# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
**WASHINGTON, D.C. 20549**

# FORM 10-Q

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

**FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2013**

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

**FOR THE TRANSITION PERIOD FROM _____ TO _____**

**COMMISSION FILE NUMBER: 001-32360**

# AKORN, INC.
(Exact Name of Registrant as Specified in its Charter)

| | |
|---|---|
| **LOUISIANA**<br>(State or Other Jurisdiction of Incorporation or Organization) | **72-0717400**<br>(I.R.S. Employer Identification No.) |
| **1925 W. Field Court, Suite 300**<br>**Lake Forest, Illinois**<br>(Address of Principal Executive Offices) | **60045**<br>(Zip Code) |

**(847) 279-6100**
(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 ☑ 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 (§ 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☑ No ☐

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

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Large accelerated filer | ☑ | Accelerated filer | ☐ | Non-accelerated filer (Do not check if a smaller reporting company) | ☐ | Smaller reporting company | ☐ |

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☑

At May 6, 2013 there were 96,090,433 shares of common stock, no par value, outstanding.

## PART I. FINANCIAL INFORMATION

**Item 1. Financial Statements.**

**AKORN, INC.**
**CONDENSED CONSOLIDATED BALANCE SHEETS**
**(In Thousands, Except Share Data)**

| | March 31, 2013 | December 31, 2012 |
|---|---|---|
| ASSETS: | (unaudited) | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 45,863 | $ 40,781 |
| Trade accounts receivable, net | 58,998 | 51,017 |
| Inventories, net | 53,958 | 52,495 |
| Deferred taxes, current | 7,886 | 9,190 |
| Prepaid expenses and other current assets | 3,951 | 5,224 |
| TOTAL CURRENT ASSETS | 170,656 | 158,707 |
| PROPERTY, PLANT AND EQUIPMENT, NET | 82,285 | 80,679 |
| OTHER LONG-TERM ASSETS: | | |
| Goodwill | 32,284 | 32,159 |
| Product licensing rights, net | 62,463 | 63,654 |
| Other intangibles, net | 16,316 | 16,731 |
| Deferred financing costs, net | 2,874 | 3,078 |
| Long-term investments | 10,420 | 10,299 |
| Deferred taxes, non-current | 1,221 | 930 |
| Other | 3,578 | 3,328 |
| TOTAL OTHER LONG-TERM ASSETS | 129,156 | 130,179 |
| TOTAL ASSETS | $ 382,097 | $ 369,565 |
| LIABILITIES AND SHAREHOLDERS' EQUITY: | | |
| CURRENT LIABILITIES: | | |
| Trade accounts payable | $ 20,270 | $ 21,784 |
| Accrued compensation | 2,144 | 7,533 |
| Accrued royalties | 5,492 | 5,768 |
| Accrued administration fees | 2,250 | 2,204 |
| Income taxes payable | 4,932 | 910 |
| Accrued expenses and other liabilities | 6,123 | 5,092 |
| TOTAL CURRENT LIABILITIES | 41,211 | 43,291 |
| LONG-TERM LIABILITIES: | | |
| Long-term debt | 105,637 | 104,637 |
| Purchase consideration payable | 16,179 | 16,113 |
| Deferred taxes – non-current | 1,534 | 1,991 |
| Product warranty liability | 1,299 | 1,299 |
| Lease incentive obligation and other long-term liabilities | 1,147 | 1,153 |
| TOTAL LONG-TERM LIABILITIES | 125,796 | 125,193 |
| TOTAL LIABILITIES | 167,007 | 168,484 |
| SHAREHOLDERS EQUITY: | | |
| Common stock, no par value – 150,000,000 shares authorized; 96,079,885 and 95,844,012 shares issued and outstanding at March 31, 2013 and December 31, 2012, respectively | 228,844 | 226,035 |
| Warrants to acquire common stock | 17,946 | 17,946 |
| Accumulated deficit | (26,154) | (36,996) |
| Accumulated other comprehensive loss | (5,546) | (5,904) |
| TOTAL SHAREHOLDERS' EQUITY | 215,090 | 201,081 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | $ 382,097 | $ 369,565 |

See notes to condensed consolidated financial statements.

**AKORN, INC.**
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**
**IN THOUSANDS, EXCEPT PER SHARE DATA**
**(UNAUDITED)**

| | Three Months Ended March 31, | |
|---|---|---|
| | **2013** | **2012** |
| Revenues | $ 73,854 | $ 51,717 |
| Cost of sales (exclusive of amortization of intangibles, included below) | 34,709 | 20,816 |
| GROSS PROFIT | 39,145 | 30,901 |
| Selling, general and administrative expenses | 12,335 | 10,339 |
| Acquisition related costs | 519 | 8,460 |
| Research and development expenses | 5,969 | 2,877 |
| Amortization of intangibles | 1,733 | 1,563 |
| TOTAL OPERATING EXPENSES | 20,556 | 23,239 |
| OPERATING INCOME | 18,589 | 7,662 |
| Amortization of deferred financing costs | (204) | (193) |
| Non-cash interest expense | (1,226) | (1,183) |
| Interest expense, net | (978) | (1,044) |
| Equity in earnings of unconsolidated joint venture | 76 | — |
| INCOME BEFORE INCOME TAXES | 16,257 | 5,242 |
| Income tax provision | 5,415 | 2,134 |
| CONSOLIDATED NET INCOME | $ 10,842 | $ 3,108 |
| NET INCOME PER SHARE: | | |
| BASIC | $ 0.11 | $ 0.03 |
| DILUTED | $ 0.10 | $ 0.03 |
| SHARES USED IN COMPUTING NET INCOME PER SHARE: | | |
| BASIC | 95,926 | 95,011 |
| DILUTED | 111,551 | 109,169 |
| | | |
| COMPREHENSIVE INCOME: | | |
| Consolidated net income | $ 10,842 | $ 3,108 |
| Foreign currency translation gain (loss) | 358 | (2,203) |
| COMPREHENSIVE INCOME | $ 11,200 | $ 905 |

See notes to condensed consolidated financial statements.

**AKORN, INC.**
**CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY**
**FOR THE THREE MONTHS ENDED MARCH 31, 2013**
**(In Thousands)**
**(Unaudited)**

| | Shares | Amount | Warrants to acquire Common Stock | Accumulated Deficit | Other Comprehensive Loss | Total |
|---|---|---|---|---|---|---|
| **BALANCES AT DECEMBER 31, 2012** | 95,844 | $ 226,035 | $ 17,946 | $ (36,996) | $ (5,904) | $ 201,081 |
| Consolidated net income | — | — | — | 10,842 | — | 10,842 |
| Exercise of stock options | 175 | 280 | — | — | — | 280 |
| Employee stock purchase plan issuances | 61 | 588 | — | — | — | 588 |
| Amortization of deferred compensation related to restricted stock awards | — | 64 | — | — | — | 64 |
| Stock-based compensation expense | — | 1,639 | — | — | — | 1,639 |
| Foreign currency translation adjustment | — | — | — | — | 358 | 358 |
| Excess tax benefit – stock compensation | — | 238 | — | — | — | 238 |
| **BALANCES AT MARCH 31, 2013** | 96,080 | $ 228,844 | $ 17,946 | $ (26,154) | $ (5,546) | $ 215,090 |

See notes to condensed consolidated financial statements.

**AKORN, INC.**
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(In Thousands)**
**(Unaudited)**

| | Three months ended March 31, | |
|---|---|---|
| | **2013** | **2012** |
| OPERATING ACTIVITIES: | | |
| Consolidated net income | $ 10,842 | $ 3,108 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 3,289 | 2,511 |
| Write-off and amortization of deferred financing fees | 204 | 193 |
| Amortization of unfavorable contract liability | (159) | — |
| Non-cash stock compensation expense | 1,703 | 1,423 |
| Non-cash interest expense | 1,226 | 1,183 |
| Deferred tax assets, net | 798 | 1,777 |
| Excess tax benefit from stock compensation | (238) | (1,595) |
| Equity in earnings of unconsolidated joint venture | (76) | — |
| Changes in operating assets and liabilities, net of effects from acquisitions: | | |
| Trade accounts receivable | (7,958) | (3,914) |
| Inventories | (1,441) | (4,155) |
| Prepaid expenses and other current assets | 1,002 | (275) |
| Trade accounts payable | (1,861) | (2,376) |
| Accrued expenses and other liabilities | (409) | 5,169 |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 6,922 | 3,049 |
| INVESTING ACTIVITIES: | | |
| Payments for acquisitions and equity investments | (269) | (55,224) |
| Purchases of property, plant and equipment | (2,689) | (5,386) |
| NET CASH (USED IN) PROVIDED BY INVESTING ACTIVITIES | (2,958) | (60,610) |
| FINANCING ACTIVITIES: | | |
| Excess tax benefit from stock compensation | 238 | 1,595 |
| Proceeds under stock option and stock purchase plans | 868 | 523 |
| NET CASH PROVIDED BY FINANCING ACTIVITIES | 1,106 | 2,118 |
| Effect of exchange rate changes on cash and cash equivalents | 12 | (181) |
| (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | 5,082 | (55,624) |
| Cash and cash equivalents at beginning of period | 40,781 | 83,962 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | $ 45,863 | $ 28,338 |
| SUPPLEMENTAL DISCLOSURES: | | |
| Amount paid for interest | 31 | 16 |
| Amount paid for income taxes | 2 | 63 |

See notes to condensed consolidated financial statements.

## NOTE 1 — BUSINESS AND BASIS OF PRESENTATION

*Business:* Akorn, Inc. and its wholly-owned subsidiaries (collectively, the "Company") manufacture and market a full line of diagnostic and therapeutic ophthalmic pharmaceuticals as well as niche hospital drugs and injectable pharmaceuticals. In addition, through its subsidiary Advanced Vision Research, Inc. ("AVR"), the Company manufactures and markets a line of over-the-counter ("OTC") ophthalmic products for the treatment of dry eye, eyelid hygiene and macular degeneration primarily under the TheraTears® brand name. The Company is a manufacturer and/or marketer of diagnostic and therapeutic pharmaceutical products in various specialty areas, including ophthalmology, antidotes, anti-infectives, vaccines, and controlled substances for pain management and anesthesia, among others. The Company operates pharmaceutical manufacturing plants in the U.S. at Decatur, Illinois and Somerset, New Jersey, and internationally at Paonta Sahib, Himachal Pradesh, India, as well as a central distribution warehouse in Gurnee, Illinois, R&D centers in Skokie and Vernon Hills, Illinois and corporate offices in Lake Forest, Illinois. Customers of the Company's products include physicians, optometrists, wholesalers, chain drug stores, group purchasing organizations and their member hospitals, alternate site providers, wholesalers, distributors, and other pharmaceutical companies.

*Basis of Presentation*: The Company's financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and accordingly do not include all the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments of a normal and recurring nature considered necessary for a fair presentation have been included in these financial statements. Operating results for the three-month period ended March 31, 2013 are not necessarily indicative of the results that may be expected for the full year. For further information, refer to the consolidated financial statements and footnotes for the year ended December 31, 2012, included in the Company's Annual Report on Form 10-K filed March 1, 2013.

