ANI PHARMACEUTICALS INC
Form 10-Q
August 07, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended June 30, 2018

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

For the transition period from to .

Commission File Number 001-31812

ANI PHARMACEUTICALS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**58-2301143**

(State or other jurisdiction of incorporation or organization)

(IRS Employer Identification Number)

210 Main Street West

Baudette, Minnesota

(Address of principal executive offices)

(218) 634-3500

(Registrant's telephone number including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO ¨

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

Large accelerated filer ¨	Accelerated filer x
Non-accelerated filer ¨ (Do not check if smaller reporting company)	Smaller reporting company ¨
	Emerging growth company ¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES ¨ NO x

As of July 31, 2018, there were 11,817,897 shares of common stock and 10,864 shares of class C special stock of the registrant outstanding.

ANI PHARMACEUTICALS, INC.

FORM 10-Q — Quarterly Report

For the Quarterly Period Ended June 30, 2018

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CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q and certain information incorporated herein by reference contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Exchange Act. Such statements include, but are not limited to, statements about future operations, products, financial position, operating results, prospects, pipeline or potential markets therefor, and other statements that are not historical in nature, particularly those that utilize terminology such as "anticipates," "will," "expects," "plans," "potential," "future," "believes," "intends," "continue," other words of similar meaning, derivations of such words, and the use of future dates.

Uncertainties and risks may cause our actual results to be materially different than those expressed in or implied by such forward-looking statements. Uncertainties and risks include, but are not limited to, the risk that we may face with respect to importing raw materials, increased competition, acquisitions, contract manufacturing arrangements, delays or failure in obtaining product approvals from the U.S. Food and Drug Administration ("FDA"), general business and economic conditions, market trends, product development, regulatory, and other approvals and marketing.

These factors should not be construed as exhaustive and should be read in conjunction with our other disclosures, including but not limited to our Annual Report on Form 10-K for the year ended December 31, 2017, including the factors described in "Item 1A. Risk Factors." Other risks may be described from time to time in our filings made under the securities laws, including our quarterly reports on Form 10-Q and our current reports on Form 8-K. New risks emerge from time to time. It is not possible for our management to predict all risks. The forward-looking statements contained in this document are made only as of the date of this document. We undertake no obligation to update or revise any forward-looking statement, whether as a result of new information, future events, or otherwise.

NOTE REGARDING TRADEMARKS

Cortenema®, Cortrophin® Gel, Cortrophin-Zinc®, Inderal® LA, Inderal® XL, InnoPran XL®, Lithobid®, Reglan®, and Vancocin® are registered trademarks subject to trademark protection and are owned by ANI Pharmaceuticals, Inc. and its consolidated subsidiary. Atacand® and Atacand HCT® are the property of AstraZeneca AB and are licensed to ANI Pharmaceuticals, Inc. for U.S. sales of those products. Arimidex® and Casodex® are the property of AstraZeneca UK Limited and are licensed to ANI Pharmaceuticals, Inc. for U.S. sales of those products.

ANI PHARMACEUTICALS, INC. AND SUBSIDIARY
Condensed Consolidated Balance Sheets
(in thousands, except share and per share amounts)
(unaudited)

	June 30, 2018	December 31, 2017
Assets		
Current Assets		
Cash and cash equivalents	$54,994	$ 31,144
Accounts receivable, net of $58,439 and $34,686 of adjustments for chargebacks and other allowances at June 30, 2018 and December 31, 2017, respectively	56,115	58,788
Inventories, net	37,756	37,727
Prepaid income taxes, net	1,734	1,162
Prepaid expenses and other current assets	1,768	2,784
Total Current Assets	152,367	131,605
Property and equipment, net	22,842	20,403
Restricted cash	5,007	5,006
Deferred tax assets, net of deferred tax liabilities and valuation allowance	23,590	22,667
Intangible assets, net	217,484	229,790
Goodwill	1,838	1,838
Other long-term assets	1,049	829
Total Assets	$424,177	$ 412,138
Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts payable	$7,949	$ 3,630
Accrued expenses and other	1,863	1,571
Accrued royalties	8,219	12,164
Accrued compensation and related expenses	1,410	2,306
Accrued government rebates	5,256	7,930
Returned goods reserve	9,764	8,274
Current component of long-term borrowing, net of deferred financing costs	5,217	3,353
Total Current Liabilities	39,678	39,228
Long-term Liabilities		
Long-term borrowing, net of deferred financing costs and current borrowing component	67,262	69,946
Convertible notes, net of discount and deferred financing costs	132,127	128,208
Total Liabilities	$239,067	$ 237,382
Commitments and Contingencies (Note 11)		

Stockholders' Equity		
Common Stock, $0.0001 par value, 33,333,334 shares authorized; 11,828,555 shares issued and 11,817,376 shares outstanding at June 30, 2018; 11,655,768 shares issued and 11,650,565 outstanding at December 31, 2017	1	1
Class C Special Stock, $0.0001 par value, 781,281 shares authorized; 10,864 shares issued and outstanding at June 30, 2018 and December 31, 2017, respectively	-	-
Preferred Stock, $0.0001 par value, 1,666,667 shares authorized; 0 shares issued and outstanding at June 30, 2018 and December 31, 2017, respectively	-	-
Treasury stock, 11,179 shares of common stock, at cost, at June 30, 2018 and 5,203 shares of common stock, at cost, at December 31, 2017	(659)	(259)
Additional paid-in capital	184,531	179,020
Retained earnings/(accumulated deficit)	1,021	(4,006)
Accumulated other comprehensive income, net of tax	216	-
Total Stockholders' Equity	185,110	174,756
Total Liabilities and Stockholders' Equity	$424,177	$ 412,138

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

ANI PHARMACEUTICALS, INC. AND SUBSIDIARY
Condensed Consolidated Statements of Operations
(in thousands, except per share amounts)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net Revenues	$ 47,268	$ 44,764	$ 93,751	$ 81,392
Operating Expenses:				
Cost of sales (excluding depreciation and amortization)	16,593	21,122	37,286	37,508
Research and development	5,137	2,167	7,239	3,785
Selling, general, and administrative	9,962	7,380	18,918	14,673
Depreciation and amortization	8,313	7,101	16,508	13,807
Total Operating Expenses	40,005	37,770	79,951	69,773
Operating Income	7,263	6,994	13,800	11,619
Other Expense, net				
Interest expense, net	(3,730)	(3,025)	(7,364)	(5,957)
Other expense, net	(30)	(19)	(91)	(37)
Income Before Provision for Income Taxes	3,503	3,950	6,345	5,625
Provision for income taxes	(726)	(1,269)	(1,318)	(1,792)
Net Income	$ 2,777	$ 2,681	$ 5,027	$ 3,833
Basic and Diluted Earnings Per Share:				
Basic Earnings Per Share	$ 0.24	$ 0.23	$ 0.43	$ 0.33
Diluted Earnings Per Share	$ 0.23	$ 0.23	$ 0.42	$ 0.33
Basic Weighted-Average Shares Outstanding	11,679	11,546	11,634	11,536
Diluted Weighted-Average Shares Outstanding	11,789	11,667	11,748	11,659

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

ANI PHARMACEUTICALS, INC. AND SUBSIDIARY
Condensed Consolidated Statements of Comprehensive Income
(in thousands)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	**2017**	**2018**	**2017**
Net income	$ 2,777	$ 2,681	$ 5,027	$ 3,833
Other comprehensive income, net of tax:				
Change in fair value of interest rate swap, net of tax	216	-	216	-
Total other comprehensive income, net of tax	216	-	216	-
Total comprehensive income, net of tax	$ 2,993	$ 2,681	$ 5,243	$ 3,833

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

ANI PHARMACEUTICALS, INC. AND SUBSIDIARY
Condensed Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	Six Months Ended June 30,	
	2018	**2017**
Cash Flows From Operating Activities		
Net income	$ 5,027	$ 3,833
Adjustments to reconcile net income to net cash and cash equivalents provided by operating activities:		
Stock-based compensation	3,159	3,193
Deferred taxes	(987)	(1,706)
Depreciation and amortization	16,508	13,807
Acquired in-process research and development ("IPR&D")	1,335	-
Non-cash interest relating to convertible notes and loan cost amortization	4,237	3,790
Changes in operating assets and liabilities:		
Accounts receivable, net	2,673	(9,618)
Inventories, net	171	776
Prepaid expenses and other current assets	1,106	836
Accounts payable	4,571	(345)
Accrued royalties	(3,945)	(701)
Accrued compensation and related expenses	(896)	(404)
Current income taxes, net	(572)	(6,389)
Accrued government rebates	(2,674)	(2,357)
Returned goods reserve	1,490	1,802
Accrued expenses and other	320	13
Net Cash and Cash Equivalents Provided by Operating Activities	31,523	6,530
Cash Flows From Investing Activities		
Acquisition of product rights, IPR&D, and other related assets	(5,169)	(50,956)
Acquisition of property and equipment, net	(3,364)	(4,442)
Net Cash and Cash Equivalents Used in Investing Activities	(8,533)	(55,398)
Cash Flows From Financing Activities		
Payment of debt issuance costs	(153)	-
Payments on term loan agreement	(938)	-
Net borrowings under line of credit agreement	-	30,000
Proceeds from stock option exercises	2,611	131
Treasury stock purchases for restricted stock vestings	(659)	(259)
Net Cash and Cash Equivalents Provided by Financing Activities	861	29,872

