TRIUMPH GROUP INC
Form 10-K
May 27, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K
(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended March 31, 2016
or

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

For the transition period from to

Commission File No. 1-12235
Triumph Group, Inc.
(Exact name of registrant as specified in its charter)

Delaware	51-0347963
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

899 Cassatt Road, Suite 210, Berwyn, Pennsylvania 19312
(Address of principal executive offices, including zip code)
Registrant's telephone number, including area code:(610) 251-1000

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, par value $.001 per share	New York Stock Exchange
(Title of each class)	(Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None

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Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No o
Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934. Yes o 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 o
Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o
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. x

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Securities Exchange Act of 1934. (Check one)

	Non-accelerated filer o	
Large accelerated filer x	Accelerated filer o	(Do not check if a smaller reporting company) Smaller reporting company o

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes o No x

As of September 30, 2015, the aggregate market value of the shares of Common Stock held by non-affiliates of the Registrant was approximately $2,041 million. Such aggregate market value was computed by reference to the closing price of the Common Stock as reported on the New York Stock Exchange on September 30, 2015. For purposes of making this calculation only, the Registrant has defined affiliates as including all directors and executive officers.

The number of outstanding shares of the Registrant's Common Stock, par value $.001 per share, on May 25, 2016 was 49,521,405.

Documents Incorporated by Reference

Portions of the following document are incorporated herein by reference:

The Proxy Statement of Triumph Group, Inc. to be filed in connection with our 2016 Annual Meeting of Stockholders is incorporated in part in Part III hereof, as specified herein.

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PART I

Item 1. Business

Cautionary Note Regarding Forward-Looking Statements

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 relating to our future operations and prospects, including statements that are based on current projections and expectations about the markets in which we operate, and management's beliefs concerning future performance and capital requirements based upon current available information. Actual results could differ materially from management's current expectations. Additional capital may be required and, if so, may not be available on reasonable terms, if at all, at the times and in the amounts we need. In addition to these factors and others described elsewhere in this report, other factors that could cause actual results to differ materially include competitive and cyclical factors relating to the aerospace industry, dependence of some of our businesses on key customers, requirements of capital, product liabilities in excess of insurance, uncertainties relating to the integration of acquired businesses, general economic conditions affecting our business segment, technological developments, limited availability of raw materials or skilled personnel, changes in governmental regulation and oversight, and international hostilities and terrorism. For a more detailed discussion of these and other factors affecting us, see the Risk Factors described in Item 1A of this Annual Report on Form 10-K. We do not undertake any obligation to revise these forward-looking statements to reflect future events.

General

Triumph Group, Inc. ("Triumph", the "Company", "we", "us", or "our") was incorporated in 1993 in Delaware. Our companies design, engineer, manufacture, repair, overhaul and distribute a broad portfolio of aerostructures, aircraft components, accessories, subassemblies and systems. We serve a broad, worldwide spectrum of the aviation industry, including original equipment manufacturers, or OEMs, of commercial, regional, business and military aircraft and aircraft components, as well as commercial and regional airlines and air cargo carriers.

Products and Services

We offer a variety of products and services to the aerospace industry through three operating segments: (i) Triumph Aerostructures Group, whose companies' revenues are derived from the design, manufacture, assembly and integration of metallic and composite aerostructures and structural components for the global aerospace OEM market; (ii) Triumph Aerospace Systems Group, whose companies design, engineer and manufacture a wide range of proprietary and build-to-print components, assemblies and systems also for the OEM market; and (iii) Triumph Aftermarket Services Group, whose companies serve aircraft fleets, notably commercial airlines, the U.S. military and cargo carriers, through the maintenance, repair and overhaul of aircraft components and accessories manufactured by third parties.

Our Aerostructures Group utilizes its capabilities to design, manufacture and build complete metallic and composite aerostructures and structural components. This group also includes companies performing complex manufacturing, machining and forming processes for a full range of structural components, as well as complete assemblies and subassemblies. This group services the full spectrum of aerospace customers, which include aerospace OEMs and the top-tier manufacturers who supply them and airlines, air cargo carriers, and domestic and foreign militaries.

The products that companies within this group design, manufacture, build and repair include:

Acoustic and thermal insulation systems	Engine nacelles
Aircraft wings	Flight control surfaces
Composite and metal bonding	Helicopter cabins
Composite ducts and floor panels	Precision machined parts
Comprehensive processing services	Stretch-formed leading edges and fuselage skins
Empennages	Wing spars and stringers

Our Aerospace Systems Group utilizes its capabilities to design and engineer mechanical, electromechanical, hydraulic and hydromechanical control systems, while continuing to broaden the scope of detailed parts and assemblies that we supply to the aerospace market. Customers typically return such systems to us for repairs and

overhauls and spare parts. This group services the full spectrum of aerospace customers, which include aerospace OEMs and the top-tier manufacturers who supply them and airlines, air cargo carriers, and domestic and foreign militaries.

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The products that companies within this group design, engineer, build and repair include:

Aircraft and engine mounted accessory drives	Thermal control systems and components
Cargo hooks	High lift actuation
Cockpit control levers	Hydraulic systems and components
Comprehensive processing services	Landing gear actuation systems
Control system valve bodies	Landing gear components and assemblies
Electronic engine controls	Main engine gear box assemblies
Exhaust nozzles and ducting	Main fuel pumps
Geared transmissions and drive train components	Secondary flight control systems
Fuel metering units	Vibration absorbers

Our Aftermarket Services Group performs maintenance, repair and overhaul services ("MRO") and supplies spare parts for the commercial and military aviation industry and primarily services the world's airline and air cargo carrier customers. This group also designs, engineers, manufactures, repairs and overhauls aftermarket aerospace gas turbine engine components, offers comprehensive MRO solutions, leasing packages, exchange programs and parts and services to airline, air cargo and third-party overhaul facilities. We also continue to develop Federal Aviation Administration ("FAA") approved Designated Engineering Representative ("DER") proprietary repair procedures for the components we repair and overhaul, which range from detailed components to complex subsystems. Companies in our Aftermarket Services Group repair and overhaul various components for the aviation industry including:

Air cycle machines	Blades and vanes
APUs	Cabin panes, shades, light lenses and other components
Constant speed drives	Combustors
Engine and airframe accessories	Stators
Flight control surfaces	Transition ducts
Integrated drive generators	Sidewalls
Nacelles	Light assemblies
Remote sensors	Overhead bins
Thrust reversers	Fuel bladder cells

Certain financial information about our three segments is set forth in Note 21 of "Notes to Consolidated Financial Statements."

Effective April 2016, the Company announced that it is realigning into four business units to better meet the evolving needs of its customers. The new structure better supports our go-to-market strategies and will allow us to more effectively satisfy the needs of our customers while continuing to deliver on our commitments, accelerate organic growth and drive predictable profitability. During the first quarter of fiscal 2017, our segment financial performance information will be presented in accordance with these new four business units.

The four business units are as follows:

- Integrated Systems. Provides integrated solutions including design, development and support of proprietary components, subsystems and systems, as well as production of complex assemblies using external designs. Capabilities include hydraulic, mechanical and electro-mechanical actuation, power and control; a complete suite of aerospace gearbox solutions including engine accessory gearboxes and helicopter transmissions; active and passive heat exchange technology; fuel pumps, fuel metering units and Full Authority Digital Electronic Control fuel systems; hydro-mechanical and electromechanical primary and secondary flight controls; and a broad spectrum of surface treatment options.

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- Aerospace Structures. Supplies commercial, business, regional and military manufacturers with large metallic and composite structures. Products include wings, wing boxes, fuselage panels, horizontal and vertical tails and sub-assemblies such as floor grids. Inclusive of the former Vought Aircraft Division, Aerospace Structures also has the capability to engineer detailed structural designs in metal and composites.
- Precision Components. Produces close-tolerance parts primarily to customer designs and model-based definition, including a wide range of aluminum, hard metal and composite structure capabilities. Capabilities include complex machining, gear manufacturing, sheet metal fabrication, forming, advanced composite and interior structures, joining processes such as welding, autoclave bonding and conventional mechanical fasteners and a variety of special processes including: super plastic titanium forming, aluminum and titanium chemical milling and surface treatments.
- Product Support. Provides full life cycle solutions for commercial, regional and military aircraft. Triumph's extensive product and service offerings include full post-delivery value chain services that simplify the MRO supply chain. Through its line maintenance, component MRO and postproduction supply chain activities, Triumph's Product Support group is positioned to provide integrated planeside repair solutions globally. Capabilities include fuel tank repair, metallic and composite aircraft structures, nacelles, thrust reversers, interiors, auxiliary power units and a wide variety of pneumatic, hydraulic, fuel and mechanical accessories.

Proprietary Rights

We benefit from our proprietary rights relating to designs, engineering and manufacturing processes and repair and overhaul procedures. For some products, our unique manufacturing capabilities are required by the customer's specifications or designs, thereby necessitating reliance on us for the production of such specially designed products. We view our name and mark, as well as the Vought and Embee tradenames, as significant to our business as a whole. Our products are protected by a portfolio of patents, trademarks, licenses or other forms of intellectual property that expire at various dates in the future. We continually develop and acquire new intellectual property and consider all of our intellectual property to be valuable. However, based on the broad scope of our product lines, management believes that the loss or expiration of any single intellectual property right would not have a material adverse effect on our results of operations, our financial position or our business segments. Our policy is to file applications and obtain patents for our new products as appropriate, including product modifications and improvements. While patents generally expire 20 years after the patent application filing date, new patents are issued to us on a regular basis.

In our overhaul and repair businesses, OEMs of equipment that we maintain for our customers often include language in repair manuals that relate to their equipment, asserting broad claims of proprietary rights to the contents of the manuals used in our operations. There can be no assurance that OEMs will not try to enforce such claims, including the possible use of legal proceedings. In the event of such legal proceedings, there can be no assurance that such actions against the Company will be unsuccessful. However, we believe that our use of manufacture and repair manuals is lawful.

Raw Materials and Replacement Parts

We purchase raw materials, primarily consisting of extrusions, forgings, castings, aluminum and titanium sheets and shapes and stainless steel alloys, from various vendors. We also purchase replacement parts, which are utilized in our various repair and overhaul operations. We believe that the availability of raw materials to us is adequate to support our operations.

Sales, Marketing and Engineering

While each of our operating companies maintains responsibility for selling and marketing its specific products, we have developed two marketing teams at the group level who are focused on cross-selling our broad capabilities. One team supports the Aerostructures and Aerospace Systems Groups and the other the Aftermarket Services Group. These teams are responsible for selling systems, integrated assemblies and repair and overhaul services, reaching across our operating companies, to our OEM, military, airline and air cargo customers. In certain limited cases, we use independent, commission-based representatives to serve our customers' changing needs and the current trends in some of the markets and geographic regions in which we operate.

The two group-level marketing teams operate as the front-end of the selling process, establishing or maintaining relationships, identifying opportunities to leverage our brand, and providing service for our customers. Each individual operating company is responsible for its own technical support, pricing, manufacturing and product

support. Also, within the Aerospace Systems Group, we have created a group engineering function to provide integrated solutions to meet our customer needs by designing systems that integrate the capabilities of our companies.

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A significant portion of our government and defense contracts are awarded on a competitive bidding basis. We generally do not bid or act as the primary contractor, but will typically bid and act as a subcontractor on contracts on a fixed-price basis. We generally sell to our other customers on a fixed-price, negotiated contract or purchase order basis.

Backlog

We have a number of long-term agreements with several of our customers. These agreements generally describe the terms under which the customer may issue purchase orders to buy our products and services during the term of the agreement. These terms typically include a list of the products or repair services customers may purchase, initial pricing, anticipated quantities and, to the extent known, delivery dates. In tracking and reporting our backlog, however, we only include amounts for which we have actual purchase orders with firm delivery dates or contract requirements generally within the next 24 months, which primarily relate to sales to our OEM customer base. Purchase orders issued by our aftermarket customers are usually completed within a short period of time. As a result, our backlog data relates primarily to the OEM customers. The backlog information set forth below does not include the sales that we expect to generate from long-term agreements for which we do not have actual purchase orders with firm delivery dates.

As of March 31, 2016, we had outstanding purchase orders representing an aggregate invoice price of approximately $4.15 billion, of which $2.96 billion, $1.15 billion and $37 million relate to the Aerostructures Group, the Aerospace Systems Group and the Aftermarket Services Group, respectively. As of March 31, 2015, our continuing operations had outstanding purchase orders representing an aggregate invoice price of approximately $5.03 billion, of which $3.74 billion, $1.24 billion and $42 million related to the Aerostructures Group, the Aerospace Systems Group and the Aftermarket Services Group, respectively. The sharp decline in backlog was due to the production rate reductions on key programs such as Boeing 747-8, 777 and G450/G550. Of the existing backlog of $4.15 billion, approximately $1.50 billion will not be shipped by March 31, 2017.

Dependence on Significant Customers

For the fiscal years ended March 31, 2016, 2015 and 2014, the Boeing Company ("Boeing") represented approximately 38%, 42% and 45%, respectively, of our net sales, covering virtually every Boeing plant and product. For the fiscal years ended March 31, 2016, 2015 and 2014, Gulfstream Aerospace Corporation ("Gulfstream") represented approximately 12%, 9% and 8%, respectively, of our net sales, covering several of Gulfstream's products. A significant reduction in sales to Boeing and/or Gulfstream would have a material adverse impact on our financial position, results of operations and cash flows.

United States and International Operations

Our revenues from customers in the United States for the fiscal years ended March 31, 2016, 2015 and 2014 ,were approximately $3,088 million, $3,136 million, and $3,142 million, respectively. Our revenues from customers in all other countries for the fiscal years ended March 31, 2016, 2015 and 2014, were approximately $798 million, $753 million, and $622 million, respectively.

As of March 31, 2016 and 2015, our long-lived assets located in the United States were approximately $2,746 million and $3,683 million, respectively. As of March 31, 2016 and 2015, our long-lived assets located in all other countries were approximately $347 million and $367 million, respectively.

Competition

We compete primarily with Tier 1 and Tier 2 aerostructures manufacturers, systems suppliers and component manufacturers, some of which are divisions or subsidiaries of other large companies, in the manufacture of aircraft structures, systems components, subassemblies and detail parts. OEMs are increasingly focusing on assembly and integration activities while outsourcing more manufacturing and, therefore, are less of a competitive force than in previous years.

Competition for the repair and overhaul of aviation components comes from four primary sources, some of whom possess greater financial and other resources than we have: OEMs, major commercial airlines, government support depots and other independent repair and overhaul companies. Some major commercial airlines continue to own and operate their own service centers, while others have begun to sell or outsource their repair and overhaul services to other aircraft operators or third parties. Large domestic and foreign airlines that provide repair and overhaul services

typically provide these services not only for their own aircraft but for other airlines as well. OEMs also maintain service centers which provide repair and overhaul services for the components they manufacture. Many governments maintain aircraft support depots in their military organizations that maintain and repair the aircraft they operate. Other independent service organizations also compete for the repair and overhaul business of other users of aircraft components.

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Participants in the aerospace industry compete primarily on the basis of breadth of technical capabilities, quality, turnaround time, capacity and price.

Government Regulation and Industry Oversight

The aerospace industry is highly regulated in the United States by the FAA and in other countries by similar agencies. We must be certified by the FAA and, in some cases, by individual OEMs, in order to engineer and service parts and components used in specific aircraft models. If material authorizations or approvals were revoked or suspended, our operations would be adversely affected. New and more stringent government regulations may be adopted, or industry oversight heightened, in the future and these new regulations, if enacted, or any industry oversight, if heightened, may have an adverse impact on us.

We must also satisfy the requirements of our customers, including OEMs, that are subject to FAA regulations, and provide these customers with products and repair services that comply with the government regulations applicable to aircraft components used in commercial flight operations. The FAA regulates commercial flight operations and requires that aircraft components meet its stringent standards. In addition, the FAA requires that various maintenance routines be performed on aircraft components, and we currently satisfy these maintenance standards in our repair and overhaul services. Several of our operating locations are FAA-approved repair stations.

Generally, the FAA only grants licenses for the manufacture or repair of a specific aircraft component, rather than the broader licenses that have been granted in the past. The FAA licensing process may be costly and time-consuming. In order to obtain an FAA license, an applicant must satisfy all applicable regulations of the FAA governing repair stations. These regulations require that an applicant have experienced personnel, inspection systems, suitable facilities and equipment. In addition, the applicant must demonstrate a need for the license. Because an applicant must procure manufacturing and repair manuals from third parties relating to each particular aircraft component in order to obtain a license with respect to that component, the application process may involve substantial cost.

The license approval processes for the European Aviation Safety Agency ("EASA"), which regulates this industry in the European Union, the Civil Aviation Administration of China, and other comparable foreign regulatory authorities are similarly stringent, involving potentially lengthy audits. EASA was formed in 2002 and is handling most of the responsibilities of the national aviation authorities in Europe, such as the United Kingdom Civil Aviation Authority.

Our operations are also subject to a variety of worker and community safety laws. For example, the Occupational Safety and Health Act of 1970, or OSHA, mandates general requirements for safe workplaces for all employees in the United States. In addition, OSHA provides special procedures and measures for the handling of hazardous and toxic substances. Specific safety standards have been promulgated for workplaces engaged in the treatment, disposal or storage of hazardous waste. We believe that our operations are in material compliance with OSHA's health and safety requirements.

Environmental Matters

Our business, operations and facilities are subject to numerous stringent federal, state, local and foreign environmental laws and regulation by government agencies, including the Environmental Protection Agency ("EPA"). Among other matters, these regulatory authorities impose requirements that regulate the emission, discharge, generation, management, transportation and disposal of hazardous materials, pollutants and contaminants, govern public and private response actions to hazardous or regulated substances which may be or have been released to the environment, and require us to obtain and maintain licenses and permits in connection with our operations. This extensive regulatory framework imposes significant compliance burdens and risks on us. Although management believes that our operations and our facilities are in material compliance with such laws and regulations, future changes in these laws, regulations or interpretations thereof or the nature of our operations or regulatory enforcement actions which may arise, may require us to make significant additional capital expenditures to ensure compliance in the future.

Certain of our facilities, including facilities acquired and operated by us or one of our subsidiaries have at one time or another been under active investigation for environmental contamination by federal or state agencies when acquired, and at least in some cases, continue to be under investigation or subject to remediation for potential environmental contamination. We are frequently indemnified by prior owners or operators and/or present owners of the facilities for liabilities which we incur as a result of these investigations and the environmental contamination found which pre-dates our acquisition of these facilities, subject to certain limitations. We also maintain a pollution liability policy

that provides coverage for material liabilities associated with the clean-up of on-site pollution conditions, as well as defense and indemnity for certain third-party suits (including Superfund liabilities at third-party sites), in each case, to the extent not otherwise indemnified. This policy applies to all of our manufacturing and assembly operations worldwide. Also, as we proceed with our plans to exit certain facilities as part of restructuring and related initiatives, the need for remediation for potential environmental contamination could be

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identified. If we are required to pay the expenses related to environmental liabilities because neither indemnification nor insurance coverage is available, these expenses could have a material adverse effect on us.

Employees

As of March 31, 2016, we employed 14,602 persons, of whom 3,465 were management employees, 125 were sales and marketing personnel, 782 were technical personnel, 889 were administrative personnel and 9,341 were production workers. Our segments were composed of the following employees: Aerostructures Group - 9,595 persons, Aerospace Systems Group - 3,567 persons, Aftermarket Services Group - 1,311 persons, and Corporate - 129 persons.

Several of our subsidiaries are parties to collective bargaining agreements with labor unions. Under those agreements, we currently employ approximately 1,907 full-time employees. Currently, approximately 13% of our permanent employees are represented by labor unions and approximately 51% of net sales are derived from the facilities at which at least some employees are unionized. The collective bargaining agreement with our union employees with International Association of Machinists and Aerospace Workers ("IAM") District 751 at our Spokane, Washington facility has expired. As of May 11, 2016, the workforce in Spokane of approximately 400 employees has elected to strike. While we are currently in negotiations with the workforce, we have implemented plans to continue production in Spokane with support from other locations. Of the 1,907 employees represented by unions, 591 employees are working under contracts that have expired or will expire within one year and 475 employees in our Red Oak, Texas and 386 employees in our Tulsa, Oklahoma facilities have not yet negotiated initial contracts. Our inability to negotiate an acceptable contract with any of these labor unions could result in strikes by the affected workers and increased operating costs as a result of higher wages or benefits paid to union members. If the unionized workers were to engage in a strike or other work stoppage, or other employees were to become unionized, we could experience a significant disruption of our operations and higher ongoing labor costs, which could have an adverse effect on our business and results of operations.

Research and Development Expenses

Certain information about our research and development expenses for the fiscal years ended March 31, 2016, 2015 and 2014 is available in Note 2 of "Notes to Consolidated Financial Statements."

Executive Officers

Name	Age	Position
Daniel J. Crowley	53	President and Chief Executive Officer and Director
Jeffrey L. McRae	52	Senior Vice President, Chief Financial Officer
John B. Wright, II	62	Senior Vice President, General Counsel and Secretary
Thomas A. Quigley, III	39	Vice President and Controller
Thomas Holtzhum	59	Executive Vice President, Integrated Systems
MaryLou Thomas	53	Acting Executive Vice President, Aerospace Structures
Rick Rozenjack	57	Executive Vice President, Precision Components
Michael Abram	63	Executive Vice President, Product Support
Richard Lovely	57	Senior Vice President, Human Resources

Daniel J. Crowley was appointed President and Chief Executive Officer and a director of the Company on January 4, 2016. Previously, Mr. Crowley served as President of two Raytheon Company business areas from 2010 through 2015. Prior to Raytheon, Mr. Crowley served as Chief Operating Officer of Lockheed Martin Aeronautics after holding a series of increasingly responsible assignments across its space, electronics, and aeronautics sectors.

Jeffrey L. McRae has been our Senior Vice President and Chief Financial Officer since February 2014. Mr. McRae was named President of Triumph Aerostructures – Vought Aircraft Division in October 2013, having previously served as President of Triumph Aerostructures – Vought Integrated Programs Division and Chief Financial Officer for Triumph Aerostructures – Vought Aircraft Division, a position he had assumed upon the completion of Triumph’s acquisition of Vought Aircraft Industries, Inc. in June 2010. Prior to the acquisition, Mr. McRae had served as Vought’s Vice President of Business Operations, and had been employed by the Company since 2007.

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John B. Wright, II has been a Vice President and our General Counsel and Secretary since 2004. From 2001 until he joined us, Mr. Wright was a partner with the law firm of Ballard Spahr LLP, where he practiced corporate and securities law.

Thomas A. Quigley, III has been our Vice President and Controller since November 2012, and serves as the Company's principal accounting officer. Mr. Quigley has served as the Company's SEC Reporting Manager since January 2009. From June 2002 until joining Triumph in 2009, Mr. Quigley held various roles within the audit practice of KPMG LLP, including Senior Audit Manager.

Thomas Holzthum was appointed Executive Vice President, Integrated Systems in April 2016. Prior thereto, he served as Corporate Vice President-Systems since 2013 with responsibility for eight Triumph Group companies in the Aerospace Systems segment. He joined Triumph in 1998 with the acquisition of Frisby Aerospace, where he held the position of Group Director, Hydraulics. Mr. Holzthum previously served as President of Triumph Actuation Systems-Connecticut and more recently led the successful integration of the hydraulic actuation business of GE Aviation after its acquisition.

MaryLou Thomas was appointed acting Executive Vice President, Aerospace Structures in April 2016. Prior thereto, she was Corporate Vice President - Composites, Structures and Interiors business area with operations in the United States, Mexico, Thailand and U.K. Ms. Thomas has more than thirty years of experience in the aerospace and defense industry, including service at Lockheed, Boeing and the Company.

Rick Rosenjack was appointed Executive Vice President, Precision Components in April 2016. He previously served as Corporate Vice President-Structures responsible for the Triumph Structures' group of companies, having joined Triumph in October 2014. Prior to joining the Company, Mr. Rosenjack was Chief Operating Officer of HM Dunn AeroSystems, and Vice President and General Manager of Precision Castparts Corp (PCC) after the acquisition of Heroux Devtek Aerostructures in 2012. Before that, Mr. Rosenjack spent 20 years with Textron, Inc., including five years with Bell Helicopter where he was Senior Vice President of the Commercial Helicopter Business.

Michael Abram was appointed Executive Vice President, Product Supply in April 2016. Since joining Triumph in 2003 as Vice President of Operations for Triumph Airborne Structures, Mr. Abram has served as Vice President of Triumph Aftermarket Services Group, North America and, most recently, Vice President-Aftermarket Services Group, where he was responsible for the company's maintenance, repair and overhaul (MRO) activities supporting commercial, regional, business and military aircraft worldwide. Before joining Triumph, he was Vice President of Operations for NORDAM Repair Division. Mr. Abram has extensive international business operations experience establishing start-up MRO facilities in Europe and Singapore.

Richard Lovely was appointed Senior Vice President, Human Resources in April 2016. Prior thereto, he served as Senior Vice President, Global Human Resources for Houghton International and Executive Vice President, Human Resources for Rohm and Haas.

Available Information

For more information about us, visit our website at www.triumphgroup.com. The contents of the website are not part of this Annual Report on Form 10-K. Our electronic filings with the Securities and Exchange Commission ("SEC") (including all Forms 10-K, 10-Q and 8-K, and any amendments to these reports) are available free of charge through our website immediately after we electronically file with or furnish them to the SEC. These filings may also be read and copied at the SEC's Public Reference Room which is located at 100 F Street, N.E., Washington, D.C. 20549. Information about the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers who file electronically with the SEC at www.sec.gov.