The Company has considered the accounting and disclosure of events occurring after the balance sheet date through the filing date of this Form 10-Q.

## NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

***Use of Estimates:*** The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

***Chargebacks and Rebates:*** The Company enters into contractual agreements with certain third parties such as hospitals and group-purchasing organizations to sell certain products at predetermined prices. The parties have elected to have these contracts administered through wholesalers that buy the product from the Company and subsequently sell it to these third parties. When a wholesaler sells products to one of these third parties that are subject to a contractual price agreement, the difference between the price paid to the Company by the wholesaler and the price under the specific contract is charged back to the Company by the wholesaler. The Company tracks sales and submitted chargebacks by product number and contract for each wholesaler. Utilizing this information, the Company estimates a chargeback percentage for each product. The Company reduces gross sales and increases the chargeback allowance by the estimated chargeback amount for each product sold to a wholesaler. The Company reduces the chargeback allowance when it processes a request for a chargeback from a wholesaler. Actual chargebacks processed by the Company can vary materially from period to period based upon actual sales volume through the wholesalers. However, the Company's provision for chargebacks is fully reserved for at the time when sales revenues are recognized.

Management obtains certain wholesaler inventory reports to aid in analyzing the reasonableness of the chargeback allowance. The Company assesses the reasonableness of its chargeback allowance by applying the product chargeback percentage based on historical activity to the quantities of inventory on hand per the wholesaler inventory reports and an estimate of in-transit inventory that is not reported on the wholesaler inventory reports at the end of the period. In accordance with its accounting policy, the Company estimates the percentage amount of wholesaler inventory that will ultimately be sold to third parties that are subject to contractual price agreements based on a six-quarter trend of such sales through wholesalers. The Company uses this percentage estimate until historical trends or other information indicate that a revision should be made. On an ongoing basis, the Company evaluates its actual chargeback rate experience, and new trends are factored into its estimates each quarter as market conditions change. The Company used an estimate of 90.0% during the quarter ended March 31, 2013 and 98.5% during the quarter ended March 31, 2012.

***Sales Returns:*** Certain of the Company's products are sold with the customer having the right to return the product within specified periods and guidelines for a variety of reasons, including but not limited to, pending expiration dates. Provisions are made at the time of sale based upon tracked historical experience, by customer in some cases. One-time historical factors or pending new developments that would impact the expected level of returns are taken into account to determine the appropriate reserve estimate at each balance sheet date. As part of the evaluation of the balance required, the Company considers actual returns to date that are in process, the expected impact of any product recalls and the wholesaler's inventory information to assess the magnitude of unconsumed product that may result in a sales return to the Company in the future. The sales returns level can be impacted by factors such as overall market demand and market competition and availability for substitute products which can increase or decrease the end-user pull through for sales of the Company's products and ultimately impact the level of sales returns. Actual returns experience and trends are factored into the Company's estimates each quarter as market conditions change. Actual returns processed can vary materially from period to period.

***Allowance for Coupons and Promotions:*** The Company issues coupons from time to time redeemable against our TheraTears® eye care products. Upon release of coupons into the market, the Company records an estimate of the dollar value of coupons expected to be redeemed. This estimate is based on historical experience and is adjusted as needed based on actual redemptions. In addition to couponing, from time to time the Company authorizes various retailers to run in-store promotional sales of its products. Upon receiving confirmation that a promotion was run, the Company accrues an estimate of the dollar amount expected to be owed back to the retailer. This estimate is trued up upon receipt of invoice from the retailer.

For our treatment of advertising and promotional expenses paid to customers, we referred to guidance contained within ASC 605-50, *Customer Payments and Incentives*.

***Inventories:*** Inventories are stated at the lower of cost (average cost method) or market (see Note 4 — "Inventories"). The Company maintains an allowance for slow-moving and obsolete inventory as well as inventory with a carrying value in excess of its net realizable value ("NRV"). For finished goods inventory, the Company estimates the amount of inventory that may not be sold prior to its expiration or is slow moving based upon recent sales activity by unit and wholesaler inventory information. The Company also analyzes its raw material and component inventory for slow moving items.

The Company capitalizes inventory costs associated with its products prior to regulatory approval when, based on management judgment, future commercialization is considered probable and the future economic benefit is expected to be realized. The Company assesses the regulatory approval process and where the product stands in relation to that approval process including any known constraints or impediments to approval. The Company considers the shelf life of the product in relation to the product timeline for approval.

***Income taxes:*** Deferred income tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities, and net operating loss and other tax credit carry-forwards. These items are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company records a valuation allowance to reduce the deferred income tax assets to the amount that is more likely than not to be realized.

***Fair Value of Financial Instruments:*** The Company applies ASC Topic 820, which establishes a framework for measuring fair value and clarifies the definition of fair value within that framework. ASC Topic 820 defines fair value as an exit price, which is the price that would be received for an asset or paid to transfer a liability in the Company's principal or most advantageous market in an orderly transaction between market participants on the measurement date. The fair value hierarchy established in ASC Topic 820 generally requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Observable inputs reflect the assumptions that market participants would use in pricing the asset or liability and are developed based on market data obtained from sources independent of the reporting entity. Unobservable inputs reflect the entity's own assumptions based on market data and the entity's judgments about the assumptions that market participants would use in pricing the asset or liability, and are to be developed based on the best information available in the circumstances.

The valuation hierarchy is composed of three categories. The classification within the valuation hierarchy is based on the lowest level of input that is significant to the fair value measurement. The categories within the valuation hierarchy are described below:

- *Level 1*—Assets and liabilities with unadjusted, quoted prices listed on active market exchanges. Inputs to the fair value measurement are observable inputs, such as quoted prices in active markets for identical assets or liabilities. The carrying value of the Company's cash and cash equivalents are considered Level 1 assets.

- *Level 2*—Inputs to the fair value measurement are determined using prices for recently traded assets and liabilities with similar underlying terms, as well as directly or indirectly observable inputs, such as interest rates and yield curves that are observable at commonly quoted intervals. The Company does not have any Level 2 assets or liabilities.

- *Level 3*—Inputs to the fair value measurement are unobservable inputs, such as estimates, assumptions, and valuation techniques when little or no market data exists for the assets or liabilities. The purchase consideration payable related to the Company's acquisition on December 22, 2011 of three branded, injectable drug products from the U.S. subsidiary of H. Lundbeck A/S (the "Lundbeck Acquisition") is a Level 3 liability.

The following table summarizes the basis used to measure the fair values of the Company's financial instruments (amounts in thousands):

| | | Fair Value Measurements at Reporting Date, Using: | | |
|---|---|---|---|---|
| **Description** | **March 31, 2013** | **Quoted Prices in Active Markets for Identical Items (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| Cash and cash equivalents | $ 45,863 | $ 45,863 | $ — | $ — |
| Total assets | $ 45,863 | $ 45,863 | $ — | $ — |
| | | | | |
| Purchase consideration payable | $ 14,433 | $ — | $ — | $ 14,433 |
| Total liabilities | $ 14,433 | $ — | $ — | $ 14,433 |

| **Description** | **December 31, 2012** | **Quoted Prices in Active Markets for Identical Items (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
|---|---|---|---|---|
| Cash and cash equivalents | $ 40,781 | $ 40,781 | $ — | $ — |
| Total assets | $ 40,781 | $ 40,781 | $ — | $ — |
| | | | | |
| Purchase consideration payable | $ 14,208 | $ — | $ — | $ 14,208 |
| Total liabilities | $ 14,208 | $ — | $ — | $ 14,208 |

The carrying amount of the purchase consideration payable was initially determined based on the terms of the underlying contracts and the Company's subjective evaluation of the likelihood of the additional purchase consideration becoming payable. The purchase consideration payable is related to the Company's obligation to pay additional consideration of $15.0 million related to the acquisition of selected assets from H. Lundbeck A/S ("Lundbeck") on December 22, 2011. The underlying obligations are long-term in nature, and therefore were discounted to present value based on an assumed discount rate. The fair value of the liability is based upon the likelihood of achieving the underlying revenue targets and a derived cost of debt based on the remaining term. Therefore, the liability is sensitive to changes in the market rate.

At December 31, 2012, the Company performed an evaluation of the fair value of this liability based on utilizing significant unobservable inputs to derive a discount rate of 2.75%, and determined that the appropriate discounted value was $14.2 million. At March 31, 2013, the Company performed an evaluation of the fair value of this liability based on utilizing significant unobservable inputs to derive a discount rate of 2.23%, and determined that the appropriate discounted value was to $14.4 million. The $0.2 million change in fair value from December 31, 2012 to March 31, 2013 was recorded as non-cash interest expense within the Company's condensed consolidated statement of comprehensive income for the three months ended March 31, 2013.

The Company initially determined that there was a 100% likelihood of the purchase consideration ultimately becoming payable, and reaffirmed as of December 31, 2012 and March 31, 2013 that this was still the Company's determination at those dates. Should subjective and objective evidence lead the Company to change this assessment, an adjustment to the carrying value of the liability would be recorded as "other income" in the Company's condensed consolidated statements of comprehensive income.

As of March 31, 2013 and December 31, 2012, the Company was carrying long-term investments valued at $10,420,000 and $10,299,000, respectively. The underlying assets are cost-basis investments for which fair value is not readily determinable.

***Business Combinations:*** Business combinations are accounted for under ASC 805, Business Combinations, using the acquisition method of accounting. The acquisition method of accounting requires an acquirer to recognize the assets acquired and the liabilities assumed at the acquisition date measured at their fair values as of that date. Fair value determinations are based on discounted cash flow analyses or other valuation techniques. In determining the fair value of the assets acquired and liabilities assumed in a material acquisition, the Company may utilize appraisals from third party valuation firms to determine fair values of some or all of the assets acquired and liabilities assumed, or may complete some or all of the valuations internally. In either case, the Company takes full responsibility for the determination of the fair value of the assets acquired and liabilities assumed. The value of goodwill will be determined as the excess of the fair value of the consideration conveyed to the seller over the fair value of the net assets received. Under the acquisition method of accounting, the Company will identify the acquirer and the closing date and apply applicable recognition principles and conditions.

Acquisition-related costs are costs the Company incurs to effect a business combination. The Company accounts for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received.

**NOTE 3 — STOCK BASED COMPENSATION**

Stock-based compensation cost is estimated at grant date based on the fair value of the award, and the cost is recognized as expense ratably over the vesting period. The Company uses the Black-Scholes model for estimating the grant date fair value of stock options. Determining the assumptions that enter into the model is highly subjective and requires judgment. The Company uses an expected volatility that is based on the historical volatility of its common stock. The expected life assumption is based on historical employee exercise patterns and employee post-vesting termination behavior. The risk-free interest rate for the expected term of the option is based on the average market rate on U.S. treasury securities in effect during the quarter in which the options were granted. The dividend yield reflects historical experience as well as future expectations over the expected term of the option. The Company estimates forfeitures at the time of grant and revises in subsequent periods, if necessary, if actual forfeitures differ from initial estimates.

