LANNETT CO INC
Form 10KSB/A
October 25, 2004

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

FORM 10-KSB/A
AMMENDMENT #2

(Mark One)

[X] ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED JUNE 30, 2003

OR

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM _____TO

Commission File No. 0-9036

LANNETT COMPANY, INC.
(Name of small business issuer in its charter)

STATE OF DELAWARE	23-0787-699
State of Incorporation	I.R.S. Employer I.D. No.

9000 STATE ROAD
PHILADELPHIA, PENNSYLVANIA 19136
(215) 333-9000
(Address of principal executive offices and telephone number)

Securities registered under Section 12(b) of the Exchange Act:
NONE

Securities registered under Section 12(g) of the Exchange Act:
COMMON STOCK, $.001 PAR VALUE
(Title of class)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes[X] No[ ]

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

Yes[ ] No [X]

The issuer had net sales of $42,486,758 for the fiscal year ended June 30, 2003.

As of August 26, 2003, the aggregate market value of the voting stock held by non-affiliates was approximately $106,812,000 computed by reference to the closing price of the stock on the American Stock Exchange.

As of August 26, 2003, there were 20,045,390 shares of the issuer's common stock, $.001 par value, outstanding.

PART I

ITEM 1. DESCRIPTION OF BUSINESS

GENERAL

Lannett Company, Inc. (the "Company") was incorporated in 1942 under the laws of the Commonwealth of Pennsylvania. In 1991, the Company merged into Lannett Company, Inc., a Delaware corporation. The sole purpose of the merger was to reincorporate the Company as a Delaware corporation. The Company develops, manufactures, packages, markets and distributes pharmaceutical products sold under generic chemical names. References herein to a fiscal year refer to the Company's fiscal year ending June 30.

Historically, the Company has competed for an increasing share of the generic market. During each of the fiscal years ended June 30, 2003 and 2002, the Company surpassed its historical highs in terms of net sales, gross profit, operating income, net income and total market capitalization value. This growth is a result of additions to the Company's line of generic products, new customers, higher unit sales, increased product prices and a management focus on minimizing unnecessary overhead and administrative costs. Some of the new generic products sold by Lannett during Fiscal 2003 and Fiscal 2002 were developed and are manufactured by Lannett while others are manufactured by Jerome Stevens Pharmaceutical, Inc. ("JSP"), one of Lannett's primary suppliers. The products manufactured by Lannett and those manufactured by JSP are identified in the section entitled "PRODUCTS" in Item 1 of this Form 10-KSB.

Over the past several years, Lannett has consistently invested a portion of its profits into research and development ("R&D") projects, including new generic product offerings. The cost of these R&D efforts are expensed during the periods incurred. However, the Company believes that such investments may be paid back in future years as it submits applications to the Food and Drug Administration ("FDA"), if it receives marketing approval from the FDA to distribute such products. In addition to profits earned on new products internally developed and manufactured, the Company sells products that are manufactured by JSP. The products are sold with the Lannett label and logo and to the same customers and the same distribution channels as the products internally manufactured. The Company has made no previous investments in R&D for these products because such investments were paid by JSP, the owner of the FDA-approved licenses. In addition to using cash generated from its operations, the Company has entered into a number of financing agreements with third parties to provide for additional cash when it is needed. These financing agreements are more fully described in the section entitled "LIQUIDITY AND CAPITAL RESOURCES" in Item 6 of this Form 10-KSB. The Company has embarked on an industrious plan to grow in future years. In addition to organic growth to be achieved through its own R&D effects, the Company has also initiated marketing projects with other companies in order to expand future revenue projections. The Company, however, expects that its growing list of generic drugs under development will drive future growth. The Company also intends to use the infrastructure it has created, and to continually reinvest a portion of its profits into additional R&D projects. The following strategies highlight Lannett's plan:

RESEARCH AND DEVELOPMENT

There are numerous stages in the generic drug development process:

1.) Formulation and Analytical Method Development: Once a drug candidate is selected for research, product development scientists perform various experiments on the active ingredient. These experiments include the creation of a number of product recipes to determine which recipe will be most suitable for the Company's subsequent development process. Various recipes, or formulations, are tested in the laboratory to measure results against the innovator drug. During this time, the Company may use reverse engineering methods on samples of the innovator drug to determine the type and quantity of inactive ingredients in the brand named drug. During the formulation phase, the Company's research and development chemists begin to develop an analytical, laboratory testing method. The successful development of this test method will allow the Company to test developmental and commercial batches of the product in the future. All of the information used in the final formulation, including the analytical test methods adopted for the generic drug candidate, will be included as part of the documentation submitted to the FDA in the generic drug application.