Item 1A. Risk Factors

Factors that have an adverse impact on the aerospace industry may adversely affect our results of operations and liquidity.

A substantial percentage of our gross profit and operating income derives from commercial aviation. Our operations have been focused on designing, engineering, manufacturing, repairing and overhauling a broad portfolio of aerostructures, aircraft components, accessories, subassemblies and systems. Therefore, our business is directly affected by economic factors and other trends that affect our customers in the aerospace industry, including a possible

decrease in outsourcing by OEMs and aircraft operators or projected market growth that may not materialize or be sustainable. We are also significantly dependent on sales to the commercial aerospace market, which has been cyclical in nature with significant downturns in the past. When these economic and other factors adversely affect the aerospace industry, they tend to reduce the overall customer demand for our products and services, which decreases our operating income. Economic and other factors that might affect the aerospace industry may have an adverse impact on our results of operations and liquidity. We have credit exposure to a number of

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commercial airlines, some of which have encountered financial difficulties. In addition, an increase in energy costs and the price of fuel to the airlines could result in additional pressure on the operating costs of airlines. The market for jet fuel is inherently volatile and is subject to, among other things, changes in government policy on jet fuel production, fluctuations in the global supply of crude oil and disruptions in oil production or delivery caused by hostility in oil-producing areas. Airlines are sometimes unable to pass on increases in fuel prices to customers by increasing fares due to the competitive nature of the airline industry, and this compounds the pressure on operating costs. Other events of general impact such as natural disasters, war, terrorist attacks against the industry or pandemic health crises may lead to declines in the worldwide aerospace industry that could adversely affect our business and financial condition.

In addition, demand for our maintenance, repair and overhaul services is strongly correlated with worldwide flying activity. A significant portion of the MRO activity required on commercial aircraft is mandated by government regulations that limit the total time or number of flights that may elapse between scheduled MRO events. As a result, although short-term deferrals are possible, MRO activity is ultimately required to continue to operate the aircraft in revenue-producing service. Therefore, over the intermediate and long-term, trends in the MRO market are closely related to the size and utilization level of the worldwide aircraft fleet, as reflected by the number of available seat miles, commonly referred to as ASMs, and cargo miles flown. Consequently, conditions or events which contribute to declines in worldwide ASMs and cargo miles flown, such as those mentioned above, could negatively impact our MRO business.

We may not be successful in achieving expected operating efficiencies and sustaining or improving operating expense reductions, and may experience business disruptions associated with restructuring, facility consolidations, realignment, cost reduction and other strategic initiatives.

Over the past several years we have implemented a number of restructuring, realignment and cost reduction initiatives, including facility consolidations, organizational realignments and reductions in our workforce. While we have realized some efficiencies from these actions, we may not realize the benefits of these initiatives to the extent we anticipated. Further, such benefits may be realized later than expected, and the ongoing difficulties in implementing these measures may be greater than anticipated, which could cause us to incur additional costs or result in business disruptions. In addition, if these measures are not successful or sustainable, we may be compelled to undertake additional realignment and cost reduction efforts, which could result in significant additional charges. Moreover, if our restructuring and realignment efforts prove ineffective, our ability to achieve our other strategic and business plan goals may be adversely affected.

Changes in levels of U.S. Government defense spending or overall acquisition priorities could negatively impact our financial position and results of operations. We derive a substantial portion of our revenue from the U.S. Government, primarily from defense related programs with the U.S. Department of Defense ("DoD") . Levels of U.S. defense spending in future periods are very difficult to predict and subject to significant risks. In addition, significant budgetary delays and constraints have already resulted in reduced spending levels, and additional reductions may be forthcoming. In August 2011, the Budget Control Act (the "Act") established limits on U.S. Government discretionary spending, including a reduction of defense spending by approximately $490 billion between the 2012 and 2021 U.S. Government fiscal years. The Act also provided that the defense budget would face “sequestration” cuts of up to an additional $500 billion during that same period to the extent that discretionary spending limits are exceeded. The impact of sequestration cuts has been reduced with respect to FY2016 and FY2017 following the enactment of The Bipartisan Budget Act of 2015 in November 2015. However, long-term uncertainty remains with respect to overall levels of defense spending and it is likely that U.S. Government discretionary spending levels will continue to be subject to significant pressure, including risk of future sequestration cuts.

In addition, there continues to be significant uncertainty with respect to program-level appropriations for the DoD and other government agencies (including NASA) within the overall budgetary framework described above. While the FY2016 appropriations enacted December 2015 included funding for Boeing’s major programs, such as F/A-18, CH-47 Chinook, AH-64 Apache, KC-46A Tanker and P-8 programs, uncertainty remains about how defense budgets in FY2017 and beyond will affect Boeing’s programs. We also expect that ongoing concerns regarding the U.S. national debt will continue to place downward pressure on DoD spending levels. Future budget cuts, including cuts

mandated by sequestration, or future procurement decisions associated with the authorizations and appropriations process could result in reductions, cancellations, and/or delays of existing contracts or programs. Any of these impacts could have a material effect on the results of the Company's operations, financial position and/or cash flows.

In addition, as a result of the significant ongoing uncertainty with respect to both U.S. defense spending levels and the nature of the threat environment, we expect the DoD to continue to emphasize cost-cutting and other efficiency initiatives in its

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procurement processes. If we can no longer adjust successfully to these changing acquisition priorities and/or fail to meet affordability targets set by the DoD customer, our revenues and market share would be further impacted.

Cancellations, reductions or delays in customer orders may adversely affect our results of operations.

Our overall operating results are affected by many factors, including the timing of orders from large customers and the timing of expenditures to manufacture parts and purchase inventory in anticipation of future sales of products and services. A large portion of our operating expenses are relatively fixed. Because several of our operating locations typically do not obtain long-term purchase orders or commitments from our customers, they must anticipate the future volume of orders based upon the historic purchasing patterns of customers and upon our discussions with customers as to their anticipated future requirements. These historic patterns may be disrupted by many factors, including changing economic conditions, inventory adjustments, or work stoppages or labor disruptions at our customers' locations. Cancellations, reductions or delays in orders by a customer or group of customers could have a material adverse effect on our business, financial condition and results of operations.

Our acquisition strategy exposes us to risks, including the risk that we may not be able to successfully integrate acquired businesses.

We have a consistent strategy to grow, in part, through the acquisition of additional businesses in the aerospace industry and are continuously evaluating various acquisition opportunities, including those outside the United States and those that may have a material impact on our business. Our ability to grow by acquisition is dependent upon, among other factors, the availability of suitable acquisition candidates. Growth by acquisition involves risks that could adversely affect our operating results, including difficulties in integrating the operations and personnel of acquired companies, the risk of diverting the attention of senior management from our existing operations, the potential amortization of acquired intangible assets, the potential impairment of goodwill and the potential loss of key employees of acquired companies. We may not be able to consummate acquisitions on satisfactory terms or, if any acquisitions are consummated, successfully integrate these acquired businesses.

A significant decline in business with a key customer could have a material adverse effect on us.

Boeing, or Boeing Commercial, Military and Space, represented approximately 38% of our net sales for the fiscal year ended March 31, 2016, covering virtually every Boeing plant and product. Gulfstream represented approximately 12% of our net sales for the fiscal year ended March 31, 2016, covering several Gulfstream plants and products. As a result, a significant reduction in purchases by Boeing and/or Gulfstream could have a material adverse impact on our financial position, results of operations, and cash flows. In addition, some of our other group companies rely significantly on particular customers, the loss of which could have an adverse effect on those businesses.

The profitability of certain development programs depends significantly on the assumptions surrounding satisfactory settlement of claims and assertions.

For certain of our new development programs, we regularly commence work or incorporate customer-requested changes prior to negotiating pricing terms for engineering work or the product which has been modified. We typically have the legal right to negotiate pricing for customer-directed changes. In those cases, we assert to our customers our contractual rights to obtain the additional revenue or cost reimbursement we expect to receive upon finalizing pricing terms. An expected recovery value of these assertions is incorporated into our contract profitability estimates when applying contract accounting. Our inability to recover these expected values, among other factors, could result in the recognition of a forward loss on these programs and could have a material adverse effect on our results of operations.

We incur risk associated with new programs.

New programs with new technologies typically carry risks associated with design responsibility, development of new production tools, hiring and training of qualified personnel, increased capital and funding commitments, ability to meet customer specifications, delivery schedules and unique contractual requirements, supplier performance, ability of the customer to meet its contractual obligations to us, and our ability to accurately estimate costs associated with such programs. In addition, any new aircraft program may not generate sufficient demand or may experience technological problems or significant delays in the regulatory certification or manufacturing and delivery schedule. If we were unable to perform our obligations under new programs to the customer's satisfaction or manufacture products at our estimated costs, if we were to experience unexpected fluctuations in raw material prices or supplier problems leading to cost overruns, if we were unable to successfully perform under revised design and manufacturing plans or

successfully resolve claims and assertions, or if a new program in which we had made a significant investment was terminated or experienced weak demand, delays or technological problems, our business, financial condition and results of operations could be materially adversely affected. This risk includes the potential for

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default, quality problems, or inability to meet weight requirements and could result in low margin or forward loss contracts, and the risk of having to write-off inventory if it were deemed to be unrecoverable over the life of the program. In addition, beginning new work on existing programs also carries risks associated with the transfer of technology, knowledge and tooling.

In order to perform on new programs we may be required to construct or acquire new facilities requiring additional up-front investment costs. In the case of significant program delays and/or program cancellations, we could be required to bear certain unrecoverable construction and maintenance costs and incur potential impairment charges for the new facilities. Also, we may need to expend additional resources to determine an alternate revenue generating use for the facilities. Likewise, significant delays in the construction or acquisition of a plant site could impact production schedules.

Future volatility in the financial markets may impede our ability to successfully access capital markets and ensure adequate liquidity and may adversely affect our customers and suppliers.

Future turmoil in the capital markets may impede our ability to access the capital markets when we would like, or need, to raise capital or restrict our ability to borrow money on favorable terms. Such market conditions could have an adverse impact on our flexibility to react to changing economic and business conditions and on our ability to fund our operations and capital expenditures in the future. In addition, interest rate fluctuations, financial market volatility or credit market disruptions may also negatively affect our customers' and our suppliers' ability to obtain credit to finance their businesses on acceptable terms. As a result, our customers' need for and ability to purchase our products or services may decrease, and our suppliers may increase their prices, reduce their output or change their terms of sale. If our customers' or suppliers' operating and financial performance deteriorates, or if they are unable to make scheduled payments or obtain credit, our customers may not be able to pay, or may delay payment of, accounts receivable owed to us, and our suppliers may restrict credit or impose different payment terms. Any inability of customers to pay us for our products and services or any demands by suppliers for different payment terms may adversely affect our earnings and cash flow.

Our international sales and operations are subject to applicable laws relating to trade, export controls and foreign corrupt practices, the violation of which could adversely affect our operations.

We must comply with all applicable export control laws and regulations of the United States and other countries. United States laws and regulations applicable to us include the Arms Export Control Act, the International Traffic in Arms Regulations ("ITAR"), the Export Administration Regulations ("EAR") and the trade sanctions laws and regulations administered by the United States Department of the Treasury's Office of Foreign Assets Control ("OFAC"). EAR restricts the export of dual-use products and technical data to certain countries, while ITAR restricts the export of defense products, technical data and defense services. The U.S. Government agencies responsible for administering EAR and ITAR have significant discretion in the interpretation and enforcement of these regulations. We cannot provide services to certain countries subject to United States trade sanctions unless we first obtain the necessary authorizations from OFAC. In addition, we are subject to the Foreign Corrupt Practices Act which generally bars bribes or unreasonable gifts to foreign governments or officials.

Violations of these laws or regulations could result in significant additional sanctions, including fines, more onerous compliance requirements, more extensive debarments from export privileges, loss of authorizations needed to conduct aspects of our international business and criminal penalties and may harm our ability to enter into contracts with the U.S. Government. A future violation of ITAR or the other regulations enumerated above could materially adversely affect our business, financial condition and results of operations.

Our expansion into international markets may increase credit, currency and other risks, and our current operations in international markets expose us to such risks.

As we pursue customers in Asia, South America and other less developed aerospace markets throughout the world, our inability to ensure the creditworthiness of our customers in these areas could adversely impact our overall profitability. In addition, with operations in Canada, China, France, Germany, Ireland, Mexico, Thailand and the United Kingdom, and customers throughout the world, we will be subject to the legal, political, social and regulatory requirements and economic conditions of other jurisdictions. In the future, we may also make additional international capital investments, including further acquisitions of companies outside the United States or companies having

operations outside the United States. Risks inherent to international operations include, but are not limited to, the following:

- difficulty in enforcing agreements in some legal systems outside the United States;
- imposition of additional withholding taxes or other taxes on our foreign income, tariffs or other restrictions on foreign trade and investment, including currency exchange controls;
- fluctuations in exchange rates which may affect demand for our products and services and may adversely affect our profitability in U.S. dollars;

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- inability to obtain, maintain or enforce intellectual property rights;
- changes in general economic and political conditions in the countries in which we operate;
- unexpected adverse changes in the laws or regulatory requirements outside the United States, including those with respect to environmental protection, export duties and quotas;
- failure by our employees or agents to comply with U.S. laws affecting the activities of U.S. companies abroad;
- difficulty with staffing and managing widespread operations; and
- difficulty of and costs relating to compliance with the different commercial and legal requirements of the countries in which we operate.

We may need additional financing for internal growth and acquisitions and capital expenditures and additional financing may not be available on terms acceptable to us.

A key element of our strategy has been, and continues to be, internal growth supplemented by growth through the acquisition of additional aerospace companies and product lines. In order to grow internally, we may need to make significant capital expenditures, such as investing in facilities in low-cost countries, and may need additional capital to do so. Our ability to grow is dependent upon, and may be limited by, among other things, access to markets and conditions of markets, availability under the Credit Facility and the Securitization Facility (each as defined in Note 10 of the "Notes to Consolidated Financial Statements") and by particular restrictions contained in the Credit Facility and our other financing arrangements. In that case, additional funding sources may be needed, and we may not be able to obtain the additional capital necessary to pursue our internal growth and acquisition strategy or, if we can obtain additional financing, the additional financing may not be on financial terms that are satisfactory to us.

Competitive pressures may adversely affect us.

We have numerous competitors in the aerospace industry. We compete primarily with the top-tier systems integrators and the manufacturers that supply them, some of which are divisions or subsidiaries of OEMs and other large companies that manufacture aircraft components and subassemblies. Our OEM competitors, which include Boeing, Airbus, Bell Helicopter, Bombardier, Cessna, General Electric, Gulfstream, Honeywell, Lockheed Martin, Northrop Grumman, Raytheon, Rolls Royce and Sikorsky, may choose not to outsource production of aerostructures or other components due to, among other things, their own direct labor and overhead considerations, capacity utilization at their own facilities and desire to retain critical or core skills. Consequently, traditional factors affecting competition, such as price and quality of service, may not be significant determinants when OEMs decide whether to produce a part in-house or to outsource. We also face competition from non-OEM component manufacturers, including Alenia Aeronautica, Fokker Technologies, Fuji Heavy Industries, GKN Westland Aerospace (U.K.), Kawasaki Heavy Industries, Mitsubishi Heavy Industries, Spirit AeroSystems and UTC Aerospace Systems. Competition for the repair and overhaul of aviation components comes from three primary sources: OEMs, major commercial airlines and other independent repair and overhaul companies.

We may need to expend significant capital to keep pace with technological developments in our industry.

The aerospace industry is constantly undergoing development and change and it is likely that new products, equipment and methods of repair and overhaul service will be introduced in the future. In order to keep pace with any new developments, such as additive technology, we may need to expend significant capital to purchase new equipment and machines or to train our employees in the new methods of production and service.

The construction of aircraft is heavily regulated and failure to comply with applicable laws could reduce our sales or require us to incur additional costs to achieve compliance, and we may incur significant expenses to comply with new or more stringent governmental regulation.

The aerospace industry is highly regulated in the United States by the FAA and in other countries by similar agencies. We must be certified by the FAA and, in some cases, by individual OEMs in order to engineer and service parts, components and aerostructures used in specific aircraft models. If any of our material authorizations or approvals were revoked or suspended, our operations would be adversely affected. New or more stringent governmental regulations may be adopted, or industry oversight heightened in the future, and we may incur significant expenses to comply with any new regulations or any heightened industry oversight.

We may not realize our anticipated return on capital commitments made to expand our capabilities.

We continually make significant capital expenditures to implement new processes and to increase both efficiency and capacity. Some of these projects require additional training for our employees and not all projects may be implemented as

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anticipated. If any of these projects do not achieve the anticipated increase in efficiency or capacity, our returns on these capital expenditures may be lower than expected.

Any product liability claims in excess of insurance may adversely affect our financial condition.

Our operations expose us to potential liability for personal injury or death as a result of the failure of an aircraft component that has been serviced by us or the failure of an aircraft component designed or manufactured by us. While we believe that our liability insurance is adequate to protect us from these liabilities, our insurance may not cover all liabilities. Additionally, as the number of insurance companies providing general aviation product liability insurance coverage has decreased in recent years, insurance coverage may not be available in the future at a cost acceptable to us. Any material liability not covered by insurance or for which third-party indemnification is not available could have a material adverse effect on our financial condition.

The lack of available skilled personnel may have an adverse effect on our operations.

From time to time, some of our operating locations have experienced difficulties in attracting and retaining skilled personnel to design, engineer, manufacture, repair and overhaul sophisticated aircraft components. Our ability to operate successfully could be jeopardized if we are unable to attract and retain a sufficient number of skilled personnel to conduct our business.

Our fixed-price contracts may commit us to unfavorable terms.

A significant portion of our net sales are derived from fixed-price contracts under which we have agreed to provide components or aerostructures for a price determined on the date we entered into the contract. Several factors may cause the costs we incur in fulfilling these contracts to vary substantially from our original estimates, and we bear the risk that increased or unexpected costs may reduce our profit or cause us to sustain losses on these contracts. In a fixed-price contract, we must fully absorb cost overruns, notwithstanding the difficulty of estimating all of the costs we will incur in performing these contracts. Because our ability to terminate contracts is generally limited, we may not be able to terminate our performance requirements under these contracts at all or without substantial liability and, therefore, in the event we are sustaining reduced profits or losses, we could continue to sustain these reduced profits or losses for the duration of the contract term. Our failure to anticipate technical problems, estimate delivery reductions, estimate costs accurately or control costs during performance of a fixed-price contract may reduce our profitability or cause significant losses on programs similar in nature to the forward losses incurred on the Boeing 747-8 ("747-8 program") and Bombardier Global 7000/8000 contracts.

Due to the size and long-term nature of many of our contracts, we are required by GAAP to estimate sales and expenses relating to these contracts in our financial statements, which may cause actual results to differ materially from those estimated under different assumptions or conditions.

Our financial statements are prepared in conformity with accounting principles generally accepted in the United States ("GAAP"). These principles require our management to make estimates and assumptions regarding our contracts that affect the reported amounts of revenue and expenses during the reporting period. Contract accounting requires judgment relative to assessing risks, estimating contract sales and costs, and making assumptions for schedule and technical issues. Due to the size and nature of many of our contracts, the estimation of total sales and cost at completion is complicated and subject to many variables. While we base our estimates on historical experience and on various assumptions that we believe to be reasonable under the circumstances at the time made, actual results may differ materially from those estimated.

Any exposure to environmental liabilities may adversely affect us.

Our business, operations and facilities are subject to numerous stringent federal, state, local and foreign environmental laws and regulations, and we are subject to potentially significant fines or penalties, including criminal sanctions, if we fail to comply with these requirements. In addition, we could be affected by future laws and regulations, including those imposed in response to climate change concerns and other actions commonly referred to as "green initiatives." Compliance with current and future environmental laws and regulations currently requires and is expected to continue to require significant operating and capital costs.

Pursuant to certain environmental laws, a current or previous owner or operator of a contaminated site may be held liable for the entire cost of investigation, removal or remediation of hazardous materials at such property, whether or not the owner or operator knew of, or was responsible for, the presence of any hazardous materials. Although

management believes that our operations and facilities are in material compliance with such laws and regulations, future changes in such laws, regulations or interpretations thereof or the nature of our operations or regulatory enforcement actions which may arise, may require us to make significant additional capital expenditures to ensure compliance in the future. Certain of our facilities, including facilities acquired and operated by us or one of our subsidiaries, have at one time or another been under active investigation for environmental contamination by federal or state agencies when acquired and, at least in some cases, continue to be under

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investigation or subject to remediation for potential or identified environmental contamination. Lawsuits, claims and costs involving environmental matters are likely to continue to arise in the future. Individual facilities of ours have also been subject to investigation on occasion for possible past waste disposal practices which might have contributed to contamination at or from remote third-party waste disposal sites. In some instances, we are indemnified by prior owners or operators and/or present owners of the facilities for liabilities which we incur as a result of these investigations and the environmental contamination found which pre-dates our acquisition of these facilities, subject to certain limitations, including, but not limited to specified exclusions, deductibles and limitations on the survival period of the indemnity. We also maintain a pollution liability policy that provides coverage, subject to specified limitations, for specified material liabilities associated with the clean-up of certain on-site pollution conditions, as well as defense and indemnity for certain third-party suits (including Superfund liabilities at third-party sites), in each case, to the extent not otherwise indemnified. Also, as we proceed with our plans to exit certain facilities as part of restructuring and related initiatives, the need for remediation for potential environmental contamination could be identified. However, if we are required to pay the expenses related to environmental liabilities because neither indemnification nor insurance coverage is available, these expenses could have a material adverse effect on our financial position, results of operations, and cash flows.

We could become involved in intellectual property litigation, which could have a material and adverse impact on our profitability.

We and other companies in our industry possess certain proprietary rights relating to designs, engineering, manufacturing processes and repair and overhaul procedures. In the event that we believe that a third party is infringing upon our proprietary rights, we may bring an action to enforce such rights. In addition, third parties may claim infringement by us with respect to their proprietary rights and may initiate legal proceedings against us in the future. The expense and time of bringing an action to enforce such rights or defending against infringement claims can be significant. Intellectual property litigation involves complex legal and factual questions which makes the outcome of any such proceedings subject to considerable uncertainty. Not only can such litigation divert management's attention, but it can also expose the Company to damages and potential injunctive relief which, if granted, may preclude the Company from making, using or selling particular products or technology. The expense and time associated with such litigation may have a material and adverse impact on our profitability.

We do not own certain intellectual property and tooling that is important to our business.

In our overhaul and repair businesses, OEMs of equipment that we maintain for our customers include language in repair manuals relating to their equipment asserting broad claims of proprietary rights to the contents of the manuals used in our operations. Although we believe that our use of manufacture and repair manuals is lawful, there can be no assurance that OEMs will not try to enforce such claims, including through the possible use of legal proceedings, or that any such actions will be unsuccessful.

Our business also depends on using certain intellectual property and tooling that we have rights to use pursuant to license grants under our contracts with our OEM customers. These contracts contain restrictions on our use of the intellectual property and tooling and may be terminated if we violate certain of these restrictions. Our loss of a contract with an OEM customer and the related license rights to use an OEM's intellectual property or tooling would materially adversely affect our business.

Any significant disruption from key suppliers of raw materials and key components could delay production and decrease revenue.

We are highly dependent on the availability of essential raw materials such as carbon fiber, aluminum and titanium, and purchased engineered component parts from our suppliers, many of which are available only from single customer-approved sources. Moreover, we are dependent upon the ability of our suppliers to provide raw materials and components that meet our specifications, quality standards and delivery schedules. Our suppliers' failure to provide expected raw materials or component parts could require us to identify and enter into contracts with alternate suppliers that are acceptable to both us and our customers, which could result in significant delays, expenses, increased costs and management distraction and adversely affect production schedules and contract profitability.

We have from time to time experienced limited interruptions of supply, and we may experience a significant interruption in the future. Our continued supply of raw materials and component parts are subject to a number of risks

including:

- availability of capital to our suppliers;
- the destruction of our suppliers' facilities or their distribution infrastructure;
- a work stoppage or strike by our suppliers' employees;
- the failure of our suppliers to provide raw materials or component parts of the requisite quality;

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- the failure of essential equipment at our suppliers' plants;
- the failure or shortage of supply of raw materials to our suppliers;
- contractual amendments and disputes with our suppliers; and
- geopolitical conditions in the global supply base.

In addition, some contracts with our suppliers for raw materials, component parts and other goods are short-term contracts, which are subject to termination on a relatively short-term basis. The prices of our raw materials and component parts fluctuate depending on market conditions, and substantial increases in prices could increase our operating costs, which, as a result of our fixed-price contracts, we may not be able to recoup through increases in the prices of our products.

Due to economic difficulty, we may face pressure to renegotiate agreements resulting in lower margins. Our suppliers may discontinue provision of products to us at attractive prices or at all, and we may not be able to obtain such products in the future from these or other providers on the scale and within the time periods we require. Furthermore, substitute raw materials or component parts may not meet the strict specifications and quality standards we and our customers demand, or that the U.S. Government requires. If we are not able to obtain key products on a timely basis and at an affordable cost, or we experience significant delays or interruptions of their supply, revenues from sales of products that use these supplies will decrease.

Our operations depend on our manufacturing facilities, which are subject to physical and other risks that could disrupt production.