For the three-month period ended March 31, 2013, the Company recorded total stock-based compensation expense of $1,703,000, of which $1,639,000 was related to stock options and the enrollment in the Employee Stock Purchase Plan ("ESPP"), and the remaining $64,000 was related to restricted stock awards. In the prior year three-month period ended March 31, 2012, the Company recorded total stock-based compensation expense of $1,423,000, of which $1,419,000 was related to stock options and the ESPP, and $4,000 was related to restricted stock awards. The Company uses the single-award method for allocating compensation cost related to stock options to each period.

Set forth below are the grant-date fair values, along with the weighted-average assumptions used in estimating those grant-date fair values, for the stock options granted during the three month periods ended March 31, 2013 and 2012:

| | Three months ended March 31, | |
|---|---|---|
| | 2013 | 2012 |
| Expected volatility | 68.2% | 85.2% |
| Expected life (in years) | 4.00 | 4.00 |
| Risk-free interest rate | 0.84% | 0.84% |
| Dividend yield | 0.00% | 0.00% |
| Fair value per stock option | $ 6.56 | $ 7.88 |
| Forfeiture rate | 8% | 8% |

The table below sets forth a summary of activity within the Company's stock-based compensation plans for the quarter ended March 31, 2013:

| | Number of Options (in thousands) | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding at December 31, 2012 | 9,727 | $ 4.22 | 2.55 | $ 88,918,000 |
| Granted | 36 | 12.77 | | |
| Exercised | (177) | 1.62 | | |
| Forfeited | (6) | 10.41 | | |
| Outstanding at March 31, 2013 | 9,580 | $ 4.30 | 2.33 | $ 91,304,000 |
| Exercisable at March 31, 2013 | 6,226 | $ 2.50 | 1.86 | $ 70,514,000 |

The aggregate intrinsic value for stock options outstanding and exercisable is defined as the difference between the market value of the Company's common stock as of the date indicated and the exercise price of the stock options. During the quarter ended March 31, 2013, a total of 177,000 stock options were exercised resulting in cash payment to the Company of $286,000. During the prior year quarter ended March 31, 2012, a total of 89,000 stock options were exercised resulting in cash payment to the Company of $155,000. These option exercises during the quarters ended March 31, 2013 and 2012 generated tax-deductible expenses totaling $2,182,000 and $902,000, respectively.

The Company also may grant restricted stock awards to certain employees and members of its Board of Directors. Restricted stock awards are valued at the closing market value of the Company's common stock on the date of grant and the total value of the award is recognized as expense ratably over the vesting period of the grants. The Company did not grant restricted stock awards during the quarters ended March 31, 2013 or March 31, 2012. The Company recognized compensation expense of $64,000 and $4,000 during the quarters ended March 31, 2013 and 2012, respectively, related to outstanding restricted stock awards.

The following is a summary of non-vested restricted stock activity:

| | Number of Shares (in thousands) | Weighted Average Grant Date Fair Value |
|---|---|---|
| Non-vested at December 31, 2012 | 18 | $ 14.63 |
| Granted | — | — |
| Forfeited | — | — |
| Vested | — | — |
| Non-vested at March 31, 2013 | 18 | $ 14.63 |

**NOTE 4 — REVENUE RECOGNITION**

Revenue is recognized when all obligations of the Company have been fulfilled and collection of the related receivable is probable. For sales of prescription and contract manufactured products, the Company recognizes sales upon the shipment of goods or completion of services as appropriate. For certain OTC eye care products and certain export sales into foreign countries, the Company recognizes sales upon receipt by the customer, consistent with the timing of transfer of title.

Provision for estimated chargebacks, rebates, discounts, product returns and doubtful accounts is made at the time of sale and is analyzed and adjusted, if necessary, at each balance sheet date.

**NOTE 5 — ACCOUNTS RECEIVABLE ALLOWANCES**

The nature of the Company's business inherently involves, in the ordinary course, significant amounts and substantial volumes of transactions and estimates relating to allowances for product returns, chargebacks, rebates, doubtful accounts and discounts given to customers. This is a natural circumstance of the pharmaceutical industry and not specific to the Company and inherently lengthens the final net collections process. Depending on the product, the end-user customer, the specific terms of national supply contracts and the particular arrangements with the Company's wholesaler customers, certain rebates, chargebacks and other credits are deducted from the Company's accounts receivable. The process of claiming these deductions depends on wholesalers reporting to the Company the amount of deductions that were earned under the respective terms with end-user customers (which in turn depends on which end-user customer, with different pricing arrangements might be entitled to a particular deduction). This process can lead to partial payments against outstanding invoices as the wholesalers take the claimed deductions at the time of payment.

The provisions for the following customer reserves are reflected in the accompanying financial statements as reductions of revenues in the statements of income with the exception of the provision for doubtful accounts which is reflected as part of selling, general and administrative expense. The ending reserve amounts are included in trade accounts receivable, net in the Company's balance sheets.

Net trade accounts receivable consists of the following (in thousands):

| | MARCH 31, 2013 | DECEMBER 31, 2012 |
|---|---|---|
| Gross accounts receivable | $ 85,230 | $ 74,855 |
| Less: | | |
| Chargeback and rebates reserves | (15,740) | (13,452) |
| Returns reserve | (8,409) | (8,409) |
| Discount and allowances reserve | (1,631) | (1,362) |
| Advertising and promotion reserve | (436) | (585) |
| Allowance for doubtful accounts | (16) | (30) |
| Net trade accounts receivable | $ 58,998 | $ 51,017 |

For the three-month periods ended March 31, 2013 and 2012, the Company recorded chargeback and rebate expense of $43,763,000 and $22,042,000, respectively. For the three-month periods ended March 31, 2013 and 2012, the Company recorded provisions for product returns of $1,231,000 and $1,419,000, respectively. For the three-month periods ended March 31, 2013 and 2012, the Company recorded provisions for cash discounts of $1,975,000 and $1,207,000, respectively. The increases in each of these sales adjustment expenses over the prior year period were primarily due to increased sales in the Ophthalmic and Hospital drugs & injectables segments.

**NOTE 6 — INVENTORIES**

The components of inventories are as follows (in thousands):

| | MARCH 31, 2013 | DECEMBER 31, 2012 |
|---|---|---|
| Finished goods | $ 21,681 | $ 24,657 |
| Work in process | 5,240 | 3,743 |
| Raw materials and supplies | 27,037 | 24,095 |
| | $ 53,958 | $ 52,495 |

The Company maintains reserves and records provisions for slow-moving and obsolete inventory as well as inventory with a carrying value in excess of its net realizable value. Inventory at March 31, 2013 and December 31, 2012 was reported net of these reserves of $3.9 million and $2.2 million, respectively.

**NOTE 7 — PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment consists of the following (in thousands):

| | MARCH 31, 2013 | DECEMBER 31, 2012 |
|---|---|---|
| Land | $ 2,729 | $ 2,715 |
| Buildings and leasehold improvements | 43,451 | 43,190 |
| Furniture and equipment | 71,280 | 70,874 |
| Sub-total | 117,460 | 116,779 |
| Accumulated depreciation | (49,194) | (47,635) |
| Property, plant and equipment placed in service, net | 68,266 | 69,144 |
| | | |
| Construction in progress | 14,019 | 11,535 |
| Property, plant and equipment, net | $ 82,285 | $ 80,679 |

A portion of the Company's property, plant and equipment is located outside the United States. At March 31, 2013 and December 31, 2012, property, plant and equipment, net, totaling $24.2 million and $23.7 million, respectively, was located outside the United States at the Company's manufacturing facility and regional corporate offices in India.

**NOTE 8 — INTANGIBLE ASSETS**

The following table sets forth information about the changes in the net book value of the Company's intangible assets during the quarter ended March 31, 2013 and the weighted average remaining amortization period as of March 31, 2013 (in thousands):

| | Goodwill | Product Licensing Rights | Trademarks | Customer Relation-ships | Non-compete Agreement | TOTAL |
|---|---|---|---|---|---|---|
| DECEMBER 31, 2012 | $ 32,159 | $ 63,654 | $ 8,972 | $ 5,588 | $ 2,171 | $ 112,544 |
| | | | | | | |
| Acquisitions | — | 100 | — | — | — | 100 |
| Currency translation adjustment | 125 | — | | 21 | 6 | 152 |
| Amortization of intangibles | — | (1,291) | (79) | (193) | (170) | (1,733) |
| MARCH 31, 2013 | $ 32,284 | $ 62,463 | $ 8,893 | $ 5,416 | $ 2,007 | $ 111,063 |
| | | | | | | |
| Weighted average remaining amortization period (in years) | N/A | 13.6 | 28.3 | 9.7 | 2.9 | |

**NOTE 9 — FINANCING ARRANGEMENTS**

*Convertible Notes*

On June 1, 2011, the Company issued $120,000,000 aggregate principal amount of 3.50% Convertible Senior Notes due 2016 (the "Notes") which includes $20,000,000 in aggregate principal amount of the Notes issued in connection with the full exercise by the initial purchasers of their over-allotment option. The Notes are governed by the Company's indenture with Wells Fargo Bank, National Association, as trustee (the "Indenture"). The Notes were offered and sold only to qualified institutional buyers. The net proceeds from the sale of the Notes were approximately $115,317,000, after deducting underwriting fees and other related expenses.

The Notes have a maturity date of June 1, 2016 and pay interest at an annual rate of 3.50% semiannually in arrears on June 1 and December 1 of each year, with the first interest payment completed on December 1, 2011. The Notes are convertible into Akorn's common stock, cash or a combination thereof at an initial conversion price of $8.76 per share, which is equivalent to an initial conversion rate of approximately 114.1553 shares per $1,000 principal amount of Notes. The conversion price is subject to adjustment for certain events described in the Indenture, including certain corporate transactions which would increase the conversion rate and decrease the conversion price for a holder that elects to convert their Notes in connection with such corporate transaction.

The Notes are not listed on any securities exchange or on any automated dealer quotation system, but are traded on a secondary market made by the initial purchasers. The initial purchasers of the Notes advised the Company of their intent to make a market in the Notes following the offering, though they are not obligated to do so and may discontinue any market making at any time.

As of March 31, 2013, the Notes were trading at approximately 173% of their face value, resulting in a total market value of $207.6 million compared to their face value of $120.0 million. The actual conversion value of the Notes is based on the product of the conversion rate and the market price of the Company's common stock at conversion, as defined in the Indenture. At March 31, 2013, the Company's common stock closed at $13.83 per share, resulting in a pro forma conversion value for the Notes of approximately $189.5 million. Increases in the market value of the Company's common stock increase the Company's obligation accordingly. There is no upper limit placed on the possible conversion value of the Notes.