Change in Cash, Cash Equivalents, and Restricted Cash	23,851	(18,996)
Cash, cash equivalents, and restricted cash, beginning of period	36,150	32,367
Cash, cash equivalents, and restricted cash, end of period	$ 60,001	$ 13,371
Reconciliation of cash, cash equivalents, and restricted cash, beginning of period		
Cash and cash equivalents	31,144	27,365
Restricted cash	5,006	5,002
Cash, cash equivalents, and restricted cash, beginning of period	36,150	32,367
Reconciliation of cash, cash equivalents, and restricted cash, end of period		
Cash and cash equivalents	54,994	8,369
Restricted cash	5,007	5,002
Cash, cash equivalents, and restricted cash, end of period	60,001	13,371
Supplemental disclosure for cash flow information:		
Cash paid for interest, net of amounts capitalized	$ 3,179	$ 2,097
Cash paid for income taxes	$ 2,895	$ 9,882
Supplemental non-cash investing and financing activities:		
Property and equipment purchased and included in accounts payable	$ 233	$ 109

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

ANI PHARMACEUTICALS, INC. and subsidiarY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. BUSINESS, PRESENTATION, AND RECENT ACCOUNTING PRONOUNCEMENTS

Overview

ANI Pharmaceuticals, Inc. and its consolidated subsidiary, ANIP Acquisition Company (together, "ANI," the "Company," "we," "us," or "our") is an integrated specialty pharmaceutical company focused on delivering value to our customers by developing, manufacturing, and marketing high quality branded and generic prescription pharmaceuticals. We focus on niche and high barrier to entry opportunities including controlled substances, anti-cancer (oncolytics), hormones and steroids, and complex formulations. Our two pharmaceutical manufacturing facilities located in Baudette, Minnesota are capable of producing oral solid dose products, as well as liquids and topicals, controlled substances, and potent products that must be manufactured in a fully-contained environment. Our strategy is to use our assets to develop, acquire, manufacture, and market branded and generic specialty prescription pharmaceuticals. By executing this strategy, we believe we will be able to continue to grow our business, expand and diversify our product portfolio, and create long-term value for our investors.

Basis of Presentation

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). In our opinion, the accompanying unaudited interim condensed consolidated financial statements include all adjustments, consisting of normal recurring adjustments, which are necessary to present fairly our financial position, results of operations, comprehensive income/(loss), and cash flows. The consolidated balance sheet at December 31, 2017, has been derived from audited financial statements of that date. The unaudited interim condensed consolidated results of operations are not necessarily indicative of the results that may occur for the full fiscal year. Certain information and footnote disclosure normally included in financial statements prepared in accordance with U.S. GAAP have been omitted pursuant to instructions, rules, and regulations prescribed by the United States Securities and Exchange Commission. We believe that the disclosures provided herein are adequate to make the information presented not misleading when these unaudited interim condensed consolidated financial statements are read in conjunction with the audited financial statements and notes previously distributed in our Annual Report on Form 10-K for the year ended December 31, 2017.

Principles of Consolidation

The unaudited interim condensed consolidated financial statements include the accounts of ANI Pharmaceuticals, Inc. and its subsidiary. All inter-company accounts and transactions are eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. In the accompanying unaudited interim condensed consolidated financial statements, estimates are used for, but not limited to, stock-based compensation, allowance for doubtful accounts, accruals for chargebacks, administrative fees and rebates, government rebates, returns and other allowances, allowance for inventory obsolescence, valuation of financial instruments and intangible assets, accruals for contingent liabilities, fair value of long-lived assets, deferred taxes and valuation allowance, deferred tax valuation allowance, purchase price allocations, and the depreciable lives of long-lived assets. Because of the uncertainties inherent in such estimates, actual results may differ from those estimates. Management periodically evaluates estimates used in the preparation of the financial statements for reasonableness.

ANI PHARMACEUTICALS, INC. and subsidiarY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. BUSINESS, PRESENTATION, AND RECENT ACCOUNTING PRONOUNCEMENTS – continued

Recent Accounting Pronouncements

Recent Accounting Pronouncements Not Yet Adopted

In June 2018, the Financial Accounting Standards Board ("FASB") issued guidance simplifying the accounting for nonemployee stock-based compensation awards. The guidance aligns the measurement and classification for employee stock-based compensation awards to nonemployee stock-based compensation awards. Under the guidance, nonemployee awards will be measured at their grant date fair value. Upon transition, the existing nonemployee awards will be measured at fair value as of the adoption date. The guidance is effective for reporting periods beginning after December 15, 2018, including interim periods within that fiscal year. Early adoption is permitted, including adoption in an interim period. We are currently evaluating the impact, if any, that the adoption of this guidance will have on our consolidated financial statements.

In June 2016, the FASB issued guidance with respect to measuring credit losses on financial instruments, including trade receivables. The guidance eliminates the probable initial recognition threshold that was previously required prior to recognizing a credit loss on financial instruments. The credit loss estimate can now reflect an entity's current estimate of all future expected credit losses. Under the previous guidance, an entity only considered past events and current conditions. The guidance is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The adoption of certain amendments of this guidance must be applied on a modified retrospective basis and the adoption of the remaining amendments must be applied on a prospective basis. We currently expect that the adoption of this guidance will likely change the way we assess the collectability of our receivables and recoverability of other financial instruments. We have not yet begun to evaluate the specific impacts of this guidance nor have we determined the manner in which we will adopt this guidance.

In February 2016, the FASB issued guidance for accounting for leases. The guidance requires lessees to recognize assets and liabilities related to long-term leases on the balance sheet and expands disclosure requirements regarding leasing arrangements. The guidance is effective for reporting periods beginning after December 15, 2018 and early

adoption is permitted. The guidance must be adopted on a modified retrospective basis and provides for certain practical expedients. We will adopt this guidance as of January 1, 2019. We are currently reviewing our leases and other contracts to determine the impact the adoption of this guidance will have on our consolidated financial statements. We currently expect that the adoption of this guidance will likely change the way we account for our operating leases and will likely result in recording the future benefits of those leases and the related minimum lease payments on our consolidated balance sheets.

We have evaluated all other issued and unadopted Accounting Standards Updates and believe the adoption of these standards will not have a material impact on our condensed consolidated statements of operations, balance sheets, or cash flows.

Recently Adopted Accounting Pronouncements

In August 2017, the FASB issued guidance improving accounting for hedging activities. The guidance is intended to simplify hedge accounting by better aligning how an entity's risk management activities and hedging relationships are presented in its financial statements. The guidance also simplifies the application of hedge accounting guidance in certain situations. The guidance is effective for the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption was permitted, including adoption in an interim period. The guidance with respect to the cash flow and net investment hedge relationships existing on the date of adoption must be applied on a modified retrospective basis and the new disclosure requirements must be applied on a prospective basis. We adopted this guidance as of January 1, 2018. The adoption of this guidance did not have a material impact on our consolidated financial statements. However, the adoption of this guidance did impact how we accounted for the interest rate swap we entered into in April 2018. See Note 4 for further details regarding the interest rate swap.

ANI PHARMACEUTICALS, INC. and subsidiarY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. BUSINESS, PRESENTATION, AND RECENT ACCOUNTING PRONOUNCEMENTS – continued

In May 2017, the FASB issued guidance clarifying when modification accounting should be used for changes to the terms or conditions of a share-based payment award. The guidance does not change the accounting for modifications, but clarifies that modification accounting guidance should only be applied if there is a change to the value, vesting conditions, or award classification and would not be required if the changes are considered non-substantive. The guidance is effective for the fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption was permitted, including adoption in an interim period. We adopted this guidance as of January 1, 2018 on a prospective basis. The adoption of this guidance did not have a material impact on our consolidated financial statements.

In May 2014, the FASB issued guidance for revenue recognition for contracts, superseding the previous revenue recognition requirements, along with most existing industry-specific guidance. The guidance requires an entity to review contracts in five steps: 1) identify the contract, 2) identify performance obligations, 3) determine the transaction price, 4) allocate the transaction price, and 5) recognize revenue. The new standard will result in enhanced disclosures regarding the nature, amount, timing, and uncertainty of revenue arising from contracts with customers. In August 2015, the FASB issued guidance approving a one-year deferral, making the standard effective for reporting periods beginning after December 15, 2017, with early adoption permitted only for reporting periods beginning after December 15, 2016. In March 2016, the FASB issued guidance to clarify the implementation guidance on principal versus agent considerations for reporting revenue gross rather than net, with the same deferred effective date. In April 2016, the FASB issued guidance to clarify the implementation guidance on identifying performance obligations and the accounting for licenses of intellectual property, with the same deferred effective date. In May 2016, the FASB issued guidance rescinding SEC paragraphs related to revenue recognition, pursuant to two SEC Staff Announcements at the March 3, 2016 Emerging Issues Task Force meeting. In May 2016, the FASB also issued guidance to clarify the implementation guidance on assessing collectability, presentation of sales tax, noncash consideration, and contracts and contract modifications at transition, with the same effective date. In September 2017, the FASB issued guidance amending and rescinding prior SEC staff announcements and observer comments related to revenue recognition, pursuant to the SEC Staff Announcement at the July 20, 2017 Emerging Issues Task Force meeting.