Our manufacturing facilities or our customers' facilities could be damaged or disrupted by a natural disaster, war, or terrorist activity. We maintain property damage and business interruption insurance at the levels typical in our industry or for our customers and suppliers, however, a major catastrophe, such as an earthquake, hurricane, fire, flood, tornado or other natural disaster at any of our sites, or war or terrorist activities in any of the areas where we conduct operations could result in a prolonged interruption of our business. Any disruption resulting from these events could cause significant delays in shipments of products and the loss of sales and customers and we may not have insurance to adequately compensate us for any of these events. For leased facilities, timely renewal of leases and risk mitigation from the sale of our leased facilities is required to avoid any business interruption.

Our business could be negatively affected by cyber or other security threats or other disruptions.

Our businesses depend heavily on information technology and computerized systems to communicate and operate effectively. The Company's systems and technologies, or those of third parties on which we rely, could fail or become unreliable due to equipment failures, software viruses, cyber threats, terrorist acts, natural disasters, power failures or other causes. These threats arise in some cases as a result of our role as a defense contractor.

Cybersecurity threats are evolving and include, but are not limited to, malicious software, attempts to gain unauthorized access to our sensitive information, including that of our customers, suppliers, subcontractors, and joint venture partners, and other electronic security breaches that could lead to disruptions in mission critical systems, unauthorized release of confidential or otherwise protected information, and corruption of data.

Although we utilize various procedures and controls to monitor and mitigate these threats, there can be no assurance that these procedures and controls will be sufficient to prevent security threats from materializing. If any of these events were to materialize, the costs related to cyber or other security threats or disruptions may not be fully insured or indemnified and could have a material adverse effect on our reputation, operating results, and financial condition.

Significant consolidation by aerospace industry suppliers could adversely affect our business.

The aerospace industry continues to experience consolidation among suppliers and customers, primarily the airlines. Suppliers have consolidated and formed alliances to broaden their product and integrated system offerings and achieve critical mass. This supplier consolidation is in part attributable to aircraft manufacturers more frequently awarding long-term sole-source or preferred supplier contracts to the most capable suppliers, thus reducing the total number of suppliers. This consolidation could cause us to compete against certain competitors with greater financial resources, market penetration and purchasing power. When we purchase component parts and services from suppliers to manufacture our products, consolidation reduces price competition between our suppliers, which could diminish incentives for our suppliers to reduce prices. If this consolidation continues, our operating costs could increase and it may become more difficult for us to be successful in obtaining new customers.

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We may be subject to work stoppages at our facilities or those of our principal customers and suppliers, which could seriously impact the profitability of our business.

At March 31, 2016, we employed 14,602 people, of which 13.1% belonged to unions. Our unionized workforces and those of our customers and suppliers may experience work stoppages. For example, The collective bargaining agreement with our union employees with the IAM District 751 at our Spokane, Washington facility has expired. As of May 11, 2016, the workforce in Spokane of approximately 400 employee has elected to strike. While we are currently in negotiations with the workforce, we have implemented plans to continue production in Spokane with support from other locations. Our union employees with Local 848 at our Red Oak, Texas and Local 952 at our Tulsa, Oklahoma, facilities of the United Auto Workers ("UAW") are currently working without a contract. If we are unable to negotiate a contract with those workforces, our operations may be disrupted and we may be prevented from completing production and delivery of products from those facilities, which would negatively impact our results. Contingency plans have been developed that would allow production to continue in the event of a strike.

Many aircraft manufacturers, airlines and aerospace suppliers have unionized workforces. Strikes, work stoppages or slowdowns experienced by aircraft manufacturers, airlines or aerospace suppliers could reduce our customers' demand for our products or prevent us from completing production. In turn, this may have a material adverse effect on our financial condition, results of operations and cash flows.

Financial market conditions may adversely affect the benefit plan assets for our defined benefit plans, increase funding requirements and materially impact our statements of financial position and cash flows.

Our benefit plan assets are invested in a diversified portfolio of investments in both the equity and debt categories, as well as limited investments in other alternative investments. The current market values of all of these investments, as well as the related benefit plan liabilities are impacted by the movements and volatility in the financial markets. In accordance with the Compensation—Retirement Benefits topic of the Accounting Standards Codification ("ASC"), we have recognized the over-funded or under-funded status of a defined benefit postretirement plan as an asset or liability on our balance sheet, and will recognize changes in that funded status in the year in which the changes occur. The funded status is measured as the difference between the fair value of the plan's assets and the projected benefit obligation. A decrease in the fair value of these plan assets or a decrease in interest rates resulting from movements in the financial markets will increase the under-funded status of the plans recorded on our statement of financial position and result in additional cash funding requirements to meet the minimum required funding levels.

The U.S. Government is a significant customer of our largest customers, and we and they are subject to specific U.S. Government contracting rules and regulations.

The military aircraft manufacturers' business, and by extension, our business, is affected by the U.S. Government's continued commitment to programs under contract with our customers. The terms of defense contracts with the U.S. Government generally permit the government to terminate contracts partially or completely, either for its convenience or if we default by failing to perform under the contract. Termination for convenience provisions provide only for our recovery of unrecovered costs incurred or committed, settlement expenses and profit on the work completed prior to termination. Termination for default provisions provide for the contractor to be liable for excess costs incurred by the U.S. Government in procuring undelivered items from another source. On contracts where the price is based on cost, the U.S. Government may review our costs and performance, as well as our accounting and general business practices. Based on the results of such audits, the U.S. Government may adjust our contract-related costs and fees, including allocated indirect costs. In addition, under U.S. Government purchasing regulations, some of our costs, including most financing costs, portions of research and development costs, and certain marketing expenses may not be subject to reimbursement.

We bear the potential risk that the U.S. Government may unilaterally suspend our customers or us from new contracts pending the resolution of alleged violations of procurement laws or regulations. Sales to the U.S. Government are also subject to changes in the government's procurement policies in advance of design completion. An unexpected termination of, or suspension from, a significant government contract, a reduction in expenditures by the U.S. Government for aircraft using our products, lower margins resulting from increasingly competitive procurement policies, a reduction in the volume of contracts awarded to us, or substantial cost overruns could have a material adverse effect on our financial condition, results of operations and cash flows.

We are subject to the requirements of the National Industrial Security Program Operating Manual for facility security clearance, which is a prerequisite for our ability to perform on classified contracts for the U.S. Government.

DoD facility security clearance is required in order to be awarded and perform on classified contracts for the DoD and certain other agencies of the U.S. Government, which is a significant part of our business. We have obtained clearance at

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appropriate levels that require stringent qualifications, and we may be required to seek higher level clearances in the future. We cannot assure you that we will be able to maintain our security clearance. If for some reason our security clearance is invalidated or terminated, we may not be able to continue to perform our present classified contracts or be able to enter into new classified contracts, which could affect our ability to compete for and capture new business.

New regulations related to conflict minerals have and will continue to force us to incur additional expenses, may make our supply chain more complex, and could adversely impact our business.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 contains provisions to improve transparency and accountability concerning the supply of certain minerals and metals, known as conflict minerals, originating from the Democratic Republic of Congo (the "DRC") and adjoining countries. As a result, in August 2012, the SEC adopted annual investigation, disclosure and reporting requirements for those companies that manufacture or contract to manufacture products that contain conflict minerals that originated from the DRC and adjoining countries. We have and will continue to incur compliance costs, including costs related to determining the sources of conflict minerals used in our products and other potential changes to processes or sources of supply as a consequence of such verification activities. The implementation of these rules could adversely affect the sourcing, supply and pricing of materials used in certain of our products. As there may be only a limited number of suppliers offering "conflict free" minerals, we cannot be sure that we will be able to obtain necessary conflict-free minerals from such suppliers in sufficient quantities or at competitive prices. Also, we may face reputational challenges if we determine that certain of our products contain minerals not determined to be conflict free.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

As of March 31, 2016, our segments owned or leased the following facilities with the following square footage:

(Square feet in thousands)	Owned	Leased	Total
Aerostructures Group	5,176	5,634	10,810
Aerospace Systems Group	1,294	1,035	2,329
Aftermarket Services Group	716	628	1,344
Corporate	—	17	17
Total	7,186	7,314	14,500

At March 31, 2016, our segments occupied 7.4 million square feet of floor space at the following major locations:

- Aerostructures Group: Nashville, Tennessee; Hawthorne, California; Red Oak, Texas; Grand Prairie, Texas; Milledgeville, Georgia; Spokane, Washington; and Stuart, Florida
- Aerospace Systems Group: West Hartford, Connecticut; and Park City, Utah
- Aftermarket Services Group: Hot Springs, Arkansas

We believe that our properties are adequate to support our operations for the foreseeable future.

Item 3. Legal Proceedings

In the ordinary course of our business, we are involved in disputes, claims, lawsuits, and governmental and regulatory inquiries that we deem to be immaterial. Some may involve claims or potential claims of substantial damages, fines or penalties. While we cannot predict the outcome of any pending or future litigation or proceeding, we do not believe that any pending matter will have a material effect, individually or in the aggregate, on our financial position or results of operations, although no assurances can be given to that effect.

Item 4. Mine Safety Disclosures

Not applicable.

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PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Range of Market Price

Our common stock is traded on the New York Stock Exchange under the symbol "TGI." The following table sets forth the range of high and low prices for our common stock for the periods indicated:

	High	Low
Fiscal 2015		
1st Quarter	$72.31	$61.86
2nd Quarter	70.38	62.00
3rd Quarter	70.93	59.53
4th Quarter	67.84	51.15
Fiscal 2016		
1st Quarter	$70.68	$57.25
2nd Quarter	67.16	41.14
3rd Quarter	47.28	32.82
4th Quarter	40.36	22.94

On May 25, 2016, the reported closing price for our common stock was $37.78. As of May 25, 2016, there were approximately 102 holders of record of our common stock and we believe that our common stock was beneficially owned by approximately 30,000 persons.

Dividend Policy

During fiscal 2016 and 2015, we paid cash dividends of $0.16 per share and $0.16 per share, respectively. However, our declaration and payment of cash dividends in the future and the amount thereof will depend upon our results of operations, financial condition, cash requirements, future prospects, limitations imposed by credit agreements or indentures governing debt securities and other factors deemed relevant by our Board of Directors. No assurance can be given that cash dividends will continue to be declared and paid at historical levels or at all. Certain of our debt arrangements, including the Credit Facility, restrict our paying dividends and making distributions on our capital stock, except for the payment of stock dividends and redemptions of an employee's shares of capital stock upon termination of employment. On May 2, 2016, the Company announced that its Board of Directors declared a regular quarterly dividend of $0.04 per share on its outstanding common stock. The dividend is next payable on June 15, 2016, to stockholders of record as of May 31, 2016.

Repurchases of Stock

In December 1998, we announced a program to repurchase up to 500,000 shares of our common stock. In February 2008, the Company's Board of Directors authorized an increase in the Company's existing stock repurchase program by up to an additional 500,000 shares of its common stock. In February 2014, the Company's Board of Directors authorized an increase in the Company's existing stock repurchase program by up to an additional 5,000,000 shares of its common stock. During the fiscal year ended March 31, 2016, we did not repurchase any shares. During the fiscal years ended March 31, 2015 and 2014, we repurchased 2,923,011 and 300,000 shares, respectively, for a purchase price of $184.4 million and $19.1 million, respectively. From the inception of the program through March 31, 2013, we repurchased 499,200 shares (prior to fiscal 2012 stock split) for a purchase price of $19.2 million. Repurchases may be made from time to time in open market transactions, block purchases, privately negotiated transactions or otherwise at prevailing prices. No time limit has been set for completion of the program. As a result, as of May 27, 2016, the Company remains able to purchase an additional 2,277,789 shares.

Equity Compensation Plan Information

The information required regarding equity compensation plan information will be included in our Proxy Statement in connection with our 2016 Annual Meeting of Stockholders to be held on July 21, 2016, under the heading "Equity Compensation Plan Information" and is incorporated herein by reference.

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The following graph compares the cumulative 5-year total return provided stockholders on our common stock relative to the cumulative total returns of the Russell 1000 index and the S&P Aerospace & Defense index. An investment of $100 (with reinvestment of all dividends) is assumed to have been made in our common stock and in each of the indexes on March 31, 2011, and its relative performance is tracked through March 31, 2016.

COMPARISON OF 5-YEAR CUMULATIVE TOTAL RETURN*
Among Triumph Group, Inc., and The Russell 1000 Indexes
And The S&P Aerospace & Defense Index
* $100 invested on March 31, 2011 in stock or index, including reinvestment of dividends.

	Fiscal year ended March 31					
	3/11	3/12	3/13	3/14	3/15	3/16
Triumph Group, Inc.	100.00	142.05	178.40	147.09	136.55	72.14
Russell 1000	100.00	107.86	123.42	151.09	170.33	171.18
S&P Aerospace & Defense	100.00	104.54	121.06	173.68	198.30	200.23

The stock price performance included in this graph is not necessarily indicative of future stock price performance.

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Item 6. Selected Financial Data

The following selected financial data should be read in conjunction with the Consolidated Financial Statements and related Notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included herein.

	Fiscal Year Ended March 31,				
	2016(1)	2015(2)	2014(3)	2013(4)	2012(5)
	(in thousands, except per share data)				
Operating Data:					
Net sales	$3,886,072	$3,888,722	$3,763,254	$3,702,702	$3,407,929
Cost of sales	3,597,299	3,141,453	2,911,802	2,763,488	2,564,995
	288,773	747,269	851,452	939,214	842,934
Selling, general and administrative expense	287,349	285,773	254,715	241,349	242,553
Depreciation and amortization	177,755	158,323	164,277	129,506	119,724
Impairment of intangible assets	874,361	—	—	—	—
Restructuring	36,182	3,193	31,290	2,665	6,342
Curtailments, settlements and early retirement incentives	(1,244)	—	1,166	34,481	(40,400)
Loss (gain) on legal settlement, net	5,476	(134,693)	—	—	—
Operating (loss) income	(1,091,106)	434,673	400,004	531,213	514,715
Interest expense and other	68,041	85,379	87,771	68,156	77,138
(Loss) income from continuing operations, before income taxes	(1,159,147)	349,294	312,233	463,057	437,577
Income tax (benefit) expense	(111,187)	110,597	105,977	165,710	155,955
(Loss) income from continuing operations	(1,047,960)	238,697	206,256	297,347	281,622
Loss from discontinued operations	—	—	—	—	(765)
Net (loss) income	$(1,047,960)	$238,697	$206,256	$297,347	$280,857
Earnings per share:					
(Loss) income from continuing operations:					
Basic	$(21.29)	$4.70	$3.99	$5.99	$5.77
Diluted(6)	$(21.29)	$4.68	$3.91	$5.67	$5.43
Cash dividends declared per share	$0.16	$0.16	$0.16	$0.16	$0.14
Shares used in computing earnings per share:					
Basic	49,218	50,796	51,711	49,663	48,821
Diluted(6)	49,218	51,005	52,787	52,446	51,873

	As of March 31,				
	2016(1)	2015(2)	2014(3)	2013(4)	2012(5)
	(in thousands)				
Balance Sheet Data:					
Working capital	$606,767	$1,023,144	$1,141,741	$892,818	$741,105
Total assets	4,835,093	5,956,325	5,553,386	5,239,179	4,597,224
Long-term debt, including current portion	1,417,320	1,368,600	1,550,383	1,329,863	1,158,862
Total stockholders' equity	$934,944	$2,135,784	$2,283,911	$2,045,158	$1,793,369

(1) Includes the acquisition of Fairchild Controls Corporation (October 2015) from the date of acquisition, forward losses on the Bombardier and 747-8 programs of $561,158 and restructuring charges of $75,596 (March 2016). See Notes to the Consolidated Financial Statements.

(2) Includes the acquisitions of Spirit AeroSytems Holdings, Inc. - Gulfstream G650 and G280 Wings Programs and forward losses on the 747-8 program of $151,992 (December 2014), North American Aircraft Services, Inc.

(October 2014) and GE Aviation - Hydraulic Actuation (June 2014) from the date of each respective acquisition. See Notes to the Consolidated Financial Statements.

(3) Includes the acquisitions of Insulfab Product Line (Chase Corporation) (October 2013), General Donlee Canada, Inc. (October 2013) and Primus Composites (May 2013) from the date of each respective acquisition. Includes the divestitures of Triumph Aerospace Systems - Wichita (January 2014) and Triumph Instruments (April 2013) from the date of respective divestiture. See Note 3 and 4 to the Consolidated Financial Statements, respectively.

(4) Includes the acquisitions of Goodrich Pump & Engine Control Systems, Inc. (March 2013) and Embee, Inc. (December 2012) from the date of each respective acquisition.

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(5) Includes the acquisition of Aviation Network Services, LLC (October 2011) from the date of acquisition.

(6) Diluted earnings per share for the fiscal years ended March 31, 2015, 2014, 2013 and 2012, included 40,177, 811,083, 2,400,439 and 2,606,189 shares, respectively, related to the dilutive effects of the Company's Convertible Notes.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the Consolidated Financial Statements and notes thereto contained elsewhere herein.

OVERVIEW

We are a major supplier to the aerospace industry and have three operating segments: (i) Triumph Aerostructures Group, whose companies' revenues are derived from the design, manufacture, assembly and integration of metallic and composite aerostructures and structural components for the global aerospace original equipment manufacturers, or OEM, market; (ii) Triumph Aerospace Systems Group, whose companies design, engineer and manufacture a wide range of proprietary and build-to-print components, assemblies and systems also for the OEM market; and (iii) Triumph Aftermarket Services Group, whose companies serve aircraft fleets, notably commercial airlines, the U.S. military and cargo carriers, through the maintenance, repair and overhaul of aircraft components and accessories manufactured by third parties.

Effective October 21, 2015, the Company acquired the ownership of all of the outstanding shares of Fairchild Controls Corporation ("Fairchild"). Fairchild is a leading provider of proprietary thermal management systems, auxiliary power generation systems and related aftermarket spares and repairs. The acquired business operates as Triumph Thermal Systems-Maryland, Inc. and its results are included in Aerospace Systems Group from the date of acquisition.

Significant financial results for the fiscal year ended March 31, 2016 include:

- Net sales for fiscal 2016 decreased 0.1% to $3.89 billion, including a 9.8% decrease in organic sales.
- Operating loss for fiscal 2016 was $(1.09) billion.
- Included in operating loss for fiscal 2016 was a non-cash impairment charge of $874.4 million primarily related to goodwill and the indefinite-lived tradename in the Aerostructures reporting, forward losses to the Bombardier Global 7000/8000 and 747-8 programs of $561.2 million and restructuring and related accelerated depreciation charges of $81.0 million.
- Net loss for fiscal 2016 was $(1.05) billion and included a charge for an income tax valuation allowance of $155.8 million.
- Backlog decreased 17.4% over the prior year to $4.15 billion.

For the fiscal year ended March 31, 2016, net sales totaled $3.89 billion, a 0.1% decrease from fiscal year 2015 net sales of $3.89 billion. Net income for fiscal year 2016 decreased 539.0% to $(1.05) billion, or $(21.29) per diluted common share, versus $238.7 million, or $4.68 per diluted common share, for fiscal year 2015.

Our working capital needs are generally funded through cash flows from operations and borrowings under our credit arrangements. For the fiscal year ended March 31, 2016, we generated $83.9 million of cash flows from operating activities, used $128.0 million in investing activities and received $32.5 million in financing activities. Cash flows from operating activities in fiscal year 2015 was $467.3 million and included $112.3 million in pension contributions.

During the fiscal year ended March 31, 2016, the Company committed to a restructuring of certain its businesses as well as the consolidation of certain of its facilities ("2016 Restructuring Plan"). The Company expects to reduce its footprint by approximately 3.5 million square feet and to reduce head count by 1,200 employees. Over the next few fiscal years, the Company estimates that it will record aggregate pre-tax charges of $150.0 million to $160.0 million related to these programs, which represent employee termination benefits, contract termination costs, accelerated depreciation and facility closure and other exit costs, and will result in future cash outlays. For the fiscal year ended March 31, 2016, the Company recorded charges of $81.0 million related to this program, including accelerated depreciation of $22.4 million and severance of $16.3 million.

We are currently performing work on several new programs, which are in various stages of development. Several of the these programs are expected to enter flight testing during our fiscal 2017, including the Bombardier Global 7000/8000, and Embraer second generation E-Jet ("E2-Jets") and we expect to deliver revenue generating production units for these programs in late fiscal 2017, or early fiscal 2018. Historically, low-rate production commences during flight testing, followed by an

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increase to full-rate production, assuming that successful testing and certification are achieved. Accordingly, we anticipate that each of these programs will begin generating full-rate production level revenues between fiscal 2019 and fiscal 2021. We are still in the early development stages for the Gulfstream G500/G600 programs, as these aircraft are not expected to enter service until fiscal 2019. Transition of each of these programs from development to recurring production levels is dependent upon the success of each program at achieving flight testing and certification, as well as the ability of the OEM to generate acceptable levels of aircraft sales.

Fiscal 2016 was a challenging year for certain of our new programs. While work progressed on these development programs, we experienced difficulties in achieving estimated cost targets particularly in the areas of engineering and estimated recurring costs. As described in more detail in “Results of Operations”, we recorded a $399.8 million forward loss on our Bombardier Global 7000/8000 wing contract in the fourth quarter of 2016. The Global 7000/8000 contract provides for fixed pricing and requires us to fund certain up-front development expenses, with certain milestone payments made by Bombardier. The Global 7000/8000 program charge resulted in the impairment of previously capitalized pre-production costs due to the combination of cost recovery uncertainty, higher than anticipated non-recurring costs and increased forecasted costs on recurring production. The increases in costs were driven by several factors, including: changing technical requirements, increased spending on the design and engineering phase of the program and uncertainty regarding cost reduction and cost recovery initiatives with our customer and suppliers. Further cost increases or an inability to meet revised recurring cost forecasts on the Global 7000/8000 program may result in additional forward loss reserves in future periods, while improvements in future costs compared to current estimates may result in favorable adjustments if forward loss reserves are no longer required.

Under our contract with Embraer, we have the exclusive right to design, develop and manufacture the center fuselage section III, rear fuselage section and various tail section components (rudder and elevator) for the E2-Jets over the initial 600 ship sets. The contract provides for funding on a fixed amount of non-recurring costs, which will be paid over a specified number of production units. Higher than expected spending on the E2-Jets program has resulted in a low single digit estimated profit margin percentage, with additional potential future cost pressures as well as opportunities for improved performance. While we still estimate positive margins for this contract, risks related to additional engineering as well as the recurring cost profile remains as this program enters flight testing.

We seek additional consideration for customer work statement changes throughout the development process as a standard course of business. The ability to recover or negotiate additional consideration is not certain and varies by contract. Varying market conditions for these products may also impact future profitability.

Although none of these new programs individually are expected to have a material impact on our net revenues, they do have the potential, either individually or in the aggregate, to materially and negatively impact our consolidated results of operations if future changes in estimates result in the need for a forward loss provision. Absent any such loss provisions, we do not anticipate that any of these new programs will significantly dilute our future consolidated margins.

In January 2016, Boeing announced a rate reduction to the 747-8 program, which lowers production to one plane every two months. We have assessed the impact of the rate reduction and have recorded an additional $161.4 million forward loss during the quarter ended March 31, 2016. This announcement follows the September 2015 decision by Boeing to in-source production of the 747-8 program beginning in the second half of fiscal 2019, effectively terminating this program with us after our current contract. Additional costs associated with exiting the facilities where the 747-8 program is manufactured, such as asset impairment, supplier and lease termination charges, as well as severance and retention payments to employees and contractors have been included in the 2016 Restructuring Plan. As disclosed during fiscal 2015, we also recognized a provision for forward losses associated with our long-term contract on the 747-8 program. There is still risk similar to what we have experienced on the 747-8 program. Particularly, our ability to manage risks related to supplier performance, execution of cost reduction strategies, hiring and retaining skilled production and management personnel, quality and manufacturing execution, program schedule delays and many other risks, will determine the ultimate performance of these long-term programs.

Consistent with our policy described in our Critical Accounting Policies here within, we performed Step 1 of the goodwill impairment test on an interim basis upon the occurrence of events or substantive changes in circumstances that indicate a reporting unit's fair value may be less than its carrying value. During the third quarter of fiscal 2016, we

performed an interim assessment of the fair value of our goodwill and indefinite-lived intangible assets due to potential indicators of impairment related to the continued decline in our stock price during the third quarter.

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Our assessment focused on the Aerostructures reporting unit since it had significant changes in its economic indicators and adjusted for select changes in the risk adjusted discount rate to consider both the current return requirements of the market and the risks inherent in the reporting unit, expected long-term growth rate and cash flow projections to determine if any decline in the estimated fair value of a reporting unit could result in a goodwill impairment. We concluded that the goodwill was not impaired as of the interim impairment assessment date. However, the excess of the fair value over the carrying value was within 5% for the Company's Aerostructures reporting unit. The amount of goodwill for our Aerostructures reporting unit amounted to $1.42 billion as of the interim testing date.

During the fourth quarter of the fiscal year ended March 31, 2016, consistent with our policy described herein, we performed our annual assessment of the fair value of our goodwill for each of our three reporting units. We concluded that the goodwill of our Aerostructures reporting unit was impaired as of the annual testing date. We concluded that the goodwill had an implied fair value of $822.8 million (Level 3) compared to a carrying value of $1.42 billion. Accordingly, we recorded a non-cash impairment charge during the fourth quarter of fiscal 2016 of $597.6 million, which is presented on the accompanying Consolidated Statements of Operations as "Impairment of intangible assets". The decline in fair value is the result of continued declines in stock price and related market multiples for stock price to EBITDA of both the Company and our peer group. Going forward, we will continue to monitor the performance of this reporting unit in relation to the key assumptions in our analysis.