The Notes may be converted at any time prior to the close of business on the business day immediately preceding December 1, 2015 under the following circumstances: (1) during any calendar quarter commencing after September 30, 2011, if the closing sale price of the Company's common stock, for at least 20 trading days (whether or not consecutive) during the period of 30 consecutive trading days ending on the last trading day of the calendar quarter immediately preceding the calendar quarter in which the conversion occurs, is more than 130% of the conversion price in effect on each applicable trading day; (2) during the five consecutive trading-day period following any five consecutive trading-day period in which the trading price for the Notes per $1,000 principal amount of Notes for each such trading day was less than 98% of the closing sale price of the Company's common stock on such date multiplied by the then-current conversion rate; or (3) upon the occurrence of specified corporate events. On or after December 1, 2015 until the close of business on the business day immediately preceding the stated maturity date, holders may surrender all or any portion of their Notes for conversion at any time, regardless of the foregoing circumstances. Upon conversion, the Company will pay or deliver, at the Company's option, cash, shares of the Company's common stock, or a combination thereof. If a "fundamental change" (as defined in the Indenture) occurs prior to the stated maturity date, holders may require the Company to purchase for cash all or a portion of their Notes.

The Notes became convertible effective April 1, 2012 as a result of the Company's common stock closing above the required price of $11.39 per share for 20 of the last 30 consecutive trading days in the quarter ended March 31, 2012. In each subsequent quarterly period, this trading price requirement has been met. Accordingly, the Notes have remained convertible and will continue to be convertible at least through June 30, 2013.

The Notes are accounted for in accordance with ASC 470-20. Under ASC 470-20, issuers of convertible debt instruments that may be settled in cash upon conversion, including partial cash settlement, are required to separately account for the liability (debt) and equity (conversion option) components.

The application of ASC 470-20 resulted in the recognition of $20,470,000 as the value for the equity component. At March 31, 2013 and December 31, 2012, the net carrying amount of the liability component and the remaining unamortized debt discount were as follows (in thousands):

| | MARCH 31, 2013 | DECEMBER 31, 2012 |
|---|---|---|
| Carrying amount of equity component | $ 20,470 | $ 20,470 |
| Carrying amount of the liability component | 105,637 | 104,637 |
| Unamortized discount of the liability component | 14,363 | 15,363 |
| Unamortized deferred financing costs | 2,597 | 2,778 |

The Company incurred debt issuance costs of $4.7 million related to its issuance of the Notes. In accordance with ASC 470-20, the Company allocated this debt issuance cost ratably between the liability and equity components of the Notes, resulting in $3.9 million of debt issuance costs allocated to the liability component and $0.8 million allocated to the equity component. The portion allocated to the liability component was classified as deferred financing costs and is being amortized by the effective interest method through the earlier of the maturity date of the Notes or the date of conversion, while the portion allocated to the equity component was recorded as an offset to additional paid-in capital upon issuance of the Notes.

For the three month periods ended March 31, 2013 and 2012, the Company recorded the following expenses in relation to the Notes (in thousands):

| Expense Description | Line Item on Condensed Consolidated Statements of Comprehensive Income | Three months ended March 31, 2013 | 2012 |
|---|---|---|---|
| Interest expense at 3.5% coupon rate | Interest (expense) income, net | $ 1,050 | $ 1,050 |
| Debt discount amortization | Non-cash interest expense | 1,001 | 932 |
| Deferred financing cost amortization | Amortization of deferred financing costs | 181 | 168 |
| | | $ 2,232 | $ 2,150 |

Upon issuing the Notes, the Company established a deferred tax liability of $8.6 million related to the debt discount of $21.3 million, with an offsetting debit of $8.6 million to Common stock. The deferred tax liability was established because the amortization of the debt discount generates non-cash interest expense that is not deductible for income tax purposes. Since the Company's net deferred tax assets were fully reserved by valuation allowance at the time the Notes were issued, the Company reduced its valuation allowance by $8.6 million upon recording the deferred tax liability related to the debt discount with an offsetting credit of $8.6 million to Common stock. As a result, the net impact of these entries was a debit of $8.6 million to the valuation reserve against the Company's deferred tax assets and a credit of $8.6 million to deferred tax liability. The deferred tax liability is being amortized monthly as the Company records non-cash interest from its amortization of the debt discount on the Notes.

*Bank of America Credit Facility*

On October 7, 2011, the Company and its domestic subsidiaries (the "Borrowers") entered into a Loan and Security Agreement (the "B of A Credit Agreement") with Bank of America, N.A. (the "Agent") and other financial institutions (collectively with the Agent, the "B of A Lenders") through which it obtained a $20.0 million revolving line of credit (the "Facility"), which includes a $2.0 million letter of credit facility. The Company may request expansion of the Facility from time to time in increments of at least $5.0 million up to a maximum commitment of $35.0 million, so long as no default or event of default has occurred and is continuing. The facility matures in March 2016. The Company may early terminate the B of A Lenders' commitments under the Facility upon 90 days' notice to the Agent at any time after the first year.

Under the terms of the B of A Credit Agreement, amounts outstanding will bear interest at the Company's election at (a) LIBOR or (b) the bank's Base Rate (which is the greatest of: (i) the prime rate, (ii) the federal funds rate plus 0.50%, or (iii) LIBOR plus 1.0%), plus an applicable margin, which margin is based on the consolidated fixed charge coverage ratio of the Company and its subsidiaries from time to time. Additionally, the Borrowers will pay an unused line fee of 0.250% per annum on the unused portion of the Facility. Interest and unused line fees will be accrued and paid monthly. In addition, with respect to any letters of credit that may be issued, the Borrowers will pay: (i) a fee equal to the applicable margin times the average amount of outstanding letters of credit, (ii) a fronting fee equal to 0.125% per annum on the stated amount of each letter of credit, and (iii) any additional fees incurred by the applicable issuer in connection with issuing the letter of credit. During an event of default, any interest or fees payable will be increased by 2% per annum.

Availability under the revolving credit line is equal to the lesser of (a) $20.0 million reduced by outstanding letter of credit obligations or (b) the amount of a Borrowing Base (as defined in accordance with the terms of the B of A Credit Agreement) determined by reference to the value of the Borrowers' eligible accounts receivable, eligible inventory and fixed assets as of the closing date and the end of each calendar month thereafter.

Obligations under the B of A Credit Agreement are secured by substantially all of the assets of each of the Borrowers and a pledge by the Borrowers of their respective equity interest in each domestic subsidiary of the Company and 65% of their respective equity interests in any foreign subsidiary of the Company. The B of A Credit Agreement contains representations and warranties, and affirmative and negative covenants customary for financings of this type, including, but not limited to, limitations on: distributions while we have any outstanding commitments or obligations under the B of A Credit Agreement; additional borrowings and liens; additional investments and asset sales; and fundamental changes to corporate structure or organization documents. The financial covenants require the Borrowers to maintain a fixed charge coverage ratio of at least 1.1 to 1.0 during any period commencing on the date that an event of default occurs or availability under the B of A Credit Agreement is less than 15% of the aggregate B of A Lenders' commitments under the B of A Credit Agreement. During the term of the agreement, the Company must provide the Agent with monthly, quarterly and annual financial statements, monthly compliance certificates, annual budget projections and copies of press releases and SEC filings.

As of both March 31, 2013 and December 31, 2012, the Company had borrowing available under the B of A Credit Agreement of $19.7 million and no outstanding borrowings or outstanding letters of credit.

**NOTE 10 — EARNINGS PER COMMON SHARE**

Basic net income per common share is based upon the weighted average common shares outstanding during the period. Diluted net income per common share is based upon the weighted average number of common shares outstanding, including the dilutive effect, if any, of stock options and warrants and the conversion feature of convertible notes using the treasury stock method.

The Company's potentially dilutive shares consist of: (i) vested and unvested stock options that are in-the-money, (ii) unvested restricted stock awards ("RSAs"), (iii) warrants that are in-the-money, and (iv) shares potentially issuable upon conversion of the Notes. The Company calculates and includes in dilutive securities incremental shares issuable related to the Notes to the extent that the conversion value of each note exceeds $1,000.

Certain shares that are potentially dilutive in the future have been excluded from the diluted net income per share computation as they would have been anti-dilutive for the period. The number of such shares subject to stock options as of March 31, 2013 and March 31, 2012 was 1,496,000 and 126,000, respectively. There were no shares subject to warrants that would have been anti-dilutive as of either March 31, 2013 or March 31, 2012.

A reconciliation of the earnings per share data from a basic to a fully diluted basis is detailed below (in thousands, except per share amounts):

| | Three months ended March 31, | |
|---|---|---|
| | 2013 | 2012 |
| Net income | $ 10,842 | $ 3,108 |
| Net income per share: | | |
| Basic | $ 0.11 | $ 0.03 |
| Diluted | $ 0.10 | $ 0.03 |
| | | |
| Shares used in computing net income per share: | | |
| Weighted average basic shares outstanding | 95,926 | 95,011 |
| Dilutive securities: | | |
| Stock options and unvested RSA's | 4,193 | 4,097 |
| Stock warrants | 6,589 | 6,502 |
| Shares issuable upon conversion of convertible notes (1) | 4,843 | 3,559 |
| Total dilutive securities | 15,625 | 14,158 |
| | | |
| Weighted average diluted shares outstanding | 111,551 | 109,169 |

(1) Shares issuable upon conversion of convertible notes assumes that that Company would repay the principal of the notes in cash and pay any incremental value in shares of the Company's common stock.

**NOTE 11 — INDUSTRY SEGMENT INFORMATION**

During the quarters ended March 31, 2013 and March 31, 2012, the Company reported results for three segments:
- Ophthalmic
- Hospital Drugs & Injectables
- Contract Services

The ophthalmic segment manufactures, markets and distributes diagnostic and therapeutic pharmaceuticals. The hospital drugs & injectables segment manufactures, markets and distributes drugs and injectable pharmaceuticals, primarily in niche markets, as well as certain vaccines. The contract services segment manufactures products for third party pharmaceutical and biotechnology customers based on their specifications. The contract services segment also includes the operating results of our subsidiary in India – Akorn India Private Limited ("AIPL") – as their principal current business activity involves the manufacture of drugs on contract for other drug companies.

The Company's reportable segments are based upon internal financial reports that aggregate certain operating information. The Company's chief operating decision maker, as defined in ASC Topic 280, *Segment Reporting*, is its chief executive officer ("CEO"). The Company's CEO oversees operational assessments and resource allocations based upon the results of the Company's reportable segments, all of which have available discrete financial information.