2.) Scale-up: After the product developments scientists and the R&D chemists agree on a final formulation to use in moving the drug candidate forward in the developmental process, the company will attempt to increase the batch size of the product. The batch size represents the standard magnitude to be used in manufacturing a batch of the product. The determination of batch size will affect the amount of raw material that is input into the manufacturing process, and the number of expected tablets or capsules to be created during the production sequence. The Company attempts to determine batch size based on the amount of active ingredient in each dosage, the available production equipment and unit sales projections. The scaled-up batch is then generally produced in the Company's commercial manufacturing facilities. During this manufacturing process, the Company will document the equipment used, the amount of time in each major processing step and any other steps needed to consistently produce a batch of that product. This information, generally referred to as the validated manufacturing process, will be included in the Company's generic drug application submitted to the FDA.

3.) Clinical testing: After a successful scale-up of the generic drug batch, the Company then schedules and performs clinical testing procedures on the product. These procedures, which are generally outsourced to third parties, include testing the absorption of the generic product in the human bloodstream, compared to the absorption of the innovator drug. The results of this testing are then documented and reported to the generic company to determine the "success" of the generic drug product. Success, in this context, means the successful comparison of the generic company's product related to the innovator product. Since bioequivalence and a stable formula are the primary requirements for a generic drug approval (assuming the manufacturing plant is in compliance with the FDA's manufacturing quality standards), lengthy and costly clinical trials proving safety and efficacy, which are generally required by the FDA for innovator drug approvals, are unnecessary for generic companies. If the results are successful, the Company will continue the collection of documentation and information for assembly of the drug

application.

4.) Submission of the ANDA for FDA review and approval: The Abbreviated New Drug Application (ANDA) process became formalized under The Drug Price Competition and Patent Term Restoration Act of 1984, also known as the Hatch-Waxman Act. An ANDA represents a generic drug company's application to the FDA to manufacture and/or distribute a drug, which is the generic equivalent to an already-approved brand named ("innovator") drug. Once bioequivalence studies are complete, the generic drug company submits an ANDA to the FDA for marketing approval.

In a presentation to the Generic Pharmaceutical Association on March 2, 2004, Gary J. Buehler, R.Ph., and Director of the FDA's Office of Generic Drugs, said that the median approval time for a new ANDA for the FDA's Fiscal 2003 year was 17.3 months. When including the amount of time necessary to develop the generic drug, and prepare the ANDA submission, the Company estimates that the total development and approval time of a generic drug may take three years or more. Additionally, there is no guarantee that the FDA will approve a company's ANDA.

When a generic drug company files an ANDA to the FDA, it must certify that no patents are listed in the Orange Book, the FDA's reference listing of approved drugs, or listed patents have expired. If there are patents covering some aspect of the innovator drug, the applicant must state whether it is seeking approval for marketing after the expiration of the Orange Book patents; or the patents listed therein are invalid, unenforceable, or not infringed -- usually referred to as a Paragraph IV Certification. ANDA's containing Paragraph IV certifications frequently result in legal actions by the innovator drug companies. These legal activities may delay the approval of the generic company's ANDA. Currently, Lannett has not filed any Paragraph IV certifications in its ANDAs because the ANDAs submitted did not contend with any patents for the applicable innovator drugs.

Lannett conducts R&D activities in carefully targeted areas where its qualified research personnel have accumulated a related body of expertise. Such targeted areas include solid oral dosage forms. During Fiscal 2003 and 2002, the Company has hired additional experienced personnel in product development, production, formulation and the R&D laboratory. Lannett believes that its ability to select appropriate products for development, develop such products on a timely basis, obtain FDA approval, and achieve economies in production will be critical for its success in the generic industry. Generally, Lannett believes in avoiding the well-known billion dollar drugs. The strategy involves a combination of decisions focusing on long-term profitability and a secure market position with fewer challenges from competitors. In addition to its market strategy, the Company pursues long-term alliances with API (active pharmaceutical ingredient) suppliers, whereby the Company attempts to arrange to have an API made for it on an exclusive basis. This practice has the effect of limiting competition without violating any federal antitrust laws. Other API manufacturers may produce the chemical ingredient for other generic competitors, but the Company believes that entering into exclusive arrangements when possible will prevent a specific API manufacturer from soliciting additional customers for their API, thereby reducing the number of generic competitors for the finished dosage product. At this time, Lannett has no exclusive agreements for APIs for its current commercial products. Lannett does have exclusive agreements for APIs for two of its developmental products, which the Company does not believe to be material in nature.

