LANNETT

MANUFACTURING AND DISTRIBUTING
HIGH QUALITY PHARMACEUTICAL PRODUCTS

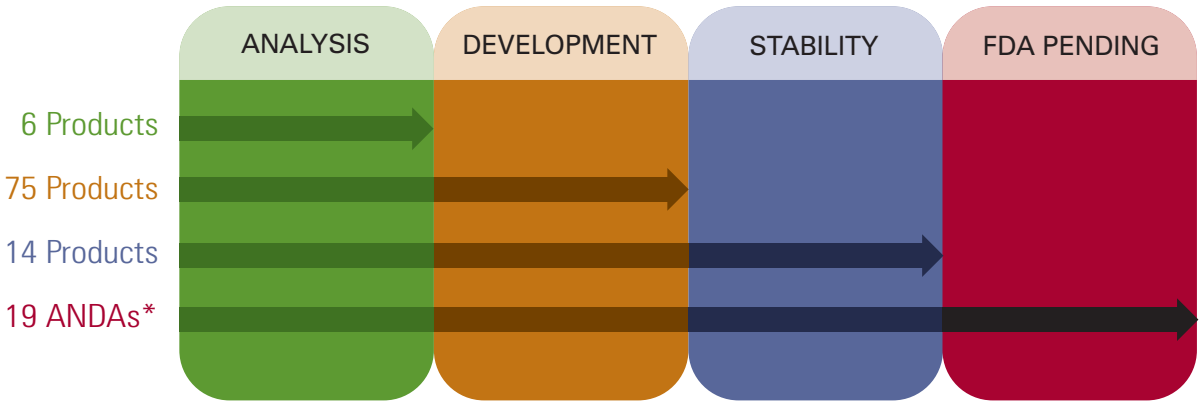
2006 ANNUAL REPORT

LANNETT

COMPANY PROFILE

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

DRUG DEVELOPMENT PIPELINE



*Abbreviated New Drug Application

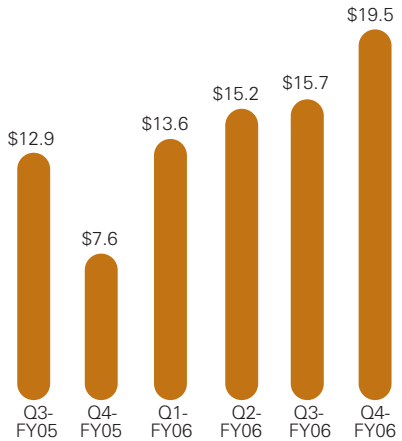
FINANCIAL HIGHLIGHTS

Fiscal Year Ended June 30,	**2006**	2005	2004	2003	2002
Net Sales	**$ 64,060,375**	$ 44,901,645	$63,781,219	$42,486,758	$25,126,214
Cost of Sales	**33,900,045**	31,416,908	26,856,875	16,257,794	8,452,677
Gross Profit	**30,160,330**	13,484,737	36,924,344	26,228,964	16,673,537
Operating Expenses	**21,706,412**	67,124,395	16,093,375	7,168,858	5,248,054
Operating Income (Loss)	**8,453,918**	(53,639,658)	20,830,969	19,060,106	11,425,483
Net Income (Loss)	**$ 4,968,922**	$ (32,779,596)	$13,215,454	$11,666,887	$ 7,195,990

Total Current Assets	**$ 43,486,847**	$ 33,938,115
Property and Equipment, Net	**19,645,549**	16,624,848
Total Assets	**105,992,064**	94,917,060
Current Liabilities	**20,624,428**	16,395,562
Long-Term Debt, Less Current Portion	**7,065,986**	7,262,672
Total Liabilities and Shareholders' Equity	**$105,992,064**	$ 94,917,060

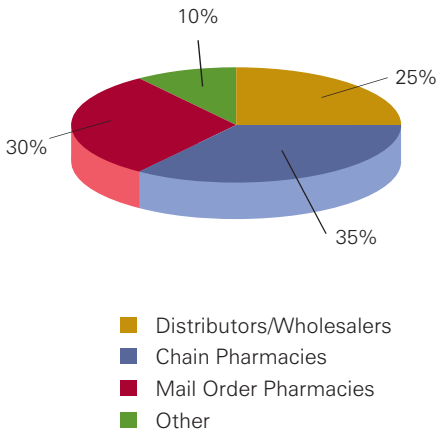
QUARTERLY NET SALES TREND

(In Millions of Dollars)



PERCENTAGE OF NET SALES

(By Customer Type)



DEAR SHAREHOLDERS:

WILLIAM FARBER, R.PH.
Chairman

ARTHUR P. BEDROSIAN, J.D.
President and
Chief Executive Officer

This past year, we implemented a plan for growing our product offering by ramping up our in-house drug development program and entering into agreements that allow us to market certain products produced by our partners.

Fiscal 2006 was a transformational year for Lannett Company. We significantly improved our financial performance, expanded our pipeline, invested in our drug development program, formed strategic alliances, received a number of drug approvals from the Food and Drug Administration (FDA), and added to our product offering with the launch of several pharmaceuticals.

FINANCIAL PERFORMANCE

For fiscal 2006, net sales exceeded $64.0 million, which is a 43% increase from net sales in fiscal 2005. Gross profit reached $30.2 million compared with $13.5 million for the prior year. Operating income rose to $8.5 million versus an operating loss of $53.6 million in fiscal 2005. Net income grew to $5.0 million from a net loss of $32.8 million in the year earlier. Financial results for fiscal 2005 included a $46.1 million non-cash impairment loss on intangible assets.

EXPANDING PRODUCT PIPELINE TO DRIVE REVENUE GROWTH

This past year, we implemented a plan for growing our product offering by ramping up our in-house drug development program and entering into agreements that allow us to market certain products produced by our partners. To that end, we invested significantly in research and development and established relationships with several drug manufacturers based in India and Europe. These alliances, with such companies as AZAD, Wintac and Olive Healthcare, provide product candidates that complement our existing portfolio and add new dosage forms that will allow us to enter new markets.

We expect to continue to evaluate opportunities with foreign and domestic pharmaceutical manufacturers to expand our product line. Our internal product development efforts, combined with products supplied by others, were key drivers to our improved financial results in fiscal 2006 and helped build a strong foundation for continued revenue growth.

DRUG APPROVALS AND LAUNCHES

In fiscal 2006, the Company received FDA approval and/or launched a number of new products, including sulfamethoxazole with trimethoprim, used to treat infections; esterified estrogens with methyltestosterone, used in the treatment of symptoms of menopause; clindamycin, used to treat infections; danazol, a sex

MANUFACTURING AND DISTRIBUTING HIGH QUALITY PHARMACEUTICAL PRODUCTS

hormone; pilocarpine, a cholinergic drug; doxycycline, an antibiotic; baclofen, used to treat symptoms associated with multiple sclerosis; and, probenecid, for treating hyperuricemia associated with gout and gouty arthritis.

PLANT EXPANSION

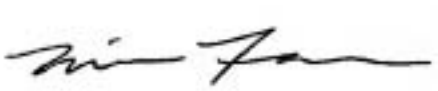
To broaden our manufacturing, pharmaceutical development and warehousing capacity, we added a new 65,000 square-foot facility located on seven acres in the City of Philadelphia. Combined with the Company's existing space, we now have more than 168,000 square feet of operating space.

BOARD AND MANAGEMENT ADDITIONS

In planning for future growth, we bolstered our leadership with accomplished and highly qualified individuals. Arthur P. Bedrosian was named chief executive officer and director, adding to his existing role as president of the Company. Arthur joined Lannett in 2000 and has nearly 40 years of experience in the generic pharmaceutical industry. In addition, new members were added to the Board of Directors. Garnet E. Peck, Ph.D., professor emeritus of the industrial and pharmacy department at Purdue University; and Kenneth P. Sinclair, Ph.D., full professor of the accounting department at Lehigh University; joined the Board in September 2005; and, Jeffrey K. Farber, president of Auburn Pharmaceutical, was appointed in May 2006. The Board now consists of eight members, five of whom are independent.

We have entered fiscal 2007 with substantial momentum and excellent prospects for continued growth. On behalf of the Board, we thank our employees for their dedication and hard work and our shareholders for their support.

Sincerely,



William Farber, R.Ph.
Chairman

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

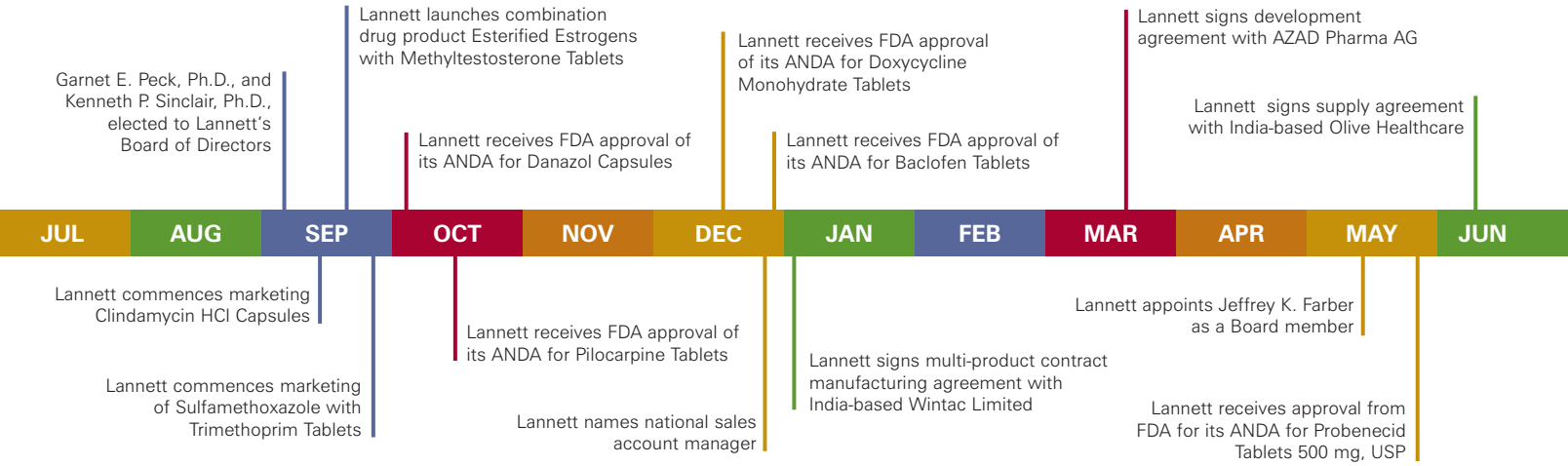
To broaden our manufacturing, pharmaceutical development and warehousing capacity, we added a new 65,000 square-foot facility located on seven acres in the City of Philadelphia.

PRODUCTS

NAME	MEDICAL INDICATION	EQUIVALENT BRAND
Acetazolamide Tablets	Glaucoma	Diamox®
Baclofen Tablets*	Muscle Relaxer	Lioresal®
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®
Diphenoxylate with Atropine Sulfate Tablets	Diarrhea	Lomotil®
Doxycycline Tablets*	Antibiotic	Adoxa®
Doxycycline Hyclate Tablets*	Antibiotic	Periostat®
Hydromorphone HCl Tablets	Pain Management	Dilaudid®
Levothyroxine Sodium Tablets	Thyroid Deficiency	Levoxyl®/Synthroid®
Methocarbamol Tablets	Muscle Relaxer	Robaxin®
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®
Sulfamethoxazole w/Trimethoprim*	Antibacterial	Bactrim®
Terbutaline Sulfate Tablets	Bronchospasms	Brethine®
Unithroid® Tablets	Thyroid Deficiency	N/A

*New product, launched during fiscal 2006

FISCAL 2006 HIGHLIGHTS



U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

[X] ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended June 30, 2006

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
(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 **X**

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 **X**

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 **X** 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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer Accelerated filer **X** Non-accelerated filer

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

Aggregate market value of Common stock held by non-affiliates of the Registrant, as of December 31, 2005 was $104,663,020 based on the closing price of the stock on the American Stock Exchange.

As of August 25, 2006, there were 24,148,014 shares of the issuer's common stock, $.001 par value, outstanding.

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 fiscal year basis, the most recent being the fiscal year ended June 30, 2006. 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 were able to increase net sales and operating income during fiscal 2006 by adding new products, as well as by improved results from existing distribution agreements. The Company plans to continue to focus on improved financial performance though additions to our line of generic products, additional sales to current customers, higher unit sales, and a focus on minimizing overhead and administrative costs. Some of the new generic products sold by Lannett were developed and are manufactured by Lannett while others are manufactured by others. The products manufactured by Lannett and those manufactured by others 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 a number of financing agreements with third parties to provide for additional cash when it is 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 an industrious 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 projections. 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 strategies highlight Lannett's plan:

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.

In a presentation to the Generic Pharmaceutical Association on February 26, 2005, Lester M. Crawford, D.V.M., Ph.D., and the Acting Commissioner of Food and Drugs at the FDA, said that the median approval time for a new ANDA for the FDA's Fiscal 2004 year was 16.2 months. However, there is no guarantee that the FDA will approve a company's ANDA or that any approval will be given within this time frame.

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, or listed patents have expired. An ANDA filer must certify, with respect to each patent that claims the listed drug for the bioequivalent of which the ANDA filer is seeking approval, [FN3] either 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. These legal activities can trigger an automatic 30 month stay of the ANDA if the innovator company files a claim and it will delay the approval of the generic company's ANDA. Currently, Lannett has no Paragraph IV certifications in 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 will 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 since 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 24 products the Company currently produces or sells. Unlike the branded, innovator companies, Lannett currently does not own proprietary drug patents. 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 corporate office. The second building contains packaging, warehouse and shipping functions, R&D and a number of administrative functions.

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, like 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. Such observations 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 upon the consumer of the Company's drug products, and whether the observation is subject to a Warning Letter from the FDA. By strictly enforcing the various FDA guidelines, namely Good Laboratory Practices, Standard Operating Procedures and cGMP, the Company has successfully kept the number of observations in its FDA inspection at a minimal level. The Company believes that such observations are minor in nature, and will be remediated in a timely fashion with no material effect on its results of operations.

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. The mail order segment continued to be one of the fastest growing classes in the Company's distribution efforts. Companies such as Medco Health, Express Scripts and Caremark are leaders in sales growth in the pharmaceutical market. Lannett also increased distribution in the wholesaler segment led by Cardinal Health and McKesson Corporation. Lannett is recognized by its customers as a dependable supplier of high quality generic pharmaceuticals. The Company's policy of maintaining an adequate inventory and fulfilling orders in a timely manner has contributed to this reputation.

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 further accomplish specific Company 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 (a)	Muscle Relaxer	Lioresal®
3	Butalbital, Aspirin and Caffeine Capsules	Migraine Headache	Fiorinal®
4	Butalbital, Aspirin, Caffeine with Codeine Phosphate Capsules	Migraine Headache	Fiorinal w/ Codeine #3®
5	Clindamycin HCl Capsules (a)	Antibiotic	Cleocin®
6	Danazol Capsules (a)	Endometriosis	Danocrine®
7	Dicyclomine Tablets/Capsules	Irritable Bowels	Bentyl®
8	Digoxin Tablets	Congestive Heart Failure	Lanoxin®
9	Diphenoxylate with Atropine Sulfate Tablets	Diarrhea	Lomotil®
10	Doxycycline Tablets (a)	Antibiotic	Adoxa®
11	Doxycycline Hyclate Tablets (a)	Antibiotic	Periostat®
12	Hydromorphone HCl Tablets	Pain Management	Dilaudid®
13	Levothyroxine Sodium Tablets	Thyroid Deficiency	Levoxyl®/ Synthroid®
14	Methocarbamol Tablets	Muscle Relaxer	Robaxin®
15	Methyltestoterone/Esterified Estrogens Tablets	Hormone Replacement	Estratest®
16	Morphine Sulfate Oral Solution (a)	Pain Management	Roxanol®
17	Oxycodone HCl Oral Solution (a)	Pain Management	Roxicodone®
18	Phentermine HCl Tablets	Weight Loss	Adipex-P®
19	Pilocarpine HCl Tablets (a)	Dryness of the Mouth	Salagen®
20	Primidone Tablets	Epilepsy	Mysoline®
21	Probenecid Tablets (a)	Gout	Benemid®
22	Sulfamethoxazole w/ Trimethoprim (a)	Antibacterial	Bactrim®
23	Terbutaline Sulfate Tablets	Bronchospasms	Brethine®
24	Unithroid® Tablets	Thyroid Deficiency	N/A

(a) – product launched during fiscal 2006.