Selected financial information by industry segment is presented below (in thousands).

| | THREE MONTHS ENDED MARCH 31, | |
|---|---|---|
| | 2013 | 2012 |
| REVENUES: | | |
| Ophthalmic | $ 25,705 | $ 21,811 |
| Hospital Drugs & Injectables | 40,434 | 27,376 |
| Contract Services | 7,715 | 2,530 |
| Total revenues | $ 73,854 | $ 51,717 |
| GROSS PROFIT: | | |
| Ophthalmic | $ 14,716 | $ 12,719 |
| Hospital Drugs & Injectables | 22,814 | 17,041 |
| Contract Services | 1,615 | 1,141 |
| Total gross profit | 39,145 | 30,901 |
| Operating expenses | 20,556 | 23,239 |
| Operating income | 18,589 | 7,662 |
| Other (expense) income | (2,332) | (2,420) |
| Income before income taxes | $ 16,257 | $ 5,242 |

The Company manages its business segments to the gross profit level and manages its operating and other costs on a company-wide basis. Inter-segment activity at the gross profit level is minimal. The Company does not identify assets by segment for internal purposes, as certain of the Company's manufacturing and warehouse facilities support more than one segment.

Sales to customers in foreign countries accounted for $8.5 million and $5.3 million of the Company's sales during the three month periods ended March 31, 2013 and 2012, respectively. Sales by AIPL to its customers represented $5.1 million and $0.9 million of the sales in these respective quarterly periods.

**NOTE 12 — BUSINESS COMBINATIONS**

On February 28, 2012, Akorn India Private Limited ("AIPL"), a wholly owned subsidiary of the Company completed and closed on its previously announced acquisition of selected assets of Kilitch Drugs (India) Limited ("KDIL"). This acquisition (the "Kilitch Acquisition") was pursuant to the terms of the Business Transfer Agreement (the "BTA") entered into among the Company, KDIL and the members of the promoter group of KDIL on October 5, 2011. In accordance with terms contained in the BTA, the Company also closed on a related Product Transfer Agreement between the Company and NBZ Pharma Limited ("NBZ"), a company associated with KDIL. The primary asset transferred in the Kilitch Acquisition was KDIL's manufacturing plant in Paonta Sahib, Himachal Pradesh, India, along with its existing book of business. KDIL was engaged in the manufacture and sale of pharmaceutical products for contract customers in India and for export to various unregulated world markets. While the Paonta Sahib manufacturing facility is not currently certified by the U.S. Food and Drug Administration (the "FDA") for the exporting of drugs to the U.S., the facility was designed with future FDA certification in mind. Accordingly, the Kilitch Acquisition provided the Company with the potential for future expansion of its manufacturing capacity for products to be sold in the U.S., as well as the opportunity to expand the Company's footprint into markets outside the U.S. The Company has determined that the assets acquired through the Kilitch Acquisition constitute a "business" as defined by Rule 11-01(d) of Regulation S-X and ASC 805, *Business Combinations*. Accordingly, the Company has accounted for the Kilitch Acquisition as a business combination.

AIPL paid the equivalent of approximately USD $60.1 million at closing. Total purchase consideration was approximately $55.2 million which consisted of approximately $51.2 million in base consideration and $4.0 million in reimbursement for capital expenditures made by KDIL from April 1, 2011 to the closing date. AIPL also paid $7.8 million related to compensation earned from the achievement of acquisition-related milestones, of which $0.5 million was recorded as expense in the quarter ended March 31, 2013, and paid $1.6 million at closing in stamp duties to transfer title to the land and buildings at Paonta Sahib from Kilitch to AIPL. The compensation for acquisition-related milestones and other acquisition costs have been recorded within "acquisition related costs" as part of operating expenses in the Company's condensed consolidated statement of comprehensive income. The BTA also contained a working capital guarantee which required KDIL to reimburse AIPL for the shortfall in the actual acquired working capital compared to the target working capital as established in the BTA.

The following table sets forth the consideration paid for the Kilitch Acquisition, the acquisition-related costs incurred, and the fair values of the assets acquired and the liabilities assumed (U.S. dollar amounts in thousands):

| **Consideration:** | Initial Fair Valuation | Changes in Estimate | Adjusted Fair Valuation |
|---|---|---|---|
| Cash paid | $ 55,224 | | $ 55,224 |
| Less working capital shortfall refunded by sellers | (890) | (138) | (1,028) |
| | $ 54,334 | $ (138) | $ 54,196 |
| | | | |
| **Acquisition-related costs:** | | | |
| Stamp duties paid for transfer of land and buildings | $ 1,583 | | $ 1,583 |
| Acquisition-related compensation expense | 6,741 | 1,030 | 7,771 |
| Due diligence, legal, travel and other acquisition-related costs | 557 | 119 | 676 |
| | $ 8,881 | $ 1,149 | $ 10,030 |
| | | | |
| **Recognized amounts of identifiable assets acquired and liabilities assumed:** | | | |
| Accounts receivable | $ 2,130 | | $ 2,130 |
| Inventory | 1,799 | | 1,799 |
| Land | 3,714 | (1,131) | 2,583 |
| Buildings, plant and equipment | 8,474 | | 8,474 |
| Construction in progress | 14,231 | | 14,231 |
| Goodwill, deductible | 21,609 | 1,004 | 22,613 |
| Other intangible assets, deductible | 5,806 | 102 | 5,908 |
| Other assets | 38 | | 38 |
| Assumed liabilities | (2,099) | (779) | (2,878) |
| Deferred tax liabilities | (1,368) | 666 | (702) |
| | $ 54,334 | $ (138) | $ 54,196 |

The changes in estimate recorded subsequent to the initial accounting estimate were primarily related to refining the calculated fair value of certain acquired assets, adjustments to the working capital settlement amount due from the sellers to the Company, and final determination regarding the tax-deductibility of the acquired intangible assets. The acquisition-related compensation expense recorded during 2012 and the first quarter of 2013 was primarily related to pre-negotiated compensation paid to members of the sellers' family based on achievement of various operational milestones.

Goodwill represents expected synergies and intangible assets that do not qualify for separate recognition. Based on a recent Indian Supreme Court ruling upholding the deductibility of goodwill for India tax purposes, the Company anticipates being able to deduct the value of goodwill for income tax purposes in India. A later Indian Supreme Court ruling raised doubt as to the tax deductibility of the cost of the non-compete agreement entered into between AIPL and the sellers. Accordingly, the Company amended its acquisition accounting to establish a deferred tax liability related to this intangible asset. The Company had initially recorded a deferred tax liability valued at $1.4 million and subsequently adjusted to $0.7 million related to intangible assets and other accrued liabilities that it does not believe will be amortizable for Indian tax purposes. This remaining deferred tax liability of $0.7 million was reversed against goodwill during 2012.

For book purposes, the other intangible assets acquired are being amortized over lives of four to five years. Goodwill is not amortized for book purposes but is subject to impairment testing, per Company policy. The tangible assets acquired consist primarily of construction in progress fair valued at $14.2 million, buildings, plant and equipment fair valued at a combined $8.5 million, land fair valued at $2.6 million, accounts receivable fair valued at $2.1 million and inventory fair valued at $1.8 million.

The unaudited pro forma results presented below reflect the consolidated results of operation of the Company as if the Kilitch Acquisition had taken place at the beginning of the period presented. The pro forma results include amortization associated with the acquired intangible assets and interest on funds used for the acquisition. The unaudited pro forma financial information presented below does not reflect the impact of any actual or anticipated synergies expected to result from the acquisition. Accordingly, the unaudited pro forma financial information is not necessarily indicative of the results of operations as they would have been had the transaction been effected on the assumed date (amounts in thousands, except per share data):

| | Three months ended March 31, 2012 |
|---|---|
| Revenue | $ 55,721 |
| Net income | $ 1,572 |
| Net income per diluted share | $ 0.01 |

The business acquired through the Kilitch Acquisition generated revenue of $5.1 million and pre-tax loss of $1.2 million during the three months ended March 31, 2013. During the post-acquisition one month ending March 31, 2012, the acquired business generated revenue of $0.9 million and a pre-tax loss of $8.3 million. The pre-tax losses were net of acquisition-related costs of $0.5 million and $8.8 million recorded in the quarterly periods ended March 31, 2013 and 2012, respectively.

**NOTE 13 — COMMITMENTS AND CONTINGENCIES**

*Product Warranty Reserve*

The Company has an outstanding product warranty reserve which relates to a ten-year expiration guarantee on injectable radiation antidote products ("DTPA") sold to the United States Department of Health and Human Services in 2006. The Company is performing yearly stability studies for this product and, if the annual stability study does not support the ten-year product life, it will replace the product at no charge. The Company's supplier, Hameln Pharmaceuticals, will also share one-half of this cost if the product does not meet the stability requirement. If the ongoing product testing confirms the ten-year stability for DTPA, the Company will not incur a replacement cost and this reserve will be eliminated with a corresponding reduction to cost of sales after the ten-year period. All studies to date have confirmed the product's stability. This reserve balance was $1,299,000 at March 31, 2013 and December 31, 2012.

*Payments Due under Strategic Business Agreements*

The Company has entered into strategic business agreements for the development and marketing of finished dosage form pharmaceutical products with various pharmaceutical development companies. Each strategic business agreement includes a future payment schedule for contingent milestone payments. The Company will be responsible for contingent milestone payments to these strategic business partners based upon the occurrence of future events. Each strategic business agreement defines the triggering event of its future payment schedule, such as meeting product development progress timelines, successful product testing and validation, successful clinical studies, various FDA and other regulatory approvals and other factors as negotiated in each agreement. None of the contingent milestone payments is expected to be individually material to the Company. These costs, when realized, will be reported as part of research and development expense in the Company's Condensed Consolidated Statement of Comprehensive Income. As of March 31, 2013, the Company has agreements with strategic business partners committing it to pay the approximate dollar amounts listed below during the anticipated years indicated (in thousands):

| Year of Payment | Amount |
|---|---|
| 2013 | $ 6,944 |
| 2014 | 503 |
| 2015 | 198 |
| 2016 | 200 |
| Total | $ 7,845 |

*Business Combinations*

The Company entered into an agreement with H. Lundbeck A/S on December 22, 2011 to acquire its rights to the NDAs of three off-patent, branded injectable products (the "Lundbeck Agreement"). Pursuant to the terms of the underlying Asset Sale and Purchase Agreement, in addition to the $45.0 million paid in cash at closing, the Company is obligated to pay $15.0 million in additional consideration on the third anniversary of the closing date. The initial $45.0 million and subsequent $15.0 million are subject to claw-back provisions should sales of the acquired products fail to reach the required levels. The Company has recorded the estimated present value of the $15.0 million as a long-term liability on its balance sheets as of March 31, 2013 and December 31, 2012.

In connection with the Lundbeck Agreement, the Company also assumed minimum annual purchase obligations under a pharmaceutical manufacturing supply agreement covering two of the three acquired products. The supply agreement committed the Company to purchase $12.9 million in product during the period from 2012 through 2015. The Company determined that its commitment under this agreement exceeds the amount of product that it anticipates being able to sell. According, the Company recorded as part of the business combination a long-term liability of $2.5 million which equaled the estimated present value of the unfavorable contract terms. This liability is being amortized over the contractual term of the supply agreement.