We performed a comprehensive review of our existing revenue arrangements as of January 1, 2018 following the five-step model. Our analysis indicated that there were no significant changes to how the amount and timing of revenue is recognized under the new guidance as compared to existing guidance. Additionally, our analysis indicated that there were no significant changes to how costs to obtain and fulfill our customer contracts are recognized under the new guidance as compared to existing guidance. We adopted this guidance as of January 1, 2018 using the

modified retrospective method and the impact of adoption on our consolidated balance sheet, statement of operations, and statement of cash flows was not material. The adoption of the new guidance impacted the way we analyze, document, and disclose revenue recognition under customer contracts beginning on January 1, 2018 and resulted in additional disclosures in our financial statements.

ANI PHARMACEUTICALS, INC. and subsidiarY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

2. REVENUE RECOGNITION AND RELATED ALLOWANCES

Revenue Recognition

As of January 1, 2018, we adopted guidance for revenue recognition for contracts, using the modified retrospective method. The implementation of the guidance had no material impact on the measurement or recognition of revenue from customer contracts of prior periods. For our revenue recognition policies prior to adopting the guidance for revenue recognition for contracts, please see Item 8. Consolidated Financial Statements, Note 1, *Description of Business and Summary of Significant Accounting Policies*, in our Annual Report on Form 10-K for the year ended December 31, 2017.

Upon adoption of this new guidance, we recognize revenue using the following steps:

- Identification of the contract, or contracts, with a customer;
- Identification of the performance obligations in the contract;
- Determination of the transaction price, including the identification and estimation of variable consideration;
- Allocation of the transaction price to the performance obligations in the contract; and
- Recognition of revenue when we satisfy a performance obligation.

We derive our revenues primarily from sales of generic and branded pharmaceutical products. Revenue is recognized when our obligations under the terms of our contracts with customers are satisfied, which generally occurs when control of the products we sell is transferred to the customer. We estimate variable consideration after considering applicable information that is reasonably available. We generally do not have incremental costs to obtain contracts that would otherwise not have been incurred. We do not adjust revenue for the promised amount of consideration for the effects of a significant financing component because our customers generally pay us within 100 days.

All revenue recognized in the accompanying unaudited interim condensed consolidated statements of operations is considered to be revenue from contracts with customers. The following table depicts the disaggregation of revenue according to contract type as of:

(in thousands)	Three Months Ended		Six Months Ended	
	June 30, 2018	**June 30, 2017**	**June 30, 2018**	**June 30, 2017**
Sales of generic pharmaceutical products	$ 30,202	$ 31,490	$ 53,429	$ 58,061
Sales of branded pharmaceutical products	10,530	11,671	27,125	19,711
Sales of contract manufactured products	1,679	1,529	2,624	3,322
Royalties from Licensing Agreements	4,769	-	10,151	-
Other[1]	88	74	422	298
Total net revenues	$ 47,268	$ 44,764	$ 93,751	$ 81,392

[1]Primarily includes laboratory services and royalties on sales of contract manufactured products

In the three and six months ended June 30, 2018, we did not incur, and therefore did not defer, any material incremental costs to obtain contracts. We recognized $6.8 million of net revenue from performance obligations satisfied in prior periods during the six months ended June 30, 2018, consisting primarily of royalties from licensing agreements and revised estimates for variable consideration, including chargebacks, rebates, returns, and other allowances, related to prior period sales.

ANI PHARMACEUTICALS, INC. and subsidiarY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

2. REVENUE RECOGNITION AND RELATED ALLOWANCES – continued

Revenue from Sales of Generic and Branded Pharmaceutical Products

Product sales consists of sales of our generic and brand pharmaceutical products. Our sole performance obligation in our contracts is to provide pharmaceutical products to customers. Our products are sold at pre-determined standalone selling prices and our performance obligation is considered to be satisfied when control of the product is transferred to the customer. Control is transferred to the customer upon delivery of the product to the customer, as our pharmaceutical products are sold on an FOB destination basis and because inventory risk and risk of ownership passes to the customer upon delivery. Payment terms for these sales are generally less than 100 days.

Sales of our pharmaceutical products are subject to variable consideration due to chargebacks, government rebates, returns, administrative and other rebates, and cash discounts. Estimates for these elements of variable consideration require significant judgment.

Chargebacks

Chargebacks, primarily from wholesalers, result from arrangements we have with indirect customers establishing prices for products which the indirect customer purchases through a wholesaler. Alternatively, we may pre-authorize wholesalers to offer specified contract pricing to other indirect customers. Under either arrangement, we provide a chargeback credit to the wholesaler for any difference between the contracted price with the indirect customer and the wholesaler's invoice price, typically Wholesale Acquisition Cost ("WAC").

Chargeback credits are calculated as follows:

Prior period chargebacks claimed by wholesalers are analyzed to determine the actual average selling price ("ASP") for each product. This calculation is performed by product by wholesaler. ASPs can be affected by several factors such as:

· A change in customer mix

· A change in negotiated terms with customers

· A change in the volume of off-contract purchases

· Changes in WAC

As necessary, we adjust ASPs based on anticipated changes in the factors above.

The difference between ASP and WAC is recorded as a reduction in both gross revenues in the consolidated statements of operations and accounts receivable in the consolidated balance sheets, at the time we recognize revenue from the product sale.

To evaluate the adequacy of our chargeback accruals, we obtain on-hand inventory counts from the wholesalers. This inventory is multiplied by the chargeback amount, the difference between ASP and WAC, to arrive at total expected future chargebacks, which is then compared to the chargeback accruals. We continually monitor chargeback activity and adjust ASPs when we believe that actual selling prices will differ from current ASPs.

ANI PHARMACEUTICALS, INC. and subsidiarY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

2. REVENUE RECOGNITION AND RELATED ALLOWANCES – continued

Government Rebates

Our government rebates reserve consists of estimated payments due to governmental agencies for purchases made by third parties under various governmental programs. The two largest government programs that impact our net revenue and our government rebates reserve are federal and state Medicaid rebate programs and Medicare.

We participate in certain qualifying federal and state Medicaid rebate programs whereby discounts and rebates are provided to participating programs after the final dispensing of the product by a pharmacy to a Medicaid plan participant. Medicaid rebates are typically billed up to 120 days after the product is shipped. Medicaid rebate amounts per product unit are established by law, based on the Average Manufacturer Price ("AMP"), which is reported on a monthly and quarterly basis, and, in the case of branded products, best price, which is reported on a quarterly basis. Our Medicaid reserves are based on expected claims from state Medicaid programs. Estimates for expected claims are driven by patient usage, sales mix, calculated AMP or best price, as well as inventory in the distribution channel that will be subject to a Medicaid rebate. As a result of the delay between selling the products and rebate billing, our Medicaid rebate reserve includes both an estimate of outstanding claims for end-customer sales that have occurred but for which the related claim has not been billed, as well as an estimate for future claims that will be made when inventory in the distribution channel is sold through to plan participants.

Many of our products are also covered under Medicare. We, like all pharmaceutical companies, must provide a discount for any products sold under New Drug Applications ("NDAs") to Medicare Part D participants. This applies to all products sold under NDAs, regardless of whether the products are marketed as branded or generic. Our estimates for these discounts are based on historical experience with Medicare rebates for our products. While such experience has allowed for reasonable estimations in the past, history may not always be an accurate indicator of future rebates. Medicare rebates are typically billed up to 120 days after the product is shipped. As a result of the delay between selling the products and rebate billing, our Medicare rebate reserve includes both an estimate of outstanding claims for end-customer sales that have occurred but for which the related claim has not been billed, as well as an estimate for future claims that will be made when inventory in the distribution channel is sold through to Medicare Part D participants.

To evaluate the adequacy of our government rebate reserves, we review the reserves on a quarterly basis against actual claims data to ensure the liability is fairly stated. We continually monitor our government rebate reserve and adjust our estimates if we believe that actual government rebates may differ from our established accruals. Accruals for government rebates are recorded as a reduction to gross revenues in the consolidated statements of operations and as an increase to accrued government rebates in the consolidated balance sheets.

Returns

We maintain a return policy that allows customers to return product within a specified period prior to and subsequent to the expiration date. Generally, product may be returned for a period beginning six months prior to its expiration date to up to one year after its expiration date. Our product returns are settled through the issuance of a credit to the customer. Our estimate for returns is based upon historical experience with actual returns. While such experience has allowed for reasonable estimation in the past, history may not always be an accurate indicator of future returns. We continually monitor our estimates for returns and make adjustments when we believe that actual product returns may differ from the established accruals. Accruals for returns are recorded as a reduction to gross revenues in the consolidated statements of operations and as an increase to the return goods reserve in the consolidated balance sheets.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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2. REVENUE RECOGNITION AND RELATED ALLOWANCES – continued

Administrative Fees and Other Rebates

Administrative fees or rebates are offered to wholesalers, group purchasing organizations and indirect customers. We accrue for fees and rebates, by product by wholesaler, at the time of sale based on contracted rates and ASPs.