In the event that market multiples for stock price to EBITDA in the aerospace and defense markets decrease, or the expected EBITDA and cash flows for our reporting units decreases, an additional goodwill impairment charge may be required, which would adversely affect our operating results and financial condition. If management determines that impairment exists, the impairment will be recognized in the period in which it is identified.

During the third quarter of the fiscal year ended March 31, 2016, we performed an interim assessment of fair value on our indefinite-lived intangible assets due to potential indicators of impairment related to the continued decline in our stock price during the fiscal third quarter. We estimated the fair value of the tradenames using the relief-from-royalty method, which uses several significant assumptions, including revenue projections that consider historical and estimated future results, general economic and market conditions, as well as the impact of planned business and operational strategies. The following estimates and assumptions were also used in the relief-from-royalty method:

•Royalty rates between 2% and 4% based on market observed royalty rates and profit split analysis; and

•Discount rates between 12% and 13% based on the required rate of return for the tradename assets.

Based on our evaluation, we concluded that the Vought tradename had a fair value of $195.8 million (Level 3) compared to a carrying value of $425.0 million. Accordingly, we recorded a non-cash impairment charge during the quarter ended December 31, 2015, of $229.2 million, which is presented on the accompanying Consolidated Statements of Operations as "Impairment of intangible assets". The decline in fair value compared to carrying value of the Vought tradename is the result of declining revenues from production rate reductions and the slower than previously projected ramp in Bombardier Global 7000/8000 and the timing of associated earnings.

During the fourth quarter of the fiscal year ended March 31, 2016, we performed our annual assessment of fair value on our indefinite-lived intangible assets. We estimated the fair value of the tradenames using the relief-from-royalty method, which uses several significant assumptions, including revenue projections that consider historical and estimated future results, general economic and market conditions, as well as the impact of planned business and operational strategies. The following estimates and assumptions were also used in the relief-from-royalty method:

•Royalty rates between 2% and 4% based on market observed royalty rates and profit split analysis; and

•Discount rate of 14% based on the required rate of return for the tradename assets, which increased from our interim assessment driven by increased risk due to continued declines in stock price and related market multiples for stock price to EBITDA of both the Company and our peer group and increased interest rates.

Based on our evaluation of indefinite-lived assets, including the tradenames, we concluded that the Vought and Embee tradenames had a fair value of $163.0 million (Level 3) compared to a carrying value of $209.2 million. The decline in fair value compared to carrying value of the tradenames is the result of the increase in discount rate during the fourth quarter, which required the Company to assess whether events and/or circumstances have changed regarding the indefinite-life conclusion. Accordingly, we revalued both the tradenames as if these intangible assets were no longer indefinite and recorded a non-cash impairment charge during the fiscal year ended March 31, 2016, of

$46.2 million, which is presented on the accompanying Consolidated Statements of Operations as "Impairment of intangible assets". Additionally, we determined that the tradenames will be amortized over their remaining estimated useful life of 20 years.

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In the event of significant loss of revenues and related earnings associated with the Vought and Embee tradenames, further impairment charges may be required, which would adversely affect our operating results.

The collective bargaining agreement with our union employees with IAM District 751 at our Spokane, Washington facility has expired. As of May 11, 2016, the workforce in Spokane of approximately 400 employees has elected to strike. While we are currently in negotiations with the workforce, we have implemented plans to continue production in Spokane with support from other locations. Our union employees with UAW Local 848 at our Red Oak, Texas facility and UAW Local 952 at our Tulsa, Oklahoma facility are currently working without a contract. If we are unable to negotiate a contract with each of those workforces, our operations may be disrupted and we may be prevented from completing production and delivery of products from those facilities, which would negatively impact our results. Contingency plans have been developed that would allow production to continue in the event of an additional strike.

Effective December 30, 2014, a wholly-owned subsidiary of the Company, Triumph Aerostructures-Tulsa LLC, doing business as Triumph Aerostructures-Vought Aircraft Division-Tulsa, completed the acquisition of the Gulfstream G650 and G280 wing programs (the "Tulsa Programs") located in Tulsa, Oklahoma, from Spirit AeroSystems, Inc. The acquisition of the Tulsa Programs establishes the Company as a leader in fully integrated wing design, engineering and production and advances its standing as a strategic Tier One Capable aerostructures supplier. The acquired business operates as Triumph Aerostructures-Vought Aircraft Division-Tulsa and its results are included in the Aerostructures Group from the date of acquisition.

Effective October 17, 2014, the Company acquired the ownership of all of the outstanding shares of North American Aircraft Services, Inc. and its affiliates ("NAAS"). NAAS is based in San Antonio, Texas, with fixed-based operator units throughout the United States as well as international locations and delivers line maintenance and repair, fuel leak detection and fuel bladder cell repair services. The acquired business operates as Triumph Aviation Services-NAAS Division and its results are included in Aftermarket Services Group from the date of acquisition.

Effective June 27, 2014, the Company acquired the hydraulic actuation business of GE Aviation ("GE"). GE's hydraulic actuation business consists of three facilities located in Yakima, Washington, Cheltenham, England and the Isle of Man and is a technology leader in actuation systems. GE's key product offerings include complete landing gear actuation systems, door actuation, nose-wheel steerings, hydraulic fuses, manifolds flight control actuation and locking mechanisms for the commercial, military and business jet markets. The acquired business operates as Triumph Actuation Systems-Yakima and Triumph Actuation Systems-UK & IOM and its results are included in Aerospace Systems Group from the date of acquisition.

RESULTS OF OPERATIONS

The following includes a discussion of our consolidated and business segment results of operations. The Company's diverse structure and customer base do not provide for precise comparisons of the impact of price and volume changes to our results. However, we have disclosed the significant variances between the respective periods.

Non-GAAP Financial Measures

We prepare and publicly release quarterly unaudited financial statements prepared in accordance with GAAP. In accordance with Securities and Exchange Commission (the "SEC") guidance on Compliance and Disclosure Interpretations, we also disclose and discuss certain non-GAAP financial measures in our public releases. Currently, the non-GAAP financial measure that we disclose is Adjusted EBITDA, which is our (loss) income from continuing operations before interest, income taxes, amortization of acquired contract liabilities, curtailments, settlements and early retirement incentives and depreciation and amortization. We disclose Adjusted EBITDA on a consolidated and a reportable segment basis in our earnings releases, investor conference calls and filings with the SEC. The non-GAAP financial measures that we use may not be comparable to similarly titled measures reported by other companies. Also, in the future, we may disclose different non-GAAP financial measures in order to help our investors more meaningfully evaluate and compare our future results of operations to our previously reported results of operations.

We view Adjusted EBITDA as an operating performance measure and, as such, we believe that the GAAP financial measure most directly comparable to it is income from continuing operations. In calculating Adjusted EBITDA, we exclude from (loss) income from continuing operations the financial items that we believe should be separately

identified to provide additional analysis of the financial components of the day-to-day operation of our business. We have outlined below the type and scope of these exclusions and the material limitations on the use of these non-GAAP financial measures as a result of these exclusions. Adjusted EBITDA is not a measurement of financial performance under GAAP and should not be considered as a measure of liquidity, as an alternative to net (loss) income, (loss) income from continuing operations, or as an indicator of any other measure of performance derived in accordance with GAAP. Investors and potential investors in our securities should not rely on Adjusted EBITDA as a substitute for any GAAP financial measure, including net (loss) income or (loss) income from

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continuing operations. In addition, we urge investors and potential investors in our securities to carefully review the reconciliation of Adjusted EBITDA to (loss) income from continuing operations set forth below, in our earnings releases and in other filings with the SEC and to carefully review the GAAP financial information included as part of our Quarterly Reports on Form 10-Q and our Annual Reports on Form 10-K that are filed with the SEC, as well as our quarterly earnings releases, and compare the GAAP financial information with our Adjusted EBITDA.

Adjusted EBITDA is used by management to internally measure our operating and management performance and by investors as a supplemental financial measure to evaluate the performance of our business that, when viewed with our GAAP results and the accompanying reconciliation, we believe provides additional information that is useful to gain an understanding of the factors and trends affecting our business. We have spent more than 20 years expanding our product and service capabilities partially through acquisitions of complementary businesses. Due to the expansion of our operations, which included acquisitions, our (loss) income from continuing operations has included significant charges for depreciation and amortization. Adjusted EBITDA excludes these charges and provides meaningful information about the operating performance of our business, apart from charges for depreciation and amortization.

We believe the disclosure of Adjusted EBITDA helps investors meaningfully evaluate and compare our performance from quarter to quarter and from year to year. We also believe Adjusted EBITDA is a measure of our ongoing operating performance because the isolation of non-cash charges, such as depreciation and amortization, and non-operating items, such as interest and income taxes, provides additional information about our cost structure, and, over time, helps track our operating progress. In addition, investors, securities analysts and others have regularly relied on Adjusted EBITDA to provide a financial measure by which to compare our operating performance against that of other companies in our industry.

Set forth below are descriptions of the financial items that have been excluded from our (loss) income from continuing operations to calculate Adjusted EBITDA and the material limitations associated with using this non-GAAP financial measure as compared to (loss) income from continuing operations:

- Legal settlements may be useful for investors to consider because it reflects gains or losses from disputes with third parties. We do not believe these earnings necessarily reflect the current and ongoing cash earnings related to our operations.
- Curtailments, settlements and early retirement incentives may be useful for investors to consider because it represents the current period impact of the change in the defined benefit obligation due to the reduction in future service costs as well as the incremental cost of retirement incentive benefits paid to participants. We do not believe these earnings necessarily reflect the current and ongoing cash earnings related to our operations.
- Amortization of acquired contract liabilities may be useful for investors to consider because it represents the non-cash earnings on the fair value of off-market contracts acquired through acquisitions. We do not believe these earnings necessarily reflect the current and ongoing cash earnings related to our operations.
- Amortization expense (including intangible asset impairments) may be useful for investors to consider because it represents the estimated attrition of our acquired customer base and the diminishing value of product rights and licenses. We do not believe these charges necessarily reflect the current and ongoing cash charges related to our operating cost structure.
- Depreciation may be useful for investors to consider because it generally represents the wear and tear on our property and equipment used in our operations. We do not believe these charges necessarily reflect the current and ongoing cash charges related to our operating cost structure.
- The amount of interest expense and other we incur may be useful for investors to consider and may result in current cash inflows or outflows. However, we do not consider the amount of interest expense and other to be a representative component of the day-to-day operating performance of our business.
- Income tax expense may be useful for investors to consider because it generally represents the taxes which may be payable for the period and the change in deferred income taxes during the period and may reduce the amount of funds otherwise available for use in our business. However, we do not consider the amount of income tax expense to be a representative component of the day-to-day operating performance of our business.

Management compensates for the above-described limitations of using non-GAAP measures by using a non-GAAP measure only to supplement our GAAP results and to provide additional information that is useful to gain an

understanding of the factors and trends affecting our business.

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The following table shows our Adjusted EBITDA reconciled to our (loss) income from continuing operations for the indicated periods (in thousands):

	Fiscal year ended March 31,		
	2016	2015	2014
(Loss) income from continuing operations	$(1,047,960)	$238,697	$206,256
Legal settlement charge (gain), net of expenses	5,476	(134,693)	—
Amortization of acquired contract liabilities	(132,363)	(75,733)	(42,629)
Depreciation and amortization *	1,052,116	158,323	164,277
Curtailments, settlements and early retirement incentives	(1,244)	—	1,166
Interest expense and other	68,041	85,379	87,771
Income tax (benefit) expense	(111,187)	110,597	105,977
Adjusted EBITDA	$(167,121)	$382,570	$522,818

* - Includes Impairment charges related to intangible assets

The following tables show our Adjusted EBITDA by reportable segment reconciled to our operating (loss) income for the indicated periods (in thousands):

	Fiscal year ended March 31, 2016				
	Total	Aerostructures	Aerospace Systems	Aftermarket Services	Corporate/ Eliminations
Operating (loss) income	$(1,091,106)	$(1,274,777)	$216,520	$ 24,977	$ (57,826)
Legal settlement charge, net	5,476	12,070	(8,494)	1,900	—
Curtailments, settlements and early retirement incentives	(1,244)	—	—	—	(1,244)
Amortization of acquired contract liabilities	(132,363)	(90,778)	(41,585)	—	—
Depreciation and amortization *	1,052,116	988,947	50,518	11,009	1,642
Adjusted EBITDA	$(167,121)	$(364,538)	$216,959	$ 37,886	$ (57,428)

* - Includes Impairment impairment charges related to intangible assets.

	Fiscal year ended March 31, 2015				
	Total	Aerostructures	Aerospace Systems	Aftermarket Services	Corporate/ Eliminations
Operating income	$434,673	$ 120,985	$184,042	$ 47,931	$ 81,715
Legal settlement (gain), net	(134,693)	—	—	—	(134,693)
Amortization of acquired contract liabilities	(75,733)	(38,719)	(37,014)	—	—
Depreciation and amortization	158,323	102,296	45,200	8,559	2,268
Adjusted EBITDA	$382,570	$ 184,562	$192,228	$ 56,490	$ (50,710)

	Fiscal year ended March 31, 2014				
	Total	Aerostructures	Aerospace Systems	Aftermarket Services	Corporate/ Eliminations
Operating income	$400,004	$ 248,637	$149,721	$ 42,265	$ (40,619)
Curtailments, settlements and early retirement incentives	1,166	—	—	—	1,166
Amortization of acquired contract liabilities	(42,629)	(25,207)	(17,422)	—	—
Depreciation and amortization	164,277	116,514	37,453	7,529	2,781
Adjusted EBITDA	$522,818	$ 339,944	$169,752	$ 49,794	$ (36,672)

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The fluctuations from period to period within the amounts of the components of the reconciliations above are discussed further below within Results of Operations.

Fiscal year ended March 31, 2016 compared to fiscal year ended March 31, 2015

	Year Ended March 31,	
	2016	2015
	(in thousands)	
Net sales	$3,886,072	$3,888,722
Segment operating (loss) income	$(1,033,280)	$352,958
Corporate (expense) income	(57,826)	81,715
Total operating (loss) income	(1,091,106)	434,673
Interest expense and other	68,041	85,379
Income tax (benefit) expense	(111,187)	110,597
Net (loss) income	$(1,047,960)	$238,697

Net sales decreased by $2.7 million, or (0.1)%, to $3.9 billion for the fiscal year ended March 31, 2016, from $3.9 billion for the fiscal year ended March 31, 2015. The acquisition of Fairchild and the fiscal 2015 acquisitions contributed $355.3 million. Organic sales decreased $352.7 million, or (9.8)%, due to production rate cuts by our customers on the 747-8, V-22, G450/G550 and C-17 programs. The prior fiscal year was negatively impacted by our customers' decreased production rates on existing programs and decreased military sales.

In the fourth quarter of fiscal 2016, we recorded a $399.8 million forward loss charge for the Bombardier Global 7000/8000 wing program. Under our contract for this program, we have the right to design, develop and manufacture wing components over the initial 300 ship sets. The Global 7000/8000 contract provides for fixed pricing and requires us to fund certain up-front development expenses, with certain milestone payments made by Bombardier. The Global 7000/8000 program charge resulted in the impairment of previously capitalized pre-production costs due to the combination of cost recovery uncertainty, higher than anticipated non-recurring costs and increased forecasted costs on recurring production. The increases in costs were driven by several factors, including: changing technical requirements, increased spending on the design and engineering phase of the program and uncertainty regarding cost reduction and cost recovery initiatives with our customer and suppliers. Further cost increases or an inability to meet revised recurring cost forecasts on the Global 7000/8000 program may result in additional forward loss reserves in future periods, while improvements in future costs compared to current estimates may result in favorable adjustments if forward loss reserves are no longer required.

In January 2016, Boeing announced a rate reduction to the 747-8 program, which lowers production to one plane every two months. We have assessed the impact of the rate reduction and have recorded an additional $161.4 million forward loss. This announcement follows the September 2015 decision by Boeing to in-source production of the 747-8 program beginning in the second half of fiscal 2019, effectively terminating this program with us after our current contract. Additional costs associated with exiting the facilities where the 747-8 program is manufactured, such as asset impairment, supplier and lease termination charges, as well as severance and retention payments to employees and contractors have been included in the 2016 Restructuring Plan.

Recognition of additional forward losses in the future periods continues to be a risk and will depend upon several factors, including the impact of the above discussed production rate change, our ability to successfully perform under current design and manufacturing plans, achievement of forecasted cost reductions as we continue production, our ability to successfully resolve claims and assertions with our customers and suppliers and our customers' ability to sell their products.

Cost of sales increased by $455.8 million, or 14.5%, to $3.6 billion for the fiscal year ended March 31, 2016, from $3.1 billion for the fiscal year ended March 31, 2015. The acquisition of Fairchild and the fiscal 2015 acquisitions contributed $274.5 million. The organic cost of sales included provisions for forward losses of $561.2 million on the Bombardier and 747-8 programs (as discussed above). Organic gross margin for the fiscal year ended March 31, 2016, was 3.9% compared with 19.1% for the fiscal year ended March 31, 2015. The prior year was impacted by additional

costs on the 747-8 program and disruption and accelerated depreciation associated with the relocation from our Jefferson Street Facilities.

Gross margin included net unfavorable cumulative catch-up adjustments on long-term contracts and provisions for forward losses as noted above ($596.2 million). The unfavorable cumulative catch-up adjustments to operating income included gross

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favorable adjustments of $33.0 million and gross unfavorable adjustments of $629.2 million, of which $561.2 million was related to forward losses associated with the Bombardier and 747-8 programs. Excluding the aforementioned forward losses, the cumulative catch-up adjustments for the fiscal year ended March 31, 2016, reflected increased labor and supplier costs on other programs. Gross margins for fiscal 2015 included net unfavorable cumulative catch-up adjustments of $156.0 million, of which $152.0 million was related to the forward losses on the 747-8 program.

Segment operating (loss) income decreased by $1,386.2 million, or (392.7)%, to $(1,033.3) million for the fiscal year ended March 31, 2016, from $353.0 million for the fiscal year ended March 31, 2015. The decreased operating income is directly related to the provisions for forward losses and gross margin changes noted above and the previously mentioned goodwill and tradename impairment charges.

Corporate operations incurred expenses of $57.8 million for the fiscal year ended March 31, 2016, as opposed to income of $81.7 million for the fiscal year ended March 31, 2015. The fiscal year ended March 31, 2015, included the legal settlement between the Company and Eaton, which resulted in a net gain of $134.7 million.

Interest expense and other decreased by $17.3 million, or 20.3%, to $68.0 million for the fiscal year ended March 31, 2016 compared to $85.4 million for the prior year. Interest expense and other for the fiscal year ended March 31, 2016, included foreign exchange losses of $2.4 million versus foreign exchange gains of $5.0 million for the fiscal year ended March 31, 2015. Interest expense and other for the fiscal year ended March 31, 2015 included the redemption of the 2018 Notes, which included $22.6 million for pre-tax losses associated with the 4.79% redemption premium, and write-off of the remaining related unamortized discount and deferred financing fees.

The effective income tax rate was 9.6% for the fiscal year ended March 31, 2016, and reflected the establishment of a valuation allowance of $155.8 million against net deferred tax assets. Based on an evaluation of both the positive and negative evidence available, we determined that it was necessary to establish a valuation allowance against substantially all of our net deferred tax assets for the fiscal year ended March 31, 2016.

A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized. When determining the amount of net deferred tax assets that are more likely than not to be realized, the Company assesses all available positive and negative evidence. This evidence includes, but is not limited to, prior earnings history, expected future earnings, carry-back and carry-forward periods and the feasibility of ongoing tax strategies that could potentially enhance the likelihood of the realization of a deferred tax asset. The weight given to the positive and negative evidence is commensurate with the extent the evidence may be objectively verified. As such, it is generally difficult for positive evidence regarding projected future taxable income exclusive of reversing taxable temporary differences to outweigh objective negative evidence of recent financial reporting losses.

Based on these criteria and the relative weighting of both the positive and negative evidence available, and in particular the activity surrounding the Company's prior earnings history, including the forward losses and intangible impairments previously recognized, management determined that it was necessary to establish a valuation allowance against principally all of its net deferred tax assets at March 31, 2016. Given the objectively verifiable negative evidence of a three-year cumulative loss and the weighting of all available positive evidence, the Company excluded projected taxable income (aside from reversing taxable temporary differences) from the assessment of income that could be used as a source of taxable income to realize the deferred tax assets.

The effective tax rate for the fiscal year ended March 31, 2015, was 31.7% and included the release of previously reserved for unrecognized tax benefits of $1.1 million, the benefit of $2.8 million from a decrease of the state deferred tax rate and the benefit of $6.0 million from the retroactive reinstatement of the R&D tax credit to January 1, 2014.

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Fiscal year ended March 31, 2015 compared to fiscal year ended March 31, 2014

	Year Ended March 31,	
	2015	2014
	(in thousands)	
Net sales	$3,888,722	$3,763,254
Segment operating income	$352,958	$440,623
Corporate income (expenses)	81,715	(40,619)
Total operating income	434,673	400,004
Interest expense and other	85,379	87,771
Income tax expense	110,597	105,977
Net income	$238,697	$206,256

Net sales increased by $125.5 million, or 3.3%, to $3.9 billion for the fiscal year ended March 31, 2015, from $3.8 billion for the fiscal year ended March 31, 2014. The fiscal 2015 and fiscal 2014 acquisitions, net of prior year divestitures, contributed $306.1 million. Organic sales decreased $180.6 million, or 4.6%, due to production rate cuts by our customers on the 747-8, V-22, G450/G550 and C-17 programs. The prior fiscal year was negatively impacted by our customers' decreased production rates on existing programs and decreased military sales.

Cost of sales increased by $229.7 million, or 7.9%, to $3.1 billion for the fiscal year ended March 31, 2015, from $2.9 billion for the fiscal year ended March 31, 2014. The fiscal 2015 and fiscal 2014 acquisitions, net of prior year divestitures, contributed $264.2 million. Despite the decrease in organic cost of sales, the organic cost of sales included a provision for forward losses of $152.0 million on the 747-8 program in addition to losses as a result of losing NADCAP certification at one of our facilities. Organic gross margin for the fiscal year ended March 31, 2015, was 20.1% compared with 23.1% for the fiscal year ended March 31, 2014. The prior year was impacted by additional programs costs on the 747-8 program and disruption and accelerated depreciation associated with the relocation from our Jefferson Street facilities. Excluding these charges, the comparable gross margin would have been 25.4% and 26.5%, respectively.

Gross margin included net unfavorable cumulative catch-up adjustments on long-term contracts and a provision for forward losses as noted above ($156.0 million). The unfavorable cumulative catch-up adjustments to operating income included gross favorable adjustments of $4.7 million and gross unfavorable adjustments of $160.7 million, of which $152.0 million was related to forward losses associated with the 747-8 program. The cumulative catch-up adjustments for the fiscal year ended March 31, 2015, were due primarily to labor cost growth, partially offset by other minor improvements. Gross margins for fiscal 2014 included net unfavorable cumulative catch-up adjustments of $53.2 million, which $29.8 million was related to the additional 747-8 program costs from reductions to profitability estimates on the 747-8 production lots that were completed during fiscal 2014 and $15.6 million of disruption and accelerated depreciation costs related to our exit from the Jefferson Street facilities which reduced profitability estimates on production lots completed during fiscal 2014. These decreases were partially offset by lower pension and other postretirement benefit expense of $12.7 million.

Segment operating income decreased by $87.7 million, or 19.9%, to $353.0 million for the fiscal year ended March 31, 2015 from $440.6 million for the fiscal year ended March 31, 2014. The organic operating income decreased $100.9 million, or 22.6%, and was a result of the decreased organic sales, the provision for forward losses and gross margin changes noted above, partially offset by decreased moving costs related to the relocation from our Jefferson Street facilities ($28.1 million), and legal fees ($4.5 million).

Corporate operations yielded income of $81.7 million for the fiscal year ended March 31, 2015, as opposed to expenses of $40.6 million for the fiscal year ended March 31, 2014. This result is due to the legal settlement between the Company and Eaton, which created a net gain of $134.7 million, partially offset by increased due diligence and acquisition related expenses ($9.8 million).

Interest expense and other decreased by $2.4 million, or 2.7%, to $85.4 million for the fiscal year ended March 31, 2015 compared to $87.8 million for the prior year. Interest expense and other for the fiscal year ended March 31, 2015 decreased due to lower average debt outstanding during the period as compared to the fiscal year ended March 31,

2014. Interest expense and other for the fiscal year ended March 31, 2015, included the redemption of the 2018 Notes, which included $22.6 million for pre-tax losses associated with the 4.79% redemption premium, and write-off of the remaining related unamortized discount and deferred financing fees. The fiscal year ended March 31, 2014, included the redemption of the 2017 Notes, which included

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$11.0 million of pre-tax losses associated with the 4% redemption premium, and the write-off of the remaining related unamortized discount and deferred financing fees.