Key Products

All of the products currently manufactured and/or sold by the Company are prescription products. Of the products listed above, Unithroid and those containing Butalbital, Digoxin, Primidone and Levothyroxine Sodium were the Company's key products, contributing more than 80%, 93% and 97% of the Company's total net sales in Fiscal 2006, 2005 and 2004 respectively. The decline in this percentage during 2006 is testament to our focus on expanding the number of products sold.

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 eight 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 2001. 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 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

Lannett received 10 ANDA approvals from the FDA during the fiscal year ended June 30, 2006. We received 2 approvals in the previous year ended June 30, 2005. Following are more specific details regarding our latest approvals. Market data is obtained from NDC Health (now known as Wolters-Kluwer).

In September 2005, Lannett received a letter from the FDA with approval to market and launch Clindamycin HCL Tablets. Clindamycin capsules are the generic equivalent of Cleocin®, marketed by Pharmacia Corporation. Annual sales for Clindamycin capsules totaled $334 million in 2004. Clindamycin is used to treat serious bacterial infections.

In September 2005, Lannett received a letter from the FDA with approval to market and launch Danazol 200mg Capsules. Danazol is the generic version of Danocrine® and is used for the treatment of endometriosis amenable to hormonal management. The market size for Danazol is $14.4 million.

In September 2005, Lannett began selling Sulfamethoxazole with Trimethoprim. According to Wolters-Kluwer, sales for generic Sulfamethoxazole with Trimethoprim tablets totaled $260 million in 2004. Sulfamethoxazole with Trimethoprim is used to treat infections such as urinary tract infections, bronchitis, ear infections (otitis), traveler's diarrhea, and Pneumocystis carinii pneumonia and is the generic equivalent of Bactrim® and Bactrim DS®, marketed by United Research Laboratories, Inc.

In October 2005, Lannett received a letter from the FDA with approval to market and launch Pilocarpine 5mg tablets. Pilocarpine is indicated for the treatment of dry mouth symptoms from salivary gland hypofunction from cancer radiotherapy or Sjogren's Syndrome. Pilocarpine is the generic version of Salagen® and has a market of $36 million.

In November 2005, Lannett received a letter from the FDA with approval to market and launch Doxycycline Hyclate 20mg tablets. Doxycycline Hyclate is indicated for use as an adjunct to scaling and root planning to promote attachment level gain and to reduce pocket depth in patients with adult periodontitis. Doxycycline Hyclate is the generic version of Periostat® and the total market is estimated at $67 million.

In December 2005, Lannett received a letter from the FDA with approval to market and launch Baclofen 20mg tablets. According to Wolters-Kluwer, total sales in 2005 of Baclofen were approximately $89.5 million. Baclofen is useful for the alleviation of signs and symptoms of spasticity resulting from multiple sclerosis, particularly for the relief of flexor spasms and concomitant pain, clonus, and muscular rigidity.

In December 2005, Lannett received a letter from the FDA as the first generic with approval to market and launch Doxycycline tablets. Doxycycline Monohydrate is the generic version of Adoxa®, marketed by Doak Dermatologics, a subsidiary of Bradley Pharmaceuticals, Inc. According to Wolters-Kluwer, total sales of Adoxa were $32 million in 2004. Doxycycline Monohydrate is a tetracycline-type antibiotic used to treat many different bacterial infections, such as urinary tract infections, acne, gonorrhea, Chlamydia, and periodontitis among others.

In January 2006, Lannett launched Morphine Sulfate Solution. Morphine Sulfate is used for the treatment of chronic and acute pain and is a generic version of Roxanol®.

In January 2006, Lannett launched Oxycodone HCL Oral Solution. Oxycodone HCL Solution is a generic version of Roxicodone® and is used for treating pain.

In May 2006, Lannett received a letter from the FDA with approval to market and launch Probenecid Tablets. According to Per-Sé, total sales in 2005 of Probenecid were approximately $26.0 million. Probenecid is indicated for the treatment of hyperuicemia associated with gout and gouty arthritis. Probenecid is also used as an adjunctive therapy with some antibiotics such as penicillin, ampicillin, methicillin, oxacillin, cloxacillin, or nafcillin, for the elevation and prolongation of plasma levels by whatever route the antibiotic is given.

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 overall cost to develop a new generic product varies in range 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 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, to make it attractive for Lannett to reconsider manufacturing and selling them. 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. 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 ANDA supplements 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	7
FDA Review	ANDA supplement	3
Clinical Testing	ANDA	2
Scale-Up	Grand-fathered	0
Scale-Up	ANDA supplement	2
Scale-Up	ANDA	4
Formulation/Method Development	ANDA	37

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 76% of the Company's inventory purchases in Fiscal 2006, 62% in Fiscal 2005 and 81% in Fiscal 2004. 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 two 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 11% of the Company's costs of purchased inventory in Fiscal 2006. The term of the agreement is three years, beginning on August 22, 2005 and continuing through August 21, 2008.

During the term of the agreement, the Company has committed to provide a rolling twelve month forecast of the estimated Product requirements to this provider. The first three months of the rolling twelve month forecast are binding and constitute a firm order.

In October 2004, the Company signed an agreement with Orion Pharma (Orion), based in Finland, to purchase and distribute three drug products. Under the terms of the agreement, Orion will supply Lannett with the finished products and all laboratory documentation, and Lannett will coordinate the completion of the clinical biostudies necessary to submit Abbreviated New Drug Applications (ANDAs) to the FDA. The Company signed supply and development agreements with Olive Healthcare, of India; Orion Pharma, of Finland; Azad Pharma AG, of Switzerland, and is in negotiations with companies in Israel and Greece for similar new product initiatives, in which Lannett will market and distribute products manufactured 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 Company has also contracted with an API Provider for the supply of raw materials and oral dosage forms relating to future products. The agreements are standard supply agreements evidencing the terms of the supply of material. There are no guaranteed purchase volume commitments. The price of the material may vary depending on the quantity of material purchased during the term of the agreement.

Customers and Marketing

The Company sells its products primarily to wholesale distributors, generic drug distributors, mail-order pharmacies, group purchasing organizations, drug chains, and other pharmaceutical companies. The industry's largest wholesale distributors McKesson, Cardinal Health, and Amerisource Bergen accounted for 17%, 15%, and 5%, respectively, of net sales in Fiscal 2006. 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 obtain 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, whereby 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 expand on its own 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 2006, 2005, and 2004, 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 generally expects a high standard of service. This service standard includes shipping product in a timely manner on receipt of customer purchase orders, 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 equally 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. The Company competes primarily on this basis, as well as by flexibility (reacting to customer needs quickly and decisively—for example shipping product via overnight delivery when the customer is in critical need of inventory), availability of inventory, and by the fact that the Company's products are available only from a limited number of suppliers. The modernization of its facilities, hiring of experienced staff, and implementation of inventory and quality control programs have improved the Company's competitive 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, Amide (marketed by Bertek Pharmaceuticals), Caraco Pharmaceutical Laboratories
Doxycycline Tablets	Par Pharmaceuticals, Ranbaxy
Levothyroxine Sodium Tablets	Abbott Laboratories, Monarch Pharmaceuticals, Mylan Laboratories, Sandoz, Forest
Primidone Tablets	Watson Pharmaceuticals, Qualitest Pharmaceuticals, URL
Sulfamethoxazole w/ Trimethoprim	URL/Mutual Pharmaceuticals, Sandoz, Vista
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 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)****:* 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. 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.

Research and Development

The Company incurred research and development (R&D) expenses of approximately $8,102,000 in 2006, $6,266,000 in 2005, and $5,896,000 in 2004. 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. In the current fiscal year, we have engaged Olive Healthcare, an India-based manufacturer and exporter of pharmaceutical products. AZAD Pharma AG, a Switzerland-based developer of Active Pharmaceutical Ingredients (APIs), has been contracted with to jointly develop and commercialize one pharmaceutical product. This agreement also includes a supply agreement to provide us with five APIs that we will develop into finished dosage forms for commercialization.

Employees

The Company currently has 193 employees.

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.

RISKS ASSOCIATED WITH INVESTING IN THE BUSINESS OF LANNETT

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;
- experiencing delays or unanticipated costs; 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.

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, as well as delay our development and sales and marketing efforts.

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 all 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.

RISKS RELATING TO INVESTING IN THE PHARMACEUTICAL INDUSTRY

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.

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.

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, 2006, our three largest customers accounted for 17%, 15% and 5% respectively, of our net revenues. 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 1b. UNRESOLVED STAFF COMMENTS

The Company has received written comments from the Securities and Exchange Commission staff during the current fiscal year. The comments relate to Form 10K dated June 30, 2005, and the Forms 10Q as of September 30, 2005, December 31, 2005 and March 31, 2006. Lannett believes these comments will be resolved in the near future. The Company does not expect the resolution to have any material effect on the financial statements or disclosures.

ITEM 2. DESCRIPTION OF PROPERTY

Lannett owns two facilities in Philadelphia, Pennsylvania, from where all operations are based. 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 December 2005, the Company refinanced the mortgages on these two properties. As of June 30, 2006, the mortgage balance was approximately $6 million.

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 us the option to buy the facility was also signed. This new facility will hold the warehouse, and will become the future headquarters of the Company. We expect to begin occupying the building in December 2006, with full conversion of the facility to take place over another 6 to 9 months. The existing facilities will continue to operate, giving the Company the ability to broaden its manufacturing and pharmaceutical development.

ITEM 3. LEGAL PROCEEDINGS

The Company monitors its compliance with all environmental laws. Any compliance costs which may be incurred are contingent upon the results of future site monitoring and will be charged to operations when incurred. No monitoring costs were incurred during the years ended June 30, 2006, 2005 and 2004.

The Company is currently engaged in several civil actions as a co-defendant with many other manufacturers of Diethylstilbestrol ("DES"), a synthetic hormone. Prior litigation established that the Company's pro rata share of any liability is less than one-tenth of one percent. Due to the fact that prior litigation established the "market share" method of prorating liability amongst the companies that manufactured DES during the drug's commercial distribution, which ended in 1971, management has accepted this method as the most reasonably expected method of determining liability for future outcomes of claims. The Company was represented in many of these actions by the insurance company with which the Company maintained coverage (subject to limits of liability) during the time period that damages were alleged to have occurred. The insurance company denies coverage for actions alleging involvement of the Company filed after January 1, 1992. With respect to these actions, the Company paid nominal damages or stipulated to its pro rata share of any liability. The Company has either settled or is currently defending over 500 such claims. At this time, management is unable to estimate a range of loss, if any, related to these actions. Management believes that the outcome of these cases will not have a material adverse impact on the financial position or results of operations of the Company.

In addition to the matters reported herein, the Company is involved in litigation which arises in the normal course of business. In the opinion of management, the resolution of these lawsuits will not have a material adverse effect on the consolidated financial position or results of the Company.

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, 2006.

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 2006 and 2005, 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, 2006		
	High	**Low**
First quarter	$5.70	$4.24
Second quarter	$8.17	$4.75
Third quarter	$8.40	$7.06
Fourth quarter	$7.56	$5.45
Fiscal Year Ended June 30, 2005		
	High	**Low**
First quarter	$15.19	$9.50
Second quarter	$12.80	$8.25
Third quarter	$10.05	$5.95
Fourth quarter	$6.45	$3.88

Holders

As of August 25, 2006, there were approximately 237 holders of record of the Company's common stock.

Dividends

The Company did not pay cash dividends in Fiscal 2006 or Fiscal 2005. 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.

Equity Compensation Plan Information

The following table summarizes the equity compensation plans as of June 30, 2006:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity Compensation plans approved by security holders	792,003	$12.98	1,613,144
Equity Compensation plans not approved by security holders	-	-	-
Total	792,003	$12.98	1,613,144

ITEM 6. SELECTED FINANCIAL DATA

Lannett Company, Inc. and Subsidiaries
Financial Highlights

As of and for the Fiscal Year Ended June 30,	2006	2005	2004	2003	2002
Operating Highlights					
Net Sales	$ 64,060,375	$ 44,901,645	$ 63,781,219	$ 42,486,758	$ 25,126,214
Gross Profit	$ 30,160,330	$ 13,484,737	$ 36,924,344	$ 26,228,964	$ 16,673,537
Operating Income/(Loss)	$ 8,453,918	$ (53,639,658)	$ 20,830,969	$ 19,060,106	$ 11,425,483
Net Income/(Loss)	$ 4,968,922	$ (32,779,596)	$ 13,215,454	$ 11,666,887	$ 7,195,990
Basic Earnings/(Loss) Per Share	$ 0.21	$ (1.36)	$ 0.63	$ 0.58	$ 0.36
Diluted Earnings/(Loss) Per Share	$ 0.21	$ (1.36)	$ 0.63	$ 0.58	$ 0.36
Weighted Average Shares Outstanding, Basic	24,130,224	24,097,472	20,831,750	19,968,633	19,895,757
Weighted Average Shares Outstanding, Diluted	24,154,409	24,097,472	21,053,944	20,121,314	20,018,548
Balance Sheet Highlights					
Current Assets	$ 43,486,847	$ 33,938,115	$ 48,862,443	$ 23,930,048	$ 10,439,630
Working Capital*	$ 22,862,419	$ 17,542,553	$ 28,923,814	$ 17,185,052	$ 6,891,998
Total Assets	$ 105,992,064	$ 94,917,060	$ 131,904,084	$ 31,834,544	$ 17,338,503
Total Debt	$ 8,196,692	$ 9,532,448	$ 10,092,857	$ 3,097,802	$ 4,142,538
Deferred Tax Liabilities	$ 2,545,734	$ 2,009,582	$ 1,614,323	$ 1,112,369	$ 681,489
Total Stockholders' Equity	$ 75,755,916	$ 69,249,244	$ 102,246,991	$ 21,597,710	$ 9,766,049

*Working capital equals current assets less current liabilities

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 2006, 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.

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 is based on historical data and sales expectations. The chargeback/rebate reserve is reviewed on a monthly basis by management using several ratio and calculated metrics. Lannett's methodology for estimating reserves has been consistent with previous periods.

New product sales also affect revenue recognition as net sales of new products are often impacted by greater incentives to wholesalers. New product net sales of $12.6 million in Fiscal 2006 are net of reserves of $3.2 million. This is a significant increase over Fiscal 2005 net sales of $500,000 and reserves of $100,000 million that were associated with new product net sales.

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

Rebates – Rebates are offered to the Company's key customers to promote customer loyalty and encourage greater 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, these rebate programs are tailored to the customers' individual programs. Hence, the reserve will depend on the mix of customers that comprise such rebate programs.

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

In the fourth quarter of fiscal year 2005, the Company recorded a $1,500,000 write-down in sales to account for expected returns. This additional reserve came about because of returns from a major wholesaler that was unable to sell a significant amount of Levothyroxine Sodium tablets that it had purchased a year earlier. The Company considered extending the shelf-life of the product in March 2005. A short extension of shelf-life is a normal practice for pharmaceutical products. However, the supplier of the product and experts within the Company were unable to agree upon any extended date, and the conclusion was ultimately reached to reserve for all estimated returns. The date that all unsold products would eventually be returned was through December 2005, and the $1,500,000 included the estimate of all returns through December 2005. The product was returned to the Company in December 2005, and concurrently written off as slow moving and short-dated inventory.