To evaluate the adequacy of our administrative fee accruals, we obtain on-hand inventory counts from the wholesalers. This inventory is multiplied by the ASPs to arrive at total expected future sales, which is then multiplied by contracted rates. The result is then compared to the administrative fee accruals. We continually monitor administrative fee activity and adjust our accruals when we believe that actual administrative fees will differ from the accruals. Accruals for administrative fees and other rebates are recorded as a reduction in both gross revenues in the consolidated statements of operations and accounts receivable in the consolidated balance sheets.

Prompt Payment Discounts

We often grant sales discounts for prompt payment. The reserve for prompt payment discounts is based on invoices outstanding. We assume, based on past experience, that all available discounts will be taken. Accruals for prompt payment discounts are recorded as a reduction in both gross revenues in the consolidated statements of operations and accounts receivable in the consolidated balance sheets.

The following table summarizes activity in the consolidated balance sheets for accruals and allowances for the six months ended June 30, 2018 and 2017, respectively:

(in thousands)	**Accruals for Chargebacks, Rebates, Returns, and Other Allowances**	
	Administrative	Prompt

	Chargebacks	Government Rebates	Returns	Fees and Other Rebates	Payment Discounts
Balance at December 31, 2016	$ 26,785	$ 5,891	$ 5,756	$ 3,550	$ 1,554
Accruals/Adjustments	88,973	5,110	5,220	10,646	3,842
Credits Taken Against Reserve	(83,757)	(7,467)	(3,418)	(8,593)	(3,448)
Balance at June 30, 2017	$ 32,001	$ 3,534	$ 7,558	$ 5,603	$ 1,948
Balance at December 31, 2017	$ 28,230	$ 7,930	$ 8,274	$ 5,226	$ 1,834
Accruals/Adjustments	104,331	4,199	6,227	14,855	4,157
Credits Taken Against Reserve	(82,145)	(6,873)	(4,737)	(13,365)	(3,859)
Balance at June 30, 2018	$ 50,416	$ 5,256	$ 9,764	$ 6,716	$ 2,132

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2. REVENUE RECOGNITION AND RELATED ALLOWANCES – continued

Contract Manufacturing Product Sales Revenue

Contract manufacturing arrangements consists of agreements in which we manufacture a pharmaceutical product on behalf of third party. Our performance obligation is to manufacture and provide pharmaceutical products to customers, typically pharmaceutical companies. The contract manufactured products are sold at pre-determined standalone selling prices and our performance obligations are considered to be satisfied when control of the product is transferred to the customer. Control is transferred to the customer when the product leaves our dock to be shipped to the customer, as our pharmaceutical products are sold on an FOB shipping point basis and the inventory risk and risk of ownership passes to the customer at that time. Payment terms for these sales are generally less than two months. We estimate returns based on historical experience. Historically, we have not had material returns for contract manufactured products.

As of June 30, 2018, the value of our unsatisfied performance obligations (or backlog) was $2.6 million, which consists of firm orders for contract manufactured products, for which our performance obligations remain unsatisfied and for which the related revenue has yet to be recognized. We anticipate satisfying these performance obligations within six months.

Royalties from Licensing Agreements

From time to time, we enter into transition agreements with the sellers of products we acquire, under which we license to the seller the right to sell the acquired products. Therefore, we recognize the revenue associated with sales of the underlying products as royalties. Because these royalties are sales-based, we recognize the revenue when the underlying sales occur, based on sales and gross profit information received from the sellers. Upon full transition of the products and upon launching the products under our own labels, we recognize revenue for the products as sales of generic or branded pharmaceutical products, as described above.

In addition, we receive royalties from a license for patent rights initially owned by Cell Genesys, which merged with BioSante in 2009. The royalties are the results of sales and milestones related to the Yescarta® product. We recognize revenue for sales-based royalties when the underlying sales occur. We estimate variable consideration related to milestones, which requires significant judgment.

Credit Concentration

Our customers are primarily wholesale distributors, chain drug stores, group purchasing organizations, and pharmaceutical companies.

During the three months ended June 30, 2018, three customers represented 32%, 23%, and 21% of net revenues, respectively. During the six months ended June 30, 2018, the same three customers represented 33%, 24%, and 20% of net revenues respectively. As of June 30, 2018, accounts receivable from these customers totaled 75% of accounts receivable, net. During the three months ended June 30, 2017, three customers represented 32%, 24%, and 23% of net revenues, respectively. During the six months ended June 30, 2017, these same three customers represented 32%, 22%, and 24% of net revenues, respectively.

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3. INDEBTEDNESS

Convertible Senior Notes

In December 2014, we issued $143.8 million of our Convertible Senior Notes due 2019 (the "Notes") in a registered public offering. The Notes pay 3.0% interest semi-annually in arrears starting on June 1, 2015 and are due December 1, 2019. The initial conversion price was $69.48 per share. Simultaneous with the issuance of the Notes, we entered into "bond hedge" (or purchased call) and "warrant" (or written call) transactions with an affiliate of one of the offering underwriters in order to synthetically raise the initial conversion price of the Notes to $96.21 per share and reduce the potential common stock dilution that may arise from the conversion of the Notes.

The Notes are convertible at the option of the holder under certain circumstances and upon conversion we may elect to settle such conversion in shares of our common stock, cash, or a combination thereof. As a result of our cash conversion option, we separately accounted for the value of the embedded conversion option as a debt discount (with an offset to Additional Paid in Capital ("APIC")) of $33.6 million. Deferred financing costs are recorded as a reduction of long-term debt in the consolidated balance sheets and are being amortized as additional non-cash interest expense on a straight-line basis over the term of the debt, since this method was not significantly different from the effective interest method.

The carrying value of the Notes is as follows as of:

(in thousands)	**June 30, 2018**	**December 31, 2017**
Principal amount	$143,750	$ 143,750
Unamortized debt discount	(10,427)	(13,924)
Deferred financing costs	(1,196)	(1,618)
Net carrying value	$132,127	$ 128,208

We had accrued interest of $0.4 million related to the Notes recorded in accrued expenses, other in our consolidated balance sheets at both June 30, 2018 and December 31, 2017.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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3. INDEBTEDNESS – continued

Credit Agreement

In December 2017, we entered into a five-year senior secured credit facility (the "Credit Agreement") with Citizens Bank, N.A. as a lender and administrative agent. As contemplated in the initial agreement, Citizens Bank, N.A. syndicated the facility to five additional lenders on February 5, 2018. The Credit Agreement is comprised of a $75.0 million five-year term loan (the "Term Loan") and a $50.0 million senior secured revolving credit facility (the "Revolving Credit Facility"), with availability subject to a borrowing base consisting of eligible accounts receivable and inventory and the satisfaction of conditions precedent specified in the agreement. We may repay borrowings under the Term Loan and Revolving Credit Facility without any premium or penalty, but must pay all borrowings thereunder by August 30, 2019 if we do not meet certain conditions relating to the repayment or refinance of our outstanding 3.0% Senior Convertible Notes due 2019, and in no event later than December 29, 2022.

The Term Loan includes a repayment schedule, pursuant to which $5.6 million of the loan will be paid in quarterly installments during the 12 months ended June 30, 2019. As a result, $5.6 million of the loan is recorded in current component of long-term borrowing, net of deferred financing in the accompanying unaudited interim condensed consolidated balance sheets. We deferred $2.9 million of total debt issuance costs related to the Credit Agreement, of which $1.8 million was allocated to the Term Loan and $1.1 million was allocated to the undrawn Revolving Credit Facility. In April 2018, we entered into an interest rate swap with Citizens Bank, N.A. to hedge the variable rate on our Term Loan balance with a fixed rate (Note 4).

The carrying value of the current and long-term components of the Term Loan as of June 30, 2018 and December 31, 2017 are:

(in thousands)	Current June 30, 2018	December 31, 2017
Current borrowing on secured term loan	$5,625	$ 3,750

Unamortized deferred financing costs	(408)	(397)
Current component of long-term borrowing, net of unamortized deferred financing costs	$5,217	$ 3,353

(in thousands)	Long-Term	
	June 30, 2018	December 31, 2017
Long-term borrowing on secured term loan	$68,438	$ 71,250
Unamortized deferred financing costs	(1,176)	(1,304)
Long-term borrowing, net of unamortized deferred financing costs and current borrowing component	$67,262	$ 69,946

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3. INDEBTEDNESS – continued

The Term Loan was accounted for as a modification of our existing Line of Credit and consequently, the remaining balance of the deferred issuance costs related to the Line of Credit are included with the Term Loan issuance costs and amortized as interest expense over the life of the Term Loan using the effective interest method. The issuance costs allocated to the Revolving Credit Facility will be deferred and amortized as interest expense on a straight-line basis over the term of the Revolving Credit Facility.

As of June 30, 2018, we had a $74.1 million balance on the Term Loan. As of June 30, 2018, we had not drawn on the Revolving Credit Facility. As of June 30, 2018, $0.8 million of unamortized deferred debt issuance costs is included in other long-term assets in the accompanying unaudited interim condensed consolidated balance sheets and $0.2 million is included in prepaid expenses and other current assets in the unaudited interim condensed consolidated balance sheets.