The effective income tax rate was 31.7% for the fiscal year ended March 31, 2015, and 33.9% for the fiscal year ended March 31, 2014. The income tax provision for the fiscal year ended March 31, 2015, was reduced to reflect the release of previously reserved for unrecognized tax benefits of $1.1 million, the benefit of $2.8 million from a decrease of the state deferred tax rate and the benefit of $6.0 million from the retroactive reinstatement of the R&D tax credit to January 1, 2014. For the fiscal year ended March 31, 2014, the income tax provision was reduced to reflect the release of previously reserved for unrecognized tax benefits of $0.7 million and additional research and development tax credit carryforward and NOL carryforward of $2.3 million.

In January 2014, the Company sold all of its shares of Triumph Aerospace Systems-Wichita, Inc. for total cash proceeds of $23.0 million, which resulted in no gain or loss from the sale.

In April 2013, the Company sold the assets and liabilities of Triumph Instruments-Burbank and Triumph Instruments-Ft. Lauderdale for total proceeds of $11.2 million, resulting in a loss of $1.5 million.

The Company expects to have significant continuing involvement in the businesses and markets of the disposed entities and therefore the disposal groups did not meet the criteria to be classified as discontinued operations.

Business Segment Performance

We report our financial performance based on the following three reportable segments: the Aerostructures Group, the Aerospace Systems Group and the Aftermarket Services Group. The Company's Chief Operating Decision Maker ("CODM") utilizes Adjusted EBITDA as a primary measure of profitability to evaluate performance of its segments and allocate resources.

The results of operations among our reportable segments vary due to differences in competitors, customers, extent of proprietary deliverables and performance. For example, our Aerostructures segment generally includes long-term sole-source or preferred supplier contracts and the success of these programs provides a strong foundation for our business and positions us well for future growth on new programs and new derivatives. This compares to our Aerospace Systems segment which generally includes proprietary products and/or arrangements where we become the primary source or one of a few primary sources to our customers, where our unique manufacturing capabilities command a higher margin. Also, OEMs are increasingly focusing on assembly activities while outsourcing more manufacturing and repair to third parties, and as a result, are less of a competitive force than in previous years. In contrast, our Aftermarket Services segment provides MRO services on components and accessories manufactured by third parties, with more diverse competition, including airlines, OEMs and other third-party service providers. In addition, variability in the timing and extent of customer requests performed in the Aftermarket Services segment can provide for greater volatility and less predictability in revenue and earnings than that experienced in the Aerostructures and Aerospace Systems segments.

The Aerostructures segment consists of the Company's operations that manufacture products primarily for the aerospace OEM market. The Aerostructures segment's revenues are derived from the design, manufacture, assembly and integration of both build-to-print and proprietary metallic and composite aerostructures and structural components, including aircraft wings, fuselage sections, tail assemblies, engine nacelles, flight control surfaces as well as helicopter cabins. Further, the segment's operations also design and manufacture composite assemblies for floor panels and environmental control system ducts. These products are sold to various aerospace OEMs on a global basis.

The Aerospace Systems segment consists of the Company's operations that also manufacture products primarily for the aerospace OEM market. The segment's operations design a wide range of proprietary and build-to-print components and engineer mechanical and electromechanical controls, such as hydraulic systems, main engine gearbox assemblies, engine control systems, accumulators, mechanical control cables, non-structural cockpit components and metal processing. These products are sold to various aerospace OEMs on a global basis.

The Aftermarket Services segment consists of the Company's operations that provide maintenance, repair and overhaul services to both commercial and military markets on components and accessories manufactured by third parties. Maintenance, repair and overhaul revenues are derived from services on auxiliary power units, airframe and engine accessories, including constant-speed drives, cabin compressors, starters and generators, and pneumatic drive units. In addition, the segment's operations repair and overhaul thrust reversers, nacelle components and flight control

surfaces. The segment's operations also perform repair and overhaul services and supply spare parts for various types of gauges for a broad range of commercial airlines on a worldwide basis.

We currently generate a majority of our revenue from clients in the commercial aerospace industry, the military, the business jet industry and the regional airline industry. Our growth and financial results are largely dependent on continued

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demand for our products and services from clients in these industries. If any of these industries experiences a downturn, our clients in these sectors may conduct less business with us. The following table summarizes our net sales by end market by business segment. The loss of one or more of our major customers or an economic downturn in the commercial airline or the military and defense markets could have a material adverse effect on our business.

	Year Ended March 31,		
	2016	2015	2014
Aerostructures			
Commercial aerospace	35.6 %	38.5 %	42.4 %
Military	10.5	14.0	16.1
Business Jets	15.6	11.0	10.0
Regional	0.4	0.4	0.4
Non-aviation	0.1	0.4	0.5
Total Aerostructures net sales	62.2 %	64.3 %	69.4 %
Aerospace Systems			
Commercial aerospace	14.6 %	13.2 %	8.4 %
Military	11.1	10.6	11.4
Business Jets	2.0	1.4	1.0
Regional	0.9	1.0	1.0
Non-aviation	1.3	1.7	1.3
Total Aerospace Systems net sales	29.9 %	27.9 %	23.1 %
Aftermarket Services			
Commercial aerospace	6.0 %	6.3 %	6.3 %
Military	1.4	1.0	0.7
Regional	0.5	0.5	0.2
Non-aviation	—	—	0.3
Total Aftermarket Services net sales	7.9 %	7.8 %	7.5 %
Total Consolidated net sales	100.0%	100.0%	100.0%

We continue to experience a higher proportion of our sales mix in the commercial aerospace end market. We recently have experienced an increase in our business jet end market due to the acquisition of the Tulsa Programs and a decrease in our military end market due to the wind-down of the C-17 program.

Business Segment Performance—Fiscal year ended March 31, 2016 compared to fiscal year ended March 31, 2015

	Year Ended March 31,		%	% of Total Sales	
	2016	2015	Change	2016	2015
	(in thousands)				
NET SALES					
Aerostructures	$2,427,809	$2,510,371	(3.3)%	62.5 %	64.6 %
Aerospace Systems	1,166,795	1,089,117	7.1 %	30.0 %	28.0 %
Aftermarket Services	311,394	304,013	2.4 %	8.0 %	7.8 %
Elimination of inter-segment sales	(19,926)	(14,779)	34.8 %	(0.5)%	(0.4)%
Total net sales	$3,886,072	$3,888,722	(0.1)%	100.0 %	100.0 %

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	Year Ended March 31,		% Change	% of Segment Sales	
	2016	2015		2016	2015
	(in thousands)				
SEGMENT OPERATING INCOME					
Aerostructures	$(1,274,777)	$120,985	(1,153.7)%	(52.5)%	4.8 %
Aerospace Systems	216,520	184,042	17.6 %	18.6 %	16.9%
Aftermarket Services	24,977	47,931	(47.9)%	8.0 %	15.8%
Corporate	(57,826)	81,715	(170.8)%	n/a	n/a
Total segment operating income	$(1,091,106)	$434,673	(351.0)%	(28.1)%	11.2%

	Year Ended March 31,		% Change	% of Segment Sales	
	2016	2015		2016	2015
	(in thousands)				
Adjusted EBITDA					
Aerostructures	$(364,538)	$184,562	(297.5)%	(15.0)%	7.4 %
Aerospace Systems	216,959	192,228	12.9 %	18.6 %	17.6%
Aftermarket Services	37,886	56,490	(32.9)%	12.2 %	18.6%
Corporate	(57,428)	(50,710)	13.2 %	n/a	n/a
	$(167,121)	$382,570	(143.7)%	(4.3)%	9.8 %

Aerostructures: The Aerostructures segment net sales decreased by $82.6 million, or 3.3%, to $2.4 billion for the fiscal year ended March 31, 2016, from $2.5 billion for the fiscal year ended March 31, 2015. Organic sales decreased by $326.7 million or 13.5%, due to decreased production rate cuts by our customers on the 747-8, Gulfstream G450/G550, A330 and C-17 programs. The acquisition of the Tulsa Programs contributed $244.1 million to net sales.

Aerostructures cost of sales increased by $382.5 million, or 17.4%, to $2.6 billion for the fiscal year ended March 31, 2016, from $2.2 billion for the fiscal year ended March 31, 2015. The acquisition of the Tulsa Programs contributed $200.6 million for the fiscal year ended March 31, 2016 and organic cost of sales increased by $200.6 million, or 9.5%. The organic cost of sales included provisions for forward losses of $561.2 million on the Bombardier and 747-8 programs (as discussed above). Excluding the aforementioned forward losses, the cumulative catch-up adjustments for the fiscal year ended March 31, 2016, included increased labor and supplier costs on other programs. The fiscal year ended March 31, 2015, included a provision for forward losses of $152.0 million on the 747-8 program and losses as a result of losing NADCAP certification at one of our facilities.

Organic gross margin for the fiscal year ended March 31, 2016, was (10.8)% compared with 12.4% for the fiscal year ended March 31, 2015. The organic gross margin included net unfavorable cumulative catch-up adjustments and provisions for forward losses of $561.2 million. The net unfavorable cumulative catch-up adjustments included gross favorable adjustments of $33.0 million and gross unfavorable adjustments of $629.2 million, which includes forward losses of $561.2 million associated with the Bombardier and 747-8 programs. The net unfavorable cumulative catch-up adjustment for the fiscal year ended March 31, 2015, was $156.0 million, which included $152.0 million of forward losses related to the 747-8 program.

Aerostructures segment operating (loss) income decreased by $1,395.8 million, or 1,153.7%, to $(1,274.8) million for the fiscal year ended March 31, 2016, from $121.0 million for the fiscal year ended March 31, 2015. The decreased operating income is directly related to the provision for forward losses and gross margin changes noted above and the previously mentioned goodwill and tradename impairment charges and included restructuring charges ($62.7 million). Additionally, the provision for forward losses and gross margin changes noted above contributed to the decrease in Adjusted EBITDA year over year.

Aerostructures segment operating income as a percentage of segment sales decreased to (52.5)% for the fiscal year ended March 31, 2016, as compared with 4.8% for the fiscal year ended March 31, 2015, due to the decrease in gross

margin as discussed above, which also caused the decline in the Adjusted EBITDA margin.

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Aerospace Systems: The Aerospace Systems segment net sales increased by $77.7 million, or 7.1%, to $1.17 billion for the fiscal year ended March 31, 2016, from $1.09 billion for the fiscal year ended March 31, 2015. The acquisitions of Fairchild and GE contributed $93.5 million of net sales. Organic net sales decreased by $15.8 million, or 1.8%, primarily due to slower commercial rotocraft demand and lower aftermarket revenue.

Aerospace Systems cost of sales increased by $53.7 million, or 7.3%, to $792.2 million for the fiscal year ended March 31, 2016, from $738.5 million for the fiscal year ended March 31, 2015. Organic cost of sales decreased by $8.4 million, or 1.5%, while the acquisitions of Fairchild and GE contributed $62.7 million in cost of sales. Organic gross margin for the fiscal year ended March 31, 2016, was 34.2% compared with 34.4% for the fiscal year ended March 31, 2015.

Aerospace Systems segment operating income increased by $32.5 million, or 17.6%, to $216.5 million for the fiscal year ended March 31, 2016, from $184.0 million for the fiscal year ended March 31, 2015. Operating income increased primarily due to the acquisitions of Fairchild and GE ($22.5 million) and the net favorable settlement of a contingent liability ($8.5 million), partially offset by restructuring charges ($4.6 million). These same factors contributed to the increase in Adjusted EBITDA year over year.

Aerospace Systems segment operating income as a percentage of segment sales increased to 18.6% for the fiscal year ended March 31, 2016, as compared with 16.9% for the fiscal year ended March 31, 2015, due to the effects of the acquisitions of Fairchild and GE. The same factors contributed to the increase in Adjusted EBITDA margin year over year.

Aftermarket Services: The Aftermarket Services segment net sales increased by $7.4 million, or 2.4%, to $311.4 million for the fiscal year ended March 31, 2016, from $304.0 million for the fiscal year ended March 31, 2015. Organic sales decreased $10.3 million, or 3.5%, and the acquisition of NAAS contributed $17.7 million. Organic sales decreased due to a decreased demand from commercial customers.

Aftermarket Services cost of sales increased by $23.6 million, or 10.7%, to $243.7 million for the fiscal year ended March 31, 2016, from $220.1 million for the fiscal year ended March 31, 2015. The organic cost of sales increased $12.5 million, or 5.9%, and the acquisition of NAAS contributed $11.1 million to cost of sales. Organic gross margin for the fiscal year ended March 31, 2016, was 20.2% compared with 27.3% for the fiscal year ended March 31, 2015. The decrease in gross margin was impacted by the impairment of excess and obsolete inventory associated with certain slow moving programs we have decided to no longer support ($21.1 million).

Aftermarket Services segment operating income decreased by $23.0 million, or 47.9%, to $25.0 million for the fiscal year ended March 31, 2016, from $47.9 million for the fiscal year ended March 31, 2015. Operating income decreased primarily due to the decreased organic sales and the decline in gross margins noted above. These same factors contributed to the decrease in Adjusted EBITDA year over year.

Aftermarket Services segment operating income as a percentage of segment sales decreased to 8.0% for the fiscal year ended March 31, 2016, as compared with 15.8% for the fiscal year ended March 31, 2015, due to the decreased organic sales and the decline in gross margins noted above. The same factors contributed to the decrease in Adjusted EBITDA margin year over year.

Business Segment Performance—Fiscal year ended March 31, 2015 compared to fiscal year ended March 31, 2014

	Year Ended March 31,		% Change	% of Total Sales	
	2015	2014		2015	2014
	(in thousands)				
NET SALES					
Aerostructures	$ 2,510,371	$ 2,622,917	(4.3)%	64.6 %	69.7 %
Aerospace Systems	1,089,117	871,750	24.9 %	28.0 %	23.2 %

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

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Level 2 Directly or indirectly observable inputs, other than quoted prices, such as quoted prices for similar assets or liabilities; quoted prices for identical or similar instruments in markets that are not active; or model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3 Unobservable inputs that are supported by little or no market activity and that are material to the fair value of the asset or liability. Financial instruments whose values are determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant judgment or estimation are examples of Level 3 assets and liabilities.

If the inputs used to measure the financial assets and liabilities fall within more than one level described above, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument.

Financial Instruments Disclosed, But Not Reported, at Fair Value

The fair value of our long-term debt was approximately $727 million and $893 million as of December 31, 2018 and June 30, 2018, respectively. We estimate the fair value of our debt utilizing market quotations for debt that have quoted prices in active markets. Since our debt does not trade on a daily basis in an active market, the fair value estimates are based on market observable inputs based on borrowing rates currently available for debt with similar terms and average maturities (Level 2).

Note 9. Investment Securities

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

In May 2018, the Company liquidated the remainder of the investment securities portfolio. As of December 31, 2018 and June 30, 2018, the Company does not own investment securities.

The Company had a net gain on investment securities of $2.0 million during the three months ended December 31, 2017, which included an unrealized gain related to securities still held at December 31, 2017 of $1.2 million.

The Company had a net gain on investment securities of $2.8 million during the six months ended December 31, 2017, which included an unrealized gain related to securities still held at December 31, 2017 of $1.1 million.

Note 10. Goodwill and Intangible Assets

The changes in the carrying amount of goodwill for the six months ended December 31, 2018 are as follows:

(In thousands)	Generic Pharmaceuticals
Balance at June 30, 2018	$ 339,566
Goodwill acquired	
Impairment	(339,566)
	$

Balance at December 31, 2018	
On August 17, 2018, JSP notified the Company that it will not extend or renew the JSP Distribution Agreement when the current term expires on March 23, 2019. The Company determined that JSP s decision represented a triggering event under U.S. GAAP to perform an analysis to determine the potential for impairment of goodwill. On October 4, 2018, the Company completed the analysis based on market data and concluded a full impairment of goodwill was required.	

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Intangible assets, net as of December 31, 2018 and June 30, 2018, consisted of the following:

(In thousands)	Weighted Avg. Life (Yrs.)	Gross Carrying Amount		Accumulated Amortization		Intangible Assets, Net	
		December 31, 2018	June 30, 2018	December 31, 2018	June 30, 2018	December 31, 2018	June 30, 2018
Definite-lived:							
Cody Labs import license	15	$	$ 581	$	$ (386)	$	$ 195
KUPI product rights	15	416,154	416,154	(83,712)	(69,840)	332,442	346,314
KUPI trade name	2	2,920	2,920	(2,920)	(2,920)		
KUPI other intangible assets	15	19,000	19,000	(3,928)	(3,295)	15,072	15,705
Silarx product rights	15	10,000	10,000	(2,389)	(2,056)	7,611	7,944
Other product rights	13	21,692	19,693	(3,396)	(1,875)	18,296	17,818
Total definite-lived		$ 469,766	$ 468,348	$ (96,345)	$ (80,372)	$ 373,421	$ 387,976
Indefinite-lived:							
KUPI in-process research and development		$ 18,000	$ 18,000	$	$	$ 18,000	$ 18,000
Silarx in-process research and development		18,000	18,000			18,000	18,000
Other product rights		449	449			449	449
Total indefinite-lived		36,449	36,449			36,449	36,449
Total intangible assets, net		$ 506,215	$ 504,797	$ (96,345)	$ (80,372)	$ 409,870	$ 424,425

For the three months ended December 31, 2018 and 2017, the Company recorded amortization expense of $8.2 million. For the six months ended December 31, 2018 and 2017, the Company recorded amortization expense of $16.4 million and $16.3 million, respectively.

Future annual amortization expense consisted of the following as of December 31, 2018:

(In thousands) Fiscal Year Ending June 30,	Amortization Expense
2019	$ 15,224
2020	30,443
2021	30,443
2022	30,443
2023	30,443
Thereafter	236,425
	$ 373,421

Note 11. Long-Term Debt

Long-term debt, net consisted of the following:

(In thousands)	December 31, 2018	June 30, 2018
Term Loan A due 2020; 7.52% as of December 31, 2018	$ 213,526	$ 227,276
Unamortized discount and other debt issuance costs	(8,843)	(10,178)
Term Loan A, net	204,683	217,098
Term Loan B due 2022; 7.90% as of December 31, 2018	650,338	670,011
Unamortized discount and other debt issuance costs	(41,569)	(47,839)
Term Loan B, net	608,769	622,172
Revolving Credit Facility due 2020		
Total debt, net	813,452	839,270
Less short-term borrowings and current portion of long-term debt	(66,845)	(66,845)
Total long-term debt, net	$ 746,607	$ 772,425

On December 10, 2018, the Company entered into an amendment to the Senior Secured Credit Facility and the Credit and Guaranty Agreement. Pursuant to the amendment, the Secured Net Leverage Ratio applicable to the financial

leverage ratio covenant was increased from 3:25:1.00 to 4.25:1.00 as of December 31, 2019 and prior to September 30, 2020, and then to 4:00:1:00 as of September 30, 2020. In exchange, the Company agreed to include a minimum liquidity covenant of $75 million, a 25-basis point

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increase to the interest rate margin paid on the Term A Loans and pay a consent fee equal to 50 basis points, paid only to consenting lenders.

Long-term debt amounts due, for the twelve-month periods ending December 31 are as follows:

(In thousands)	Amounts Payable to Institutions
2019	$ 66,845
2020	225,371
2021	39,345
2022	532,303
Total	$ 863,864

Note 12. Legal, Regulatory Matters and Contingencies

Connecticut Attorney General Inquiry

In July 2014, the Company received interrogatories and subpoena from the State of Connecticut Office of the Attorney General concerning its investigation into the pricing of digoxin. According to the subpoena, the Connecticut Attorney General is investigating whether anyone engaged in any activities that resulted in (a) fixing, maintaining or controlling prices of digoxin or (b) allocating and dividing customers or territories relating to the sale of digoxin in violation of Connecticut antitrust law. In June 2016, the Connecticut Attorney General issued interrogatories and a subpoena to an employee of the Company in order to gain access to documents and responses previously supplied to the Department of Justice. In December 2016, the Connecticut Attorney General, joined by numerous other State Attorneys General, filed a civil complaint alleging that six pharmaceutical companies engaged in

anti-competitive behavior related to doxycycline hyclate and gliburide. The Company was not named in the action and does not compete on the products that formed the basis of the complaint. The complaint was later transferred for pretrial purposes to the United States District Court for the Eastern District of Pennsylvania as part of a multidistrict litigation captioned In re: Generic Pharmaceuticals Pricing Antitrust Litigation. On October 31, 2017, the state Attorneys General filed a motion in the District Court for leave to amend their complaint to add numerous additional defendants, including the Company, and claims relating to 13 additional drugs. The claim relating to Lannett involves alleged price-fixing for one drug, doxycycline monohydrate, but does not involve the pricing for digoxin. The state Attorneys General also allege that all defendants were part of an overarching, industry-wide conspiracy to allocate markets and fix prices generally. The Court granted that motion on June 5, 2018. The state Attorneys General filed their amended complaint on June 15, 2018. None of the defendants, including the Company, has responded yet to the amended complaint.

The Company maintains that it acted in compliance with all applicable laws and regulations and continues to cooperate with the Connecticut Attorney General investigation.

Federal Investigation into the Generic Pharmaceutical Industry

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

through the dates of the subpoenas.

The Company received a Civil Investigative Demand (CID) from the Department of Justice on May 14, 2018. The CID requests information regarding allegations that the generic pharmaceutical industry engaged in market allocation, price fixing, payment of illegal remuneration and submission of false claims. The CID requests information from 2009-present. The Company is in the process of responding to the CID.

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

Texas Medicaid Investigation

In August 2015, KUPI received a letter from the Texas Office of the Attorney General alleging that it had inaccurately reported certain price information in violation of the Texas Medicaid Fraud Prevention Act. UCB, KUPI s previous parent company is handling the defense and is evaluating the allegations and cooperating with the Texas Attorney General s Office. Per the terms of the Stock Purchase Agreement between the Company and UCB (Stock Purchase Agreement) dated September 2, 2015, the Company is fully

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indemnified for any pre-acquisition amounts. In December 2018, KUPI and the State of Texas settled the allegations for the sum of $8.0 million, which is fully indemnified by UCB. UCB forwarded the $8.0 million to KUPI in December 2018 and, following its receipt of the fully executed settlement agreement, KUPI forwarded the settlement funds to the State of Texas in January 2019.

Government Pricing

During the quarter ended December 31, 2016, the Company completed a contract compliance review, for the period January 1, 2012 through June 30, 2016, for one of KUPI s government-entity customers. As a result of the review, the Company identified certain commercial customer prices and other terms that were not properly disclosed to the government-entity resulting in potential overcharges. As of December 31, 2018 and June 30, 2018, the Company s best estimate of the liability for potential overcharges was approximately $9.3 million. For the period January 1, 2012 through November 24, 2015 (the pre-acquisition period), the Company is fully indemnified per the Stock Purchase Agreement. Accordingly, the Company has recorded an indemnification asset and related liability of $8.3 million related to the pre-acquisition period. The Company does not believe that the ultimate resolution of this matter will have a significant impact on our financial position, results of operations or cash flows.

EPA Violation Notice

On July 13, 2017, the United States Department of Environmental Protection Agency (EPA) sent a Finding of Violation to KUPI alleging several violations of national emissions standards for

hazardous air pollutants at KUPI s Seymour, Indiana facility. The EPA and KUPI have entered into an agreed Administrative Consent Order and Consent Assessment and Final Order to resolve the alleged violations, whereby KUPI made a payment of $60,000 to the EPA and escrowed the sum of $225,000 to be used to fund an environmental project. The Orders were fully executed on December 31, 2018.

Private Antitrust and Consumer Protection Litigation

The Company and certain competitors have been named as defendants in a number of lawsuits filed in 2016 and 2017 alleging that the Company and certain generic pharmaceutical manufacturers have conspired to fix prices of generic digoxin, levothyroxine, ursodiol and baclofen. These cases are part of a larger group of more than 100 lawsuits generally alleging that over 30 generic pharmaceutical manufacturers and distributors conspired to fix prices for at least 18 different generic drugs in violation of the federal Sherman Act, various state antitrust laws, and various state consumer protection statutes. The United States also has been granted leave to intervene in the cases. On April 6, 2017, the Judicial Panel on Multidistrict Litigation (the JPML) ordered that all of the cases alleging price-fixing for generic drugs be consolidated for pretrial proceedings in the United States District Court for the Eastern District of Pennsylvania under the caption In re: Generic Pharmaceuticals Pricing Antitrust Litigation. The various plaintiffs are grouped into three categories Direct Purchaser Plaintiffs, End Payer Plaintiffs, and Indirect Reseller Purchasers and filed Consolidated Amended Complaints (CACs) against the Company and the other defendants on August 15, 2017.

The CACs naming the Company as a defendant involve generic digoxin, levothyroxine, ursodiol and baclofen. Pursuant to a court-ordered schedule grouping the 18 different drug cases into three separate tranches, the Company and

other generic pharmaceutical manufacturer defendants on October 6, 2017 filed joint and individual motions to dismiss the CACs involving the six drugs in the first tranche, including digoxin. On October 16, 2018, the Court (with one exception) denied defendants motions to dismiss plaintiffs Sherman Act claims with respect to the drugs in the first tranche. Defendants motions to dismiss plaintiffs state law claims with respect to those drugs remain pending.

On January 22, 2018, three opt-out direct purchasers filed a complaint alleging an overarching conspiracy and individual conspiracies on behalf of the Company and numerous other defendants to fix the prices of and allocate markets for at least 30 different drugs, including digoxin, doxycycline, levothyroxine, ursodiol and baclofen. On August 3, 2018, another opt-out direct purchaser filed a complaint alleging an overarching conspiracy and individual conspiracies on behalf of the Company and numerous other defendants to fix the prices of and allocate markets for 16 different drugs, including digoxin, doxycycline, levothyroxine, ursodiol and baclofen. On January 16, 2019, another opt-out direct purchaser filed a complaint alleging an overarching conspiracy and individual conspiracies on behalf of the Company and numerous other defendants to fix the prices of and allocate markets for the 30 different drugs, including digoxin, doxycycline, levothyroxine, ursodiol, baclofen and acetazolamide. None of the defendants, including the Company, has responded yet to the opt-out complaints.