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. When competitors enter the market of existing products, shelf stock adjustments are issued to maintain price competitiveness. Management foresaw this occurrence and appropriately reserved for it as seen in the table below.

The following tables identify the reserves for each major category of revenue allowance and a summary of the activity for the years ended June 30, 2006, 2005 and 2004:

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)	(1,272,400)	(59,300)	(10,712,700)
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	36,221,000
Actual credits issued related to sales in fiscal 2006	(18,178,800)	(3,573,700)	(900)	(992,800)	(23,246,200)
Reserve Balance as of June 30, 2006	$ 10,137,400	$ 2,183,100	$ 416,000	$ 275,600	$13,012,100

For the Year Ended June 30, 2005

Reserve Category	Chargebacks	Rebates	Returns	Other	Total
Reserve balance as of June 30, 2004	$ 6,484,500	$ 1,864,200	$ 448,000	$ 88,300	$ 8,885,000
Actual credits issued related to sales recorded in prior fiscal years	(4,978,300)	(1,970,000)	(523,100)	(95,800)	(7,567,200)
Reserves or (reversals) charged during Fiscal 2005 related to sales recorded in prior fiscal years	-	130,000	(130,000)	-	-
Reserves charged to net sales in fiscal 2005 related to sales recorded in fiscal 2005	21,028,100	6,970,100	2,933,900	623,400	31,685,500
Actual credits issued related to sales in fiscal 2005	(14,534,600)	(5,965,500)	(1,036,800)	(586,400)	(22,253,300)
Reserve balance as of June 30, 2005	$ 7,999,700	$ 1,028,800	$ 1,692.000	$ 29,500	$10,750,000

For the Year Ended June 30, 2004

Reserve Category	Chargebacks	Rebates	Returns	Other	Total
Reserve balance as of June 30, 2003	$ 1,638,000	$ 889,900	$ 210,200	$ 33,900	$ 2,772,000
Actual credits issued related to sales recorded in prior fiscal years	(1,604,000)	(1,166,400)	(182,700)	-	(2,953,100)
Reserves or (reversals) charged during Fiscal 2004 related to sales recorded in prior fiscal years	-	300,000	-	-	300,000
Reserves charged to net sales in fiscal 2004 related to sales recorded in fiscal 2004	18,897,500	4,563,900	480,600	464,400	24,406,400
Actual credits issued related to sales in fiscal 2004	(12,447,000)	(2,723,200)	(60,100)	(410,000)	(15,640,300)
Reserve balance as of June 30, 2004	$ 6,484,500	$ 1,864,200	$ 448,000	$ 88,300	$ 8,885,000

Reserve Activity 2006 vs. 2005

The chargeback reserve increased from $10,750,000 at June 30, 2005 to $13,012,100 at June 30, 2006 due to an increased level of sales in the months of May and June as compared to prior year. Historically, the ratio of the reserve to gross sales is between 30% and 40%. The fiscal years ended June 30, 2006 and 2005 were 36% and 40%, respectively. In fiscal 2005, there were additional reserves taken for an expected Levothyroxine return. This accounted for an additional $1.4 million or 1.8%. Additional rebate reserves of $500,000 were incurred during Fiscal 2006, and these were offset by reduced reserves return reserves of the same amount. Rebates have decreased both in amount and as a percentage of the reserve in the "additional credits issued-related to sales recorded in Fiscal 2006" due to the classification of rebates from wholesale customers. When the reserve for chargebacks and rebates is calculated for the wholesale/distribution customers, it is calculated in aggregate, that is, on a combined basis, since they submit the amounts together. This is in part the reason why the chargeback amount has increased. However there is 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%. "Other" increased due to an increase in shelf stock adjustments. Additional competitors in the Primidone 50 market have caused Lannett to give more of this type of credit. Currently, the Company is in the process of developing systematic tracking of rebates and chargebacks to improve the accuracy of estimating chargebacks and rebates.

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, an increase in wholesale sales will result in a higher level of chargebacks. For the first, second, third and fourth quarters of Fiscal 2006, reserves recorded against sales amounted to $7.5 million, $7.9 million, $12.5 million and $10.0 million, respectively. Wholesaler sales were $9.3 million, $9.9 million, $16.7 million and $15.8 million, respectively. The increase in the dollar value of the reserves corresponds to the increase in wholesale sales, most significantly in the third quarter. This third quarter increase in sales and reserves 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. 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.

Management performs several types of analysis to ensure reserves are reasonable. This includes ratio analysis of: wholesaler versus direct (or retail) sales mix; revenue reserve to gross sales; comparison of net receivables to net sales; comparison of gross receivables to gross sales; and recalculation of wholesaler inventory levels. Through these steps, management is able to ensure that all reserves are reasonably stated.

Since we are unable to independently verify product sales levels at the final customer, wholesaler inventory reports are used to recalculate potential chargebacks and rebates based on known contracted rebate and chargeback rates.

Reserve Activity 2005 vs. 2004

Actual credits processed against fiscal year 2004 chargebacks during fiscal year 2005 are nearly $1.5 million less than the June 30, 2004 balance of $6,484,500, a result of overestimating the required reserve at June 30, 2004. The large majority of chargebacks occur from sales to wholesalers. Sales through these wholesalers were beginning to decline by the end of fiscal 2004. This decline resulted in lower chargebacks. In addition, the competition within the generic industry, by competitors introducing similar pharmaceuticals, led to pressures on product sales and pricing. Often these competitors' product introductions are not known in advance, and require the Company to maintain flexible pricing strategies in order to not lose market share. At this point, the sales decline through wholesalers was a result of greater competition. Due to the relatively small size of Lannett's product offerings, the sales through the wholesalers may decline without much notice. Lannett's ability to compete will depend on the ability to add new products to offer wholesalers as well as pharmacy customers. The Company continued to

estimate higher chargebacks than needed. By the end of the fiscal year, sales through the wholesalers had increased again, the result of customers buying greater quantities before the fiscal year ended, and requiring a reserve of nearly $8 million.

The rebates reserve of $1,864,000 at June 30, 2004 had $1,970,000 of credits issued against it during fiscal year 2005. This difference of $106,000 is an underestimate of rebates, which was corrected in the additional reserves taken in fiscal year 2005. By June 30, 2005, the rebates reserve is estimated to be $1,029,000, a result of declining overall sales during the last quarter of fiscal year 2005.

The returns reserve balance at June 30, 2004, $448,000, had actual credits of $523,000 issued against it during fiscal year 2005. This difference of $75,000 is not related to any one product. By June 30, 2005 the returns reserve was increased to $1,692,000 as the company was anticipating a significant return from one customer on its Levothyroxine Sodium tablets.

The Company ships its products to the warehouses of its wholesale, mail order, distributor and retail chain customers. When the Company and a customer come to 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 continually 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, cost, 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, third-party payers, institutional formularies and other buyers of drugs that must change prescribing habits, therapeutic modalities 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 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.

In the fourth quarter of fiscal year 2005, the Company recorded a $4,000,000 write-down of slow moving and short dated inventory primarily related to Levothyroxine Sodium tablets, which had been returned by a wholesaler during the quarter.

Intangible Asset – On March 23, 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. The agreement was included as an Exhibit in the Form 8-K filed by the Company on May 5, 2004, as subsequently amended.

In June 2004, JSP's Levothyroxine Sodium tablet product received from the FDA an AB rating to the brand drug Levoxyl®. In December 2004, the product received from the FDA a second AB rating to the brand drug Synthroid®. As a result of the dual AB ratings, the Company was required to pay JSP an additional $1.5 million in cash to reimburse JSP for expenses related to obtaining the AB ratings. As of March 31, 2005, the Company recorded an addition to the intangible asset of $1.5 million.

During Fiscal 2005, events occurred which indicated that the carrying value of the intangible asset was not recoverable. In accordance with Statement of Financial Accounting Standards No. 144 (FAS 144), *Accounting for the Impairment or Disposal of Long-Lived Assets*, the Company engaged a third party valuation specialist to assist in the performance of an impairment test for the quarter ended March 31, 2005. The impairment test was performed by discounting forecasted future net cash flows for the JSP products covered under the agreement and then comparing the discounted present value of those cash flows to the carrying value of the asset (inclusive of the $1.5 million paid to JSP for the dual AB ratings). As a result of the testing, the Company determined that the intangible asset was impaired as of March 31, 2005. In accordance with FAS 144, the Company recorded a non-cash impairment loss of approximately $46,093,000 to write the asset down to its fair value of approximately $16,062,000 as of the date of the impairment. This impairment loss is shown on the statement of operations as a component of operating loss. Management concluded that, as of June 30, 2006, the intangible asset is correctly stated at fair value and, therefore, no additional adjustment is required.

New Accounting Pronouncements – In November 2004, the FASB issued FASB Statement No. 151, "Inventory Costs — an amendment of ARB No. 43, Chapter 4" (SFAS No. 151), which is the result of its efforts to converge U.S. accounting standards for inventories with International Accounting Standards. SFAS No. 151 requires abnormal amounts of idle facility expense, freight, handling costs and wasted material or spoilage to be recognized as current-period charges. It also requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 was effective for inventory costs incurred beginning January 1, 2006. The adoption of this standard did not have any impact on the Company.

In March 2005, the FASB issued FIN 47 "Accounting for Conditional Asset Retirement Obligations, an Interpretation of FASB Statement No. 143." This Interpretation clarifies that a conditional retirement obligation refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Accordingly, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. The liability should be recognized when incurred, generally upon acquisition, construction or development of the asset. FIN 47 is effective no later than the end of fiscal years ending after December 15, 2005. The adoption of FIN 47 had no impact on our financial statements.

In May 2005, the FASB issued FASB Statement No. 154, "Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3" (SFAS No. 154). Previously, APB Opinion No. 20, "Accounting Changes" and FASB Statement No. 3, "Reporting Accounting Changes in Interim Financial Statements" required the inclusion of the cumulative effect of changes in accounting principle in net income of the period of the change. SFAS No. 154 requires companies to recognize a change in accounting principle, including a change required by a new accounting pronouncement when the pronouncement does not include specific transition provisions retrospectively to prior period financial statements. SFAS No. 154 was effective as of January 1, 2006. The adoption of this standard did not have any impact on the Company in the current fiscal year.

In September 2005, the FASB ratified Emerging Issues Task Force (EITF) Issue No. 04-13, "Accounting for Purchases and Sales of Inventory with the Same Counterparty" (EITF 04-13). EITF 04-13 provides guidance on whether two or more inventory purchase and sales transactions with the same counterparty should be viewed as a single exchange transaction within the scope of APB No. 29, "Accounting for Nonmonetary Transactions." In addition, EITF 04-13 indicates whether nonmonetary exchanges of inventory within the same line of business should be recognized at cost or fair value. EITF 04-13 was effective as of April 1, 2006. There has been no impact on the Company's financial statements, effective from April 1, 2006 to date.

In April 2006, the FASB issued FASB Staff Position No. FIN 46(R)-6, "Determining the Variability to Be Considered in Applying FASB Interpretation No. 46(R)" (FSP No. 46(R)-6). This pronouncement provides guidance on how a reporting enterprise should determine the variability to be considered in applying FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities," which could impact the assessment of whether certain variable interest entities are consolidated. FSP No. 46(R)-6 will be effective for the Company on July 1, 2006. The provisions of FSP No. 46(R)-6 are applied prospectively. FSP No. 46(R)-6 has had no impact on the Company in the current year.

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48), to clarify the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS 109, "Accounting for Income Taxes." Effective January 1, 2007, FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company is currently evaluating the impact, if any, that FIN 48 will have on its financial statements.

Results of Operations – Fiscal 2006 compared to Fiscal 2005

Net sales increased by 43%, from $44,901,645 in Fiscal 2005 to $64,060,375 in Fiscal 2006. The increase was due in part from a rebound in Levothyroxine sales which increased $6.4 million, or 75%. The Company also had additional growth with the introduction of several new products which accounted for $12.6 million in sales. Several other products besides Levothyroxine Sodium experienced increased sales over prior year – including Digoxin 29%, Acetazolamide 8%, Unithroid 38%, and Hydromorphone 398%. Volume and price increases attributed to increased sales – 33% due to increase in volume (new sales are included in volume

increases) and 11% increase in prices. Prices rebounded in the sales of Levothyroxine and Digoxin. Both saw increased price pressure in the prior year as several competitors entered into the market.

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 2006 Net Sales	Fiscal 2005 Net Sales	Fiscal 2004 Net Sales
Wholesaler/Distributor	$44.0 million	$24.8 million	$43.0 million
Retail Chain	$10.6 million	$10.5 million	$12.1 million
Mail-Order Pharmacy	$7.0 million	$5.9 million	$4.3 million
Private Label	$2.5 million	$3.7 million	$4.4 million
Total	$64.1 million	$44.9 million	$63.8 million

Wholesaler/Distributor sales increased due to a rebound in Levothyroxine Sodium sales and sales of new products. Levothyroxine Sodium sales increased as Wholesalers reduced their inventories and began to reorder the product in larger volumes in Fiscal 2006. Mail Order Pharmacy sales increased due to new product sales and the fact that this area of the industry is growing at a faster rate than the other areas. Retail Chain sales remained unchanged from the prior year, as new products sales replaced the loss of any existing products. Private label sales decreased due to our largest private label customer, Qualitest, receiving FDA approval in late November 05 to manufacture its own Primidone 50mg. Sales to the Private Label category may continue 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 increased 8%, from $31,416,908 in Fiscal 2005 to $33,900,045 in Fiscal 2006. This increase is due in part to higher production volumes to meet increased sales demand. Gross margins were 47% in 2006, an improvement over 30% in 2005. Improvement was, in part, affected by the prior year write-off of short-dated Levothyroxine Sodium. , The prior year also experienced an increased return accrual, taken in anticipation of an unusually large return of Levothyroxine. The Levothyroxine related write-offs accounted for 10% of cost of sales in the prior year. Aside from the prior year one-time incidents related to Levothyroxine, the margins increased due to additional product offerings and higher effective pricing. Despite new entrants to the Primidone market, the Company was able to maintain its market share and competitive price. The Company was also able to take advantage of its new products and the higher margin on these products. Depending on future market conditions for each of the Company's products, changes in the future sales product mix may occur. These changes may affect the gross profit percentage in future periods.

Research and development ("R&D") expenses increased by $1,836,943, or 29%. The increase in R&D is primarily due to an increase in raw material consumption for production of experimental batches.

Selling, general and administrative expenses increased $2.6 million, or 28%. The increase is primarily due to the adoption of SFAS 123(R) which contributed stock compensation expense of $1.4 million.

Amortization expense decreased $3.7 million from $5.5 million to $1.8 million due to the write down of the intangible asset that occurred in March 2005. Please see further description of this event in Note 1 of the Notes to Consolidated Financial Statements, under the heading "Intangible Assets."

As a result of the revaluation of the intangible asset, the Company's financial results changed from an operating loss of ($53,639,659) in Fiscal 2005 to an operating income of $8,532,559 in Fiscal 2006.

The Company's income tax classification changed to an income tax expense of $3,561,175 from an income tax benefit of ($21,045,902) in Fiscal 2005. The effective tax rate increased slightly from 39% in 2005 to 41% in 2006.

The Company reported net income of $4,968,922 for Fiscal 2006, or $.21 basic and diluted income per share, compared to net loss of ($32,779,596) for Fiscal 2005, or ($1.36) basic and diluted loss per share.