**NOTE 14 — CUSTOMER, SUPPLIER AND PRODUCT CONCENTRATIONS**

***Customer Concentrations***

A significant percentage of the Company's sales are to three large wholesale drug distributors: AmerisourceBergen Health Corporation ("Amerisource"); Cardinal Health, Inc.; ("Cardinal") and McKesson Drug Company ("McKesson"). These three wholesalers (the "Big 3 Wholesalers") are all distributors of the Company's products, as well as suppliers of a broad range of health care products. The following table sets forth the percentage of the Company's gross accounts receivable as of March 31, 2013 and December 31, 2012, and the gross and net sales for the three month periods ended March 31, 2013 and 2012 attributable to the Big 3 Wholesalers:

| | Three months ended March 31, | |
|---|---|---|
| Big 3 Wholesalers combined: | **2013** | **2012** |
| Percentage of gross sales | 59% | 57% |
| Percentage of net sales | 42% | 32% |

| | **March 31, 2013** | **December 31, 2012** |
|---|---|---|
| Percentage of gross trade accounts receivable | 62% | 73% |

If sales to any of the Big 3 Wholesalers were to diminish or cease, the Company believes that the end users of its products would find little difficulty obtaining the Company's products either directly from the Company or from another distributor.

***Supplier Concentrations***

The Company requires a supply of quality raw materials and components to manufacture and package pharmaceutical products for its own use and for third parties with which it has contracted. The principal components of the Company's products are active and inactive pharmaceutical ingredients and certain packaging materials. Certain of these ingredients and components are available from only a single source and, in the case of certain of the Company's ANDAs and New Drug Applications ("NDAs"), only one supplier of raw materials has been identified. Because FDA approval of drugs requires manufacturers to specify their proposed suppliers of active ingredients and certain packaging materials in their applications, FDA approval of any new supplier would be required if active ingredients or such packaging materials were no longer available from the specified supplier. The qualification of a new supplier could delay the Company's development and marketing efforts. If for any reason the Company is unable to obtain sufficient quantities of any of the raw materials or components required to produce and package its products, it may not be able to manufacture its products as planned, which could have a material adverse effect on the Company's business, financial condition and results of operations.

During the quarters ended March 31, 2013 and 2012, no individual supplier represented 10% or more of the Company's total purchases during that period.

***Product Concentrations***

During the quarters ended March 31, 2013 and March 31, 2012, one injectable product represented 10.6% and 13.4% of the Company's total sales, respectively. No other product represented 10% or more of the Company's revenue during these periods. The Company attempts to minimize the risk associated with product concentrations by continuing to acquire and develop new products to add to its portfolio.

**NOTE 15 — INCOME TAXES**

The following table sets forth the Company's income tax provision for the periods indicated (dollar amounts in thousands):

| | Three months ended March 31, | |
|---|---|---|
| | **2013** | **2012** |
| Income before income taxes | $ 16,257 | $ 5,242 |
| Income tax provision | 5,415 | 2,134 |
| Consolidated net income | $ 10,842 | $ 3,108 |
| | | |
| Income tax provision as a percentage of income before income taxes | 33.3% | 40.7% |

During the three months ended March 31, 2013, the Company recorded an income tax provision of $5.4 million, which equals 33.3% of income before income taxes. The Company estimated that its anticipated global tax rate for 2013 will be approximately 37.0%. The difference between this 37.0% estimated tax rate and the 33.3% provision rate applied to the quarter ended March 31,2013 was related to the effect of 2012 R&D tax credits recognized in the first quarter of 2013 upon passage of the bill retroactively extending these tax credits to 2012. The Company calculated the net impact of its 2012 R&D tax credit to be $0.6 million.

The Company's provision for income taxes for the quarter ended March 31, 2012 was equal to 40.7% of income before income taxes. This figure equaled the blended effective income tax rate that was expected for the year 2012, and took into consideration certain costs related to the acquisition of KDIL that have been expensed for book and are not expected to be deductible. This tax provision rate factored in various domestic deductions and the impact of foreign operations on the Company's overall tax rate.

In accordance with ASC 740-10-25, *Income Taxes – Recognition*, the Company reviews its tax positions to determine whether it is "more likely than not" that its tax positions will be sustained upon examination, and if any tax positions are deemed to fall short of that standard, the Company reserves based on the financial exposure and the likelihood of its tax positions not being sustained. Based on its evaluations, the Company determined that it would not recognize tax benefits on $1.7 million and $1.5 million of its tax positions as of March 31, 2013 and December 31, 2012, respectively. If recognized, $0.5 million and $0.3 million of these tax positions as of March 31, 2013 and December 31, 2012, respectively, will impact the Company's effective rate. The remaining $1.2 million at each date was related to temporary differences and therefore would not impact the Company's effective rate, if recognized.

**NOTE 16 — UNCONSOLIDATED JOINT VENTURE**

On September 22, 2004, the Company entered into a 50/50 joint venture agreement (the "Joint Venture Agreement") with Strides Arcolab Limited ("Strides"), a pharmaceutical manufacturer based in India, for the development, manufacturing and marketing of various generic pharmaceutical products for sale in the United States. The joint venture, known as Akorn-Strides LLC (the "Joint Venture Company"), launched its first commercialized product during 2008. The Joint Venture Company operated until May 2011, ceasing operations after the sale and transfer of its operating assets to Pfizer, Inc. pursuant to an Asset Purchase Agreement entered into on December 29, 2010. It is anticipated that the Joint Venture Company will continue to exist until all product that it sold is beyond the potential product return period.

Under the Joint Venture Agreement, Strides was primarily responsible for developing and manufacturing products, while the Company was responsible for marketing and selling the products. To supplement Strides' manufacturing capabilities, the Company began manufacturing one Joint Venture Company product in the second quarter of 2010. For its sales and marketing efforts, the Company earned revenue from the Joint Venture Company in the form of a fee calculated as a percentage of the Joint Venture Company's monthly net sales revenue.

On December 29, 2010, the Joint Venture Company entered into an Asset Purchase Agreement with Pfizer, Inc. ("Pfizer") to sell the rights to all of its abbreviated new drug applications ("ANDAs") to Pfizer for $63.2 million in cash. In accordance with an amendment to the Joint Venture Agreement, the proceeds were split unevenly, with the Company receiving $35.0 million and Strides receiving $28.2 million. The Asset Purchase Agreement included an initial closing date of December 29, 2010 and a final closing date of May 1, 2011. The ANDAs for dormant and in-development products were transferred on the initial closing date, while the ANDAs for actively-marketed products were transferred to Pfizer on the final closing date. The Joint Venture Company recognized a gain of $63.1 million from the sale, of which $38.9 million was recognized in the fourth quarter of 2010 and the remaining $24.2 million was be recognized in the second quarter of 2011. Having sold all of its ANDAs, the Joint Venture Company discontinued product sales in the second quarter of 2011 and its operations ceased.

During the quarter ended March 31, 2013, the Company evaluated the adequacy of the product returns reserve carried on the Joint Venture Company's books and determined based on remaining returns exposure that the amount being carried exceeded its requirements. Accordingly, an adjustment was recorded to recapture a portion of the product returns reserve as revenue of the Joint Venture Company. The following tables set forth a condensed statement of income of the Joint Venture Company for the quarters ended March 31, 2013 and 2012, as well as condensed balance sheets as of March 31, 2013 and December 31, 2012.

**AKORN-STRIDES LLC**
**CONDENSED STATEMENTS OF INCOME**
**(IN THOUSANDS)**

| | Three months ended March 31, | |
|---|---|---|
| | 2013 | 2012 |
| Revenues | $ 155 | $ — |
| Cost of sales | — | — |
| Gross profit | 155 | — |
| Operating expenses | 2 | — |
| Operating income | 153 | — |
| Income before income taxes | 153 | — |
| Income tax provision | — | — |
| Net income | $ 153 | $ — |

**CONDENSED BALANCE SHEETS**
**(IN THOUSANDS)**

| | March 31, 2013 | December 31, 2012 |
|---|---|---|
| Assets: | | |
| Cash | $ 794 | $ 794 |
| Other assets | — | — |
| Total assets | $ 794 | $ 794 |
| | | |
| Liabilities and members' equity: | | |
| Trade accounts payable & other accrued liabilities | $ 111 | $ 308 |
| Accounts payable – members | 167 | 123 |
| Total liabilities | 278 | 431 |
| | | |
| Members' deficit, net of advances | 516 | 363 |
| Total liabilities & members' deficit | $ 794 | $ 794 |

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

**FORWARD-LOOKING STATEMENTS AND FACTORS AFFECTING FUTURE RESULTS**

Certain statements in this Form 10-Q are forward looking statements and are intended to be "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act. These statements relate to future events or future financial performance, and involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as "may," "should," "could," "expects," "plans," "intends," "anticipates," "believes," "estimates," "predicts," "potential" or "continue" or the negative of such terms or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. These statements are only predictions.

You should not place undue reliance on forward-looking statements because they involve known and unknown risks, uncertainties, and other factors that are, in some cases, beyond our control and that could materially affect actual results, levels of activity, performance or achievements. Factors that could materially affect our actual results, levels of activity, performance or achievements include, without limitation, those detailed under the caption "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012, as filed with the SEC on March 1, 2013, and include the following items:

- Our ability to comply with all of the requirements of the U.S. Food and Drug Administration ("FDA"), including current Good Manufacturing Practices regulations;
- Our ability to obtain additional funding or financing to operate and grow our business;
- The effects of federal, state and other governmental regulation on our business;
- Our ability to obtain and maintain regulatory approvals for our products;
- Our success in developing, manufacturing, acquiring and marketing new products;
- Our ability to generate cash flow from operations sufficient to meet our working capital requirements;
- The success of our strategic partnerships for the development and marketing of new products;
- Our ability to bring new products to market and the effects of sales of such products on our financial results;
- Our ability to successfully integrate acquired businesses and products;
- The effects of competition from generic pharmaceuticals and from other pharmaceutical companies;
- Availability of raw materials needed to produce our products; and
- Other factors referred to in this Form 10-Q, our Form 10-K and our other Securities and Exchange Commission ("SEC") filings.

If any of these risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may vary significantly from what we projected. Any forward-looking statement you read in the following Management's Discussion and Analysis of Financial Condition and Results of Operations reflects our current views with respect to future events and is subject to these and other risks, uncertainties, and assumptions relating to our operations, results of operations, growth strategy, and liquidity. We assume no obligation to publicly update or revise these forward-looking statements for any reason, whether as a result of new information, future events, or otherwise.