In addition to the lawsuits brought by private plaintiffs, the Attorneys General of 48 states, the District of Columbia and Puerto Rico have filed parens patriae lawsuits alleging price-fixing conspiracies by various generic pharmaceutical manufacturers. The JPML has consolidated the suits by the state Attorneys General in the Eastern District of Pennsylvania as part of the multidistrict litigation. The original lawsuits did not name the Company, but the state Attorneys General filed an amended complaint on June 5, 2018 to add numerous additional defendants,

including the Company, and claims relating to 13 additional drugs. The claim relating to Lannett involves alleged price-fixing for one drug, doxycycline monohydrate, although the state Attorneys General allege that all defendants

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were part of an overarching, industry-wide conspiracy to allocate markets and fix prices generally. None of the defendants, including the Company, has responded yet to the amended complaint.

Following the lead of the state Attorneys General, the Direct Purchaser Plaintiffs, End Payer Plaintiffs and Indirect Reseller Plaintiffs have filed their own complaints also alleging an overarching conspiracy, making similar allegations to those contained in the state Attorneys General complaint, relating to 14 generic drugs in the End Payer complaint and 15 generic drugs in the Indirect Reseller complaint. The End Payer Plaintiffs filed their complaint on June 7, 2018, the Indirect Reseller Plaintiffs filed their complaint on June 18, 2018, and the Direct Purchaser Plaintiffs filed their complaint on June 22, 2018. Although the complaints allege an overarching conspiracy with respect to all of the drugs identified, the specific allegations related to drugs Lannett makes involve acetazolamide and doxycycline monohydrate. None of the defendants, including the Company, has responded yet to these complaints.

On September 25, 2018, two other alleged direct purchasers filed a purported class action complaint alleging an overreaching, industry-wide horizontal and vertical conspiracy involving the company, other generic pharmaceutical manufacturers, and various pharmaceutical distributors to allocate markets and fix prices generally for a variety of generic drugs. The case has been added to the multidistrict litigation. On December 21, 2018, the plaintiffs filed an amended complaint. None of the defendants, including the Company, has responded yet to the amended complaint.

The Company believes that it acted in compliance with all applicable laws and regulations. Accordingly, the Company

disputes the allegations set forth in these class actions.

Shareholder Litigation

In November 2016, a putative class action lawsuit was filed against the Company and two of its officers claiming that the Company damaged the purported class by including in its securities filings false and misleading statements regarding the Company s drug pricing methodologies and internal controls. An amended complaint was filed in May 2017, and the Company filed a motion to dismiss the amended complaint in September 2017. In December 2017, counsel for the putative class filed a second amended complaint, and the Court denied as moot the Company s motion to dismiss the first amended complaint. The Company filed a motion to dismiss the second amended complaint in February 2018. In July 2018, the court granted the Company s motion to dismiss the second amended complaint. In September 2018, counsel for the putative class filed a third amended complaint. The Company filed a motion to dismiss the third amended complaint in November 2018. The Company cannot reasonably predict the outcome of the suit at this time.

In July 2018, a shareholder derivative complaint was filed against the Company and certain of its current and former directors and executives in the United States District Court for the Eastern District of Pennsylvania. The derivative complaint alleges that the Company engaged in an illegal conspiracy to fix generic drug prices and that the Company s directors and executives violated their fiduciary duties by allowing the Company to violate the applicable laws and regulations and failing to take any action to curtail management s deliberate price-fixing scheme. The derivative complaint includes causes of action for violation of Section 10(b) of the Exchange Act, violation of Section 14(a) of the Exchange Act, violation of Section 29(a) of the Exchange Act, and for breach of fiduciary duty. In October 2018, the Court issued an order

stating the derivative suit for all purposes for a period of 180 days or until the Court issues an order on the motion to dismiss the third amended complaint filed in the matter of *Utesch v. Lannett Co., Inc.,* et al., No. 2:16cv-05932, whichever is later. The Company cannot reasonably predict the outcome of the suit at this time.

In October 2018, a putative class action lawsuit was filed against the Company and two of its officers in the federal court for the Eastern District of Pennsylvania, alleging that the Company, its Chief Executive Officer and its Chief Financial Officer damaged the purported class by making false and misleading statements in connection with the possible renewal of the JSP Distribution Agreement. The Company and the corporate executives named in the complaint deny that they made any false or misleading statements. In December 2018, counsel for the putative class filed an amended complaint. The Company moved to dismiss the amended complaint in January 2019. The Company cannot reasonably predict the outcome of this suit at this time.

In December 2018, the Chairman of the Company s Board of Directors received a letter sent on behalf of two purported shareholders demanding that the Company s Board of Directors investigate and commence legal proceedings against certain former and/or current directors, officers, and agents of the Company relating to alleged breaches of fiduciary duties, corporate waste, and unjust enrichment. The Company and the Company s Board of Directors responded to the demand letter by requesting that the purported shareholders provide proof of their status and shareholders of the Company. The Company and the Company s Board of Directors recently received a reply to the letter sent in response to the demand letter and are reviewing the information provided. At this time the Company cannot reasonably predict what outcome, if any, will follow from the Company and the Company s Board of Director s receipt of the demand letter.

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Genus Life Sciences

In December 2018, Genus Lifesciences, Inc. (Genus) sued the Company, Cody Labs, and others in California federal court, alleging violations of the Lanham Act, Sherman Act, and California false advertising law. Genus received FDA approval for a cocaine hydrochloride product in December 2018, and its claims are premised in part on allegations that the Company falsely advertises its unapproved cocaine hydrochloride product, C-Topical. The Company denies that it is falsely advertising its C-Topical product and continues to market its unapproved product relying on the Guidance for FDA Staff and Industry, Marketed Unapproved Drugs Compliance Policy Guide, pending approval of its 505(b)(2) application. The Company cannot reasonably predict the outcome of this suit at this time.

Patent Infringement (Paragraph IV Certification)

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

Zomig®

The Company filed with the FDA an ANDA No. 206350, along with a paragraph IV certification, alleging that

the two patents associated with the Zomig® nasal spray product (U.S. Patent No. 6,750,237 and U.S. Patent No. 67,220,767) are invalid.

In July 2014, AstraZeneca AB, AstraZeneca UK Limited and Impax Laboratories, Inc. filed two patent infringement lawsuits in the United States District Court for the District of Delaware, alleging that the Company s filing of ANDA No. 206350 constitutes an act of patent infringement and seeking a declaration that the two patents at issue are valid and infringed.

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

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

A trial was conducted in September 2016. The Court issued its decision on March 29, 2017, finding that Lannett did not prove that the patents at issue are invalid. The Company has appealed the decision. All briefing to the appellate court has been submitted, and oral argument before the appellate court was conducted on April 5, 2018. The appellate court issued an opinion on June 28, 2018, upholding the decision of the District Court. The Company requested a rehearing by the appellate court on August 13, 2018. The appellate

court denied the request on September 14, 2018, and issued its mandate terminating the appeal on September 21, 2018.

Other Litigation Matters

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

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Note 13. Commitments

Leases

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

Future minimum lease payments under noncancelable operating leases (with initial or remaining lease terms in excess of one year) for the remainder of Fiscal 2019 and the twelve-month periods ending June 30 thereafter are as follows:

(In thousands)	Amounts Due
Remainder of 2019	$ 922
2020	1,855
2021	1,406
2022	1,080
2023	1,080
Thereafter	4,158
Total	$ 10,501

Other Commitment

During the third quarter of Fiscal 2017, the Company signed an agreement with a company operating in the pharmaceutical business, under which the Company agreed to provide up to $15.0 million in revolving loans, which expires in seven years and bears interest at 2.0%, for the purpose of expansion and other business needs. The decision to provide any portion of the revolving loan is at the Company s sole discretion. Prior to the first quarter of Fiscal 2019, the Company had the option to convert the first $7.5 million into a 50% ownership interest in the entity. The board of the entity is

comprised of five members, one of which is an employee of the Company.

In the first quarter of Fiscal 2019, the Company sold 50% of the outstanding loan to a third party for $5.6 million and, in addition to assigning 50% of all right, title and interest in the loan and loan documents, the Company relinquished its right to convert a portion of the outstanding loan balance to an equity interest in the entity. As of December 31, 2018, $5.8 million was outstanding under the revolving loan and is included in other assets. In addition to the loan repayment, the agreement was amended to eliminate the Company s ability to convert the outstanding loan balance into an ownership interest. Based on the guidance set forth in ASC 810-10 *Consolidation*, the Company has concluded that it has a variable interest in the entity. However, the Company is not the primary beneficiary to the entity and as such, is not required to consolidate the entity s results of operations.

Note 14. Accumulated Other Comprehensive Loss

The Company s Accumulated Other Comprehensive Loss was comprised of the following components as of December 31, 2018 and 2017:

(In thousands)	December 31, 2018	December 31, 2017
Foreign Currency Translation		
Beginning Balance, June 30	$ (515)	$ (222)
Net gain (loss) on foreign currency translation (net of tax of $0 and $0)	13	(125)
Reclassifications to net income (net of tax of $0 and $0)		
Other comprehensive income (loss), net of tax	13	(125)
Ending Balance, December 31	(502)	(347)
Total Accumulated Other Comprehensive Loss	$ (502)	$ (347)

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Note 15. Earnings (Loss) Per Common Share

A dual presentation of basic and diluted earnings (loss) per common share is required on the face of the Company s Consolidated Statement of Operations as well as a reconciliation of the computation of basic earnings per common share to diluted earnings per common share. Basic earnings (loss) per common share excludes the dilutive impact of potentially dilutive securities and is computed by dividing net income (loss) by the weighted average number of common shares outstanding for the period. Diluted earnings (loss) per common share is computed using the treasury stock method and includes the effect of potential dilution from the exercise of outstanding stock options and treats unvested restricted stock and performance-based shares as if they were vested. Potentially dilutive securities have been excluded in the weighted average number of common shares used for the calculation of earnings per share in periods of net loss because the effect of including such securities would be anti-dilutive. A reconciliation of the Company s basic and diluted earnings (loss) per common share was as follows:

(In thousands, except share and per share data)	Three Months Ended December 31, 2018	2017
Net income	$ 12,362	$ 14,022
Basic weighted average common shares outstanding	37,761,176	37,066,902
Effect of potentially dilutive stock options and restricted stock awards	1,351,371	1,223,456
Diluted weighted average common shares outstanding	39,112,547	38,290,358
Earnings per common share:		
Basic	$ 0.33	$ 0.38
Diluted	$ 0.32	$ 0.37

	Six Months Ended December 31,

(In thousands, except share and per share data)	2018	2017
Net income (loss)	$ (275,166)	$ 27,279
Basic weighted average common shares outstanding	37,674,208	37,029,483
Effect of potentially dilutive stock options and restricted stock awards		1,058,343
Diluted weighted average common shares outstanding	37,674,208	38,087,826
Earnings (loss) per common share:		
Basic	$ (7.30)	$ 0.74
Diluted	$ (7.30)	$ 0.72

The number of anti-dilutive shares that have been excluded in the computation of diluted earnings per share for the three months ended December 31, 2018 and 2017 were 540 thousand and 3.0 million, respectively. The number of anti-dilutive shares that have been excluded in the computation of diluted earnings per share for the six months ended December 31, 2018 and 2017 were 2.2 million and 3.0 million, respectively.

Note 16. Warrant

In connection with the KUPI acquisition on November 25, 2015, Lannett issued to UCB Manufacturing a warrant to purchase up to a total of 2.5 million shares of Lannett s common stock (the Warrant).

The Warrant had a term of three years (expiring November 25, 2018) and an exercise price of $48.90 per share, subject to customary adjustments, including for stock splits, dividends and combinations. The Warrant also contained a weighted average anti-dilution adjustment provision. The fair value included as part of the total consideration transferred to UCB at the acquisition date was $29.9 million. The fair value assigned to the Warrant was determined using the Black-Scholes valuation model. The Company concluded that the warrant was indexed to its own stock and therefore the Warrant was classified as an equity instrument. On November 25, 2018, the Warrant expired and was not exercised.

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Note 17. Share-Based Compensation

At December 31, 2018, the Company had two share-based employee compensation plans (the 2011 Long-Term Incentive Plan LTIP and the 2014 LTIP). Together these plans authorized an aggregate total of 4.5 million shares to be issued. The plans have a total of 615 thousand shares available for future issuances. On January 23, 2019, the shareholders of the Company approved an Amendment to and Restatement of the 2014 LTIP to increase the amount of shares authorized to be issued by 2.0 million shares.

The Company issues share-based compensation awards with a vesting period ranging up to 3 years and a maximum contractual term of 10 years. The Company issues new shares of stock when stock options are exercised. As of December 31, 2018, there was $14.4 million of total unrecognized compensation cost related to non-vested share-based compensation awards. That cost is expected to be recognized over a weighted average period of 2.2 years.

Stock Options

The Company measures share-based compensation cost for options using the Black-Scholes option pricing model. The following table presents the weighted average assumptions used to estimate fair values of the stock options granted during the six months ended December 31, 2018 and 2017:

	Six Months Ended December 31, 2018	December 31, 2017
Risk-free interest rate	2.9%	1.9%
Expected volatility	58.4%	57.4%

Expected dividend yield	%	%
Forfeiture rate	6.5%	6.5%
Expected term (in years)	5.3 years	5.4 years
Weighted average fair value	$ 6.52	$ 9.06

Expected volatility is based on the historical volatility of the price of our common shares during the historical period equal to the expected term of the option. The Company uses historical information to estimate the expected term, which represents the period of time that options granted are expected to be outstanding. The risk-free rate for the period equal to the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The forfeiture rate assumption is the estimated annual rate at which unvested awards are expected to be forfeited during the vesting period. This assumption is based on our actual forfeiture rate on historical awards. Periodically, management will assess whether it is necessary to adjust the estimated rate to reflect changes in actual forfeitures or changes in expectations. Additionally, the expected dividend yield is equal to zero, as the Company has not historically issued and has no immediate plans to issue, a dividend.

A stock option roll-forward as of December 31, 2018 and changes during the six months then ended, is presented below:

(In thousands, except for weighted average price and life data)	**Awards**	**Weighted-Average Exercise Price**	**Aggregate Intrinsic Value**	**Weighted Average Remaining Contractual Life (yrs.)**
Outstanding at June 30, 2018	1,057	$ 22.46	$ 2,584	5.4
Granted	73	$ 12.20		
Exercised	(32)	$ 4.39	$ 141	
Forfeited, expired or repurchased	(336)	$ 34.95		
Outstanding at December 31, 2018	762	$ 16.71	$ 170	5.2
Vested and expected to vest at December 31, 2018	752	$ 16.74	$ 170	5.1
Exercisable at December 31, 2018	648	$ 16.84	$ 170	4.4

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Restricted Stock

The Company measures restricted stock compensation costs based on the stock price at the grant date less an estimate for expected forfeitures. The annual forfeiture rate used to calculate compensation expense was 6.5% for the six months ended December 31, 2018 and 2017.

A summary of restricted stock awards as of December 31, 2018 and changes during the six months then ended, is presented below:

(In thousands, except for weighted average price and life data)	Awards	Weighted Average Grant-date Fair Value	Aggregate Intrinsic Value
Non-vested at June 30, 2018	704	$ 20.06	
Granted	1,170	$ 9.91	
Vested	(383)	$ 20.12	$ 3,732
Forfeited	(94)	$ 14.33	
Non-vested at December 31, 2018	1,397	$ 11.93	

Performance-Based Shares

On September 22, 2017 and July 30, 2018, the Company approved and granted performance-based awards to certain key executives. The stock-settled awards will vest based on relative Total Shareholder Return (TSR) over a three-year period. The Company measures share-based compensation cost for TSR awards using a Monte-Carlo simulation model.

A summary of performance-based share awards as of December 31, 2018 and changes during the current fiscal year, is presented below:

(In thousands, except for weighted average price and life data)	Awards	Weighted Average Grant-date Fair Value	Aggregate Intrinsic Value
Non-vested at June 30, 2018	20	$ 25.58	
Granted	52	$ 17.69	
Vested		$	$
Forfeited		$	
Non-vested at December 31, 2018	72	$ 19.92	

Employee Stock Purchase Plan

In February 2003, the Company s stockholders approved an Employee Stock Purchase Plan (ESPP). Employees eligible to participate in the ESPP may purchase shares of the Company s stock at 85% of the lower of the fair market value of the common stock on the first day of the calendar quarter or the last day of the calendar quarter. Under the ESPP, employees can authorize the Company to withhold up to 10% of their compensation during any quarterly offering period, subject to certain limitations. The ESPP was implemented on April 1, 2003 and is qualified under Section 423 of the Internal Revenue Code. The Board of Directors authorized an aggregate total of 1.1 million shares of the Company s common stock for issuance under the ESPP. During the six months ended December 31, 2018 and 2017, 95 thousand shares and 28 thousand shares were issued under the ESPP, respectively. As of December 31, 2018, 702 thousand total cumulative shares have been issued under the ESPP.

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

	Three Months Ended December 31,		Six Months Ended December 31,	
(In thousands)	2018	2017	2018	2017
Selling, general and administrative expenses	$ 1,095	$ 1,926	$ 3,309	$ 3,713
Research and development	199	176	400	327

expenses				
Cost of sales	655	461	1,276	712
Total	$ 1,949	$ 2,563	$ 4,985	$ 4,752
Tax benefit at statutory rate	$ 439	$ 756	$ 1,122	$ 1,402

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Note 18. Employee Benefit Plan

The Company has a 401k defined contribution plan (the Plan) covering substantially all employees. Pursuant to the Plan provisions, the Company is required to make matching contributions equal to 50% of each employee s contribution, not to exceed 4% of the employee s compensation for the Plan year. Contributions to the Plan during the three months ended December 31, 2018 and 2017 were $445 thousand and $458 thousand, respectively. Contributions to the Plan during the six months ended December 31, 2018 and 2017 were $1.1 million and $1.0 million, respectively.

Note 19. Income Taxes

The Company uses the liability method to account 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.

The federal, state and local income tax expense for the three months ended December 31, 2018 was $2.6 million compared to $18.1 million for the three months ended December 31, 2017. The effective tax rates for the three months ended December 31, 2018 and 2017 were 17.6% and 56.4%, respectively. The effective tax rate for the three months ended December 31, 2018 was lower compared to the three months ended December 31, 2017 primarily due to the

application of 2017 Tax Reform in the prior-year period, which resulted in a revaluation of the Company s net long term deferred tax assets. In addition, the federal statutory tax rate for the three months ended December 31, 2018 was 21% compared to a blended federal statutory tax rate of 28% in the prior-year period.

The federal, state and local income tax benefit for the six months ended December 31, 2018 was $73.0 million compared to income tax expense of $25.6 million for the six months ended December 31, 2017. The effective tax rates for the six months ended December 31, 2018 and 2017 were 21.0% and 48.4%, respectively. The effective tax rate for the six months ended December 31, 2018 was lower compared to the six months ended December 31, 2017 primarily due to the application of 2017 Tax Reform in the prior-year period, which resulted in a revaluation of the Company s net long term deferred tax assets. In addition, the federal statutory tax rate for the six months ended December 31, 2018 was 21% compared to a blended federal statutory tax rate of 28% in the prior-year period.

The Company may recognize the tax benefit from an uncertain tax position claimed on a tax return only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement.

As of December 31, 2018 and June 30, 2018, the Company has total unrecognized tax benefits of $2.2 million and 2.5 million, respectively, which would impact the Company s effective tax rate if recognized. As a result of the positions taken during the period, the Company has not recorded any interest and penalties for the period ended December 31, 2018 in the statement of

operations and no cumulative interest and penalties have been recorded either in the Company s statement of financial position as of December 31, 2018 and June 30, 2018. The Company will recognize interest accrued on unrecognized tax benefits in interest expense and any related penalties in operating expenses.

As of December 31, 2018 and June 30, 2018, the Company had net long term deferred tax assets of $100.0 million and $22.1 million, respectively. The significant increase was primarily a result of the goodwill impairment charge recorded in the first quarter of Fiscal 2019, which negatively impacted book income, but is excluded from the calculation of taxable income.

The Company files income tax returns in the United States federal jurisdiction and various states. The Company s tax returns for Fiscal Year 2014 and prior generally are no longer subject to review as such years generally are closed. The Company s Fiscal Year 2016 federal return is currently under examination by the Internal Revenue Service (IRS). The Company cannot reasonably predict the outcome of the examination at this time. In July 2018, the Company was notified that the IRS will also expand their examination to include the Company s Fiscal 2015 and Fiscal 2017 federal returns. In October 2018, the Company was notified that the State of Pennsylvania will conduct a routine field audit of the Company s Fiscal 2016 and Fiscal 2017 corporate tax returns.

Note 20. Related Party Transactions

The Company had sales of $1.0 million and $1.2 million during the three months ended December 31, 2018 and 2017, respectively, to a generic distributor, Auburn Pharmaceutical Company (Auburn), which is a member of the Premier Buying Group. Sales to Auburn for the six months ended

December 31, 2018 and 2017 were $1.5 million and $2.0 million, respectively. Jeffrey Farber, a current board member, is the owner of Auburn. Accounts receivable includes amounts due from Auburn of $849 thousand and $585 thousand at December 31, 2018 and June 30, 2018, respectively.

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The Company also had sales of $920 thousand and $516 thousand during the three months ended December 31, 2018 and 2017, respectively, to a generic distributor, KeySource, which is a member of the OptiSource Buying Group. Sales to KeySource for the six months ended December 31, 2018 and 2017 were $1.5 million and $983 thousand, respectively. Albert Paonessa, a current board member, was appointed the CEO of KeySource in May 2017. Accounts receivable includes amounts due from KeySource of $605 thousand and $514 thousand as of December 31, 2018 and June 30, 2018, respectively.

The Company incurred expenses totaling $188 thousand and $369 thousand during the three and six months ended December 31, 2018, respectively, for online medical benefit services provided by a subsidiary of a variable interest entity. See Note 13 Commitments for more information. Accounts payable includes amounts due to the variable interest entity of $58 thousand as of June 30, 2018. There were no amounts due to the variable interest entity as of December 31, 2018.

Note 21. Material Contracts with Suppliers

Jerome Stevens Pharmaceuticals Distribution Agreement:

The Company s primary finished goods inventory supplier is JSP, in Bohemia, New York. Purchases of finished goods inventory from JSP accounted for approximately 34% and 39% of the Company s inventory purchases in

the three months ended December 31, 2018 and 2017, respectively. Purchases of finished goods inventory from JSP accounted for approximately 33% and 36% of the Company s inventory purchases in the six months ended December 31, 2018 and 2017, respectively.

On August 19, 2013, the Company entered into an agreement with JSP to extend its initial contract to continue as the exclusive distributor in the United States of three JSP products: Butalbital, Aspirin, Caffeine with Codeine Phosphate Capsules USP; Digoxin Tablets USP; and Levothyroxine Sodium Tablets USP. The amendment to the original agreement extends the initial contract, which was due to expire on March 22, 2014, for five years through March 2019. In connection with the amendment, the Company issued a total of 1.5 million shares of the Company s common stock to JSP and JSP s designees. In accordance with its policy related to renewal and extension costs for recognized intangible assets, the Company recorded a $20.1 million expense in cost of sales, which represents the fair value of the shares on August 19, 2013. On August 20, 2018, the Company announced that the JSP Distribution Agreement, which expires on March 23, 2019, will not be renewed or extended.

Note 22. Assets Held for Sale

In the first quarter of Fiscal 2019, the Company approved a plan to sell the Cody API business, which includes the manufacturing and distribution of active pharmaceutical ingredients for use in finished goods production. As such, all assets and liabilities associated with the Cody API business are recorded in the assets and liabilities held for sale captions in the Consolidated Balance Sheet as of December 31, 2018. As part of the held for sale classification, the Company recorded the assets of the Cody API business at fair value less costs to sell. The Company performed a fair value

analysis which resulted in a $29.9 million impairment of the Cody long-lived assets.

The following table summarizes the assets and liabilities of the Cody API business as of December 31, 2018:

(In thousands)	December 31, 2018
Assets	
Inventories	$ 3,351
Other current assets	355
Property, plant and equipment	6,736
Intangible assets, net	176
Other assets	804
Total assets held for sale	$ 11,422
Liabilities	
Accounts payable	$ 291
Accrued expenses	138
Accrued payroll and payroll-related expenses	775
Total liabilities held for sale	$ 1,204

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The following table summarizes the financial results of the Cody API business for the three and six months ended December 31, 2018 and 2017:

	Three Months Ended December 31,		Six Months Ended December 31,	
(In thousands)	2018	2017	2018	2017
Net sales	$ 654	$ 387	$ 2,142	$ 1,086
Pretax loss attributable to Cody API business	(4,314)	(4,468)	(39,335)	(9,957)

The loss attributable to the Cody API business during the six months ended December 31, 2018 includes the $29.9 million impairment charge to adjust the long-lived assets to its fair value less costs to sell.