Results of Operations – Fiscal 2005 compared to Fiscal 2004

Net sales decreased by 30%, from $63,781,219 in Fiscal 2004 to $44,901,645 in Fiscal 2005. The decrease was generally due to increased competition in the generic drug market that affected most of the Company's products. The increased competition, both from existing competitors and new entrants, has resulted in significant price pressures. Sales of the Levothyroxine Sodium line of products declined by $4,948,000 due in part to a delay in the AB rating, which gave the competition a market advantage. The sales of Unithroid tablets declined $2,036,000. Sales of Butalbital with Aspirin and Caffeine capsules declined $3,240,000. Sales of Primidone tablets, seeing competition for the first time, declined $4,390,000. Sales of Digoxin tablets declined $3,480,000. New product sales contributed $500,000 to the sales in Fiscal 2005. Year over year decline in existing product sales were a result of volume declines of 8% and price reductions of 22%.

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 2005 Net Sales	Fiscal 2004 Net Sales	Fiscal 2003 Net Sales
Wholesaler/Distributor	$24.8 million	$43.0 million	$20.6 million
Retail Chain	$10.5 million	$12.1 million	$9.9 million
Mail-Order Pharmacy	$5.9 million	$4.3 million	$2.6 million
Private Label	$3.7 million	$4.4 million	$9.4 million
Total	$44.9 million	$63.8 million	$42.5 million

Sales in every category, with the exception of 'Mail-Order Pharmacy,' decreased in Fiscal 2005. This is a result of the factors described in the previous paragraph. Sales to mail order pharmacy increased due to an increase in product lines offered, and a general increase across the business sector. Sales to wholesalers/distributors declined mainly due to the loss of primary position on the Amerisource Bergen pro-generic contract and a decrease in pricing with all wholesalers and distributors due to the competitive market.

Cost of sales increased by 17%, from $26,856,875 in Fiscal 2004 to $31,416,908 in Fiscal 2005. These costs include raw materials/cost of finished goods purchased and resold, production expenses, and shipping expenses. The cost of purchased materials increased approximately $4,071,000, shipping expenses increased by approximately $199,000 and other miscellaneous production-related expenses increased by approximately $290,000. Gross margin (exclusive of amortization of intangible assets) decreased from 58% in Fiscal 2004 to 30% in Fiscal 2005. The decrease in gross profit margin was a result of the accrual of additional return of Levothyroxine Sodium. In addition to decreases in net weighted average prices of some of the Company's products due to increased market competition, increases in direct and indirect costs as well as a change in the product sales mix also resulted in lower gross margins. Please see additional information regarding the Company's gross margin in Note 1 of the Notes to Consolidated Financial Statements, under the heading "Intangible Assets."

Research and development ("R&D") expenses increased by 6%, from $5,895,096 in Fiscal 2004 to $6,265,522 in Fiscal 2005. The increase in R&D is a result of contracting formulation development out to a third party laboratory for product development for $940,000 in Fiscal 2005, and an increase of raw material consumption of approximately $1,200,000 used in the development and formulation of new products not yet approved by the FDA. These costs were offset by a decrease in Bio studies of $1,185,000 from Fiscal 2004 to Fiscal 2005.

Selling**,** general and administrative expenses increased by 4%, from $8,863,966 in Fiscal 2004 to $9,194,377 in Fiscal 2005. This increase is primarily a result of Sarbanes-Oxley related accounting and consulting costs of approximately $520,000 and an increase in insurance of $160,000. These increases were partially offset by savings in various other expense accounts.

The Company's interest expense increased from approximately $45,000 in Fiscal 2004 to approximately $351,000 in Fiscal 2005 as a result of the borrowing under the "2003 Loan Financing" which included a mortgage loan, equipment loan and construction loan, each of which started in Fiscal 2005. Interest income increased from approximately $24,000 in Fiscal 2004 to approximately $165,622 in Fiscal 2005, as a result of an investment of excess cash in marketable securities and a higher cash balance.

As a result of the items discussed above, the Company's financial results changed from an operating income of $20,830,969 in Fiscal 2004 to an operating loss of ($53,639,659) in Fiscal 2005.

The Company's income tax classification changed from an income tax expense of $7,594,316 in Fiscal 2004 to an income tax benefit of ($21,045,902) in Fiscal 2005 as a result of the Company's pre-tax loss. The effective tax rate increased slightly from 36.5% in 2004 to 39.1% in 2005.

The Company reported net loss of ($32,779,596) for Fiscal 2005, or ($1.36) basic and diluted loss per share, compared to net income of $13,215,454 for Fiscal 2004, or $0.63 basic and diluted earnings per share.

Liquidity and Capital Resources

Net cash provided by operating activities of $3,368,921 for the year ended June 30, 2006 was attributable to net income of $5,004,359 as adjusted for the effects of non-cash items of $5,240,864 and net changes in operating assets and liabilities totaling ($6,876,303). Significant changes in operating assets and liabilities are described below.

1. An increase in trade accounts receivable of $11,924,058 was partially due to increased sales in the most recent months of Fiscal 2006. The May to June sales figures for 2006 were $7.2 million greater than the same period in Fiscal 2005. Also, the prior year had 3 customers with substantial credit balances at June 30, 2005. The Company monitors its liquidity in a number of ways. A Days Sales Outstanding (DSO) calculation is used to determine our ability to collect accounts receivable. DSO is analyzed in two ways, Gross A/R compared to Average Daily Gross Sales, and Net A/R (net of reserve for chargebacks and rebates) compared to Average Daily Net Sales. For the first, second, third and fourth quarters of Fiscal 2006, this Gross DSO amounted to 64 days, 68 days, 76 days and 78 days, respectively. The increase is due to delayed processing of credits from wholesale customers. Some delays were the result of customers failing to report all credits. For these items, the Company is working with customer personnel to speed up and improve the reporting of information to Lannett. Some unprocessed credits were the result of the increased volume of credits, and the Company's inability to adequately handle the extra volume. The Company has acted to reduce the volume of manual credits and improve automated processing of credits, which is reducing the amount of unprocessed credits. For the first, second, third and fourth quarters of Fiscal 2006, this Net DSO amounted to 26 days, 49 days, 52 days and

56 days, respectively. Net DSO was low in the first quarter of Fiscal 2006 due to two significant customers that had credit balances at September 30, 2005. These customers' balances returned to normal balances due from the customers as additional sales were made.

2. Inventory increased $1,487,734 due to the increase in quantity of products offered by the Company. The Company offers 11 more drugs than was offered in the previous year. As a result, inventory increases were needed to be prepared for increasing product launches. As our product offerings increase, higher inventory levels are expected, both in dollars and quantities. This investment in inventory is vital to Lannett's strategy of maintaining our reputation of always in-stock.
3. A decrease in prepaid taxes of $1,358,919 is primarily attributable to taxable income in Fiscal 2006 compared to a loss in Fiscal 2005.
4. An increase in accrued expenses of $3,550,257 was due to increased personnel expenses, professional expenses, and a receiving accrual for materials received at the end of the fiscal year. These fluctuations are in the normal course of business.

The Company monitors both Net DSO and Gross DSO as an overall check on collections and reasonableness of reserves. In order to be effective indicators, both types of DSO are evaluated on a quarterly basis. The Gross DSO calculation 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 reserves charged during the period. Standard payment terms offered to customers are consistent with industry practice at 60 days.

The net cash used in investing activities of $5,874,697 for the twelve months ended June 30, 2006 was attributable to the Company's loan to an API provider of $3,182,498. The Company also had capital expenditures of $4,912,047 primarily related to several investments in production equipment and facility improvements. This was offset by the sale of $2,219,848 of its marketable securities.

On December 13, 2005 the Company refinanced $5,750,000 of its debt through the Philadelphia Industrial Development Corporation (PIDC) and the Pennsylvania Industrial Development Authority (PIDA). With the proceeds from the refinancing, the Company paid off its Mortgage and Construction Loan, as well as a portion of the Equipment loan. These loans were with Wachovia Bank. The Company financed $4,500,000 through the Immigrant Investor Program (PIDC Regional Center, LP III). 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 remaining $1,250,000 is financed through the PIDA Loan. 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 $1,221,780 outstanding as of June 30, 2006 with $69,090 currently due. None of the PIDC Loan is currently due.

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. As of June 30, 2006, $476,560 is outstanding and $95,019 is currently due.

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, 2006 was 4.13%. At June 30, 2006, the Company has $955,566 outstanding on the Authority loan, of which $654,996 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, 2006, no portion of the letter of credit has been utilized.

The Equipment Loan consists of a term loan with a maturity date of five years. The Company, as part of the 2003 Loan Financing agreement with Wachovia, is required to make equal payments of principal and interest. As of June 30, 2006, the Company has outstanding $1,042,786 under the Equipment Loan, of which $320,520 is classified as currently due.

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, 2006, the interest rate for the 2003 Loan Financing (of which only the Equipment loan remains) was 6.85%.

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.

The terms of the Equipment loan require that the Company meet certain financial covenants and reporting standards, including the attainment of standard financial liquidity and net worth ratios. As of June 30, 2006, the Company has complied with such terms, and successfully met its financial covenants.

The following table represents annual contractual obligations as of June 30, 2006:

Contractual Obligations

	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-Term Debt	$ 8,196,692	$ 1,130,706	$ 1,283,600	$ 4,924,653	$ 857,733
Operational Leases	1,983,288	331,972	783,802	799,570	67,944
Purchase Obligations	164,000,000	17,000,000	37,000,000	41,000,000	69,000,000
Other	-	-	-	-	-
Total	$ 174,179,980	$ 18,462,678	$ 39,067,402	$ 46,724,223	$ 69,925,677

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. It 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. The FDA allows generic manufacturers to manufacture and sell products which are equivalent to innovator drugs which are grand-fathered, under FDA rules, prior to the passage of the Hatch-Waxman Act of 1984. The FDA allows generic manufacturers to produce and sell generic versions of such grand-fathered products by simply performing and internally documenting the product's stability over a period of time. Under this scenario, a generic company can forego the time required for FDA ANDA approval.

The Company signed supply and development agreements with Olive Healthcare, of India; Orion Pharma, of Finland; Azad Pharma AG, of Switzerland, and is in negotiations with companies in Israel and Greece for similar new product initiatives, in which Lannett will market and distribute products manufactured 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. For example, the Company has entered into prepayment arrangements in exchange for discounted purchase prices on certain active pharmaceutical ingredients (API) and oral dosage forms. The Company has also arranged for a loan to a certain API provider as well as continued funding of recent operations of this API provider that should facilitate the availability of difficult to source material in the future. The Company plans to continue to explore such areas for potential opportunities to enhance shareholder value.

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, 2006. 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, 2006. 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, 2006, our internal control over financial reporting is effective. Please see the Report of Independent Registered Public Accounting Firm at the beginning of the Company's Financial Statements.

ITEM 9B. OTHER INFORMATION

None

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Directors and Executive Officers

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

	Age	Position
Directors:		
William Farber	74	Chairman of the Board
Ronald A. West	72	Vice Chairman of the Board, Director
Myron Winkelman	68	Director
Albert Wertheimer	63	Director
Garnet Peck	76	Director
Kenneth Sinclair	60	Director
Jeffrey Farber	46	Director
Officers:		
Arthur P. Bedrosian	60	President and Chief Executive Officer
Brian J. Kearns	40	Vice President of Finance, Treasurer, Secretary and Chief Financial Officer
Kevin Smith	46	Vice President of Sales and Marketing
Bernard Sandiford	77	Vice President of Operations
William Schreck	57	Vice President of Logistics

William Farber R. Ph. was elected as Chairman of the Board of Directors in August 1991. From April 1993 to the end of 1993, Mr. Farber was the President and a director of Auburn Pharmaceutical Company. From 1990 through March 1993, Mr. Farber served as Director of Purchasing for Major Pharmaceutical Corporation. From 1965 through 1990, Mr. Farber was the Chief Executive Officer of Michigan Pharmacal Corporation. Mr. Farber is a registered pharmacist in the State of Michigan.

Albert I. Wertheimer 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 22 books and more than 360 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 and Economic 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 Physical Science Doctorate from Purdue University and a Post Doctoral Fellowship from the University of London, St. Thomas' Medical School.

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, R&M Resources, an investment and consulting services company and North East Staffing, Inc., an employee services company. Prior to this, from 1983 to 1987, Mr. West, financial expert for 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.

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.

Garnet Peck, Ph.D., was elected a director of the Company in September 2005. Dr. Peck is Professor Emeritus of the Industrial and Physical Pharmacy department at Purdue University, where he has held numerous positions since 1967. Earlier in his career, Dr. Peck served as senior scientist and group leader at Mead Johnson Research Center and as a Pharmacist in the United States Army. Dr. Peck has also consulted for some of the largest pharmaceutical companies in the world and served on several committees of the United States Food and Drug Administration. Dr. Peck has chaired numerous pharmaceutical conferences and is a published author and frequent lecturer. He earned his Bachelor of Science Degree in Pharmacy, with distinction, from Ohio Northern University, and a Master of Science degree and Doctorate Degree in Industrial Pharmacy from Purdue University.

Kenneth Sinclair, Ph.D., was elected director of the Company in September 2005. Dr. Sinclair is currently Professor and Chair of the Accounting Department 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.

Jeffrey Farber was elected director of the Company, Inc in May 2006. 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.

Arthur P. Bedrosian, J.D. was elected 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, and as a Director from February 2000 to January 2002. 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 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 was elected Vice President of Finance, Treasurer and Chief Financial Officer of the Company in March 2005 and 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.

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.

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. 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.

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 2006, all filing requirements applicable to its officers, directors and greater-than-10% beneficial owners were complied with.

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, Chief Accounting 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 Chief Accounting Officer and 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

Summary Compensation Table

The following table summarizes all compensation paid to or earned by the named executive officers of the Company for Fiscal 2006, Fiscal 2005 and Fiscal 2004.

		Annual Compensation			Long Term Compensation			
					Awards		Payouts	
(a) Name and Principal Position	**(b)** Fiscal Year	**(c)** Salary[1]	**(d)** Bonus	**(e)** Other Annual Compen-sation	**(f)** Restricted Stock Award(s)	**(g)** Securities Under-lying Options/ SARs	**(h)** LTIP Payouts Amount	**(i)** All Other Compensation Amounts
Arthur P. Bedrosian[2]	2006	$278,641	$92,970	$0	0	25,000	$0	$3,003
	2005	236,709	168,750	0	0	0	0	0
President and Chief Executive Officer	2004	212,548	240,000	0	0	177,900	0	0
Brian Kearns	2006	193,572	20,712	0	0	0	0	1,526
Chief Financial Officer, Treasurer[3]	2005	47,115	0	0	0	100,000	0	0
	2004	0	0	0	0	0	0	0
Bernard Sandiford	2006	178,883	54,898	0	0	12,000	0	5,146
	2005	140,932	58,500	0	0	0	0	0
Vice President of Operations	2004	159,440	78,000	0	0	0	0	0
Kevin Smith	2006	191,810	66,895	0	0	12,000	0	6,212
Vice President of Sales and Marketing	2005	171,578	95,518	0	0	0	0	0
	2004	160,488	158,410	0	0	0	0	0
William Schreck	2006	169,134	60,000	0	0	12,000	0	6,604
Vice President of Logistics	2005	140,862	73750	0	0	0	0	0
	2004	103,927	37,500	0	0	0	0	0

[1] Includes car allowance, and for Bernard Sandiford, salary contains apartment allowance.

[2] Mr. Bedrosian joined the Company on January 24, 2002 as Vice President of Business Development. On May 5, 2002, he was elected President of the Company. On January 3, 2006, he was promoted to President and Chief Executive Officer.

[3] Brian Kearns was hired March 14, 2005 as Chief Financial Officer.