The following table sets forth the components of total interest expense related to the Notes and Term Loan recognized in the accompanying unaudited interim condensed consolidated statements of operations for the three and six months ended June 30, 2018 and 2017:

	Three Months Ended		Six Months Ended	
(in thousands)	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Contractual coupon	$ 1,752	$ 1,078	$ 3,476	$ 2,156
Amortization of debt discount	1,760	1,668	3,497	3,315
Amortization of finance fees	371	211	741	422
Capitalized interest	(105)	(134)	(297)	(224)
	$ 3,778	$ 2,823	$ 7,417	$ 5,669

As of June 30, 2018, the combined effective interest rate on the Notes and Term Loan was 6.8%, on an annualized basis.

4. DERIVATIVE FINANCIAL INSTRUMENT AND HEDGING ACTIVITY

We use derivative financial instruments to hedge our exposure to interest rate risks. All derivative financial instruments are recognized as either assets or liabilities at fair value on the consolidated balance sheet and are classified as current or long-term based on the scheduled maturity of the instrument.

When we enter into a hedge arrangement and intend to apply hedge accounting, we formally document the hedge relationship and designate the instrument for financial reporting purposes as a fair value hedge, a cash flow hedge, or a net investment hedge. When we determine that a derivative financial instrument qualifies as a cash flow hedge and is effective, the changes in fair value of the instrument are recorded in accumulated other comprehensive income/(loss), net of tax in our consolidated balance sheets and will be reclassified to earnings when the hedged item affects earnings.

In April 2018, we entered into an interest rate swap arrangement, which is considered a derivative financial instrument, with Citizens Bank, N.A. to manage our exposure to changes in LIBOR-based interest rates underlying our Term Loan. The interest rate swap hedges the variable cash flows associated with the borrowings under our Term Loan (Note 3), effectively providing a fixed rate of interest throughout the life of the Term Loan.

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4. DERIVATIVE FINANCIAL INSTRUMENT AND HEDGING ACTIVITY – continued

The interest rate swap arrangement with Citizens Bank, N.A became effective on April 29, 2018, with a maturity date of December 29, 2022. The notional amount of the swap agreement at inception was $74.1 million and will decrease in line with our Term Loan. As of June 30, 2018, the notional amount of the interest rate swap was $74.1 million. The interest rate swap has a weighted average fixed rate of 2.60% and has been designated as an effective cash flow hedge and therefore qualifies for hedge accounting. As of June 30, 2018, the fair value of the interest rate swap asset was valued at $0.3 million and was recorded in other long-term assets in the accompanying unaudited condensed consolidated balance sheets. During the three months ended June 30, 2018, changes in the fair value of the interest rate swap of $0.3 million was recorded in accumulated other comprehensive income, net of tax in the accompanying unaudited condensed consolidated balance sheets. Differences between the hedged LIBOR rate and the fixed rate recorded as interest expense in the same period that the related interest is recorded for the Term Loan based on the LIBOR rate. In both the three and six-month periods ended June 30, 2018, $0.1 million of interest expense was recognized in relation to the interest rate swap.

5. EARNINGS PER SHARE

Basic earnings per share is computed by dividing net income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period.

For periods of net income, and when the effects are not anti-dilutive, we calculate diluted earnings per share by dividing net income available to common shareholders by the weighted-average number of shares outstanding plus the impact of all potential dilutive common shares, consisting primarily of common stock options, shares to be purchased under our Employee Stock Purchase Plan (“ESPP”), unvested restricted stock awards, stock purchase warrants, and any conversion gain on our Notes (Note 3), using the treasury stock method. For periods of net loss, diluted loss per share is calculated similarly to basic loss per share.

Our unvested restricted shares contain non-forfeitable rights to dividends, and therefore are considered to be participating securities; in periods of net income, the calculation of basic and diluted earnings per share excludes from the numerator net income attributable to the unvested restricted shares, and excludes the impact of those shares from the denominator.

For purposes of determining diluted earnings per share, we have elected a policy to assume that the principal portion of the Notes (Note 3) is settled in cash. As such, the principal portion of the Notes has no effect on either the numerator or denominator when determining diluted earnings per share. Any conversion gain is assumed to be settled in shares and is incorporated in diluted earnings per share using the treasury method. The warrants issued in conjunction with the issuance of the Notes (Note 3) are considered to be dilutive when they are in-the-money relative to our average stock price during the period; the bond hedge purchased in conjunction with the issuance of the Notes is always considered to be anti-dilutive.

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5. EARNINGS PER SHARE – continued

Earnings per share for the three and six months ended June 30, 2018 and 2017 are calculated for basic and diluted earnings per share as follows:

(in thousands, except per share amounts)	Basic Three Months Ended June 30,		Diluted Three Months Ended June 30,		Basic Six Months Ended June 30,		Diluted Six Months Ended June 30,	
	2018	2017	2018	2017	2018	2017	2018	2017
Net income	$2,777	$2,681	$2,777	$2,681	$5,027	$3,833	$5,027	$3,833
Net income allocated to restricted stock	(28)	(20)	(28)	(20)	(50)	(28)	(50)	(28)
Net income allocated to common shares	$2,749	$2,661	$2,749	$2,661	$4,977	$3,805	$4,977	$3,805
Basic Weighted-Average Shares Outstanding	11,679	11,546	11,679	11,546	11,634	11,536	11,634	11,536
Dilutive effect of stock options and ESPP			110	121			114	123
Diluted Weighted-Average Shares Outstanding			11,789	11,667			11,748	11,659
Earnings Per Share	$0.24	$0.23	$0.23	$0.23	$0.43	$0.33	$0.42	$0.33

The number of anti-dilutive shares, which have been excluded from the computation of diluted earnings per share, including the shares underlying the Notes, was 4.7 million and 4.8 million for the three months ended June 30, 2018 and 2017 and was 4.6 million and 4.7 million for the six months ended June 30, 2018 and 2017, respectively. Anti-dilutive shares consist of out-of-the-money Class C Special stock, out-of-the-money common stock options, common stock options that are anti-dilutive when calculating the impact of the potential dilutive common shares using the treasury stock method, underlying shares related to out-of-the-money bonds issued as convertible debt, and out-of-the-money warrants exercisable for common stock.

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6. INVENTORIES

Inventories consist of the following as of:

(in thousands)	June 30, 2018	December 31, 2017	
Raw materials	$25,766	$ 22,139	
Packaging materials	1,859	1,527	
Work-in-progress	639	510	
Finished goods	10,280	13,901	(1)
	38,544	38,077	
Reserve for excess/obsolete inventories	(788)	(350)	
Inventories, net	$37,756	$ 37,727	

(1) Includes finished goods acquired in asset purchases (Note 12).

Vendor Concentration

We source the raw materials for our products, including active pharmaceutical ingredients (“API”), from both domestic and international suppliers. Generally, only a single source of API is qualified for use in each product due to the cost and time required to validate a second source of supply. As a result, we are dependent upon our current vendors to reliably supply the API required for ongoing product manufacturing. During the three months ended June 30, 2018, we purchased approximately 40% of our inventory from three suppliers. As of June 30, 2018, the amounts payable to these suppliers was immaterial. During the six months ended June 30, 2018, we purchased approximately 15% of our inventory from one supplier. As of June 30, 2018, the amounts payable to this supplier was immaterial. During the three months ended June 30, 2017, we purchased approximately 27% of our inventory (exclusive of inventory acquired in asset purchases (Note 12)) from two suppliers. During the six months ended June 30, 2017, we purchased approximately 18% of our inventory (exclusive of inventory acquired in asset purchases (Note 12)) from one supplier.

7. PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment consist of the following as of:

(in thousands)	June 30, 2018	December 31, 2017
Land	$160	$ 160
Buildings	3,835	3,835
Machinery, furniture, and equipment	16,008	12,334
Construction in progress	9,878	10,663
	29,881	26,992
Less: accumulated depreciation	(7,039)	(6,589)
Property, Plant, and Equipment, net	$22,842	$ 20,403

Depreciation expense was $0.4 million and $0.3 million for the three months ended June 30, 2018 and 2017, respectively. Depreciation expense was $0.7 million and $0.6 million for the six months ended June 30, 2018 and 2017, respectively. During the three months ended June 30, 2018 and 2017, there was $0.2 million and $0.1 million of interest capitalized into construction in progress, respectively. During the six months ended June 30, 2018 and 2017, there was $0.4 million and $0.2 million of interest capitalized into construction in progress, respectively. Construction in progress consists of multiple projects, primarily related to new equipment to expand our manufacturing capability as our product lines continue to grow.

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8. GOODWILL AND INTANGIBLE ASSETS

Goodwill

As a result of our 2013 merger with BioSante Pharmaceuticals, Inc. ("BioSante"), we recorded goodwill of $1.8 million in our one reporting unit. We assess the recoverability of the carrying value of goodwill as of October 31st of each year, and whenever events occur or circumstances change that would, more likely than not, reduce the fair value of our reporting unit below its carrying value. There have been no events or changes in circumstances that would have reduced the fair value of our reporting unit below its carrying value during the six months ended June 30, 2018. No impairment losses were recognized during the three or six months ended June 30, 2018 or 2017.