Note 23. Amneal Distribution and Transition Support Agreement

On November 9, 2018, the Company entered into the Amneal Agreement, pursuant to which Amneal will be the Company s sole customer for Levothyroxine Sodium Tablets USP (the Product) from December 1, 2018 through March 23, 2019 and Amneal will re-sell the Product to its customers. Pursuant to the terms of the Agreement, the Company will receive an upfront payment of $50 million, which will guarantee the Company at least $50 million of gross profit on approximately $80 million of net sales of the Product during the term of the Agreement, subject to certain adjustments. The Company will continue to distribute Butalbital, Aspirin, Caffeine with Codeine Phosphate Capsules USP and Digoxin Tablets USP pursuant to its distribution agreement with JSP through March 23, 2019. Upon the effective date of the agreement on December 1, 2018, the Company received an upfront payment of $43.0 million, which was recorded as deferred revenue in the

Consolidated Balance Sheet, with the remaining $7.0 million to be received on February 1, 2019. As of December 31, 2018, based on Product sold to Amneal under the agreement, the remaining deferred revenue balance is $24.0 million.

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ITEM 2.
MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Cautionary Statement About Forward-Looking Statements

This Report on Form 10-Q and certain information incorporated herein by reference contains forward-looking statements which are not historical facts made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are not promises or guarantees and investors are cautioned that all forward-looking statements involve risks and uncertainties, including but not limited to the impact of competitive products and pricing, product demand and market acceptance, new product development, acquisition-related challenges, the regulatory environment, interest rate fluctuations, reliance on key strategic alliances, availability of raw materials, fluctuations in operating results and other risks detailed from time to time in our filings with the Securities and Exchange Commission (the SEC). These statements are based on management s current expectations and are naturally subject to uncertainty and changes in circumstances. We caution you not to place undue reliance upon any such forward-looking statements which speak only as of the date made. Lannett is under no obligation to, and expressly disclaims any such obligation to, update or alter its forward-looking statements, whether as a result of new information, future events or otherwise.

The following information should be read in conjunction with the consolidated financial statements and notes in Part I, Item 1 of this Quarterly Report and

with Management s Discussion and Analysis of Financial Condition and Results of Operations contained in the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 2018. All references to Fiscal 2019 or Fiscal Year 2019 shall mean the fiscal year ending June 30, 2019 and all references to Fiscal 2018 or Fiscal Year 2018 shall mean the fiscal year ended June 30, 2018.

Company Overview

Lannett Company, Inc. (a Delaware corporation) and its subsidiaries (collectively, the Company , Lannett , we or us) primarily develop, manufacture, package, market and distribute solid oral and extended release (tablets and capsules), topical, liquids, nasal and oral solution finished dosage forms of drugs, generic forms of both small molecule and biologic medications, that address a wide range of therapeutic areas. Certain of these products are manufactured by others and distributed by the Company. Additionally, the Company is pursuing partnerships, research contracts and internal expansion for the development and production of other dosage forms including: ophthalmic, nasal, patch, foam, buccal, sublingual, suspensions, soft gel, injectable and oral dosages.

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

The Company operates pharmaceutical manufacturing plants in Philadelphia,

Pennsylvania; Cody, Wyoming; Carmel, New York and Seymour, Indiana. The Company s customers include generic pharmaceutical distributors, drug wholesalers, chain drug stores, private label distributors, mail-order pharmacies, other pharmaceutical manufacturers, managed care organizations, hospital buying groups, governmental entities and health maintenance organizations. In the second quarter of Fiscal 2019, the Company ceased manufacturing functions at its State Road facility in Philadelphia, Pennsylvania. The Company discontinued distribution from its Townsend Road facility in Philadelphia, Pennsylvania as of January 31, 2019. The Company intends to sell its Townsend Road facility by the end of Fiscal 2019.

JSP Distribution Agreement

On March 23, 2004, the Company entered into an agreement with JSP (the JSP Distribution Agreement) for the exclusive distribution rights in the United States to four different JSP products, in exchange for 4.0 million shares of the Company s common stock. On August 19, 2013, the Company entered into an agreement with JSP to extend the JSP Distribution Agreement to continue as the exclusive distributor in the United States of three JSP products: Butalbital, Aspirin, Caffeine with Codeine Phosphate Capsules USP; Digoxin Tablets USP; and Levothyroxine Sodium Tablets USP. The amendment to the JSP Distribution Agreement extended the term of the initial contract, which was due to expire on March 22, 2014, for five years through March 23, 2019. In connection with the amendment, the Company issued a total of 1.5 million shares of the Company s common stock to JSP and JSP s designees.

Net sales of JSP products totaled $253.1 million and $144.9 million in Fiscal Year 2018 and the first six months of Fiscal Year 2019, respectively. Of that amount, Levothyroxine Sodium Tablets USP net sales totaled $245.9 million and $142.4 million in Fiscal Year 2018 and the first six months of Fiscal Year 2019, respectively. Gross margins were

approximately 60% in both periods.

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After the close of business on August 17, 2018, JSP notified the Company that it will not extend or renew the JSP Distribution Agreement when the current term expires on March 23, 2019.

Because products covered by the JSP Distribution Agreement generate a significant portion of our revenues and gross profits, JSP s decision not to renew or extend its distribution agreement with us will materially adversely affect our future operating results and cash flows beginning in the fourth quarter of Fiscal 2019. When announced on August 20, 2018, this resulted in a significant decline in the Company s market capitalization.

As noted above, JSP s decision not to renew or extend its distribution agreement with us will materially adversely affect our future operating results, liquidity and cash flows, which could impact our ability to comply with the financial and other covenants in our Amended Senior Secured Credit Facility. As of December 31, 2018, the Company was in compliance with its financial covenants. As of December 31, 2018, cash and cash equivalents totaled $163.8 million in addition to availability under our undrawn Revolver totaling $125.0 million.

On December 10, 2018, the Company entered into an amendment to the Senior Secured Credit Facility and the Credit and Guaranty Agreement. Pursuant to the amendment, the Secured Net Leverage Ratio applicable to the financial leverage ratio covenant was increased from 3:25:1.00 to 4.25:1.00 as of December 31, 2019 and prior to September 30, 2020, and then to 4:00:1:00 as of September 30, 2020.

Based on its projections over the next twelve months, the Company expects to have sufficient liquidity and cashflows to meet its operating and debt service requirements for at least the next twelve months from the issuance of the December 31, 2018 consolidated financial statements. The Company also expects to be in compliance with its financial covenants during the same period.

Although management cannot predict with certainty the precise impact its plans will have on offsetting the loss of the JSP Distribution Agreement, management is continuing to finalize plans to offset the impact of the loss on a short- and long-term basis. These plans currently include, among other things, an emphasis on reducing cost of sales, research and development (R&D) and selling, general and administrative (SG&A) expenses; continuing to accelerate new product launches; increasing the level of strategic partnerships; and reducing capital expenditures. To that end, the Company has already launched more than 15 new products since January 2018, which are expected to generate annualized net sales of over $80 million, and expects to maintain this pace with approximately 10 additional launches in the first half of calendar year 2019, two of which have already launched in January 2019. The Company has also signed several distribution and in-licensing agreements during this fiscal year that will provide immediate contribution margins in the near future. Additionally, the Company continues to supplement existing in-process cost reduction plans with additional cost savings initiatives, which is expected to generate annualized cost savings of approximately $66.0 million by the end of Fiscal 2020 when compared to the Fiscal 2018 expenses, of which approximately half will be reinvested into other business growth opportunities. Management will also continue its emphasis on accelerating ANDA filings, as evidenced by the five ANDAs filed with the FDA in the first half of Fiscal 2019. Management also plans to attempt, at the appropriate time, to refinance a significant portion of its outstanding long-term debt to reduce principal repayment requirements and eliminate

existing financial covenants, which we expect will increase related interest expense, but will positively impact short-term cash flows.

Amneal Distribution and Transition Support Agreement

On November 9, 2018, the Company entered into a Distribution and Transition Support Agreement (the Amneal Agreement) with Amneal Pharmaceuticals, Inc. (Amneal) and JSP, pursuant to which Amneal will be the Company s sole customer for Levothyroxine Sodium Tablets USP (the Product) from December 1, 2018 through March 23, 2019 and Amneal will re-sell the Product to its customers. Pursuant to the terms of the Agreement, the Company will receive an upfront payment of $50 million, which will guarantee the Company at least $50 million of gross profit on approximately $80 million of net sales of the Product during the term of the Agreement, subject to certain adjustments. The Company will continue to distribute Butalbital, Aspirin, Caffeine with Codeine Phosphate Capsules USP and Digoxin Tablets USP pursuant to its distribution agreement with JSP through March 23, 2019.

Sale of Cody API Business

The Company is analyzing and exploring various financing and operational courses to improve the Company s base business, including a focus on nearer term opportunities and an overall strategic shift toward the Company s core competencies and optimization of its cost structure. In connection therewith, the Company approved a plan in September 2018 to sell the active pharmaceutical ingredient manufacturing and distribution business of its Cody Laboratories subsidiary (the Cody API business). As part of its decision, the Company considered (i) the Cody API business s timeline to profitability, (ii) continuing investment needed to be competitive and (iii) the

reduction to the Company s operating expenses, estimated to be approximately $18 million on an annualized basis, that would result from a sale of the Cody API business. Excluded from the sale will be the manufacturing of the finished dosage form of the Company s Cocaine Hydrochloride product line.

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As a result of the decision to sell the Cody API business, all of the assets, excluding the Cocaine Hydrochloride product line mentioned above, and all of the liabilities associated with the Cody API business, are classified as assets and liabilities held for sale on the Company s Consolidated Balance Sheet as of December 31, 2018, with such assets and liabilities recorded at fair value less costs to sell. As a result of a fair value analysis of the Cody API business, the Company recorded an impairment charge of $29.9 million in the first quarter of Fiscal 2019.

Cody Restructuring Plan

On June 29, 2018, the Company announced a restructuring plan related to the future of Cody Laboratories, Inc. and the Company s operations (the Cody Restructuring Plan). The plan focuses on a more select set of opportunities which will result in streamlined operations, improved efficiencies and a reduced cost structure. The Company currently estimates that it will incur approximately $4.5 million of total costs to implement the Cody Restructuring Plan, comprised primarily of approximately $3.0 million of severance and employee-related costs. These amounts are preliminary estimates based on the information currently available to management. It is possible that additional charges and future cash payments could occur in relation to the restructuring actions.

2016 Restructuring Plan

On February 1, 2016, in connection with the acquisition of KUPI, the Company announced a plan related to the future integration of KUPI and the Company s operations (the 2016 Restructuring Program). The plan focuses on the closure of KUPI s corporate functions and the consolidation of manufacturing, sales,

research and development and distribution functions. The Company estimates that it will incur an aggregate of up to approximately $20.0 million in restructuring charges for actions that have been announced or communicated since the 2016 Restructuring Program began. Of this amount, approximately $11.0 million relates to employee separation costs, approximately $1.0 million relates to contract termination costs and approximately $8.0 million relates to facility closures costs and other actions. In the second quarter of Fiscal 2019, the Company ceased manufacturing functions at its State Road facility in Philadelphia, Pennsylvania. The Company discontinued distribution from its Townsend Road facility in Philadelphia, Pennsylvania as of January 31, 2019. The Company intends to sell its Townsend Road facility by the end of Fiscal 2019.

Financial Summary

For the second quarter of Fiscal Year 2019, net sales increased to $193.7 million compared to $184.3 million in the same prior-year period. Gross profit decreased to $69.8 million compared to $87.5 million in the prior-year period and gross profit percentage decreased to 36% compared to 47% in the prior-year period. R&D expenses decreased 9% to $9.7 million compared to $10.7 million in the second quarter of Fiscal Year 2018 while SG&A expenses decreased 19% to $23.2 million from $28.5 million in the prior-year period. Restructuring expenses decreased to $213 thousand from $1.0 million in the prior-year period. Operating income for the second quarter of Fiscal Year 2019 was $36.7 million compared to $47.1 million in the second quarter of Fiscal Year 2018. Net income for the second quarter of Fiscal Year 2019 was $12.4 million, or $0.32 per diluted share compared to $14.0 million, or $0.37 per diluted share in the second quarter of Fiscal Year 2018.

For the first six months of Fiscal 2019, net sales increased to $348.8 million compared to $339.3 million in the same prior-year period. Gross profit decreased

to $129.0 million compared to $155.1 million in the prior-year period. Gross profit percentage decreased to 37% compared to 46% in the prior-year period. R&D expenses increased 8% to $19.5 million compared to $18.1 million in the first six months of Fiscal 2018 while SG&A expenses decreased 8% to $43.8 million from $47.5 million in the prior-year period. Restructuring expenses decreased to $1.2 million from $1.6 million in the prior-year period. Operating loss for the first six months of Fiscal 2019, which included asset impairment charges totaling $369.5 million was $305.1 million compared to operating income of $87.8 million in the prior-year period. Net loss for the first six months of Fiscal 2019 was $275.2 million, or $7.30 per diluted share compared to net income of $27.3 million, or $0.72 per diluted share in the prior-year period.

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

Results of Operations - Three months ended December 31, 2018 compared with the three months ended December 31, 2017

Net sales increased 5% to $193.7 million for the three months ended December 31, 2018. The following table identifies the Company s net product sales by medical indication for the three months ended December 31, 2018 and 2017:

(In thousands) Medical Indication	Three Months Ended December 31, 2018	2017
Antibiotic	$ 4,187	$ 3,552
Anti-Psychosis	14,036	22,799
Cardiovascular	25,680	10,135
Central Nervous System	6,187	6,925
Gallstone	2,489	5,282
Gastrointestinal	10,009	15,055
Glaucoma	512	2,164
Migraine	12,551	15,484
Muscle Relaxant	3,121	3,219
Pain Management	8,968	6,128
Respiratory	1,163	2,230
Thyroid Deficiency	88,477	68,794
Urinary	1,606	2,840
Other	6,827	13,105
Contract manufacturing revenue	7,905	6,593
Net sales	$ 193,718	$ 184,305

The increase in net sales was driven by increased volumes of $39.8 million, partially offset by decreased average selling price of products of $30.4 million. Volumes were favorably impacted due to increased sales of Levothyroxine as customer demand increased in anticipation of the transition of the Product. Additional sales in the Cardiovascular medical indication related

to a distribution agreement entered into with Aralez in November 2017 also contributed to increased volumes. On August 10, 2018, Aralez filed a Chapter 11 petition in the United States Bankruptcy Court for the Southern District of New York and continues to operate its business in the normal course. The Company does not believe this will materially affect our distribution agreement with Aralez. Average selling prices were negatively impacted by price protection and stock-shelf adjustments in the second quarter of Fiscal 2019 as a result of anticipated price increases and decreases, respectively, on certain products. Average selling prices were also impacted by product mix, changes within distribution channels and, to a lesser extent, competitive pricing pressures. Although the Company has benefited in the past from favorable pricing trends, these trends have reversed.

In January 2017, a provision in the Bipartisan Budget Act of 2015 required drug manufacturers to pay additional rebates to state Medicaid programs if the prices of their generic drugs rise at a rate faster than inflation. The provision negatively impacted the Company s net sales by $7.1 million during the three months ended December 31, 2018 and 2017, respectively.

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

Medical indication	Sales volume change %	Sales price change %
Antibiotic	30%	(12)%
Anti-Psychosis	(15)%	(23)%
Cardiovascular	133%	20%
Central Nervous System	(3)%	(8)%
Gallstone	8%	(61)%
Gastrointestinal	(3)%	(31)%
Glaucoma	(58)%	(18)%
Migraine	(7)%	(12)%
Muscle Relaxant	13%	(16)%
Pain Management	62%	(16)%
Respiratory	(47)%	(1)%
Thyroid Deficiency	34%	(5)%

Urinary	(17)%	(26)%

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Central Nervous System.

Methylphenidate Hydrochloride Extended Release Tablets (Methylphenidate ER)

Per a teleconference in November 2014, the FDA informed KUPI that it was changing the therapeutic equivalence rating of its Methylphenidate ER product from AB (therapeutically equivalent) to BX. A BX-rated drug is a product for which data is insufficient to determine therapeutic equivalence; it is still approved and can be prescribed, but the FDA does not recommend it as automatically substitutable for the brand-name drug at the pharmacy.

During the November 2014 teleconference, the FDA also asked KUPI to either voluntarily withdraw its product or to conduct new bioequivalence (BE) testing in accordance with the recommendations for demonstrating bioequivalence to Concerta proposed in a new draft BE guidance that the FDA issued earlier that November. The Company agreed to conduct new BE studies per the new draft BE guidance. KUPI submitted the data from those studies to the FDA in June 2015 and met with the FDA to discuss the results in July 2015.

On October 18, 2016, the Company received notice from the FDA that it will seek to withdraw approval of the Company s ANDA for Methylphenidate ER. The FDA s notice includes an opportunity for the Company to request a hearing on this matter. Following the Company s request under the Freedom of Information Act (FOIA) for documents to support its request for a hearing, the FDA granted an extension to submit all data, information and analyses upon which the request for a hearing relies. The FDA has not yet made a decision as to whether to grant a hearing to the Company.

The Company intends to continue working with the FDA to regain the AB rating, and in the meantime, maintain the drug on the U.S. market with a BX rating. However, there can be no assurance as to when or if the Company will regain the AB rating or be permitted to remain on the market. If the Company was to receive the AB rating, net sales of the product could increase subject to market factors existing at that time. The Company also agreed to potential acquisition-related contingent payments to UCB related to Methylphenidate ER if the FDA reinstates the AB-rating and certain sales thresholds are met. Such potential contingent payments are set to expire after December 31, 2020.

In August 2018, the Company entered into an exclusive perpetual licensing agreement with Andor Pharmaceuticals, LLC (Andor) for Methylphenidate ER tablets USP (CII) in 18 mg, 27 mg, 36 mg and 54 mg strengths. Andor s pending ANDA of Methylphenidate included all bioequivalence metrics recommended by the FDA and is expected to be approved as an AB-rated generic equivalent to the brand Concerta®.

Under the licensing agreement with Andor, Lannett will primarily provide sales, marketing and distribution support of Andor s Methylphenidate ER product, for which it will receive a percentage of the net profits.

Pain Management. *Cocaine Topical Solution (C-Topical)*

In December 2017, a competitor received approval from the FDA to market and sell a Cocaine Hydrochloride topical product. This approval affects the Company s right to market and sell its unapproved C-Topical product. According to FDA guidance, the FDA typically allows the marketing of unapproved products for up to one year following the approval of an

NDA for the product. Subsequently, the Company would not be permitted to market and sell its unapproved C-Topical product. During the six months ended December 31, 2018 and 2017, the Company s net sales of C-Topical were $7.0 million and $9.7 million, respectively.

The competitor s Cocaine Hydrochloride topical product first appeared in FDA s Orange Book in January 2018, and the Orange Book listing was updated in February 2018 to include New Chemical Entity (NCE) exclusivity. Under the Federal Food Drug and Cosmetic Act, the grant of NCE exclusivity provides that additional applications for approval of the same product under Section 505(b)(2) may not be submitted to the FDA for approval before the expiration of five years from the date of the approval of the first application. Because the Company submitted its application for approval prior to the date of approval of the competitor s Cocaine Hydrochloride topical application, the Company does not believe the NCE exclusivity will apply to the Company s application. The FDA continues to review the Company s application, and in July 2018 issued a Complete Response Letter which required an additional study and other information. The Company is in the process of addressing the Complete Response Letter and cannot say for certain when or if the application will be approved.

The competitor filed a citizen petition with the FDA in February 2019, claiming that the grant of the NCE exclusivity blocks the approval of the Company s application for five years and requesting that the FDA refuse to accept any further submissions in furtherance of the Company s Section 505(b)(2) application, treat as withdrawn any submissions made by the Company after December 2017 and withdraw the Company s Section 505(b)(2) application. The Company intends to file an opposition to the citizen petition.

At this time, the Company cannot predict the ultimate impact that these developments will have on its business and financial performance, including but not limited to any possible price reductions based on the competitor product, for how long the Company will continue to be permitted to market and sell C-Topical, or the possible effect on the Company s pending NDA application.

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Gastrointestinal. *Polyethylene Glycol (PEG)3350 (Glycolax)*

On April 2, 2018, the FDA issued a Federal Register notice (Docket No. FDA-2008-N-0549) indicating that it was affirming a preliminary summary judgment decision that the FDA issued in 2014, denying a hearing, and withdrawing all ANDAs for prescription PEG 3350 products, including the Company s Glycolax product. The FDA s decision is based on the FDA finding that there are no meaningful differences between Rx PEG 3350 products and OTC PEG 3350 products and, therefore, that the Rx products are misbranded. The FDA ordered the Company s ANDA withdrawn effective May 2, 2018, after which the Company would no longer be permitted to market or sell its Glycolax product. The Company disputes the FDA s finding that there are no meaningful differences and disputes that summary judgment was appropriate in light of the factual issues raised by the ANDA holders. On April 9, 2018, the Company, along with three other PEG 3350 ANDA holders, filed a request for a stay of the FDA order pending appeal of the decision to the District of Columbia Circuit Court of Appeals. On April 16, 2018, the FDA granted a stay of its order withdrawing the Company s ANDA through November 2, 2018, after which the Company will no longer be permitted to market or sell its Glycolax product. The Company filed an appeal of the FDA withdrawal order to the United States Court of Appeals for the District of Columbia. In July 2018, the Company filed a brief in support of the appeal. All briefing was completed by September 15, 2018 and an argument hearing was held on October 12, 2018. The Company is unable to say whether the Court will decide the appeal prior to the November 2, 2018 withdrawal date. During the six months ended December 31, 2018 and 2017, the Company s net sales of Glycolax were $6.0 million and $8.3 million, respectively, although gross profit percentages for this product were in the single-digits in each of these periods. At this time, the Court has not yet issued a

ruling and the Company is unable to determine the outcome of this matter nor can it predict when or if the Company s product will be removed from the market.

Thalomid®

The Company filed with the FDA an ANDA No. 206601, along with a paragraph IV certification, alleging that the fifteen patents associated with the Thalomid drug product are invalid, unenforceable and/or not infringed. On January 30, 2015, Celgene Corporation and Children s Medical Center Corporation filed a patent infringement lawsuit in the United States District Court for the District of New Jersey, alleging that the Company s filing of ANDA No. 206601 constitutes an act of patent infringement and seeking a declaration that the patents at issue are valid and infringed. A settlement agreement was reached and the Court dismissed the lawsuit in October 2017. Pursuant to the settlement agreement, the Company entered into a license agreement that permits Lannett to manufacture and market in the U.S. its generic thalidomide product as of August 1, 2019 or earlier under certain circumstances. In the second quarter of Fiscal 2019, the Company received a major complete response letter that may delay the Company s ability to market this product.

The Company sells its products to customers in various distribution channels. The table below presents the Company s net sales to each distribution channel for the three months ended December 31:

(In thousands) Customer Distribution Channel	December 31, 2018	December 31, 2017
Wholesaler/Distributor	$ 153,641	$ 126,765
Retail Chain	24,627	40,233
Mail-Order Pharmacy	7,545	10,714
Contract manufacturing revenue	7,905	6,593
Net sales	$ 193,718	$ 184,305

Net sales to wholesalers/distributors increased significantly primarily due to additional sales of Levothyroxine related to the Amneal Agreement. Net sales to retail chains decreased significantly as a result of additional sales in the three months ended December 31, 2017 to a customer that was unable to obtain supply from a competitor due to a temporary disruption in the competitor s supply chain.

Cost of Sales, including amortization of intangibles. Cost of sales, including amortization of intangibles, for the second quarter of Fiscal 2019 increased 28% to $123.9 million from $96.9 million in the same prior-year period. The increase was primarily attributable to increased volumes of products sold, and to a lesser extent, increased product royalties. Product royalties expense included in cost of sales totaled $10.8 million for the second quarter of Fiscal Year 2019 and $7.2 million for the second quarter of Fiscal Year 2018. Amortization expense included in cost of sales totaled $8.2 million for the second quarter of Fiscal 2019 compared to $7.9 million for the second quarter of Fiscal 2018.

Gross Profit. Gross profit for the second quarter of Fiscal 2019 decreased 20% to $69.8 million or 36% of net sales. In comparison, gross profit for the second quarter of Fiscal 2018 was $87.5 million or 47% of net sales. The decrease in gross profit percentage was primarily attributable to price protection and stock-shelf adjustments in the second quarter of Fiscal 2019 as well as lower average

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selling price of certain key products and increased product royalties related to a distribution agreement entered into with Aralez in November 2017.

Research and Development Expenses. Research and development expenses for the second quarter decreased 9% to $9.7 million in Fiscal 2019 from $10.7 million in Fiscal 2018. The decrease was primarily due to lower incentive compensation-related expenses.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased 19% to $23.2 million in the second quarter of Fiscal 2019 compared with $28.5 million in Fiscal 2018. The decrease was primarily due to lower incentive-based compensation and a reduction of selling and marketing expenses related to product salesforce, partially offset by depreciation related to software integration costs.

The Company is focused on controlling operating expenses and has implemented its 2016 Restructuring Plan and Cody Restructuring Plan as noted above, however increases in personnel and other costs to facilitate enhancements in the Company s infrastructure and expansion may continue to impact operating expenses in future periods.

Restructuring Expenses. Restructuring expenses decreased $822 thousand to $213 thousand for the second quarter of Fiscal

Year 2019 compared to the prior-year period primarily due to a reversal of employee separation costs related to the Cody Restructuring Program. See Note 4 Restructuring Charges for more information.