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

(a) **Name**	(b) **Shares Acquired On Exercise**	(c) **Value Realized**	(d) **Number of Securities Underlying Unexercised Options at FY-End Exercisable/ Unexercisable**	(e) **Value of Unexercised In-the-Money Options at FY-End Exercisable/ Unexercisable**
Arthur P. Bedrosian President and Chief Executive Officer	0	0	167,900/ 35,000	$18,360/ 0
Brian Kearns Chief Financial Officer, Treasurer	0	0	33,333/ 66,667	$0/ 0
Bernard Sandiford Vice President of Operations	0	0	30,380/ 19,500	$0/ 0
Kevin Smith Vice President of Sales and Marketing	0	0	54,093/ 29,667	$0/ 0
William Schreck Vice President of Logistics	0	0	17,745/ 12,000	$0/ 0

Compensation of Directors

Non-employee directors received a retainer of $2,500 per month as compensation for their services during Fiscal 2006. They also were compensated $1,000 per Board meeting. There were twelve Board meetings held during Fiscal 2006. Additional committees of the Board of Directors include the Audit Committee, the Compensation Committee and the Strategic Planning Committee. Committee members received $1,000 and the Chairman received $1,500 per Committee meeting attended. There were seven Audit Committee meetings, six Strategic Planning Committee meetings and seven Compensation Committee meetings held during Fiscal 2006. Directors are also reimbursed for expenses incurred in attending Board and Committee meetings. There were no stock options granted to directors in Fiscal 2006.

Employment Agreements

The Company has entered into employment agreements with Arthur P. Bedrosian, Brian Kearns, Kevin Smith, Bill Schreck, and Bernard Sandiford (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.

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

The following table sets forth, as of June 30, 2006, 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 and Debentures		Including Options (*)	
Name and Address of Beneficial Owner	Office	Number of Shares	Percent of Class	Number of Shares	Percent of Class
Directors/Executive Officers:					
William Farber 9000 State Road Philadelphia, PA 19136	Chairman of the Board	**13,619,129**[1]	**56.41%**	**13,689,963**[2]	**55.66%**
Albert Wertheimer 9000 State Road Philadelphia, PA 19136	Director	**1,000**	**0.00%**	**7,667**[3]	**0.03%**
Myron Winkelman 9000 State Road Philadelphia, PA 19136	Director	**1,000**	**0.00%**	**24,333**[4]	**0.10%**
Ronald A. West 9000 State Road Philadelphia, PA 19136	Director	**7,310**	**0.03%**	**43,925**[5]	**0.18%**
Jeffrey Farber 9000 State Road Philadelphia, PA 19136	Director	**147,120**	**0.61%**	**162,120**[6]	**0.66%**
Arthur Bedrosian 9000 State Road Philadelphia, PA 19136	President and Chief Executive Officer	**460,997**[7]	**1.91%**	**617,897**[8]	**2.51%**
Brian Kearns 9000 State Road Philadelphia, PA 19136	Chief Financial Officer	**0**	**0.00%**	**33,333**[9]	**0.14%**
Kevin Smith 9000 State Road Philadelphia, PA 19136	Vice President of Sales and Marketing	**1,236**	**0.00%**	**61,996**[10]	**0.25%**
William Schreck 9000 State Road Philadelphia, PA 19136	Vice President of Logistics	**0**	**0.00%**	**17,745**[11]	**0.07%**
Bernard Sandiford 9000 State Road Philadelphia, PA 19136	Vice President of Operations	**287**	**0.00%**	**30,667**[12]	**0.12%**
All directors and executive officers as a group (10 persons)		**14,238,079**	**58.97%**	**14,689,646**	**59.73%**

[1] Includes 300,000 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. 16,667 vested options to purchase common stock at an exercise price of $17.36. 16,667 vested options to purchase common stock at an exercise price of $16.04.

[3] Includes 6,666 vested options to purchase common stock at an exercise price of $9.02 per share.

[4] Includes 10,000 vested options to purchase common stock at an exercise price of $17.36. 13,333 vested options to purchase common stock at an exercise price of $16.04.

[5] Includes 9,948 vested options to purchase common stock at an exercise price of $7.97 per share, 10,000 vested options to purchase common stock at an exercise price of $17.36 per share, and 16,667 vested options to purchase common stock at an exercise price of $16.04.

[6] Includes 6,667 vested options to purchase common stock at an exercise price of $17.36 per share and 8,333 vested options to purchase common stock at an exercise price of $16.04.

[7] Includes 27,450 shares owned by Arthur Bedrosian's wife, Shari Bedrosian and 9,000 shares owned by Arthur Bedrosian's daughter, Talin Bedrosian. Mr. Bedrosian disclaims beneficial ownership of these shares.

[8] 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, 22,000 vested options to purchase common stock at an exercise price of $17.36, and 20,000 vested options to purchase common stock at an exercise price of $16.04.

[9] Includes 33,333 vested options to purchase common stock at an exercise price of $6.75 per share.

[10] Includes 38,760 vested options to purchase common stock at an exercise price of $7.97 per share, 8,667 vested options to purchase common stock at an exercise price of $17.36, and 13,333 vested options to purchase common stock at an exercise price of $16.04 per share.

[11] Includes 17,745 vested options to purchase common stock at an exercise price of $11.27 per share.

[12] Includes 15,380 vested options to purchase common stock at an exercise price of $11.27 per share, 6,667 vested options to purchase common stock at an exercise price of $17.36, and 8,333 vested options to purchase common stock at an exercise price of $16.04.

* Assumes that all options exercisable within sixty days have been exercised, which results in 24,593,892 shares outstanding.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The Company had sales of approximately $1,143,000, $590,000, and $590,000 during the fiscal years ended June 30, 2006, 2005 and 2004, 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 $191,000 and $179,000 at June 30, 2006 and 2005, 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 pursuant to which it purchased for $100,000 and future royalty payments the proprietary rights to manufacture and distribute a product for which Pharmeral, Inc. owns the ANDA. This agreement is subject to Lannett Holdings, Inc.'s ability to obtain FDA approval to use the proprietary rights. In the event that such FDA approval cannot be obtained, Pharmeral, Inc. must repay the $100,000 to Lannett Holdings, Inc. Accordingly, the Company has treated this payment as a prepaid asset. Arthur Bedrosian, President of Lannett, was formerly the President and Chief Executive Officer of Pharmeral, Inc and currently owns 100% of Pharmeral, Inc. This transaction was approved by the Board of Directors of Lannett and, in its opinion, the terms were not more favorable to the related party than they would have been to a non-related party.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Grant Thornton LLP served as the independent auditors of the Company during Fiscal 2006, 2005 and 2004. No relationship exists other than the usual relationship between independent public accountant and client. The following table identifies the fees paid to Grant Thornton LLP in Fiscal 2006, 2005 and 2004.

	Audit Fees	Audit-Related (1)	Tax Fees (2)	All Other Fees (3)	Total Fees
Fiscal 2006:	$180,418	$ -	$52,942	$135,248	$368,608
Fiscal 2005:	$260,500	$2,850	$52,475	$53,895	$369,720
Fiscal 2004:	$92,124	$5,000	$29,621	$38,325	$165,070

(1) Audit-related fees include fees paid for preparation and participation in Board of Director meetings, and Audit Committee meetings.

(2) Tax fees include fees paid for preparation of annual federal, state and local income tax returns, quarterly estimated income tax payments, and various tax planning services. Fiscal 2006 and 2005 include fees paid to Grant Thornton for services rendered during an IRS audit.

(3) Other fees include:

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

Fiscal 2005 – Other fees were for review of various SEC correspondence and fees for services rendered in connection with the Company's application to various local and state entities for benefits related to the Company's facility expansion.

Fiscal 2004 – Fees paid for services rendered in connection with arbitrage calculations on certain tax exempt bond issues, review of stock option documentation, review of S-3 registration statement filing for the four million shares granted to JSP, review of various SEC correspondence and fees for services rendered in connection with the Company's application to various local and state entities for benefits related to the Company's facility expansion.

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, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) 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

(b) Consolidated Financial Statements and Supplementary Data

The following are included herein:

• Report of Independent Registered Public Accounting Firm
• Consolidated Balance Sheets as of June 30, 2006 and 2005
• Consolidated Statements of Operations for each of the three years in the period ended June 30, 2006
• Consolidated Statements of Changes in Shareholders' Equity for each of the three years in the period ended June 30, 2006
• Consolidated Statements of Cash Flows for each of the three years in the period ended June 30, 2006
• Notes to Consolidated Financial Statements
• Supplementary Data (Unaudited)

(c) On May 22, 2006, the Company filed a Form 8-K disclosing Item 5 and Item 9 thereof and including as an exhibit the press release announcing that Jeffrey Farber was elected to the Board of Directors of the Company.

On May 10, 2006, the Company filed a Form 8-K disclosing Item 2 and Item 9 thereof and including as an exhibit the press release announcing the Company's results of operations for the quarter and nine months ended March 31, 2006.

On January 17, 2006, the Company filed a Form 8-K disclosing Item 5 and Item 9 thereof and including as an exhibit the press release announcing that Arthur P. Bedrosian, Lannett Company's president, was appointed chief executive officer and director, succeeding William Farber.

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 13, 2006

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

Date: September 13, 2006

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 13, 2006

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

Date: September 13, 2006

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

Date: September 13, 2006

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

Date: September 13, 2006

By: / s / Jeffrey Farber
Jeffrey Farber,
Director

Date: September 13, 2006

By: / s / Garnet Peck
Garnet Peck,
Director

Date: September 13, 2006

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

Date: September 13, 2006

By: / s / Albert Wertheimer
Albert Wertheimer,
Director

Date: September 13, 2006

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

Exhibit 13
Annual Report on Form 10-K

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheets of Lannett Company, Inc. (a Pennsylvania corporation) and Subsidiaries as of June 30, 2006 and 2005, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended June 30, 2006. 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes 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, 2006 and 2005, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2006 in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Lannett Company, Inc. and Subsidiaries' internal control over financial reporting as of June 30, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated September 6, 2006 expressed an unqualified opinion on management's assessment of the effectiveness of internal controls over financial reporting and an unqualified opinion on the effectiveness of internal control over financial reporting.

/s/ Grant Thornton, LLP
Philadelphia, Pennsylvania
September 6, 2006

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Lannett Company, Inc. (a Pennsylvania Corporation) and Subsidiaries maintained effective internal control over financial reporting as of June 30, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Lannett Company, Inc. and Subsidiaries' management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, management's assessment that Lannett Company, Inc. and Subsidiaries maintained effective internal control over financial reporting as of June 30, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also in our opinion, Lannett Company, Inc. and Subsidiaries maintained, in all material respects, effective internal control over financial reporting as of June 30, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Lannett Company, Inc. and Subsidiaries as of June 30, 2006 and 2005, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended June 30, 2006 and our report dated September 6, 2006 expressed an unqualified opinion on those financial statements.

/s/ Grant Thornton LLP
Philadelphia, Pennsylvania
September 6, 2006

CONSOLIDATED BALANCE SHEETS

	June 30, 2006	June 30, 2005
ASSETS		
Current Assets		
Cash	$ 468,359	$ 4,165,601
Trade accounts receivable (net of allowance of $250,000 and $70,000, respectively)	24,921,671	10,735,529
Inventories	11,476,503	9,988,769
Interest receivable	193,549	-
Prepaid taxes	3,212,511	3,957,993
Deferred tax assets - current portion	3,123,953	3,123,953
Other current assets	1,753,082	1,966,270
Total Current Assets	45,149,628	33,938,115
Property, plant, and equipment	28,782,350	23,746,161
Less accumulated depreciation	(9,136,801)	(7,121,313)
	19,645,549	16,624,848
Construction in progress	1,955,508	2,079,650
Investment securities - available for sale	5,621,609	7,888,708
Note receivable	3,182,498	-
Intangible asset (product rights) - net of accumulated amortization	13,831,168	15,615,835
Deferred tax asset	16,407,893	18,610,159
Other assets	198,211	159,745
TOTAL ASSETS	$ 105,992,064	$ 94,917,060
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Current Liabilities		
Accounts payable	$ 763,744	$ 1,208,148
Accrued expenses	5,217,894	1,667,638
Unearned grant funds	500,000	500,000
Current portion of long term debt	1,130,706	2,269,776
Rebates and chargebacks payable	13,012,084	10,750,000
Total Current Liabilities	20,624,428	16,395,562
Long term debt, less current portion	7,065,986	7,262,672
Deferred tax liability	2,545,734	2,009,582
TOTAL LIABILITIES	30,236,148	25,667,816
SHAREHOLDERS' EQUITY		
Common stock - authorized 50,000,000 shares, par value $0.001; issued and outstanding, 24,141,325 and 24,111,140 shares, respectively	24,141	24,111
Additional paid in capital	71,742,402	70,157,431
Retained earnings (deficit)	4,456,387	(512,535)
Accumulated other comprehensive loss	(72,444)	(25,193)
	76,150,486	69,643,814
Less: Treasury stock at cost - 50,900 shares	394,570	394,570
TOTAL SHAREHOLDERS' EQUITY	75,755,916	69,249,244
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 105,992,064	$ 94,917,060

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

CONSOLIDATED STATEMENTS OF OPERATIONS

FISCAL YEARS ENDED JUNE 30,	**2006**	**2005**	**2004**
Net sales	$ 64,060,375	$ 44,901,645	$ 63,781,219
Cost of sales (excluding amortization of intangible asset)	33,900,045	31,416,908	26,856,875
Gross profit	30,160,330	13,484,737	36,924,344
Research and development expense	8,102,465	6,265,522	5,895,096
Selling, general, and administrative expense	11,799,994	9,194,377	8,863,966
Amortization of intangible assets	1,784,665	5,516,417	1,314,510
Loss on sale of assets	19,288	1,466	19,803
Loss on impairment/abandonment of assets	-	46,146,613	-
Operating income(loss)	8,453,918	(53,639,658)	20,830,969
OTHER INCOME(EXPENSE):			
Interest income	437,470	165,622	43,101
Interest expense	(361,291)	(351,462)	(64,300)
	76,179	(185,840)	(21,199)
Income(loss) before income tax expense(benefit)	8,530,097	(53,825,498)	20,809,770
Income tax expense(benefit)	3,561,175	(21,045,902)	7,594,316
Net income(loss)	$ 4,968,922	$ (32,779,596)	$ 13,215,454
Basic earnings(loss) per common share	$ 0.21	$ (1.36)	$ 0.63
Diluted earnings(loss) per common share	$ 0.21	$ (1.36)	$ 0.63

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

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

FISCAL YEARS ENDED JUNE 30, 2006, 2005 AND 2004

	Common Stock		Additional	Retained			
	Shares Issued	Amount	Paid-in Capital	Earnings (Deficit)	Treasury Stock	Accum. Other Comp. Loss	Shareholders' Equity
BALANCE, JUNE 30, 2003	20,025,871	$ 20,026	$ 2,526,077	$ 19,051,607	$ -	$ -	$ 21,597,710
Exercise of stock options	36,867	37	232,079	-	-	-	232,116
Shares issued in connection with employee stock purchase plan	11,972	12	161,699	-	-	-	161,711
Shares issued in connection with JSP product rights contract	4,000,000	4,000	67,036,000	-	-	-	67,040,000
Net income	-	-	-	13,215,454	-	-	13,215,454
BALANCE, JUNE 30, 2004	24,074,710	$ 24,075	$ 69,955,855	$ 32,267,061	$ -	$ -	$ 102,246,991
Exercise of stock options	19,126	19	60,892	-	-	-	60,911
Shares issued in connection with employee stock purchase plan	17,304	17	140,684	-	-	-	140,701
Other comprehensive loss	-	-	-	-	-	(25,193)	(25,193)
Cost of treasury stock	-	-	-	-	(394,570)	-	(394,570)
Net loss	-	-	-	(32,779,596)	-	-	(32,779,596)
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
Stock compensation expense	-	-	1,440,711	-	-	-	1,440,711
Other comprehensive loss	-	-	-	-	-	(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