Definite-lived Intangible Assets

Acquisition of Abbreviated New Drug Applications

In April 2018, we entered into an agreement with Impax Laboratories, Inc. (now Amneal Pharmaceuticals, Inc., or "Amneal") to purchase the approved ANDAs for three previously-commercialized generic drug products, the approved ANDAs for two generic drug products that have not yet been commercialized, the development package for one generic drug product, a license, supply, and distribution agreement for a generic drug product with an ANDA that is pending approval, and certain manufacturing equipment required to manufacture one of the products, for $2.3 million in cash up front. The transaction closed in May 2018 and we made the $2.3 million payment using cash on hand. We also capitalized $0.1 million of costs directly related to the transaction. We accounted for this transaction as an asset purchase. The $1.0 million acquired ANDA intangible assets are being amortized in full over their estimated useful lives of 10 years. Please see Note 12 for further details regarding the transaction.

In April 2018, we entered into an agreement with IDT Australia, Limited to purchase the ANDAs for 23 previously-marketed generic drug products and API for four of the acquired products for $2.7 million in cash and a

single-digit royalty on net profits from sales of one of the products. The transaction closed in April 2018 and we made the $2.7 million payment using cash on hand. We also capitalized $18 thousand of costs directly related to the transaction. We accounted for this transaction as an asset purchase. The $2.5 million acquired ANDA intangible assets are being amortized in full over their estimated useful lives of 10 years. Please see Note 12 for further details regarding the transaction.

Acquisition of New Drug Applications and Product Rights

In December 2017, we entered into an agreement with AstraZeneca AB and AstraZeneca UK Limited to purchase the right, title, and interest in the NDAs and the U.S. rights to market Atacand, Atacand HCT, Arimidex, and Casodex, for $46.5 million in cash. We also entered into a license agreement for use of these trademarks in the U.S. We made the $46.5 million cash payment with funds from our Term Loan (Note 3). We also capitalized $0.2 million of costs directly related to the asset purchase. We accounted for this transaction as an asset purchase. The $46.7 million product rights assets are being amortized in full over their estimated useful lives of 10 years. Please see Note 12 for further details regarding the transaction.

In February 2017, we entered into an agreement with Cranford Pharmaceuticals, LLC to purchase a distribution license, trademark, and certain finished goods inventory for Inderal XL for $20.2 million in cash. We made the $20.2 million cash payment using cash on hand. We accounted for this transaction as an asset purchase. We also capitalized $40 thousand of costs directly related to the transaction. The $15.1 million product rights intangible asset acquired in the asset purchase is being amortized in full over its estimated useful life of 10 years. Please see Note 12 for further details regarding the transaction.

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8. GOODWILL AND INTANGIBLE ASSETS – continued

In February 2017, we entered into an agreement with Holmdel Pharmaceuticals, LP to purchase the NDA, trademark, and certain finished goods inventory for InnoPran XL, including a license to an Orange Book listed patent, for $30.6 million in cash. We made the $30.6 million cash payment using $30.0 million of funds from our former Line of Credit and $0.6 million of cash on hand. We accounted for this transaction as an asset purchase. We also capitalized $0.1 million of costs directly related to the transaction. The $19.0 million product rights intangible asset acquired in the asset purchase is being amortized in full over its estimated useful life of 10 years. Please see Note 12 for further details regarding the transaction.

The components of net definite-lived intangible assets are as follows:

(in thousands)	June 30, 2018		December 31, 2017		Weighted Average Amortization Period
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization	
Acquired ANDA intangible assets	$46,194	$ (14,787)	$42,076	$ (12,592)	10.0 years
NDAs and product rights	230,974	(49,656)	230,974	(37,091)	10.0 years
Marketing and distribution rights	10,423	(6,087)	11,042	(5,087)	4.6 years
Non-compete agreement	624	(201)	624	(156)	7.0 years
	$288,215	$ (70,731)	$284,716	$ (54,926)	

Definite-lived intangible assets are stated at cost, net of amortization, generally using the straight-line method over the expected useful lives of the intangible assets. In the case of the Inderal XL and InnoPran XL asset purchases, because we anticipate that the acquired assets will provide a greater economic benefit in the earlier years, we are amortizing 80% of the value of the intangible assets over the first five years of useful lives of the assets and amortizing the remaining 20% of the value of the intangible assets over the second five years of useful lives of the assets. Amortization expense was $7.9 million and $6.8 million for the three months ended June 30, 2018 and 2017, respectively. Amortization expense was $15.8 million and $13.2 million for the six months ended June 30, 2018 and 2017, respectively.

We test for impairment of definite-lived intangible assets when events or circumstances indicate that the carrying value of the assets may not be recoverable. No such triggering events were identified during the three and six months ended June 30, 2018 and 2017 and therefore no impairment loss was recognized in the three and six months ended June 30, 2018 or 2017.

Expected future amortization expense is as follows:

(in thousands)	
2018 (remainder of the year)	$15,880
2019	31,761
2020	31,279
2021	29,833
2022	26,428
2023 and thereafter	82,303
Total	$217,484

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9.STOCK-BASED COMPENSATION

In July 2016, we commenced administration of the ANI Pharmaceuticals, Inc. 2016 Employee Stock Purchase Plan. As of June 30, 2018, we have 0.2 million shares of common stock available under the ESPP. Under the ESPP, participants can purchase shares of our stock at a 15% discount. In the three and six months ended June 30, 2018, we recognized $2 thousand and $4 thousand of stock-based compensation expense related to the ESPP in cost of sales, $2 thousand, and $3 thousand of stock-based compensation expense related to the ESPP in research and development, and $14 thousand and $28 thousand of stock-based compensation expense related to the ESPP in sales, general, and administrative expense in our accompanying unaudited interim condensed consolidated statements of operations, respectively. In the three and six months ended June 30, 2017, we recognized $2 thousand and $4 thousand of stock-based compensation expense related to the ESPP in cost of sales and $26 thousand and $39 thousand of stock-based compensation expense related to the ESPP in sales, general, and administrative expense in our accompanying unaudited interim condensed consolidated statements of operations, respectively.

All equity-based service awards are granted under the ANI Pharmaceuticals, Inc. Amended and Restated 2008 Stock Incentive Plan (the “2008 Plan”). As of June 30, 2018, 0.6 million shares of our common stock remained available for issuance under the 2008 Plan.

The following table summarizes stock-based compensation expense incurred under the 2008 Plan and included in our accompanying unaudited interim condensed consolidated statements of operations:

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Cost of sales	$ 24	$ 26	$ 42	$ 49
Research and development	220	168	380	307
Selling, general, and adminstrative	1,520	1,585	2,702	2,794
	$ 1,764	$ 1,779	$ 3,124	$ 3,150

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9.STOCK-BASED COMPENSATION – continued

A summary of stock option and restricted stock activity under the 2008 Plan during the six months ended June 30, 2018 and 2017 is presented below:

(in thousands)	Options	RSAs
Outstanding December 31, 2016	578	63
Granted	185	50
Options Exercised/RSAs Vested	(2)	(27)[1]
Forfeited	(3)	-
Outstanding June 30, 2017	758	86
Outstanding December 31, 2017	767	86
Granted	151	65
Options Exercised/RSAs Vested	(111)	(33)[2]
Forfeited	(16)	-
Outstanding June 30, 2018	791	118

[1] Includes five thousand shares purchased from employees to cover employee income taxes related to income earned upon vesting of restricted stock. The shares purchased are held in treasury and the $259 thousand total purchase price for the shares is included in Treasury stock in our accompanying unaudited interim condensed consolidated balance sheets.

[2] Includes 11 thousand shares purchased from employees to cover employee income taxes related to income earned upon vesting of restricted stock. The shares purchased are held in treasury and the $659 thousand total purchase price for the shares is included in Treasury stock in our accompanying unaudited interim condensed consolidated balance sheets.

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10. INCOME TAXES

We use the asset and liability method of accounting for income taxes. Deferred tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that such tax rate changes are enacted.

The measurement of a deferred tax asset is reduced, if necessary, by a valuation allowance if it is more likely than not that some portion or all of the deferred tax asset will not be realized. The utilization of our NOL carryforwards will be limited in future years as prescribed by Section 382 of the U.S. Internal Revenue Code. As of both June 30, 2018 and December 31, 2017, we had provided a valuation allowance against certain state net operating loss (“NOL”) carryforwards of $0.3 million.

We use a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by taxing authorities. We have not identified any uncertain income tax positions that could have a material impact on the consolidated financial statements. We recognize interest and penalties accrued on any unrecognized tax exposures as a component of income tax expense; we did not have any such amounts accrued as of June 30, 2018 and December 31, 2017. We are subject to taxation in various jurisdictions and all of our income tax returns remain subject to examination by tax authorities due to the availability of NOL carryforwards.