**RESULTS OF OPERATIONS**

The following table sets forth the amounts and percentages of total revenue for certain items from our Condensed Consolidated Statements of Comprehensive Income and our segment reporting information for the quarters ended March 31, 2013 and 2012 (dollar amounts in thousands):

| | Three months ended March 31, | | | |
|---|---|---|---|---|
| | 2013 | | 2012 | |
| | Amount | Percent of Revenue | Amount | Percent of Revenue |
| Revenues: | | | | |
| Ophthalmic | $ 25,705 | 34.8% | $ 21,811 | 42.2% |
| Hospital drugs & injectables | 40,434 | 54.8% | 27,376 | 52.9% |
| Contract services | 7,715 | 10.4% | 2,530 | 4.9% |
| Total revenues | 73,854 | 100.0% | 51,717 | 100.0% |
| Gross profit: | | | | |
| Ophthalmic | 14,716 | 57.2% | 12,719 | 58.3% |
| Hospital drugs & injectables | 22,814 | 56.4% | 17,041 | 62.2% |
| Contract services | 1,615 | 20.9% | 1,141 | 45.1% |
| Total gross profit | 39,145 | 53.0% | 30,901 | 59.8% |
| Operating expenses: | | | | |
| Selling, general & administrative expenses | 12,335 | 16.7% | 10,339 | 20.0% |
| Research and development expenses | 5,969 | 8.1% | 2,877 | 5.6% |
| Acquisition related costs | 519 | 0.7% | 8,460 | 16.4% |
| Amortization of intangibles | 1,733 | 2.3% | 1,563 | 3.0% |
| Operating income | 18,589 | 25.2% | 7,662 | 14.8% |
| Other (expense) income, net | (2,332) | (3.2)% | (2,420 ) | (4.7)% |
| Income before income taxes | $ 16,257 | 22.0% | $ 5,242 | 10.1% |
| Income tax provision | 5,415 | 7.3% | 2,134 | 4.1% |
| Net income | $ 10,842 | 14.7% | $ 3,108 | 6.0% |

Our consolidated revenues were $73.9 million for the quarter ended March 31, 2013, an increase of $22.1 million, or 42.8%, compared to the corresponding quarter in 2012. This increase in revenue was related to a number of factors, including the impact of new product approvals, a full quarter's revenue from Akorn India, and growth from additional sales of new and re-launched products. Of the $22.1 million increase in revenue, $15.4 million was the result of new product approvals and the re-launch of dormant products, $4.2 million was related to our acquisition of selected assets of Kilitch Drugs (India) Limited on February 28, 2012 (the "Kilitch Acquisition"), and $3.6 million was due to increased sales of core products, partially offset by a $1.0 million reduction related to pricing changes on these core products.

Consolidated gross profit was $39.1 million, or 53.0% of revenue for the quarter ended March 31, 2013, compared to $30.9 million, or 59.8% of revenue, for the corresponding prior year quarter. The increase in gross profit was primarily the result of the launch of certain new products during 2012. The overall reduction in margin was due to a number of factors, including: increased low margin contract manufacturing revenue generated by our subsidiary in India; an increase in royalties payable to third party manufacturers of several of the new products we launched during 2012; pricing pressures for certain of our products; and fewer opportunities related to drug shortages in the current year quarter compared to the prior year quarter.

Selling, general and administrative ("SG&A") expenses were $12.3 million in the quarter ended March 31, 2013 compared to $10.3 million in the quarter ended March 31, 2012. The largest contributor to the $2.0 million increase was our sales and marketing functions, which increased by $1.1 million over the prior year as we expanded our sales force to better support our growing product portfolio. In addition, our domestic corporate SG&A expenses increase by $0.5 million, with much of the increase in stock-based compensation expenses and accounting and auditing fees, and Akorn India SG&A increased by $0.4 million due to having a full quarter of activity in the current year period.

Research and development ("R&D") expenses were $6.0 million in the quarter ended March 31, 2013, an increase of $3.1 million, or 107.5%, over the corresponding prior year period. This increase reflects our expansion of R&D activities, both in-house through hiring additional staff and opening a new, larger R&D facility, and through partnerships with outside firms. While R&D expenses can vary quarter by quarter, we expect R&D expenses for the remainder of this year to be at a similar pace to the quarter ended March 31, 2013.

Acquisition related costs were $0.5 million in the quarter ended March 31, 2013 and $8.5 million in the prior year quarter ended March 31, 2012. In both years, the acquisition related costs were primarily related to the Kilitch Acquisition. The $0.5 million recorded in 2013 and $6.7 million of the acquisition related costs in 2012 were related to fees paid and payable to the former owners of the Kilitch business for various services provided to Akorn. The 2012 expenses also included $1.6 million in stamp duties for transfer of ownership of the land and buildings in Paonta Sahib, India to Akorn.

Amortization of intangibles was $1.7 million in the quarter ended March 31, 2013 compared to $1.6 million in the prior year quarter. The small increase was primarily related to recording a full quarter's amortization of the intangible assets acquired through the Kilitch Acquisition that we completed on February 28, 2012.

Other expense was $2.3 million in the quarter ended March 31, 2013 compared to $2.4 million in the corresponding prior year quarter. The expense in each period primarily consisted of interest accruals and amortization of debt discount related to our $120 million in 3.50% convertible senior notes due 2016.

For the quarter ended March 31, 2013, our income tax provision was $5.4 million, or 33.3% of pre-tax income, compared to $2.1 million, or 40.7% of pre-tax income, in the prior year period. Our current quarter's tax rate of 33.3% includes the effect of a $0.6 million adjustment to our 2012 taxes related to R&D tax credits. The legislation renewing the allowance of R&D tax credits for 2012 was not passed into law until the January 2013, so R&D tax credits were not factored into our effective rate during 2012. Excluding this discrete item, we anticipate our effective global income tax rate to be 37.0% in 2013.

We reported net income of $10.8 million for the three months ended March 31, 2013 compared to $3.1 million for the three months ended March 31, 2012. This increase in net income was the result of our revenue growth, as well as lower acquisition related costs in the current year period, more than offsetting an increase in R&D expenses.

**FINANCIAL CONDITION AND LIQUIDITY**

**Overview**

During the quarter ended March 31, 2013, we generated $6.9 million in cash flow from operations. This operating cash flow was primarily generated from our net income of $10.8 million, net non-cash expenses of $6.3 million, and change in deferred tax assets of $0.8 million, partially offset by increases of $8.0 million in accounts receivable and $1.4 million in inventory, and a $1.9 million decline in accounts payable.

We used $3.0 million in cash for investing activities during the quarter ended March 31, 2013. This use of cash consisted of $2.7 million used for the purchase of property, plant and equipment, and $0.3 million used to acquire drug products rights and for other equity investments.

Financing activities generated $1.1 million in cash flow during the quarter ended March 31, 2013. This cash flow included $0.9 million in proceeds from stock option exercises and share purchases under the employee stock purchase plan, and $0.2 million in excess tax benefits from stock-based compensation.

During the prior year quarter ended March 31, 2012, we generated $3.0 million in cash from operations. This operating cash flow was primarily due to net income of $3.1 million, non-cash expenses of $5.3 million and a $5.2 million increase in accrued expenses and other liabilities, partially offset by a $3.9 million increase in trade receivables and $4.2 million increase in inventory and a $2.4 million decrease in accounts payable.

We used $60.6 million in cash for investing activities during the quarter ended March 31, 2012, consisting of $55.2 million used to complete the Kilitch Acquisition, and $5.4 million used to acquire property, plant and equipment.

Financing activities generated $2.1 million in cash flow during the quarter ended March 31 2012, of which $1.6 million related to excess tax benefits from stock-based compensation and $0.5 million represented proceeds from the exercise of stock options and share purchases under our employee stock purchase plan.

As of March 31, 2013, we had $45.9 million in cash and cash equivalents, of which $44.3 million was in U.S. accounts and $1.6 million was in the accounts of our foreign subsidiaries, primarily Akorn India Private Limited. At March 31, 2013, we had no outstanding balance under our credit facility with Bank of America N.A. The total loan commitment under this credit facility was $20.0 million, and we had borrowing availability of $19.7 million as of March 31, 2013.

We anticipate paying up to $22 million for purchase of property, plant and equipment during the remainder of 2013, related principally to projects at our manufacturing facilities in the U.S. and India. We believe that operating cash flows and availability under our credit facility will be sufficient to meet our cash needs for the foreseeable future.

***Bank of America Credit Facility***

On October 7, 2011, the Company and its domestic subsidiaries (the "Borrowers") entered into a Loan and Security Agreement (the "B of A Credit Agreement") with Bank of America, N.A. (the "Agent") and other financial institutions (collectively with the Agent, the "B of A Lenders") through which we obtained a $20.0 million revolving line of credit (the "Facility"), which includes a $2.0 million letter of credit facility. We may request expansion of the Facility from time to time in increments of at least $5.0 million up to a maximum commitment of $35.0 million, so long as no default or event of default has occurred and is continuing. The Facility matures in March 2016. We may early terminate the B of A Lenders' commitments under the Facility upon 90 days' notice to the Agent at any time after the first year.

Under the terms of the B of A Credit Agreement, amounts outstanding will bear interest at our election at (a) LIBOR or (b) the bank's Base Rate (which is the greatest of: (i) the prime rate, (ii) the federal funds rate plus 0.50%, or (iii) LIBOR plus 1.0%), plus an applicable margin, which margin is based on the consolidated fixed charge coverage ratio of Akorn, Inc. and its subsidiaries from time to time. Additionally, the Borrowers will pay an unused line fee of 0.250% per annum on the unused portion of the Facility. Interest and unused line fees will be accrued and paid monthly. In addition, with respect to any letters of credit that may be issued, the Borrowers will pay: (i) a fee equal to the applicable margin times the average amount of outstanding letters of credit, (ii) a fronting fee equal to 0.125% per annum on the stated amount of each letter of credit, and (iii) any additional fees incurred by the applicable issuer in connection with issuing the letter of credit. During an event of default, any interest or fees payable will be increased by 2% per annum.

Availability under the revolving credit line is equal to the lesser of (a) $20.0 million reduced by outstanding letter of credit obligations or (b) the amount of a Borrowing Base (as defined in accordance with the terms of the B of A Credit Agreement) determined by reference to the value of the Borrowers' eligible accounts receivable, eligible inventory and fixed assets as of the closing date and the end of each calendar month thereafter.

Obligations under the B of A Credit Agreement are secured by substantially all of the assets of each of the Borrowers and a pledge by the Borrowers of their respective equity interest in each of our domestic subsidiaries and 65% of their respective equity interests in any foreign subsidiaries. The B of A Credit Agreement contains representations and warranties, and affirmative and negative covenants customary for financings of this type, including, but not limited to, limitations on: distributions while we have any outstanding commitments or obligations under the B of A Credit Agreement; additional borrowings and liens; additional investments and asset sales; and fundamental changes to corporate structure or organization documents. The financial covenants require the Borrowers to maintain a fixed charge coverage ratio of at least 1.1 to 1.0 during any period commencing on the date that an event of default occurs or availability under the B of A Credit Agreement is less than 15% of the aggregate B of A Lenders' commitments under the B of A Credit Agreement. During the term of the agreement, we must provide the Agent with monthly, quarterly and annual financial statements, monthly compliance certificates, annual budget projections and copies of press releases and SEC filings.

At March 31, 2013 and December 31, 2012, we had no outstanding borrowings or letters of credit against the B of A Credit Agreement and total borrowing availability of $19.7 million.

