective November 15, 2007).

/s/ Grant Thornton LLP

Philadelphia, Pennsylvania
September 29, 2008

**Exhibit 31.1**

**CERTIFICATION PURSUANT TO**
**18 U.S.C. SECTION 1350,**
**AS ADOPTED PURSUANT TO**
**SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Arthur Bedrosian, certify that:

1. I have reviewed this report on Form 10-K of Lannett Company, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

    (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;

    (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

    (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/Arthur Bedrosian

Date: September 29, 2008
President and Chief Executive Officer

**Exhibit 31.2**

**CERTIFICATION PURSUANT TO**
**18 U.S.C. SECTION 1350,**
**AS ADOPTED PURSUANT TO**
**SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Brian Kearns, certify that:

1. I have reviewed this report on Form 10-K of Lannett Company, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/Brian Kearns

Date: September 29, 2008

Vice President of Finance, Treasurer and Chief Financial
Officer

**Exhibit 32**

**Certification Pursuant to**
**18 U.S.C. Section 1350,**
**as Adopted Pursuant to**
**Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Annual Report of Lannett Company, Inc. (the “Company”) on Form 10-K for the year ended June 30, 2008 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Arthur P. Bedrosian, the Chief Executive Officer of the Company, and I, Brian Kearns, the Chief Financial Officer of the Company, hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report complies with the requirements of Section13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: September 29, 2008

/s/Arthur P. Bedrosian

Arthur P. Bedrosian,
President and Chief Executive Officer

Dated: September 29, 2008

/s/Brian Kearns

Brian Kearns,
Vice President of Finance, Treasurer, and
Chief Financial Officer

## BOARD OF DIRECTORS

**William Farber, R.Ph.**
Chairman of the Board

**Ronald West**
Vice Chairman
General Managing Partner, Beecher Associates

**Arthur P. Bedrosian, J.D.**
President and Chief Executive Officer, Lannett Company, Inc.

**Jeffrey Farber**
President, Auburn Pharmaceutical

**Kenneth Sinclair, Ph.D.**
Professor of Accounting,
Lehigh University

**Albert Wertheimer, Ph.D.**
Professor, Temple University School of Pharmacy,
Director, Center for Pharmaceutical Health Services Research

**Myron Winkelman, R.Ph.**
President, Winkelman Management Consulting, Inc.

## MANAGEMENT TEAM

**Arthur P. Bedrosian, J.D.**
President, Chief Executive Officer, Director

**Brian Kearns**
Chief Financial Officer,
Vice President—Finance, Treasurer, Secretary

**Ernest Sabo**
Vice President—Regulatory and Corporate Compliance

**Bernard Sandiford**
Vice President—Operations

**William Schreck**
Vice President—Logistics

**Kevin Smith**
Vice President—Sales & Marketing

## CORPORATE INFORMATION

**Corporate Headquarters**
9000 State Road
Philadelphia, PA 19136
(215) 333-9000

**Independent Registered Public Accounting Firm**
Grant Thornton LLP
2001 Market Street
Two Commerce Square, Suite 3100
Philadelphia, PA 19103

**Legal Counsel**
Fox Rothschild LLP
2000 Market Street
Philadelphia, PA 19103

**Investor Relations**
PondelWilkinson Inc.
1880 Century Park East, Suite 700
Los Angeles, CA 90067
(310) 279-5980

**Transfer Agent and Registrar**
Registrar and Transfer Company
10 Commerce Drive
Cranford, NJ 07016
(800) 368-5948

**Securities Listing**
The common stock of Lannett Company, Inc. is traded on the NYSE Alternext US under the symbol "LCI."

**Annual Report and Form 10-K**
Additional copies of this annual report and the Company's Form 10-K may be obtained without charge and the exhibits to the Form 10-K may be obtained for a nominal fee by writing to:

Lannett Company, Inc.
Investor Relations
9000 State Road
Philadelphia, PA 19136

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

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 located elsewhere in this Annual 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 and 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.

LANNETT

Lannett Company, Inc.
9000 State Road
Philadelphia, PA 19136
(215) 333-9000, (800) 325-9994
Fax (215) 333-9004