For interim periods, we recognize an income tax provision/(benefit) based on our estimated annual effective tax rate expected for the entire year. The interim annual estimated effective tax rate is based on the statutory tax rates then in effect, as adjusted for estimated changes in temporary and estimated permanent differences, and excludes certain discrete items whose tax effect, when material, is recognized in the interim period in which they occur. These changes in temporary differences, permanent differences, and discrete items result in variances to the effective tax rate from period to period. We also have elected to exclude the impacts from significant pre-tax non-recognized subsequent events from our interim estimated annual effective rate until the period in which they occur. Our estimated annual effective tax rate changes throughout the year as our on-going estimates of pre-tax income, changes in temporary differences, and permanent differences are revised, and as discrete items occur.

The estimated consolidated effective tax rate for the three months ended June 30, 2018 was 20.7% of pre-tax income reported in the period, calculated based on the estimated annual effective rate anticipated for the year ending December 31, 2018 plus the effects of certain discrete items occurring in the second quarter. Our effective tax rate for the three months ended June 30, 2018 was impacted primarily by the Tax Cuts and Jobs Act of 2017, which was enacted on December 22, 2017 and lowered the U.S. corporate tax rate from 35% to 21%, beginning in 2018. Our effective tax rate was also impacted by the discrete impact of current period awards of stock-based compensation, stock option exercises, and disqualifying dispositions of incentive stock options, all of which impact the consolidated effective rate in the period in which they occur.

The effective tax rate for the three months ended June 30, 2017 was 32.1% of pre-tax income reported in the period, calculated based on the estimated annual effective rate anticipated for the year ending December 31, 2017 plus the effects of certain material discrete items that occurred in the second quarter. Our effective tax rate for the three months ended June 30, 2017 was impacted primarily by the Domestic Production Activities Deduction, as well as the impact of current period awards of stock-based compensation, stock option exercises, and disqualifying dispositions of incentive stock options, all of which impact the consolidated effective rate in the period in which they occur.

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10. INCOME TAXES – continued

The estimated consolidated effective tax rate for the six months ended June 30, 2018 was 20.8% of pre-tax income reported in the period, calculated based on the estimated annual effective rate anticipated for the year ending December 31, 2018 plus the effects of certain discrete items occurring in 2018. Our effective tax rate for the six months ended June 30, 2018 was impacted primarily by the Tax Cuts and Jobs Act of 2017, which was enacted on December 22, 2017 and lowered the U.S. corporate tax rate from 35% to 21%, beginning in 2018. Our effective tax rate was also impacted by the discrete impact of current period awards of stock-based compensation, stock option exercises, and disqualifying dispositions of incentive stock options, all of which impact the consolidated effective rate in the period in which they occur.

The effective tax rate for the six months ended June 30, 2017 was 31.9% of pre-tax income reported in the period, calculated based on the estimated annual effective rate anticipated for the year ending December 31, 2017 plus the effects of certain material discrete items that occurred in 2017. Our effective tax rate for the six months ended June 30, 2017 was impacted primarily by the Domestic Production Activities Deduction, as well as the impact of current period awards of stock-based compensation, stock option exercises, and disqualifying dispositions of incentive stock options, all of which impact the consolidated effective rate in the period in which they occur.

11. COMMITMENTS AND CONTINGENCIES

Government Regulation

Our products and facilities are subject to regulation by a number of federal and state governmental agencies. The FDA, in particular, maintains oversight of the formulation, manufacture, distribution, packaging, and labeling of all of our products. The Drug Enforcement Administration (“DEA”) maintains oversight over our products that are controlled substances.

Unapproved Products

Two of our products, Esterified Estrogen with Methyltestosterone (“EEMT”) and Opium Tincture, are marketed without approved NDAs or Abbreviated New Drug Applications (“ANDAs”). During the three months ended June 30, 2018 and 2017, net revenues for these products totaled $6.5 million and $6.7 million, respectively. During the six months ended June 30, 2018 and 2017, net revenues for these products totaled $12.1 million and $12.9 million, respectively.

The FDA's policy with respect to the continued marketing of unapproved products is stated in the FDA's September 2011 Compliance Policy Guide Sec. 440.100 titled “Marketed New Drugs without Approved NDAs or ANDAs.” Under this policy, the FDA has stated that it will follow a risk-based approach with regard to enforcement against such unapproved products. The FDA evaluates whether to initiate enforcement action on a case-by-case basis, but gives higher priority to enforcement action against products in certain categories, such as those marketed as unapproved drugs with potential safety risks or that lack evidence of effectiveness. We believe that, so long as we comply with applicable manufacturing standards, the FDA will not take action against us under the current enforcement policy. There can be no assurance, however, that the FDA will continue this policy or not take a contrary position with any individual product or group of products. If the FDA were to take a contrary position, we may be required to seek FDA approval for these products or withdraw such products from the market. If we decide to withdraw the products from the market, our net revenues for generic pharmaceutical products would decline materially, and if we decide to seek FDA approval, we would face increased expenses and might need to suspend sales of the products until such approval was obtained, and there are no assurances that we would receive such approval.

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11. COMMITMENTS AND CONTINGENCIES – continued

In addition, one group of products that we manufacture on behalf of a contract customer is marketed by that customer without an approved NDA. If the FDA took enforcement action against such customer, the customer may be required to seek FDA approval for the group of products or withdraw them from the market. Our contract manufacturing revenues for these unapproved products for the three months ended June 30, 2018 and 2017 were $0.6 million and $0.4 million, respectively. Our contract manufacturing revenues for these unapproved products for the six months ended June 30, 2018 and 2017 were $1.0 million and $0.9 million, respectively.

We receive royalties on the net sales of a group of contract-manufactured products, which are marketed by the contract customer without an approved NDA. If the FDA took enforcement action against such customer, the customer may be required to seek FDA approval for the group of products or withdraw them from the market. Our royalties on the net sales of these unapproved products for the three and six months ended June 30, 2018 and 2017 were less than 1% of total revenues.

Louisiana Medicaid Lawsuit

On September 11, 2013, the Attorney General of the State of Louisiana filed a lawsuit in Louisiana state court against numerous pharmaceutical companies, including us, under various state laws, alleging that each defendant caused the state's Medicaid agency to provide reimbursement for drug products that allegedly were not approved by the FDA and therefore allegedly not reimbursable under the federal Medicaid program. The lawsuit relates to three cough and cold prescription products manufactured and sold by our former Gulfport, Mississippi operation, which was sold in September 2010. Through its lawsuit, the state seeks unspecified damages, statutory fines, penalties, attorneys' fees, and costs. While we cannot predict the outcome of the lawsuit at this time, we could be subject to material damages, penalties, and fines. We intend to vigorously defend against all claims in the lawsuit.

Civil Action

In November of 2017, we were served with a complaint filed by Arbor Pharmaceuticals, LLC, in the United States District Court, District of Minnesota. The complaint alleges false advertising and unfair competition in violation of Section 43(a) of the Lanham Act, Section 1125(a) of Title 15 of the United States Code, and Minnesota State law, and seeks injunctive relief and damages. In December of 2017, we filed a motion to dismiss, which is currently pending before the Court. We intend to defend this action vigorously.

Other Commitments and Contingencies

All manufacturers of the drug Reglan and its generic equivalent metoclopramide, including ANI, have faced allegations from plaintiffs in various states, including California, New Jersey, and Pennsylvania, claiming bodily injuries as a result of ingestion of metoclopramide or its brand name, Reglan, prior to the FDA's February 2009 Black Box warning requirement. In August 2012, we were dismissed with prejudice from all New Jersey complaints. In August 2016, we settled the outstanding California short form complaints and in February 2018, we settled the remaining four complaints that were not captured in the 2016 settlement. We consider our exposure to this litigation to be limited due to several factors: (1) the only generic metoclopramide that we manufactured prior to the implementation of the FDA's warning requirement was an oral solution introduced after May 28, 2008; (2) our market share for the oral solution was a very small portion of the overall metoclopramide market; and (3) once we received a request for change of labeling from the FDA, we submitted our proposed changes within 30 days, and such changes were subsequently approved by the FDA.

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11. COMMITMENTS AND CONTINGENCIES – continued

At the present time, we are unable to assess the likely outcome of the cases in the remaining states. Our insurance company has assumed the defense of this matter and paid all losses in settlement of the California cases. We cannot provide assurances that the outcome of these matters will not have an adverse effect on our business, financial condition, and operating results. Furthermore, like all pharmaceutical manufacturers, we may be exposed to other product liability claims in the future, which could limit our coverage under future insurance policies or cause those policies to become more expensive, which could harm our business, financial condition, and operating results.