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

FISCAL YEARS ENDED JUNE 30,

	2006	2005	2004
OPERATING ACTIVITIES:			
Net income (loss)	$ 4,968,922	$ (32,779,596)	$ 13,215,454
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	3,967,127	6,970,932	2,506,427
(Gain) Loss on disposal/impairment of assets	(5,945)	46,093,236	19,803
Deferred tax	2,786,714	(20,229,832)	(37,209)
Stock compensation expense	1,440,711	-	-
Changes in assets and liabilities which provided cash:			
Trade accounts receivable	(11,924,058)	15,370,358	(12,953,719)
Inventories	(1,487,734)	2,824,481	(4,637,452)
Prepaid taxes	161,034	(3,075,380)	(882,613)
Prepaid expenses and other current assets	(18,827)	(905,862)	(356,057)
Accounts payable	(444,404)	(4,431,906)	9,089,751
Accrued expenses	3,550,257	(1,757,219)	2,898,429
Income taxes payable	536,152	-	(63,617)
Net cash provided by operating activities	3,529,950	8,079,212	8,799,197
INVESTING ACTIVITIES:			
Purchases of property, plant and equipment	(5,114,626)	(3,213,297)	(10,749,636)
Note receivable	(3,182,498)	-	-
Purchase of intangible asset	-	(1,500,000)	-
Sales(purchases) of AFS investment securities	2,219,848	(7,913,901)	-
Net cash used in investing activities	(6,035,726)	(12,627,198)	(10,749,636)
FINANCING ACTIVITIES:			
Repayments of debt	(7,585,755)	(2,163,015)	(1,085,669)
Proceeds from grant funding	-	500,000	-
Proceeds from debt, net of restricted cash released in 2004	6,250,000	1,602,606	8,080,724
Proceeds from issuance of stock	144,290	201,612	393,827
Treasury stock transactions	-	(394,570)	-
Net cash (used in)provided by financing activities	(1,191,465)	(253,367)	7,388,882
NET (DECREASE)/INCREASE IN CASH	(3,697,242)	(4,801,353)	5,438,443
CASH, BEGINNING OF YEAR	4,165,601	8,966,954	3,528,511
CASH, END OF YEAR	$ 468,359	$ 4,165,601	$ 8,966,954
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION -			
Interest paid	$ 321,277	$ 351,462	$ 32,102
Income taxes paid	$ 50,000	$ 3,149,620	$ 8,540,546

Non-Cash Transaction: In Fiscal 2004, the Company had a non-cash transaction associated with the JSP Product Rights Contract. For the exclusive rights to all of JSP products, the Company issued 4,000,000 shares to JSP. The Company recorded an intangible asset in the amount of $67,040,000. No cash was exchanged in the transaction.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

Lannett Company, Inc. and subsidiaries (the "Company"), a Delaware corporation, 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.

Principles of Consolidation - The consolidated financial statements include the accounts of the operating parent company, Lannett Company, Inc., its wholly owned subsidiary, Lannett Holdings, Inc., and its inactive wholly owned subsidiary, Astrochem Corporation. 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 is based on historical data and sales expectations. The chargeback/rebate reserve is reviewed on a monthly basis by management using several ratio and calculated metrics. Lannett's methodology for estimating reserves has been consistent with previous periods.

Chargebacks – The provision for chargebacks is the most significant and complex estimate used in the recognition of revenue. The Company sells its products directly to wholesale distributors, generic distributors, retail pharmacy chains, and mail-order pharmacies. The Company also sells its products indirectly to independent pharmacies, managed care organizations, hospitals, nursing homes, and group purchasing organizations, collectively referred to as "indirect customers." Lannett enters into agreements with its indirect customers to establish pricing for certain products. The indirect customers then independently select a wholesaler from which to actually purchase the products at these agreed-upon prices. Lannett will provide credit to the wholesaler for the difference between the agreed-upon price

with the indirect customer and the wholesaler's invoice price if the price sold to the indirect customer is lower than the direct price to the wholesaler. This credit is called a chargeback. The provision for chargebacks is based on expected sell-through levels by the Company's wholesale customers to the indirect customers and estimated wholesaler inventory levels. As sales to the large wholesale customers, such as Cardinal Health, AmerisourceBergen, and McKesson, increase, the reserve for chargebacks will also generally increase. However, the size of the increase depends on the product mix. The Company continually monitors the reserve for chargebacks and makes adjustments when management believes that actual chargebacks may differ from estimated reserves.

Rebates – Rebates are offered to the Company's key customers to promote customer loyalty and encourage greater 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, these rebate programs are tailored to the customers' individual programs. Hence, the reserve will depend on the mix of customers that comprise such rebate programs.

Returns – Consistent with industry practice, the Company has a product returns policy that allows select customers to return product within a specified period prior to and subsequent to the product's lot expiration date in exchange for a credit to be applied to future purchases. The Company's policy requires that the customer obtain pre-approval from the Company for any qualifying return. The Company estimates its provision for returns based on historical experience, changes to business practices, and credit terms. While such experience has allowed for reasonable estimations in the past, history may not always be an accurate indicator of future returns. The Company continually monitors the provisions for returns and makes adjustments when management believes that actual product returns may differ from established reserves. Generally, the reserve for returns increases as net sales increase. The reserve for returns is included in the rebates 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, 2006 and 2005:

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)	(1,272,400)	(59,300)	(10,712,700)
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	36,221,000

Actual credits issued related to sales in fiscal 2006	(18,178,800)	(3,573,700)	(900)	(992,800)	(23,246,200)
Reserve Balance as of June 30, 2006	$ 10,137,400	$ 2,183,100	$ 416,000	$ 275,600	$13,012,100

For the Year Ended June 30, 2005

Reserve Category	**Chargebacks**	**Rebates**	**Returns**	**Other**	**Total**
Reserve balance as of June 30, 2004	$ 6,484,500	$ 1,864,200	$ 448,000	$ 88,300	$ 8,885,000
Actual credits issued related to sales recorded in prior fiscal years	(4,978,300)	(1,970,000)	(523,100)	(95,800)	(7,567,200)
Reserves or (reversals) charged during Fiscal 2005 related to sales recorded in prior fiscal years	-	130,000	(130,000)	-	-
Reserves charged to net sales in fiscal 2005 related to sales recorded in fiscal 2005	21,028,100	6,970,100	2,933,900	623,400	31,685,500
Actual credits issued related to sales in fiscal 2005	(14,534,600)	(5,965,500)	(1,036,800)	(586,400)	(22,253,300)
Reserve balance as of June 30, 2005	$ 7,999,700	$ 1,028,800	$ 1,692.000	$ 29,500	$10,750,000

For the Year Ended June 30, 2004

Reserve Category	**Chargebacks**	**Rebates**	**Returns**	**Other**	**Total**
Reserve balance as of June 30, 2003	$ 1,638,000	$ 889,900	$ 210,200	$ 33,900	$ 2,772,000
Actual credits issued related to sales recorded in prior fiscal years	(1,604,000)	(1,166,400)	(182,700)	-	(2,953,100)
Reserves or (reversals) charged during Fiscal 2004 related to sales recorded in prior fiscal years	-	300,000	-	-	300,000
Reserves charged to net sales in fiscal 2004 related to sales recorded in fiscal 2004	18,897,500	4,563,900	480,600	464,400	24,406,400
Actual credits issued related to sales in fiscal 2004	(12,447,000)	(2,723,200)	(60,100)	(410,000)	(15,640,300)
Reserve balance as of June 30, 2004	$ 6,484,500	$ 1,864,200	$ 448,000	$ 88,300	$ 8,885,000

The Company ships its products to the warehouses of its wholesale and retail chain customers. When the Company and a customer come to 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 continually 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 for excess and obsolete inventory may increase. 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.

Property, Plant and Equipment - Property, plant and equipment are stated at cost. Depreciation is provided for by the straight-line and accelerated methods over the estimated useful lives of the assets. Depreciation expense for the fiscal years ended June 30, 2006, 2005, and 2004 was approximately $2,182,000, $1,799,000, and $1,192,000, 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. If a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded and a new cost basis in the investment is established. There were no securities determined by management to be other-than-temporarily impaired for the twelve month period ended June 30, 2006.

Deferred Debt Acquisition Costs - Costs incurred in connection with obtaining financing are amortized by the straight-line method over the term of the loan agreements. Amortization expense for debt acquisition costs for the fiscal years ended June 30, 2006, 2005 and 2004 was approximately $83,000, $23,000, and $35,000, respectively.

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 expenses are charged to operations as incurred.

Intangible Assets – On March 23, 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. The agreement was included as an Exhibit in the Form 8-K filed by the Company on May 5, 2004, as subsequently amended.

In June 2004, JSP's Levothyroxine Sodium tablet product received from the FDA an AB rating to the brand drug Levoxyl®. In December 2004, the product received from the FDA a second AB rating to the brand drug Synthroid®. As a result of the dual AB ratings, the Company was required to pay JSP an additional $1.5 million in cash to reimburse JSP for expenses related to obtaining the AB ratings. As of June 30, 2005, the Company had recorded an addition to the intangible asset of $1.5 million.

During Fiscal 2005, events occurred (as described in subsequent paragraphs) which indicated that the carrying value of the intangible asset was not recoverable. In accordance with Statement of Financial Accounting Standards No. 144 (FAS 144), *Accounting for the Impairment or Disposal of Long-Lived Assets*, the Company engaged a third party valuation specialist to assist in the performance of an impairment test for the quarter ended March 31, 2005. The impairment test was performed by discounting forecasted future net cash flows for the JSP products covered under the agreement and then comparing the discounted present value of those cash flows to the carrying value of the asset (inclusive of the $1.5 million payable to JSP for the second AB rating). As a result of the testing, the Company had determined that the intangible asset was impaired as of March 31, 2005. In accordance with FAS 144, the Company recorded a non-cash impairment loss of approximately $46,093,000 to write the asset down to its fair value of approximately $16,062,000 as of the date of the impairment. This impairment loss is shown on the statement of operations as a component of operating loss. Management concluded that, as of June 30, 2006, the intangible asset is correctly stated at fair value and, therefore, no adjustment was required.

Several factors contributed to the impairment of this asset. In December 2004, the Levothyroxine Sodium tablet product received the AB rating to Synthroid®. The expected sales increase as a result of the AB rating did not occur in the third quarter of 2005. The delay in receiving the AB rating to Synthroid® caused the Company to be competitively disadvantaged with its Levothyroxine Sodium tablet product and to lose market share to competitors whose products had already received AB ratings to both major brand thyroid deficiency drugs. Additionally, the generic market for thyroid deficiency drugs turned out to be smaller than it was anticipated to be as a result of a lower brand-to-generic substitution rate. Increased competition in the generic drug market, both from existing competitors and new entrants, has resulted in significant pricing pressure on other products supplied by JSP. The combination of these factors resulted in diminished forecasted future net cash flow which, when discounted, yield a lower present value than the carrying value of the asset before impairment.

The Company will incur annual amortization expense of approximately $1,785,000 for the intangible asset over the remaining term of the contract. For the period ending June 30, 2005, the Company incurred $5,516,000 of non-cash amortization expense associated with the JSP intangible asset.

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

Fiscal Year Ending June 30,	Annual Amortization Expense
2007	$1,785,000
2008	1,785,000
2009	1,785,000
2010	1,785,000
2011	1,785,000
Thereafter	4,906,000
	$13,831,000

Advertising Costs - The Company charges advertising costs to operations as incurred. Advertising expense for the fiscal years ended June 30, 2006, 2005 and 2004 was approximately $165,000, $157,000, and $291,000, 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 on one operating segment. The following table identifies the Company's approximate net product sales by medical indication for the fiscal years ended June 30, 2006 and 2005:

Medical Indication	**For the Fiscal Year Ended June 30,**		
	2006	**2005**	**2004**
Migraine Headache	$ 11,667,330	$ 11,808,286	$ 16,516,171
Epilepsy	12,815,637	14,019,832	18,411,603
Heart Failure	7,214,182	5,608,899	9,089,493
Thyroid Deficiency	17,931,743	10,700,868	17,684,639
Other	14,431,483	2,763,760	2,079,313
Total	$ 64,060,375	$ 44,901,645	$ 63,781,219

Long-Lived Assets - In accordance with Statement of Financial Accounting Standards No. 144 (FAS 144), *Accounting for the Impairment or Disposal of Long-Lived Assets*, the Company engaged a third party valuation specialist to assist in the performance of an impairment test on the JSP product rights intangible asset for the quarter ended March 31, 2005. The impairment test was performed by discounting forecasted future net cash flows for the JSP products covered under the agreement and then comparing the discounted present value of those cash flows to the carrying value of the asset (inclusive of the $1.5 million payable to JSP for the second AB rating). As a result of the testing, the Company has determined that the intangible asset was impaired as of March 31, 2005. In accordance with FAS 144, the Company recorded a non-cash impairment loss of approximately $46,093,000 to write the asset down to its fair value of approximately $16,062,000 as of March 31, 2005. This impairment loss is shown on the statement of operations as a component of operating loss. Impairment losses recognized during the years ended June 30, 2006, 2005 and 2004 were $0, $46,093,000, and $0, respectively.

Concentration of Market and Credit Risk – Five of the Company's products, defined as generics containing the same active ingredient or combination of ingredients, accounted for approximately 28%, 20%, 11%, 10%, and 7% of net sales for the fiscal year ended June 30, 2006; and 24%, 31%, 12%, 16%, and 10%, respectively, of net sales for the fiscal year ended June 30, 2005, and 22%, 21%, 17%, 15%, and 10%for the fiscal year ended June 30, 2004.

Three of the Company's customers accounted for 17%, 15%, and 5%, respectively, of net sales for the fiscal year ended June 30, 2006; and 17%, 14%, and 9%, respectively, of net sales for the fiscal year ended June 30, 2005 and 17%, 17%, and 10%, respectively, of net sales for the fiscal year ended June 30, 2004.

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.

Stock Options - In December 2004, the Financial Accounting Standards Board (FASB) issued 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 are required to 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.

At June 30, 2006, the Company had two stock-based employee compensation plans. The Company adopted an Incentive Stock Option Plan in 2003 (the "2003" plan) that authorized 1,125,000 shares to be reserved. The options generally vest over a three-year period and expire no later than 10 years from the date of grant. Prior to July 1, 2005, the Company accounted for those plans under the recognition and measurement provisions of APB 25, and related Interpretations, as permitted by SFAS 123. No stock-based employee compensation cost was recognized in the Statement of Operations for the fiscal year ended June 30, 2005, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of the grant. Effective July 1, 2005, the Company adopted the fair value recognition provisions of SFAS 123(R), using the modified-prospective-transition method.