**CRITICAL ACCOUNTING POLICIES**

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. A summary of our significant accounting policies is included in Item 1. Financial Statements, Note 2 — Summary of Significant Accounting Policies, which are included in our Annual Report on Form 10-K for the year ended December 31, 2012. Certain of our accounting policies are considered critical, as these policies require significant, difficult or complex judgments by management, often employing the use of estimates about the effects of matters that are inherently uncertain. Such policies are summarized in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" of our Annual Report on Form 10-K for the year ended December 31, 2012.

The Company consolidates the financial statements of its foreign subsidiary in accordance with ASC 830, *Foreign Currency Matters*, pursuant to which the statement of operations amounts are translated from Indian rupees ("INR") to U.S. dollars ("USD") at the average exchange rate during the applicable period, while balance sheet balances are generally translated at the exchange rate in place as of the applicable balance sheet date. Cash flows are translated at the average exchange rate in place during the applicable period. Differences arising from foreign currency translation are included in other comprehensive income (loss) and are carried as a separate component of equity on our condensed consolidated balance sheets.

**NEW ACCOUNTING PRONOUNCEMENTS**

On February 5, 2013, the FASB issues ASU No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. This amendment requires an entity to present either parenthetically on the face of the financial statements or in the notes significant amounts reclassified from each component of accumulated other comprehensive income and the line item(s) affected by the reclassification. An entity would not need to show the income statement line item affected for certain components that are not required to be reclassified in their entirety to net income, such as amounts amortized into net periodic pension cost. For public companies, this amendment is effective for annual periods beginning after December 15, 2012, and for interim periods within those annual periods. Adoption of ASU No. 2013-02 will not impact our financial position or results of operations, and is not anticipated to have a significant effect on our financial reporting.

In July 2012, the FASB issued ASU No. 2012-02, *Intangibles – Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment.* The amendments in this update aim to simplify the impairment test for indefinite-lived intangible assets by permitting an entity the option to first assess qualitative factors to determine whether it is more likely than not (defined as having a likelihood of more than 50 percent) that an indefinite-lived intangible asset is impaired as a basis for determining whether the quantitative impairment test included in Accounting Standards Codification Subtopic 350-30, *Intangibles – Goodwill and Other – General Intangibles Other than Goodwill* must be performed. The amendment is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Adoption of this amendment is not expected to have a material effect on our financial position or operating results.

**OFF-BALANCE SHEET ARRANGEMENTS**

We do not have any off-balance sheet arrangements that have had, or are reasonably likely to have, a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

As of March 31, 2013, we are party to a $20.0 million revolving Credit and Security Agreement with Bank of America, N.A (the "B of A Credit Agreement"). Interest on borrowing under the B of A Credit Agreement is calculated at a premium above either the current prime rate or current LIBOR rates, exposing us to interest rate risk on such borrowings. At March 31, 2013, we had no outstanding loans or letters of credit under the B of A Credit Agreement.

Our principal debt is related to our $120 million of 3.50% Senior Convertible Notes due 2016 (the "Notes"). The Notes bear a fixed interest rate of 3.50%, with semi-annual interest payments due every June 1 and December 1 until the notes mature on June 1, 2016. Since the interest rate on this debt is fixed, we have no interest rate risk related to the Notes.

We are subject to foreign exchange risk from our wholly-owned subsidiary, Akorn India Private Limited. This business operates in India, conducting its business in Indian rupees, in addition to exporting products to various unregulated world markets. We maintain cash balances in India sufficient to fund our business activities there, and those balances would be subject to foreign exchange risk. Export sales payable in foreign currencies would likewise be subject to foreign exchange risk. Aside from these matters related to our Indian subsidiary, our foreign exchange risk is limited due to the fact that our export sales from the U.S. to foreign countries are typically transacted in U.S. dollars.

Our financial instruments include cash and cash equivalents, accounts receivable, and accounts payable. The reported amounts of cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of the short maturity of these instruments.

**Item 4. Controls and Procedures.**

**Evaluation of Disclosure Controls and Procedures**

An evaluation was performed, under the supervision and with the participation of Company management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Act")). There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including cost limitations, judgments used in decision making, assumptions regarding the likelihood of future events, soundness of internal controls, fraud, the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can provide only reasonable, and not absolute, assurance of achieving their control objectives. Based on that evaluation, management, including the CEO and CFO, has concluded that, as of March 31, 2013, the Company's disclosure controls and procedures were not effective at the reasonable assurance level due to a material weakness in our internal control over financial reporting, which is described below.

Based on our evaluation under the criteria set forth in Internal Control — Integrated Framework, our management concluded that, as of December 31, 2012, our internal control over financial reporting was not effective due to the identification of a material weakness related to our controls over our financial statement close process. More specifically, we did not maintain financial close process and procedures that were adequately designed, documented and executed to support the accurate and timely reporting of our financial results, and we did not maintain effective controls to provide reasonable assurance that accounts were complete and accurate and agreed to detailed support, and that account reconciliations were properly performed, reviewed and approved.

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. With the oversight of senior management and our audit committee, we have taken steps and plan to take additional measures to remediate the underlying causes of the material weakness, primarily through improved processes, as well as the hiring of additional finance personnel. While the Company believes it will remediate the material weakness prior to filing its Form 10-K for the period ending December 31, 2013, the Company can provide no assurance at this time that management will be able to report that our internal control over financial reporting is effective as of December 31, 2013.

Notwithstanding the identified material weakness, management believes the consolidated financial statements included in this Quarterly Report on Form 10-Q fairly represent in all material respects our financial condition, results of operations and cash flows at and for the period presented in accordance with U.S. GAAP.

On February 28, 2012, the Company, though its wholly-owned subsidiary, Akorn India Private Limited ("AIPL"), acquired selected assets of Kilitch Drugs (India) Limited ("KDIL") (see Note 12 – Business Combinations). As permitted by Securities and Exchange Commission Staff interpretive guidance for newly acquired businesses, management excluded AIPL from its annual evaluation of internal control over financial reporting as of December 31, 2012. The Company will incorporate this acquisition into its annual report on internal control over financial reporting for its fiscal year end 2013. As of March 31, 2013, AIPL's total assets represented approximately 16% of the Company's consolidated total assets and approximately 7% of the Company's consolidated revenues for the quarter ended March 31, 2013.

**Changes in Internal Control Over Financial Reporting**

Except as otherwise described in this Item 4, in the three months ended March 31, 2013, there has been no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II. OTHER INFORMATION

**Item 1. Legal Proceedings.**

On September 12, 2012, Fera Pharmaceuticals, LLC ("Fera") filed a civil complaint against the Company and certain individual defendants (together, the "Defendants") in the Supreme Court of New York (the "Fera lawsuit"). The complaint alleges, among other things, breach of manufacturing and confidentiality agreements and misappropriation of the plaintiff's trade secrets. On October 15, 2012, the case was removed to the Federal District Court for the Southern District of New York. Fera filed an amended complaint on December 21, 2012. The Defendants filed a motion to dismiss portions of the amended complaint on January 25, 2013. The Company intends to vigorously defend these allegations. However, no assurance may be given regarding the ultimate outcome of this lawsuit.

In April 2012, Allergan Sales ("Allergan") filed a lawsuit alleging patent infringement claims against the Company relating to the 0.4% ketorolac tromethamine formulation. Allergan seeks unspecified monetary damages in this case. The Company has asserted invalidity and non-infringement. The Company intends to vigorously defend these allegations. However, no assurance may be given regarding the ultimate outcome of this lawsuit.

We are also party to other legal proceedings and potential claims arising in the ordinary course of our business. The amount, if any, of ultimate liability with respect to legal proceedings involving the Company cannot be determined. Despite the inherent uncertainties of litigation, we at this time do not believe that such proceedings will have a material adverse impact on our financial condition, results of operations, or cash flows.

**Item 1A. Risk Factors.**

There have been no material changes from the risk factors disclosed in Part 1, Item 1A, of our Form 10-K filed March 1, 2013.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

None.

**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Mine Safety Disclosures.**

Not applicable.

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

The list of exhibits in the Exhibit Index to this Report is incorporated herein by reference.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AKORN, INC.

/s/ TIMOTHY A. DICK
Timothy A. Dick
Chief Financial Officer
(On behalf of the registrant and as Principal Financial Officer)

Date: May 10, 2013

**EXHIBIT INDEX**

Those exhibits marked with a (*) refer to exhibits filed herewith. The other exhibits are incorporated herein by reference, as indicated in the following list. Portions of the exhibits marked with a ( Ω ) are the subject of a Confidential Treatment Request under 17 C.F.R. §§ 200.80(b)(4), 200.83 and 240.24b-2.

| Exhibit No. | Description |
|---|---|
| (31.1)* | Certification of Chief Executive Officer pursuant to Rule 13a-14(a). |
| (31.2)* | Certification of Chief Financial Officer pursuant to Rule 13a-14(a). |
| (32.1)* | Certification of Chief Executive Officer pursuant to 18 U.S.C. § 1350. |
| (32.2)* | Certification of Chief Financial Officer pursuant to 18 U.S.C. § 1350. |
| 101 | The financial statements and footnotes from the Akorn, Inc. Quarterly Report on Form 10-Q for the quarter ended March 31, 2013, filed on May 10, 2013, formatted in XBRL: (i) Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Comprehensive Income, (iii) Condensed Consolidated Statement of Shareholders' Equity, (iv) Condensed Consolidated Statements of Cash Flows, and (v) Notes to Condensed Consolidated Financial Statements. |

**EXHIBIT 31.1**

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER**

I, Rajat Rai, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Akorn, Inc.;

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

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

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

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

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

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

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

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

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

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

/s/ RAJAT RAI
Rajat Rai
Chief Executive Officer

Date: May 10, 2013

**EXHIBIT 31.2**

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER**

I, Timothy A. Dick, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Akorn, Inc.;

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

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

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

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

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

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

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

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

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

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

/s/ TIMOTHY A. DICK
Timothy A. Dick
Chief Financial Officer

Date: May 10, 2013

**EXHIBIT 32.1**

CERTIFICATION PURSUANT TO 18 U.S.C 1350

In connection with the Quarterly Report of Akorn, Inc. (the "Company") on Form 10-Q for the period ended March 31, 2013, as filed with the Securities and Exchange Commission and to which this Certification is an exhibit (the "Report"), the undersigned officer of the Company does hereby certify, pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350) and Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934 (17 CFR 240.13a-14(b)), that to my knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

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

Date: May 10, 2013

/s/ RAJAT RAI
Rajat Rai
Chief Executive Officer

**EXHIBIT 32.2**

CERTIFICATION PURSUANT TO 18 U.S.C. 1350

In connection with the Quarterly Report of Akorn, Inc. (the "Company") on Form 10-Q for the period ended March 31, 2013, as filed with the Securities and Exchange Commission and to which this Certification is an exhibit (the "Report"), the undersigned officer of the Company does hereby certify, pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350) and Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934 (17 CFR 240.13a-14(b)), that to my knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

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

Date: May 10, 2013

/s/ TIMOTHY A. DICK
Timothy A. Dick
Chief Financial Officer