Other Income (Loss). Interest expense for the three months ended December 31, 2018 totaled $21.5 million compared to $20.7 million for the three months ended December 31, 2017. The weighted average interest rate for the second quarter of Fiscal 2019 and 2018 was 9.6% and 8.3%, respectively. Investment income totaled $556 thousand in the second quarter of Fiscal 2019 compared with $2.3 million in the second quarter of Fiscal 2018.

Income Tax. The Company recorded income tax expense in the second quarter of Fiscal 2019 of $2.6 million compared to $18.1 million in the second quarter of Fiscal 2018. The effective tax rate for the three months ended December 31, 2018 was 17.6%, compared to 56.4% for the three months ended December 31, 2017. The effective tax rate for the three months ended December 31, 2018 was lower compared to the three months ended December 31, 2017 primarily due to the application of 2017 Tax Reform in the prior-year period, which resulted in a revaluation of the Company s net long term deferred tax assets. In addition, the federal statutory tax rate for the three months ended December 31, 2018 was 21% compared to a blended federal

statutory tax rate of 28% in the prior-year period.

Net Income. For the three months ended December 31, 2018, the Company reported net income of $12.4 million, or $0.32 per diluted share. Comparatively, net income in the corresponding prior-year period was $14.0 million, or $0.37 per diluted share.

Results of Operations - Six months ended December 31, 2018 compared with the six months ended December 31, 2017

Net sales increased 3% to $348.8 million for the six months ended December 31, 2018. The following table identifies the Company s net product sales by medical indication for the six months ended December 31, 2018 and 2017:

(In thousands) Medical Indication	Six Months Ended December 31, 2018	2017
Antibiotic	$ 8,276	$ 6,900
Anti-Psychosis	24,924	37,791
Cardiovascular	47,450	21,441
Central Nervous System	13,384	15,742
Gallstone	4,703	11,846
Gastrointestinal	25,048	29,608
Glaucoma	1,060	4,832
Migraine	22,288	30,499
Muscle Relaxant	6,300	7,010
Pain Management	13,915	11,889
Respiratory	2,178	3,876
Thyroid Deficiency	142,354	116,008
Urinary	3,158	5,837
Other	21,168	25,802
Contract manufacturing revenue	12,566	10,185
Net sales	$ 348,772	$ 339,266

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The increase in net sales was driven by increased volumes of $52.3 million, partially offset by decreased average selling price of products of $42.8 million. Volumes were favorably impacted due to increased sales of Levothyroxine as customer demand increased in anticipation of the transition of the Product. Additional sales in the Cardiovascular medical indication related to a distribution agreement entered into with Aralez in November 2017 also contributed to increased volumes. On August 10, 2018, Aralez filed a Chapter 11 petition in the United States Bankruptcy Court for the Southern District of New York and continues to operate its business in the normal course. The Company does not believe this will materially affect our distribution agreement with Aralez. Average selling prices were negatively impacted by price protection and stock-shelf adjustments in the second quarter of Fiscal 2019 as a result of anticipated price increases and decreases, respectively, on certain products. Average selling prices were also impacted by product mix, changes within distribution channels and, to a lesser extent, competitive pricing pressures. Although the Company has benefited in the past from favorable pricing trends, these trends have reversed.

In January 2017, a provision in the Bipartisan Budget Act of 2015 required drug manufacturers to pay additional rebates to state Medicaid programs if the prices of their generic drugs rise at a rate faster than inflation. The provision negatively impacted the Company s net sales by $15.0 million and $12.5 million during the six months ended December 31, 2018 and 2017, respectively, which contributed to the overall decreased average selling price.

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

Medical indication	Sales volume change %	Sales price change %
Antibiotic	16%	4%
Anti-Psychosis	(13)%	(21)%
Cardiovascular	124%	(3)%
Central Nervous System	(10)%	(5)%
Gallstone	(2)%	(58)%
Gastrointestinal	2%	(17)%
Glaucoma	(61)%	(17)%
Migraine	(18)%	(9)%
Muscle Relaxant	(3)%	(7)%
Pain Management	32%	(15)%
Respiratory	(49)%	5%
Thyroid Deficiency	28%	(5)%
Urinary	(41)%	(5)%

The Company sells its products to customers in various distribution channels. The table below presents the Company s net sales to each distribution channel for the six months ended December 31, 2018 and 2017:

(In thousands) Customer Distribution Channel	December 31, 2018	December 31, 2017
Wholesaler/Distributor	$ 269,994	$ 247,566
Retail Chain	49,668	59,001
Mail-Order Pharmacy	16,544	22,514
Contract manufacturing revenue	12,566	10,185
Net sales	$ 348,772	$ 339,266

Net sales to wholesalers/distributors increased significantly primarily due to additional sales of Levothyroxine related to the Amneal Agreement. Net sales to retail chains decreased significantly as a result of additional sales in the six months ended December 31, 2017 to a customer that was unable to obtain supply from a competitor due to a temporary disruption in the competitor s supply chain. The decrease in sales to retail chains was partially offset by additional sales of a product in the Cardiovascular medical indication related to a distribution agreement entered into with Aralez in November 2017.

Cost of Sales, including amortization of intangibles. Cost of sales, including amortization of intangibles for the

first six months of Fiscal 2019 increased 19% to $219.8 million from $184.1 million in the same prior-year period. The increase was primarily attributable to increased volumes of products sold, and to a lesser extent, increased product royalties. Product royalties expense included in cost of sales totaled $16.8 million for the first six months of Fiscal Year 2019 and $13.9 million for the first six months of Fiscal Year 2018. Amortization expense included in cost of sales totaled $16.4 million for the first six months of Fiscal Year 2019 and $15.7 million for the first six months of Fiscal Year 2018.

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Gross Profit. Gross profit for the first six months of Fiscal 2019 decreased 17% to $129.0 million or 37% of net sales. In comparison, gross profit for the first six months of Fiscal 2018 was $155.1 million or 46% of net sales. The decrease in gross profit percentage was primarily attributable to price protection and stock-shelf adjustments in the second quarter of Fiscal 2019 as well as lower average selling price of certain key products and increased product royalties related to a distribution agreement entered into with Aralez in November 2017.

Research and Development Expenses. Research and development expenses for the first six months increased 8% to $19.5 million in Fiscal 2019 from $18.1 million in Fiscal 2018. The increase was primarily due to higher product development expenses related to various pipeline projects, partially offset by lower incentive compensation-related expenses.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased 8% to $43.8 million in the first six months of Fiscal 2019 compared with $47.5 million in Fiscal 2018. The decrease was primarily due to lower incentive compensation-related expenses and a reduction of selling and marketing expenses related to product salesforce, partially offset by additional regulatory and

quality control costs as well as depreciation related to software integration costs.

The Company is focused on controlling operating expenses and has implemented its 2016 Restructuring Plan and Cody Restructuring Plan as noted above, however increases in personnel and other costs to facilitate enhancements in the Company s infrastructure and expansion may continue to impact operating expenses in future periods.

Restructuring Expenses. Restructuring expenses decreased 21% to $1.2 million compared to the prior-year period primarily due to a reversal of employee separation costs related to the Cody Restructuring Program in the second quarter of Fiscal 2019. See Note 4 Restructuring Charges for more information.

Asset Impairment Charges. In the first quarter of Fiscal 2019, the Company approved a plan to sell the Cody API business. As such, all assets and liabilities associated with the Cody API business are recorded in the assets and liabilities held for sale captions in the Consolidated Balance Sheet as of December 31, 2018. As part of the held for sale classification, the Company recorded the assets of the Cody API business at fair value less costs to sell. The Company performed a fair value analysis which resulted in a $29.9 million impairment of the Cody long-lived assets. See Note 22 Assets Held for Sale for more information.

On August 17, 2018, JSP notified the Company that it will not extend or renew the JSP Distribution Agreement when the current term expires on March 23, 2019. The Company determined that JSP s decision represented a triggering event under U.S. GAAP to perform an analysis to determine the potential for impairment of goodwill. On October 4, 2018, the Company completed the analysis based on market data and concluded that it would record a full impairment of goodwill totaling $339.6 million. See Note 10 Goodwill and Intangible Assets for more information.

Other Income (Loss). Interest expense in the first six months of Fiscal 2019 totaled $42.9 million compared to $41.6 million in Fiscal 2018. The weighted average interest rate for the first six months of Fiscal 2019 and 2018 was 9.5% and 8.3%, respectively. Investment income in the first six months of Fiscal 2019 totaled $935 thousand compared with investment income of $3.5 million in Fiscal 2018.

Income Tax. The Company recorded an income tax benefit in the first six months of Fiscal 2019 of $73.0 million compared to income tax expense of $25.6 million in the first six months of Fiscal 2018. The effective tax rate for the six months ended December 31, 2018 was 21.0% compared to 48.4% for the six months ended December 31, 2017. The effective tax rate for the six months ended December 31, 2018 was lower compared to the same prior-year period primarily due to the application of 2017 Tax Reform in the prior-year period, which resulted in a revaluation of the Company s net long term deferred

tax assets. In addition, the federal statutory tax rate for the six months ended December 31, 2018 was 21% compared to a blended federal statutory tax rate of 28% in the prior-year period.

Net Income (Loss). For the six months ended December 31, 2018, the Company reported net loss of $275.2 million, or $7.30 per diluted share. Comparatively, net income in the corresponding prior-year period was $27.3 million, or $0.72 per diluted share.

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Liquidity and Capital Resources

Cash Flow

Until November 25, 2015, the date of the KUPI acquisition, the Company had historically financed its operations with cash flow generated from operations supplemented with borrowings from various government agencies and financial institutions. At December 31, 2018, working capital was $350.6 million as compared to $326.0 million at June 30, 2018, an increase of $24.6 million. Current product portfolio sales as well as sales related to future product approvals are anticipated to continue to generate positive cash flow from operations.

Net cash provided by operating activities of $94.0 million for the six months ended December 31, 2018 reflected net loss of $275.2 million, adjustments for non-cash items of $334.3 million, as well as cash used by changes in operating assets and liabilities of $34.9 million. In comparison, net cash provided by operating activities of $76.1 million for the six months ended December 31, 2017 reflected net income of $27.3 million, adjustments for non-cash items of $61.7 million, as well as cash used by changes in operating assets and liabilities of $12.9 million.

Significant changes in operating assets and liabilities from June 30, 2018 to December 31, 2018 were comprised of:

- An increase in accounts receivable of $25.9 million primarily as a result of the timing of receipts as well as increased sales of Levothyroxine as

customer demand increased in anticipation of the transition of the Product. The Company s days sales outstanding (DSO) at December 31, 2018, based on gross sales for the six months ended December 31, 2018 and gross accounts receivable at December 31, 2018 was 81 days. The level of DSO at December 31, 2018 was comparable to the Company s expectations that DSO will be in the 70 to 85 day range based on customer payment terms.

- An increase in deferred revenues totaling $24.0 million due to upfront payment received as part of the Amneal Agreement, partially offset by product sold under the agreement in the second quarter of Fiscal 2019.

- A decrease in prepaid income taxes totaling $17.5 million primarily due to receipt of approximately $15.2 million in tax refunds from the Internal Revenue Service (IRS).

- An increase in accrued payroll and payroll-related costs of $8.5 million primarily due to higher accrued incentive compensation-related costs and, to a lesser extent, the timing of payroll payments

- An increase in settlement liability totaling $8.0 million due to the settlement of the Texas Medicaid Investigation. See Note 12 Legal, Regulatory Matters and Contingencies for more information.

Significant changes in operating assets and liabilities from June 30, 2017 to December 31, 2017 were comprised of:

- An increase in accounts receivable of $52.7 million mainly due to increased sales as well as the timing of collections during the quarter ended December 31, 2017 compared to the quarter ended June 30, 2017. The Company s days sales outstanding (DSO) at December 31, 2017, based on gross sales for the six months ended December 31, 2017 and gross accounts receivable at December 31, 2017 was 75 days. The level of DSO at December 31, 2017 was comparable to the Company s expectations that DSO will be in the 70 to 80 day range based on customer payment terms.

- An increase in accounts payable totaling $28.9 million primarily due to the timing of payments to a few major suppliers.

- An increase in inventories totaling $13.0 million primarily due to the timing of customer order fulfillment.

- An increase in accrued payroll and payroll-related costs of $11.2 million primarily due to higher incentive compensation-related costs as well as approximately $2.6 million related to severance benefits for the former chief executive officer.

- A decrease in prepaid income taxes totaling $15.0 million primarily due to income tax refunds received from the IRS.

Net cash provided by investing activities of $5.7 million for the six months ended December 31, 2018 is mainly the result of proceeds from the sale of property, plant

and equipment of $14.1 million and proceeds from the sale of an outstanding VIE loan to a third party of $5.6 million, partially offset by purchases of property, plant and equipment of $12.0 million and purchases of an intangible asset of $2.0 million. Net cash used in investing activities of $26.3 million for the six months ended December 31, 2017 is mainly the result of purchases of investment securities of $42.8 million and purchases of property, plant and equipment of $26.4 million and the purchase of an intangible asset of $2.0 million, partially offset by proceeds from the sale of investment securities of $44.9 million.

Net cash used in financing activities of $34.5 million for the six months ended December 31, 2018 was primarily due to debt repayments of $33.4 million, payments of debt issuance costs totaling $1.1 million and purchases of treasury stock totaling $475 thousand, partially offset by proceeds from issuance of stock pursuant to stock compensation plans of $521 thousand. Net cash used in financing activities of $27.5 million for the six months ended December 31, 2017 was primarily due to debt repayments of $27.3

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million, purchases of treasury stock totaling $1.0 million, partially offset by proceeds from issuance of stock pursuant to stock compensation plans of $806 thousand.

Credit Facility and Other Indebtedness

The Company has previously entered into and may enter into future agreements with various government agencies and financial institutions to provide additional cash to help finance the Company s various capital investments and potential strategic opportunities. These borrowing arrangements as of December 31, 2018 are as follows:

Amended Senior Secured Credit Facility

On November 25, 2015, in connection with its acquisition of KUPI, Lannett entered into a credit and guaranty agreement (the Credit and Guaranty Agreement) among certain of its wholly-owned domestic subsidiaries, as guarantors, Morgan Stanley Senior Funding, Inc., as administrative agent and collateral agent and other lenders providing for a senior secured credit facility (the Senior Secured Credit Facility). The Senior Secured Credit Facility consisted of Term Loan A in an aggregate principal amount of $275.0 million, Term Loan B in an aggregate principal amount of $635.0 million and a revolving credit facility providing for revolving loans in an aggregate principal amount of up to $125.0 million.

On June 17, 2016, Lannett amended the Senior Secured Credit Facility and the Credit and Guaranty Agreement to raise an incremental term loan in the principal amount of $150.0 million (the

Incremental Term Loan) and amended certain sections of the agreement (the Amended Senior Secured Credit Facility). The terms of this Incremental Term Loan are substantially the same as those applicable to the Term Loan B. The Company used the proceeds of the Incremental Term Loan and cash on hand to repurchase the outstanding $250.0 million aggregate principal amount of Lannett s 12.0% Senior Notes due 2023 (the Senior Notes) issued in connection with the KUPI acquisition.

On December 10, 2018, the Company entered into an amendment to the Senior Secured Credit Facility and the Credit and Guaranty Agreement. Pursuant to the amendment, the Secured Net Leverage Ratio applicable to the financial leverage ratio covenant was increased from 3:25:1.00 to 4.25:1.00 as of December 31, 2019 and prior to September 30, 2020, and then to 4:00:1:00 as of September 30, 2020. In exchange, the Company agreed to include a minimum liquidity covenant of $75 million, a 25-basis point increase to the interest rate margin paid on the Term A Loans and pay a consent fee equal to 50 basis points, paid only to consenting lenders.

Refer to the Company s Form 10-K for the fiscal year ended June 30, 2018 for further details on the Amended Senior Secured Credit Facility.

Other Liquidity Matters

Refer to the JSP Distribution Agreement section above for the impact of the nonrenewal of the JSP agreement on our future liquidity.

Future Acquisitions

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

We may also from time to time depending on market conditions and prices, contractual restrictions, our financial liquidity and other factors, seek to prepay outstanding debt or repurchase our outstanding debt through open market purchases, privately negotiated purchases, or otherwise. The amounts involved in any such transactions, individually or in the aggregate, may be material and may be funded from available cash or from additional borrowings.

Research and Development Arrangements

In the normal course of business, the Company has entered into certain research and development and other arrangements. As part of these arrangements, the Company has agreed to certain contingent payments which generally become due and payable only upon the achievement of certain developmental, regulatory, commercial and/or other milestones. In addition, under certain arrangements, we may be required to make royalty payments based on a percentage of future sales, or other metric, for products currently in development in the event that the Company begins to market and sell the product. Due to the inherent uncertainty related to these developmental, regulatory, commercial and/or other milestones, it is unclear if the Company will ever be required to make such payments.

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In the second quarter of Fiscal 2019, the Company entered into an agreement in principle with North South Brother Pharmacy Investment Co., Ltd. and HEC Group PTY, Ltd. (collectively, HEC) to develop an insulin glargine product that would be biosimilar to Lantus Solostar pursuant to a License and Collaboration Agreement to be executed by the parties. This agreement modifies and supersedes a May 3, 2016 Collaboration and Supply Agreement with HEC. Under the terms of the deal, among other things, the Company shall fund up to $32 million of the development costs and split 50/50 any development costs in excess thereof. Lannett shall receive an exclusive license to distribute and market the product in the United States upon FDA approval under the 50/50 profit split for the first ten years following commercialization, followed by a 60/40 split in favor of HEC for the following five years.

Critical Accounting Policies

The preparation of our consolidated financial statements in accordance with accounting principles generally accepted in the United States and the rules and regulations of the U.S. Securities & Exchange Commission requires the use of estimates and assumptions. A listing of the Company s significant accounting policies is detailed in Note 3 Summary of Significant Accounting Policies. A subsection of these accounting policies have been identified by management as Critical Accounting Policies. Critical accounting policies are those which require management to make estimates using assumptions that were uncertain at the time the estimates were made and for which the use of different assumptions, which reasonably could have been used, could have a material impact on the financial condition or results of operations.

Management has identified the following as Critical Accounting Policies : Revenue Recognition, Inventories, Income Taxes, Valuation of Long-Lived Assets, including Goodwill and Intangible Assets, In-Process Research and Development and Share-based Compensation.

Revenue Recognition

On July 1, 2018, the Company adopted Accounting Standards Codification (ASC) Topic 606, *Revenue from Contracts with Customers*, which superseded ASC Topic 605, *Revenue Recognition*. Under ASC 606, the Company recognizes revenue when title and risk of loss of promised goods or services have transferred to the customer at an amount that reflects the consideration the Company is expected to be entitled. Our revenue consists almost entirely of sales of our pharmaceutical products to customers, whereby we ship product to a customer pursuant to a purchase order. Revenue contracts such as these do not generally give rise to contract assets or contract liabilities because: (i) the underlying contracts generally have only a single performance obligation and (ii) we do not generally receive consideration until the performance obligation is fully satisfied. The new revenue standard also impacts the timing of the Company s revenue recognition by requiring recognition of certain contract manufacturing arrangements to change from upon shipment or delivery to over time . However, the recognition of these arrangements over time does not currently have a material impact on the Company s consolidated results of operations or financial position. The Company adopted ASC 606 using the modified retrospective method. Refer to the *Recent Accounting Pronouncements* section of this footnote for further discussion of the impact of the adoption.

When revenue is recognized, a simultaneous adjustment to gross sales is made for estimated chargebacks, rebates, returns, promotional adjustments and other potential adjustments. These

provisions are primarily estimated based on historical experience, future expectations, contractual arrangements with wholesalers and indirect customers and other factors known to management at the time of accrual. Accruals for provisions are presented in the Consolidated Financial Statements as a reduction to gross sales with the corresponding reserve presented as a reduction of accounts receivable or included as rebates payable, depending on the nature of the reserve.

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

Chargebacks

The provision for chargebacks is the most significant and complex estimate used in the recognition of revenue. The Company sells its products directly to wholesale distributors, generic distributors, retail pharmacy chains and mail-order pharmacies. The Company also sells its products indirectly to independent pharmacies, managed care organizations, hospitals, nursing homes and group purchasing organizations, collectively referred to as indirect customers. The Company enters into agreements with its indirect customers to establish pricing for certain products. The indirect customers then independently select a wholesaler from which to purchase the products. If the price paid by the indirect customers is lower than the price paid by the wholesaler, the Company will provide a credit, called a chargeback, to the wholesaler for the difference between the contractual price with the indirect customers and the wholesaler purchase price. The provision for chargebacks is based on expected sell-through levels by the Company s wholesale customers to the indirect customers and estimated wholesaler inventory levels. As sales to

the large wholesale customers, such as Cardinal Health,

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AmerisourceBergen and McKesson increase (decrease), the reserve for chargebacks will also generally increase (decrease). However, the size of the increase (decrease) depends on product mix and the amount of sales made to indirect customers with which the Company has specific chargeback agreements. The Company continually monitors the reserve for chargebacks and makes adjustments when management believes that expected chargebacks may differ from the actual chargeback reserve.

Rebates

Rebates are offered to the Company s key chain drug store, distributor and wholesaler customers to promote customer loyalty and increase product sales. These rebate programs provide customers with credits upon attainment of pre-established volumes or attainment of net sales milestones for a specified period. Other promotional programs are incentive programs offered to the customers. Additionally, as a result of the Patient Protection and Affordable Care Act (PPACA) enacted in the U.S. in March 2010, the Company participates in a new cost-sharing program for certain Medicare Part D beneficiaries designed primarily for the sale of brand drugs and certain generic drugs if their FDA approval was granted under a NDA or 505(b) NDA versus an ANDA. Because our drugs used for the treatment of thyroid deficiency and our Morphine Sulfate Oral Solution product were both approved by the FDA as 505(b)(2) NDAs, they are considered brand drugs for purposes of the PPACA. Drugs purchased within the Medicare Part D coverage gap (commonly referred to as the donut hole) result in additional rebates. The Company estimates the reserve for rebates and other promotional credit programs based on the specific terms in each agreement when revenue is recognized. The reserve for rebates increases (decreases) as sales to certain wholesale and retail customers increase (decrease). However, since these rebate programs are not identical for all

customers, the size of the reserve will depend on the mix of sales to customers that are eligible to receive rebates.

Returns

Consistent with industry practice, the Company has a product returns policy that allows customers to return product within a specified time period prior to and subsequent to the product s expiration date in exchange for a credit to be applied to future purchases. The Company s policy requires that the customer obtain pre-approval from the Company for any qualifying return. The Company estimates its provision for returns based on historical experience, changes to business practices, credit terms and any extenuating circumstances known to management. While historical experience has allowed for reasonable estimations in the past, future returns may or may not follow historical trends. The Company continually monitors the reserve for returns and makes adjustments when management believes that actual product returns may differ from the established reserve. Generally, the reserve for returns increases as net sales increase.

Other Adjustments

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

in market prices and estimates of inventory held by customers. The Company regularly monitors these and other factors and evaluates the reserve as additional information becomes available. Other adjustments also include prompt payment discounts and failure-to-supply adjustments. If the Company is unable to fulfill certain customer orders, the customer can purchase products from our competitors at their prices and charge the Company for any difference in our contractually agreed upon prices.

Refer to the Company s Form 10-K for the fiscal year ended June 30, 2018 for a description of our remaining Critical Accounting Policies.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

On November 25, 2015, in connection with the acquisition of KUPI, the Company entered into a Senior Secured Credit Facility, which was subsequently amended in June 2016 and December 2018. Based on the variable-rate debt outstanding at December 31, 2018, each 1/8% increase in interest rates would yield $1.1 million of incremental annual interest expense.

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

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this Form 10-Q, management performed, with the participation of our Chief Executive Officer and Chief Financial Officer, an evaluation of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act). Our disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded,

processed, summarized and reported within the time periods specified in the SEC s rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures.

Based upon the evaluation, the Chief Executive Officer and Chief Financial Officer concluded that Lannett s disclosure controls and procedures were effective as of the end of the period covered by this report.

Change in Internal Control Over Financial Reporting

There has been no change in Lannett s internal control over financial reporting during the three months ended December 31, 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Information pertaining to legal proceedings can be found in Note 12. Legal, Regulatory Matters and Contingencies of the Consolidated Financial Statements included in Part I, Item 1. of this Quarterly Report on Form 10-Q and is incorporated by reference herein.

ITEM 1A. RISK FACTORS

Lannett Company, Inc. s Annual Report on Form 10-K for the fiscal year ended June 30, 2018 includes a detailed description of its risk factors.

ITEM 6. EXHIBITS

(a) A list of the exhibits required by Item 601 of Regulation S-K to be filed as a part of this Form 10-Q is shown on the Exhibit Index filed herewith.

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Exhibit Index

10.54	Amneal Distribution and Transition Support Agreement	Filed Herewith
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed Herewith
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed Herewith
32	Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed Herewith
101.INS	XBRL Instance Document	
101.SCH	XBRL Taxonomy Extension Schema Document	
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	

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SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LANNETT COMPANY, INC.

Dated: February 7, 2019 By: /s/ Timothy C. Crew

Timothy C. Crew
Chief Executive Officer

Dated: February 7, 2019 By: /s/ Martin P. Galvan

Martin P. Galvan
Vice President of Finance and
Chief Financial Officer

Dated: February 7, 2019 By: /s/ G. Michael Landis

G. Michael Landis
Senior Director of Finance,
Principal Accounting Officer and Treasurer