Accordingly, prior periods have not been restated. Under this method, we are required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding as of the beginning of the period of adoption. We measured share-based compensation cost using the Black-Scholes option pricing model. The following ranges of assumptions were used to compute share-based compensation:

Risk-free interest rate	2.92% - 4.5%
Expected volatility	55% -59.46%
Expected dividend yield	0.0%
Expected life (in years)	5.00
Forfeiture rate	3.0%
Weighted average fair value at date of grant	$2.36 - $9.54

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. We use historical information to estimate expected

life and forfeitures 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 will be forfeited during the next year. This assumption is based on our historical forfeiture rate. Periodically, management will assess whether it is necessary to adjust the forfeiture rate to reflect its 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 following table presents all share-based compensation costs recognized in our statements of income. All share based compensation expenses are included in S,G&A:

	Twelve months ended June 30,		
	2006	2005	2004
Method used to account for share-based compensation	Fair Value	Intrinsic	Intrinsic
Share-based compensation under SFAS 123(R)	$ 1,440,711	$ -	$ -
Tax benefit at effective rate	$ 317,400	$ -	$ -

The following table illustrates the pro forma effect on net income and earnings per share if we had recorded compensation expense based on the fair value method for all share-based compensation awards:

	Twelve months ended June 30,		
	2006	2005	2004
Net income (loss) - as reported	$ 4,968,922	$ (32,779,597)	$ 13,215,454
Deduct: total share-based compensation, determined under fair value based method	-	(2,616,888)	(950,658)
Add: tax benefit at effective rate	-	1,023,203	346,933
Net income (loss) – pro forma	$ 4,968,922	$ (34,373,282)	$ 12,611,729
Basic earnings (loss) per share - as reported	$ 0.21	$ (1.36)	$ 0.63
Basic earnings (loss) per share - pro forma	$ 0.21	$ (1.43)	$ 0.61
Diluted earnings (loss) per share - as reported	$ 0.21	$ (1.36)	$ 0.63
Diluted earnings (loss) per share - pro forma	$ 0.21	$ (1.43)	$ 0.60

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

	Awards	Weighted-Average Exercise Price	Aggregate Intrinsic Value	Weighted Average Contractual Life
Outstanding at July 1, 2005	857,108	$ 13.72		
Granted	108,500	$ 6.07		
Exercised	1,000	$ 4.63		
Forfeited or expired	172,605	$ -		
Outstanding at June 30, 2006	792,003	$ 10.89	$ -	7.3
Outstanding at June 30, 2006 and not yet vested	297,780	$ 9.92	$ -	7.8
Exercisable at June 30, 2006	494,223	$ 11.47	$ -	7.1

	Awards	Weighted-Average Exercise Price	Aggregate Intrinsic Value	Weighted Average Contractual Life
Outstanding at July 1, 2004	801,424	$ 12.45		
Granted	131,070	$ 7.42		
Exercised	19,126	$ 3.70		
Forfeited or expired	56,260	$ 14.02		
Outstanding at June 30, 2005	857,108	$ 13.72	$ -	8.3
Outstanding at June 30, 2005 and not yet vested	491,045	$ 14.43	$ -	8.7
Exercisable at June 30, 2005	366,063	$ 12.85	$ -	8.7

	Awards	Weighted-Average Exercise Price	Aggregate Intrinsic Value	Weighted Average Contractual Life
Outstanding at July 1, 2003	409,721	$ 7.47		
Granted	428,570	$ 16.69		
Exercised	36,867	$ 6.29		
Forfeited or expired	-	$ -		
Outstanding at June 30, 2004	801,424	$ 12.45	$ -	8.9
Outstanding at June 30, 2004 and not yet vested	622,240	$ 13.91	$ -	9.2
Exercisable at June 30, 2004	179,184	$ 7.39	$ -	8.0

As of June 30, 2006, there was approximately $1,210,000 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 1.2 years

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:

	2006		2005		2004	
	Net Income (Numerator)	Shares (Denominator)	Net Loss (Numerator)	Shares (Denominator)	Net Income (Numerator)	Shares (Denominator)
Basic earnings/(loss) per share factors	$ 5,114,984	24,130,224	$ (32,779,596)	24,097,472	$ 13,215,454	20,831,750
Effect of potentially dilutive option plans		26,665		-		222,194
Diluted (loss)/earnings per share factors	$ 5,114,984	24,156,889	$ (32,779,596)	24,097,472	$ 13,215,454	21,053,944
Basic (loss)/earnings per share	$ 0.21		$ (1.36)		$ 0.63	
Diluted (loss)/earnings per share	$ 0.21		$ (1.36)		$ 0.63	

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, 2006, 2005 and 2004 were 726,833, 857,108, and 178,500, respectively.

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 2. New Accounting Standards

In March 2005, the FASB issued FIN 47 "Accounting for Conditional Asset Retirement Obligations, an Interpretation of FASB Statement No. 143." This Interpretation clarifies that a conditional retirement obligation refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Accordingly, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. The liability should be recognized when incurred, generally upon acquisition, construction or development of the asset. FIN 47 is effective no later than the end of the fiscal years ending after December 15, 2005.

In November 2004, the FASB issued FASB Statement No. 151, "Inventory Costs — an amendment of ARB No. 43, Chapter 4" (SFAS No. 151), which is the result of its efforts to converge U.S. accounting standards for inventories with International Accounting Standards. SFAS No. 151 requires abnormal amounts of idle facility expense, freight, handling costs and wasted material or spoilage to be recognized

as current-period charges. It also requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 was effective for inventory costs incurred beginning January 1, 2006. The adoption of this standard did not have any impact on the Company in the current fiscal year.

In May 2005, the FASB issued FASB Statement No. 154, "Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3" (SFAS No. 154). Previously, APB Opinion No. 20, "Accounting Changes" and FASB Statement No. 3, "Reporting Accounting Changes in Interim Financial Statements" required the inclusion of the cumulative effect of changes in accounting principle in net income of the period of the change. SFAS No. 154 requires companies to recognize a change in accounting principle, including a change required by a new accounting pronouncement when the pronouncement does not include specific transition provisions, retrospectively to prior period financial statements. SFAS No. 154 was effective as of January 1, 2006. The adoption of this standard did not have any impact on the Company in the current fiscal year.

In September 2005, the FASB ratified Emerging Issues Task Force (EITF) Issue No. 04-13, "Accounting for Purchases and Sales of Inventory with the Same Counterparty" (EITF 04-13). EITF 04-13 provides guidance on whether two or more inventory purchase and sales transactions with the same counterparty should be viewed as a single exchange transaction within the scope of APB No. 29, "Accounting for Nonmonetary Transactions." In addition, EITF 04-13 indicates whether nonmonetary exchanges of inventory within the same line of business should be recognized at cost or fair value. EITF 04-13 will be effective as of April 1, 2006. There has been no impact on the Company's financial statements from the effective date, April 1, 2006 to date.

In April 2006, the FASB issued FASB Staff Position No. FIN 46(R)-6, "Determining the Variability to Be Considered in Applying FASB Interpretation No. 46(R)" (FSP No. 46(R)-6). This pronouncement provides guidance on how a reporting enterprise should determine the variability to be considered in applying FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities," which could impact the assessment of whether certain variable interest entities are consolidated. FSP No. 46(R)-6 will be effective for the Company on July 1, 2006. FSP No. 46(R)-6 has had no impact to the Company in the current year.

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48), to clarify the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS 109, "Accounting for Income Taxes." Effective January 1, 2007, FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company is currently evaluating the impact, if any, that FIN 48 will have on its financial statements.

Note 3. Inventories

Inventories at June 30, 2006 and 2005 consist of the following:

	2006	2005
Raw Materials	$ 5,143,714	$ 5,091,883
Work-in-process	1,438,794	1,351,112
Finished Goods	4,511,274	3,303,478
Packaging Supplies	382,721	242,296
	$ 11,476,503	$ 9,988,769

The preceding amounts are net of inventory obsolescence reserves of $1,054,498 and $5,300,000 at June 30, 2006 and 2005, respectively.

Note 4. Property, Plant and Equipment

Property, plant and equipment at June 30, 2006 and 2005 consist of the following:

	Useful Lives	2006	2005
Land	-	$ 233,414	$ 233,414
Building and improvements	10 - 39 years	10,612,954	9,339,706
Machinery and equipment	5 - 10 years	17,109,279	13,347,416
Furniture and fixtures	5 - 7 years	826,703	825,625
		$ 28,782,350	$ 23,746,161
Less accumulated depreciation		(9,136,801)	(7,121,313)
Total		$ 19,645,549	$ 16,624,848

Note 5. Bank Line of Credit

The Company has a $3,000,000 line of credit from Wachovia Bank, N.A. that bears interest at the prime interest rate less 0.25% (8.00% at June 30, 2006). The line of credit was renewed and extended to November 30, 2006. At June 30, 2006 and 2005, the Company had $0 outstanding and $3,000,000 available under the line of credit. The line of credit is collateralized by substantially all of the Company's assets. The Company currently has no plans to borrow under this line of credit.

Note 6. Long-Term Debt

Long-term debt at June 30, 2006 and 2005 consists of the following:

	June 30, 2006	June 30, 2005
PIDC Regional Center, LP III loan	$ 4,500,000	$ -
Pennsylvania Industrial Development Authority loan	1,221,780	-
Pennsylvania Department of Community & Economic Development loan	476,560	-
Tax-exempt bond loan (PAID)	955,566	1,645,720
Mortgage loan	-	2,700,000
Equipment loan	1,042,786	4,486,729
Construction loan	-	699,999
Total debt	8,196,692	9,532,448
Less current portion	1,130,706	2,269,776
Long term debt	$ 7,065,986	$ 7,262,672

On December 13, 2005, the Company refinanced $5,750,000 of its debt through the Philadelphia Industrial Development Corporation (PIDC) and the Pennsylvania Industrial Development Authority

(PIDA). With the proceeds from the refinancing, the Company paid off its Mortgage and Construction Loan, as well as a portion of the Equipment loan. These loans were with Wachovia Bank. The Company financed $4,500,000 through the Immigrant Investor Program (PIDC Regional Center, LP III). 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 remaining $1,250,000 is financed through the PIDA Loan. 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 $1,221,780 outstanding as of June 30, 2006, and $69,060 is currently due; none of the PIDC Loan is currently due.

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. As of June 30, 2006, $476,560 is outstanding, and $86,130 is currently due.

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, 2006 was 4.13%. At June 30, 2006, the Company has $955,566 outstanding on the Authority loan, of which $654,996 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, 2006, no portion of the letter of credit has been utilized.

The Equipment Loan consists of a term loan with a maturity date of five years. The Company, as part of the 2003 Loan Financing agreement with Wachovia, is required to make equal payments of principal and interest. As of June 30, 2006, the Company has outstanding $1,042,786 under the Equipment Loan, of which $320,520 is classified as currently due.

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, 2006, the interest rate for the 2003 Loan Financing (of which only the Equipment loan remains) was 6.85%.

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.

The terms of the Equipment loan require that the Company meet certain financial covenants and reporting standards, including the attainment of standard financial liquidity and net worth ratios. As of June 30, 2006, the Company has complied with such terms, and successfully met its financial covenants.

Long-term debt amounts are due as follows:

Fiscal Year Ending June 30,	Amounts Payable to Institutions
2007	$ 1,130,706
2008	824,892
2009	458,709
2010	259,397
2011	4,665,256
Thereafter	857,732
	$ 8,196,692

Note 7. Income Taxes

The provision for income taxes consists of the following for the years ended June 30,

	2006	2005	2004
Current Income Taxes			
Federal	$ 822,617	$ (815,930)	$ 6,054,428
State and Local Taxes	-	-	1,577,097
Total	822,617	(815,930)	7,631,525
Deferred Income Taxes			
Federal	2,281,537	(16,861,925)	(35,349)
State and Local Taxes	457,021	(3,368,047)	(1,860)
Total	2,738,558	(20,229,972)	(37,209)
Total	$ 3,561,175	$ (21,045,902)	$ 7,594,316

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

	2006	2005	2004
Federal income tax at statutory rate	35.0%	35.0%	35.0%
State and local income tax, net	3.5%	4.1%	4.9%
Disqualifying dispositions	0.0%	0.0%	-0.8%
Nondeductible expenses	3.0%	0.0%	0.0%
Other	0.2%	0.0%	-2.6%
Income taxes expense	41.7%	39.1%	36.5%

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. 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, 2006 and 2005, temporary differences which give rise to deferred tax assets and liabilities are as follows:

	2006	2005
Deferred tax assets:		
Accrued expenses	$ 54,765	$ 14,069
Stock Compensation Expense	319,036	-
Unearned Grant Funds	195,000	-
Reserves for Accounts Receivable and Inventory	1,406,407	3,109,884
Intangible impairment	16,777,944	17,976,270
State net operating loss	268,783	158,517
Accumulated Amortization on Intangible Asset	509,911	475,512
	19,531,846	21,734,252
Valuation allowance	-	-
Total	19,531,846	21,734,252
Deferred tax liabilities:		
Prepaid Expenses	44,029	103,479
Property, Plant and Equipment	2,501,705	1,906,103
Net Deferred Tax Asset/(Liability)	$ 16,986,112	$ 19,724,670

Note 8. 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, 2006, 58,461 shares have been issued under the ESPP. Compensation expense of $43,975, $24,829 and $50,782 has been recognized in fiscal years 2006, 2005 and 2004, respectively, relating to the ESPP.

Note 9. Employee Benefit Plan

The Company has a defined contribution 401k plan (the "Plan") covering substantially all employees. Pursuant to the Plan provisions, the Company is required to make matching contributions equal to each employee's contribution, but not to exceed 3% of the employee's compensation for the Plan year. Contributions to the Plan during the years ended June 30, 2006, 2005 and 2004 were $240,000, $246,000, and $187,000, respectively.

Note 10. Contingencies

The Company monitors its compliance with all environmental laws. Any compliance costs which may be incurred are contingent upon the results of future site monitoring and will be charged to operations when incurred. No monitoring costs were incurred during the years ended June 30, 2006, 2005 and 2004.

The Company is currently engaged in several civil actions as a co-defendant with many other manufacturers of Diethylstilbestrol ("DES"), a synthetic hormone. Prior litigation established that the Company's pro rata share of any liability is less than one-tenth of one percent. Due to the fact that prior litigation established the "market share" method of prorating liability amongst the companies that manufactured DES during the drug's commercial distribution, which ended in 1971, management has accepted this method as the most reasonably expected method of determining liability for future outcomes of claims. The Company was represented in many of these actions by the insurance company with which the Company maintained coverage (subject to limits of liability) during the time period that damages were alleged to have occurred. The insurance company denies coverage for actions alleging involvement of the Company filed after January 1, 1992. With respect to these actions, the Company paid nominal damages or stipulated to its pro rata share of any liability. The Company has either settled or is currently defending over 500 such claims. At this time, management is unable to estimate a range of loss, if any, related to these actions. Management believes that the outcome of these cases will not have a material adverse impact on the financial position or results of operations of the Company.

In addition to the matters reported herein, the Company is involved in litigation which arises in the normal course of business. In the opinion of management, the resolution of these lawsuits will not have a material adverse effect on the consolidated financial position or results of operations.

Note 11. 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 us the option to buy the facility was also signed. There are also 4 acres of undeveloped land available to the company, if future expansion requires. This new facility will hold the warehouse, and will become the future headquarters of the Company. We expect to begin occupying the building in December 2006, with full conversion of the facility to take place over another 6 to 9 months. The existing facilities will continue to operate, giving the Company the ability to broaden its manufacturing and pharmaceutical development.

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

Rental expense for the years ended June 30, 2006, 2005 and 2004 was approximately $47,000, $50,000, and $321,000, respectively.

Contractual Obligations

The following table represents annual contractual purchase obligations as of June 30, 2006:

Contractual Obligations

	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-Term Debt	$ 8,196,692	$ 1,130,706	$ 1,283,600	$ 4,924,653	$ 857,733
Operational Leases	1,983,288	331,972	783,802	799,570	67,944
Purchase Obligations	164,000,000	17,000,000	37,000,000	41,000,000	69,000,000
Interest on Obligations	1,277,000	300,000	585,000	302,000	90,000
Total	$ 175,456,980	$ 18,762,678	$ 39,652,402	$ 47,026,223	$ 70,015,677

The purchase obligations above are due to the agreement with Jerome Stevens Pharmaceuticals, Inc. If the minimum purchase requirement is not met, Jerome Stevens has the right to terminate the contract within 60 days of Lannett's failure to meet the requirement. If Jerome Stevens 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. No matter 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, Brian Kearns, Kevin Smith, Bernard Sandiford and William Schreck (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 12. Related Party Transactions

The Company had sales of approximately $1,143,000, $590,000, and $590,000 during the years ended June 30, 2006, 2005 and 2004, 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 $191,000 and $179,000 at June 30, 2006 and 2005, 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 pursuant to which it purchased for $100,000 and future royalty payments the proprietary rights to manufacture and distribute a product for which Pharmeral, Inc. owns the ANDA. This agreement is subject to Lannett Holdings, Inc.'s ability to obtain FDA approval to use the proprietary rights. In the event that such FDA approval cannot be obtained, Pharmeral, Inc. must repay the $100,000 to Lannett Holdings, Inc. Accordingly, the Company has treated this payment as a prepaid asset. Arthur Bedrosian, President of Lannett, 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 Lannett and, in its opinion; the terms were not more favorable to the related party than they would have been to a non-related party.