We launched Erythromycin Ethylsuccinate (“EES”) on September 27, 2016 under a previously approved ANDA. In August 2016, we filed with the FDA to reintroduce this product under a Changes Being Effected in 30 Days submission (a “CBE-30 submission”). Under a CBE-30 submission, certain defined changes to an ANDA can be made if the FDA does not object in writing within 30 days. The FDA’s regulations, guidance documents, and historic actions support the filing of a CBE-30 for the types of changes that we proposed for our EES ANDA. We received no formal written letter from the FDA within 30 days of the CBE-30 submission date, and as such, launched the product in accordance with FDA regulations. On December 16, 2016, and nearly four months after our CBE-30 submission, the FDA sent us a formal written notice that a Prior Approval Supplement (“PAS”) was required for this ANDA. Under a PAS, proposed changes to an ANDA cannot be implemented without prior review and approval by the FDA. Because we did not receive this notice in the timeframe prescribed by the FDA’s regulations, we believe that our supplemental ANDA is valid, and as such continue to market the product. In addition, we filed a PAS which was accepted by the FDA and was originally assigned action date of June 2017. This date was later revised to October 2017 due to the election by the FDA to perform a Pre-Approval Inspection (“PAI”) of our Baudette manufacturing facilities. The FDA conducted its PAI between May 15, 2017 and May 18, 2017. On July 31, 2017, we received an Establishment Inspection Report from the FDA documenting that no objectionable conditions resulted from the inspection and that no FDA-483 or verbal observations were issued. On September 21, 2017, we received a Major CR Letter (Complete Response Letter). In February 2018, we submitted our response to the letter. In March 2018, we received notification from the FDA that our response to the letter had received priority review status. On May 25, 2018, we received a second Major CR letter and we are currently in the process of responding to the letter. We continue to reserve all of our legal options in this matter.

On or about September 20, 2017, the Company and certain of its employees were served with search warrants and/or grand jury subpoenas to produce documents and possibly testify relating to a federal investigation of the generic pharmaceutical industry. The Company has been cooperating and intends to continue cooperating with the investigation. However, no assurance can be given as to the timing or outcome of the investigation.

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12. FAIR VALUE DISCLOSURES

Fair value is the price that would be received from the sale of an asset or paid to transfer a liability assuming an orderly transaction in the most advantageous market at the measurement date. U.S. GAAP establishes a hierarchical disclosure framework that prioritizes and ranks the level of observability of inputs used in measuring fair value.

The inputs used in measuring the fair value of cash and cash equivalents are considered to be level 1 in accordance with the three-tier fair value hierarchy. The fair market values are based on period-end statements supplied by the various banks and brokers that held the majority of our funds. The fair value of short-term financial instruments (primarily accounts receivable, prepaid expenses, accounts payable, accrued expenses, borrowings under line of credit, and other current liabilities) approximate their carrying values because of their short-term nature. While our Notes are recorded on our accompanying unaudited interim condensed consolidated balance sheets at their net carrying value of $132.1 million as of June 30, 2018, the Notes are being traded on the bond market and their fair value is $161.0 million, based on their closing price on June 30, 2018, a Level 1 input.

Financial Assets and Liabilities Measured at Fair Value on a Recurring Basis

Our contingent value rights (“CVRs”), which were granted coincident with our merger with BioSante and expire in June 2023, are considered contingent consideration and are classified as liabilities. As such, the CVRs were recorded as purchase consideration at their estimated fair value, using level 3 inputs, and are marked to market each reporting period until settlement. The fair value of CVRs is estimated using the present value of our projection of the expected payments pursuant to the terms of the CVR agreement, which is the primary unobservable input. If our projection or expected payments were to increase substantially, the value of the CVRs could increase as a result. The present value of the liability was calculated using a discount rate of 15%. We determined that the fair value of the CVRs was immaterial as of June 30, 2018 and December 31, 2017. We also determined that the changes in such fair value were immaterial in the three and six months ended June 30, 2018 and 2017.

In April 2018, we entered into an interest rate swap (Note 4) to manage our exposure to the variable interest rate on our Term Loan (Note 3). The notional amount of our interest rate swap is set to match the balance of our Term Loan. Both the notional amount of the interest rate swap and the balance of our Term Loan were $74.1 million as of June 30,

2018. The fair value of our interest rate swap is estimated based on the present value of projected future cash flows using the LIBOR forward rate curve. The model used to value the interest rate swap includes inputs of readily observable market data, a Level 2 input. As described in detail in Note 4, the fair value of the interest rate swap was a $0.3 million asset at June 30, 2018.

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12. FAIR VALUE DISCLOSURES – continued

The following table presents our financial assets and liabilities accounted for at fair value on a recurring basis as of June 30, 2018 and December 31, 2017, by level within the fair value hierarchy:

(in thousands)

Description	Fair Value at June 30, 2018	Level 1	Level 2	Level 3
Assets				
Interest rate swap	$ 280	$ -	$ 280	$ -
Liabilities				
CVRs	$ -	$ -	$ -	$ -

Description	Fair Value at December 31, 2017	Level 1	Level 2	Level 3
Assets				
Interest rate swap	$ -	$ -	$ -	$ -
Liabilities				
CVRs	$ -	$ -	$ -	$ -

Financial Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis

We do not have any financial assets and liabilities that are measured at fair value on a non-recurring basis.

Non-Financial Assets and Liabilities Measured at Fair Value on a Recurring Basis

We do not have any non-financial assets and liabilities that are measured at fair value on a recurring basis.

Non-Financial Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis

We measure our long-lived assets, including property, plant, and equipment, intangible assets, and goodwill, at fair value on a non-recurring basis. These assets are recognized at fair value when they are deemed to be other-than-temporarily impaired. No such fair value impairment was recognized in the three and six months ended June 30, 2018 and 2017.

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12. FAIR VALUE DISCLOSURES – continued

Acquired Non-Financial Assets Measured at Fair Value

In April 2018, we entered into an agreement with Impax Laboratories, Inc. (now Amneal) to purchase the approved ANDAs for three previously-commercialized generic drug products, the approved ANDAs for two generic drug products that have not yet been commercialized, the development package for one generic drug product, a license, supply, and distribution agreement for a generic drug product with an ANDA that is pending approval, and certain manufacturing equipment required to manufacture one of the products, for $2.3 million in cash (Note 8). At the same time, we entered into a supply agreement with Amneal under which we may elect to purchase the finished goods for one of the products for up to 17 months beginning October 1, 2019, under certain conditions. If we do elect to purchase the finished goods from Amneal for this period, we may be required to pay a milestone payment of up to $10.0 million upon launch, depending on the number of competitors selling the product at the time of launch. This milestone payment was determined to be contingent consideration and will be recognized when the contingency is resolved. When one of the approved ANDAs that have not yet been commercialized is launched, we could be required to pay a milestone of $25.0 million to Teva Pharmaceuticals (“Teva”), depending on the number of competitors selling the product at the time of launch. In addition, depending on the number of competitors selling the product one year after the launch date, we could be required to pay a second milestone of $15.0 million to Teva. These milestones are determined to be contingent liabilities and will be recognized if and when they are both estimable and probable. Because we believe that neither milestone is both estimable and probable, we did not record a contingent liability for the milestones. We made the $2.3 million cash payment using cash on hand and capitalized $0.1 million of costs directly related to the asset purchase. We accounted for this transaction as an asset purchase. The $1.0 million acquired ANDA intangible assets were recorded at their relative fair value, determined using Level 3 unobservable inputs. In order to determine the fair value of the acquired ANDA intangible assets, we used the present value of the estimated cash flows related to the approved ANDAs, using discount rates of 10 to 15%. The acquired ANDAs will be amortized in full over their 10-year useful lives, and will be tested for impairment when events or circumstances indicate that the carrying value of the assets may not be recoverable. The $58 thousand of manufacturing equipment used to manufacture one of the products was recorded at its relative fair value, based on the estimated net book value of the equipment purchased. The equipment will be amortized in full over its 5-year useful life, and will be tested for impairment when events or circumstances indicate that the carrying value of the asset may not be recoverable. No such triggering events were identified during the period from the date of acquisition to June 30, 2018 and therefore no impairment loss was recognized for the six months ended June 30, 2018. The $1.3 million of in-process research and development was recorded at its relative fair value, determined using Level 3 unobservable inputs. In order to determine the fair value of the in-process research and development, we used the present value of the estimated cash flows related to the products, using a discount rate of 75%, reflective of the higher risk associated with these products. As the transaction was accounted for as an asset purchase, the $1.3 million of in-process research and development

was immediately recognized as research and development expense.

In April 2018, we entered into an agreement with IDT Australia, Limited to purchase the ANDAs for 23 previously-marketed generic drug products and API for four of the acquired products for $2.7 million in cash and a single-digit royalty on net profits from sales of one of the products (Note 8). We made the $2.7 million cash payment using cash on hand and capitalized $18 thousand of costs directly related to the asset purchase. We accounted for this transaction as an asset purchase. The $2.5 million acquired ANDA intangible assets were recorded at their relative fair value, determined using Level 3 unobservable inputs. In order to determine the fair value of the product rights intangible assets, we used the present value of the estimated cash flows related to the product rights, using discount rates of 10% to 15%. The acquired ANDA intangible assets will be amortized in full over their 10-year useful lives, and will be tested for impairment when events or circumstances indicate that the carrying value of the asset may not be recoverable. No such triggering events were identified during the period from the date of acquisition to June 30, 2018 and therefore no impairment loss was recognized for the six months ended June 30, 2018. We also recorded $0.2 million of raw materials inventory, measured at fair value. The fair value of the raw materials inventory was determined based on the estimated replacement cost.

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12. FAIR VALUE DISCLOSURES – continued

In December 2017, we entered into an agreement with AstraZeneca AB and AstraZeneca UK Limited to purchase the right, title, and interest in the NDAs and the U.S. right to market Atacand, Atacand HCT, Arimidex, and Casodex, for $46.5 million in cash (Note 8). We also licensed these trademarks for use in the U.S. We made t