Note 13. 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 76% of the Company's inventory purchases in Fiscal 2006, 62% in Fiscal 2005 and 81% in Fiscal 2004. 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 million. Thereafter, the minimum quantity to be purchased 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 two 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, 2006, JSP has not exercised the nomination provision of the agreement. The agreement was included as an Exhibit in the Current Report on Form 8-K filed by the Company on May 5, 2004, as subsequently amended.

Management determined that the intangible product rights asset created by this agreement was impaired as of March 31, 2005. Refer to Note 1 – intangible assets for additional disclosure and discussion of this impairment.

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 11% of the Company's costs of purchased inventory in Fiscal 2006. The term of the agreement is three years, beginning on August 22, 2005 and continuing through August 21, 2008.

During the term of the agreement, the Company has committed to provide a rolling twelve month forecast of the estimated Product requirements to this provider. The first three months of the rolling twelve month forecast are binding and constitute a firm order.

Note 14. 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. On a quarterly basis, the Company will monitor its progress in fulfilling the requirements of the grant funding program and will determine the status of the liability. As of June 30, 2006, the Company is in the process of renegotiation the funding arrangement with the Commonwealth of Pennsylvania, and thus continues to record the grant funding as a short term liability under the caption of Unearned Grant Funds.

Note 15. 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, 2006 and June 30, 2005:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Government Agency	$ 4,586,248	$ 78	$ (92,221)	$ 4,494,105
Mortgage-Backed Securities	312,904	-	(20,916)	291,988
Asset-Backed Securities	843,197	-	(7,681)	835,516
	$ 5,742,349	$ 78	$ (120,818)	$ 5,621,609

Available for Sale Securities **6/30/05**

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Government Agency	$ 6,582,022	$ 8,970	$ (35,794)	$ 6,555,198
Mortgage-Backed Securities	363,429	-	(10,105)	353,324
Asset-Backed Securities	985,245	5,361	(10,421)	980,185
	$ 7,930,696	$ 14,331	$ (56,320)	$ 7,888,707

The amortized cost and fair value of the Company's current available-for-sale securities by contractual maturity at June, 30, 2006 and June 30, 2005 are summarized as follows:

	June 30, 2006 Available for Sale		June 30, 2005 Available for Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ -	$ -	$ -	$ -
Due after one year through five years	3,944,872	3,881,558	5,136,208	5,115,807
Due after five years through ten years	804,965	797,517	791,760	792,426
Due after ten years	992,512	942,534	2,002,728	1,980,475
	$ 5,742,349	$ 5,621,609	$ 7,930,696	$ 7,888,708

The Company uses the specific identification method to determine the cost of securities sold. For the fiscal years ended June 30, 2006 and June 30, 2005, the Company had realized losses of $25,233 and $1,466, respectively.

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

The Company adopted Emerging Issues Task Force (EITF) Issue No. 03-1, *The Meaning of Other than Temporary Impairment and Its Application to Certain Investments* as of June 30, 2004. EITF 03-1 includes certain disclosures regarding quantitative and qualitative disclosures for investment securities accounted for under Statement of Financial Accounting Standards No. 115 (FAS 115), *Accounting for Certain Investments in Debt and Equity Securities,* that are impaired at the balance sheet date, but an other-than temporary impairment has not been recognized. The disclosures under EITF 03-1 are required for financial statements for years ending after December 15, 2003 and are included in these financial statements.

The table below indicates the length of time individual securities have been in a continuous unrealized loss position as of June 30, 2006:

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	25	$ 3,212,666	$ (43,310)	$ 1,174,894	$ (48,911)	$ 4,387,560	$ (92,221)
Mortgage-Backed Securities	3	143,925	(4,670)	148,063	(16,246)	291,988	(20,916)
Asset-Backed Securities	3	217,170	(5,758)	118,346	(1,923)	335,516	(7,681)
Total temporarily impaired investment securities	31	$ 3,573,761	$ (53,738)	$ 1,441,303	$ (67,080)	$ 5,015,064	$ (120,818)

There were no securities determined by management to be other-than-temporarily impaired for the year ended June 30, 2006.

Note 16. Comprehensive 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, 2006 and 2005:

COMPREHENSIVE INCOME (LOSS)	For Fiscal Year Ended June 30, 2006	2005
Other Comprehensive Loss:		
Unrealized Holding Loss on Securities	$ (78,751)	$ (41,989)
Add: Tax savings at effective rate	31,500	16,796
Total Unrealized Loss on Securities, Net	(47,251)	(25,193)
Total Other Comprehensive Loss	(47,251)	(25,193)
Net Income (Loss)	5,114,984	(32,779,596)
Total Comprehensive Income (Loss)	$ 5,067,733	$ (32,804,789)

There were no items of other comprehensive income in Fiscal year 2004.

Note 17. Quarterly Financial Information (unaudited)

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

	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	9,569,130	9,404,156	8,063,974	6,862,785
Gross Profit	9,883,766	6,333,024	7,164,793	6,778,747
Other Operating Expenses	8,199,972	4,242,708	5,082,860	4,180,872
Operating Income	1,683,794	2,090,316	2,081,933	2,597,875
Other (Expense) Income	(25,741)	20,745	24,659	56,516
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
Fiscal 2005				
Net Sales	$ 9,368,438	$ 7,603,189	$ 12,918,522	$ 15,011,496
Cost of Goods Sold	12,443,756	4,266,839	7,085,479	7,620,834
Gross Profit	(3,075,318)	3,336,350	5,833,043	7,390,662
Other Operating Expenses	5,620,448	51,888,438	4,466,319	5,149,190
Operating Income	(8,695,766)	(48,552,088)	1,366,724	2,241,472
Other (Expense)	(40,145)	(45,194)	(54,326)	(46,175)
Income Taxes	(3,010,067)	(19,438,914)	524,921	878,156
Net (Loss) Income	(5,725,844)	(29,158,368)	787,477	1,317,141
Basic (Loss) Earnings Per Share	$ (0.24)	$ (1.21)	$ 0.03	$ 0.05
Diluted (Loss) Earnings Per Share	$ (0.24)	$ (1.21)	$ 0.03	$ 0.05
Fiscal 2004				
Net Sales	$ 17,985,581	$ 16,000,251	$ 16,573,601	$ 13,221,786
Cost of Goods Sold	8,451,582	6,947,195	6,660,845	4,797,253
Gross Profit	9,533,999	9,053,056	9,912,756	8,424,533
Other Operating Expenses	6,412,636	3,638,461	3,429,246	2,613,032
Operating Income	3,121,363	5,414,595	6,483,510	5,811,501
Other (Expense) Income	(25,119)	1,632	10,404	(8,116)
Income Taxes	336,120	2,217,829	2,661,367	2,379,000
Net Income	2,760,124	3,198,398	3,832,547	3,424,385
Basic Earnings Per Share	$ 0.12	$ 0.16	$ 0.19	$ 0.17
Diluted Earnings Per Share	$ 0.12	$ 0.16	$ 0.19	$ 0.17

Please see Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) section entitled "Intangible Assets," for more information on the impairment charge on our intangible asset taken during the third quarter of fiscal year 2005, included in the $51,888,438 of other operating expenses. Also, please see the MD&A section entitled "Returns" for more information related to returns reserve affecting $9,368,438 of Net Sales during the fourth quarter of fiscal year 2005. Please see the MD&A section entitled "Inventories" for more information related to the write-off of slow moving and short dated inventory during the fourth quarter of fiscal year 2005, resulting in Cost of Goods Sold of $12,443,756.

Net sales for the fourth quarter of Fiscal 2006 have increased as a result of change in sales mix and customer mix. The Company was able to increase sales to customers that do not require significant reserves for chargebacks and rebates, and as a result the sales increase exceeded the increase in reserves for the fourth quarter of Fiscal 2006.

Schedule II

Valuation and Qualifying Accounts
For the year ended June 30, 2006

Description	Balance at Beginning of Fiscal Year	Charged to (reduction of) Expense	Deductions	Balance at End of Fiscal Year
Allowance for Doubtful Accounts				
2006	$ 70,000	$ 180,000	$ 0	$ 250,000
2005	260,000	(186,789)	3,211	70,000
2004	$ 128,000	$ 132,000	$ 0	$ 260,000
Inventory Valuation				
2006	$ 5,300,000	$ (1,515,589)	$ 2,729,912	$ 1,054,499
2005	515,000	5,590,425	805,425	5,300,000
2004	$ 235,246	$ 700,324	$ 420,570	$ 515,000

Exhibit Index

Exhibit Number	Description	Method of Filing	Page
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 Larry Dalesandro	Incorporated by reference to Exhibit 10.9 to the Annual Report on 2004 Form 10-KSB	-

Exhibit Number	Description	Method of Filing	Page
10.9 (Note A)	Agreement between Lannett Company, Inc and Siegfried (USA), Inc.	Incorporated by reference to Exhibit 10.9 to the Annual Report on 2003 Form 10-KSB	-
10.10 (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	-
11	Computation of Earnings Per Share	Filed Herewith	68
13	Annual Report on Form 10-K	Filed Herewith	1-87
21	Subsidiaries of the Company	Filed Herewith	83
23.1	Consent of Grant Thornton	Filed Herewith	84
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed Herewith	85
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed Herewith	86
32	Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed Herewith	87

Exhibit 21
Subsidiaries of the Company

The following list identifies the subsidiaries of the Company:

Subsidiary Name	**State of Incorporation**
Astrochem Corporation	New Jersey
Lannett Holdings, Inc.	Delaware

Exhibit 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We have issued our reports dated September 6, 2006 accompanying the consolidated financial statements and management's assessment of the effectiveness of internal control over financial reporting included in the Annual Report of Lannett Company, Inc. and Subsidiaries on Form 10-K for the year ended June 30, 2006. We hereby consent to the inclusion of said reports in the Registration Statement of Lannett Company, Inc. and Subsidiaries on Form S-3 (File No. 333-115746, effective May 21, 2004) and on Form 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, and File No. 33-103236, effective February 14, 2003).

/s/ Grant Thornton LLP

Philadelphia, Pennsylvania
September 6, 2006

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 annual report on Form 10-K;
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 13, 2006

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 annual report on Form 10-K;
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 13, 2006

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, 2006 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 13, 2006 /s/ Arthur P. Bedrosian

Arthur P. Bedrosian,
President and Chief Executive Officer

Dated: September 13, 2006 /s/ Brian Kearns

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

THIS PAGE LEFT INTENTIONALLY BLANK

THIS PAGE LEFT INTENTIONALLY BLANK

Our valuable Lannett associates

Patricia Adamson
Shahbaz Ahmad
Aurea Almazan
Benito Amado
Shyroine Anthony
Jessica Banff
Sheryl Banks
Partha Basumallik
Arthur Bedrosian
Donna Bennett
Scott Bertolami
Manish Bhagat
Joshua Birch
Tyrone Bond
Amin Bowman
George Boyd
Renee Brown
Kevin Burgess
Daniel Burns
Joyce Bustard
Paul Butts
Theresa Carroll
Twanna Carroll
Luvina Carter
Sandra Caserta
Thomas Chacko
Stephen Churchill
Irma Claudio
John Cook
Ralph Cooper
Philip Cristiano
Philip Cristiano III
John Crum
Deborah Daniels
Juanita Davie
Valerie Davis
Lilia Delgado
Amy DiCicco
Loc Dinh
Frederick Dinnini
Jeffrey Dische
Derek Dobson
Dan Dominquez
Robin Dornewass
Jason Edwards
Robert Ehlinger
Steve Ellingson
John Ewald
Denise Fairman
Johnson Fernandez
Wallace Ferrell
Romeo Fider
Nina Fleysh
Robert Foley
Henry Furlong
Christine Gagne
Alla Manoj Gajjar
Alla Gampel
Tsilina Gampel
Anthony Gawronski
Mathew George
Edward Glover
Jeffrey Guadagno
Allison Haddock
Mulugetta Haile
Lionel Hampton
Jennifer Hernandez
Kevin Higgins
Lauren Hinkle
Jamie Holt
Abraham Jacob
Desiree Jefferies
Brian Kearns
Shaheen Khan
Sofia Kipnis
Christine Kirn
Jeremy Klein
Marie Klein
Michael Kobel
Laura Koch
Anthony Kozar
Hilda Krekevich
Michael Krekevich
Sabu Kuriakose
Sam Kurian
Marc Kurtzman
Duc Lam
Mark Langjahr
Beryldene Liburd
Yuh-Herng Lin
Gregory Liscio
Joseph Lock
Lorraine Locke
Sun Loesch
Christopher Lucas
Arezu Madani
Carol Maio
Beatrice Marengo
Christopher Marks
Richard Matchett
Thomas Mathew
Varghese Mattammel
Steven Mays
Patricia McBride
Lynn McBride-Lazicki
Michael McCormick
Jim McMonagle
Rita Melendez
Mary Ellen Menz
Michelle Miller
John Morales
Mayietta Morris-Moore
Asa Mosby
Daniel Moser
Denise Murphy
Herbert Murphy
John Murphy
Brian Myers
Joseph Naluparayil
Varsha Narielwala
Barbara Ney
James Nichols
David Oliver
Diana Olshansky
Henry Ortiz
Ravindra Oza
Santhosh Panicker
Sheetal Patel
Elena Pena
Zhong Peng
Michael Perreault
Thomas Peters
Michael Phares
Alan Phillips
Barbara Pierce
Subhash Poreddy
Kevin Porter
Vincent Post
Suresh Potti
Paul Pratts
Saudy Ramos
Heather Regitko
MaryBeth Reilly
Adam Reuter
James Riddick
DelRoy Roach
Scott Rodman
Ariel Royzin
John Ryman
Ernest Sabo
Carlos Sacanell
Raisa Saltisky
Bernard Sandiford
Caroline Sandlin
Thomas Santella
William Schreck
Daniel Septak
Haroun Sillah
Kerry Sivak
Kevin Smith
Linda Soroka
Francis Spires Jr.
Steven Stein
Thomas Stein
Kristie Stephens
Catherine Stoklosa
Paulette Strand
Elena Streltsova
Carmen Suarez del Villar
Jenumon Thomas
Rolland Thomas
Amy Trinidad
Anthony Trombetta
Chau Truong
Anthony Tursi
Andrew Uerkwitz
Miriam Vargas
Rony Varughese
Mark Velardo
Nelli Vorobyeva
Bradley Wagner
Kevin Walker
Michael Walker
George Wei
Ronald Wenger
Kenneth White
Joyce Williams
Brian Wilson
Matthew Wilson
Mary Wojtiw
Gerald Woolf
Valeria Yelkin
Steven Youmans
Varghese Zachariah
Ping Zhong
Isaak Zilberman
Denise Zobnowski

BOARD OF DIRECTORS

William Farber, R.Ph.
Chairman of the Board

Ronald West
Vice Chairman, Lannett Company, Inc.

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

Jeffrey Farber
President, Auburn Pharmaceutical

Garnet Peck, Ph.D.
Professor Emeritus, Purdue University
Department of Industrial and Physical Pharmacy

Kenneth Sinclair, Ph.D.
Professor and Chair of the Accounting Department,
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

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