Competition in generic pharmaceutical manufacturing will continue to grow

as more pharmaceutical products lose patent protection. However, the Company believes with strong technical know-how, low overhead expenses, and efficient product development, manufacturing and marketing, it can remain competitive. It is the intention of the Company to reinvest as much capital as possible to develop new products since the success of any generic pharmaceutical manufacturer depends on its ability to continually introduce new generic products to the market. Over time, if a generic drug market for a specific product remains stable and consumer demand remains consistent, there is likelihood that additional generic manufacturing companies will pursue a generic product market by developing the generic drug, submitting an ANDA, and potentially receiving marketing approval from the FDA. If this occurs, the generic competition for

the drug increases, and a company's market share may drop. In addition to reduced unit sales, the unit selling price may also drop due to the product's availability from additional suppliers. This may have the effect of reducing a generic company's future net sales of the product. Due to these factors that may potentially affect a generic company's future results of operations, the ability to properly assess the competitive effect of new products, including market share, the number of competitors and the generic unit price erosion, is critical to a generic company's R&D plan. A generic company may be able to reduce the potential exposure to competitive influences that negatively affect its sales and profits by having several drug candidates in its R&D pipeline queue. As such, a generic company may be able to avoid becoming materially dependent on the sales of one drug. The Company has invested approximately $2.6 million and $1.7 million, respectively, in Fiscal 2003 and Fiscal 2002, or 12% and 14%, respectively, of its Fiscal 2003 and Fiscal 2002 pre-tax income, exclusive of R&D expenses, in R&D resources related to several R&D projects. These costs are expensed in the period incurred. During Fiscal 2003 and Fiscal 2002, no individual R&D project incurred costs in excess of materially significant amounts. Additionally, no individual R&D product candidate is expected to be materially significant to the Company's results of operations. For more information regarding Lannett's R&D projects, please see the section entitled `PRODUCTS' of Item 1 in this Form 10-KSB.

Unlike the branded, drug-discovery companies, Lannett currently does not own proprietary drug patents. However, the typical intellectual property in the generic drug industry are the ANDAs that generic drug companies own.

VALIDATED PHARMACEUTICAL CAPABILITIES

Lannett's quality manufacturing facility consists of 31,000 square feet on 3.5 acres owned by the Company. In July 2003, the Company signed a lease purchase agreement for a 63,000 square feet building located at 9001 Torresdale Avenue, Philadelphia, Pennsylvania. The renovation of the building has been initiated; and the Company expects to begin to move some of its staff and operations into that building in Fiscal 2004. Lannett currently leases another 24,000 square feet approximately 2 miles from the Company's headquarters (9000 State Road). This leased facility serves as the Company's main warehousing operation, and also houses certain R&D personnel. This facility's lease expires in April 2004, at around which time the Company plans to move its operations to the Torresdale Avenue building. The Company intends to renew its lease on a short-term basis on the rented property after April 2004.

Many FDA regulations relating to cGMP (current Good Manufacturing Practices) have been adopted by the Company in the last several years. In designing its laboratory, full attention was given to material flow, equipment and automation, quality control and inspection. A granulator, an automatic film coating machine, high-speed tablet presses, blenders, encapsulators, fluid bed

dryers, high shear mixers and high-speed bottle filling are a few examples of the sophisticated product development, manufacturing and packaging equipment the Company uses. In addition, the Company's Quality Control laboratory facilities are equipped with high precision instruments, like automated high-pressure liquid chromatographs, gas chromatographs and laser particle sizers.

Lannett continues to pursue its comprehensive plan for improving and maintaining adequate quality control and quality assurance programs for its pharmaceutical development and manufacturing facilities. The FDA periodically inspects the Company's production facilities to determine the Company's compliance with the FDA's manufacturing standards. Typically, after the FDA completes its inspection, it will issue the Company a report, entitled a Form 483,

containing the FDA's observations of possible violations of cGMP. Such observations may be minor or severe in nature. The degree of severity of the observation is generally determined by the time necessary to remediate the cGMP violation, and not have a serious impact upon the consumer of the Company's drug products, and whether the observation is subject to a Warning Letter from the FDA and/or attempts by the FDA to shutdown a manufacturing plant. By strictly enforcing the various FDA guidelines, namely Good Laboratory Practices, Standard Operating Procedures and current Good Manufacturing Practices, the Company has successfully reduced the number of observations in its latest FDA inspection. The Company believes that such observations are minor in nature, and will be remediated in a timely fashion with no material effect on Lannett's results of operations.

SALES AND CUSTOMER RELATIONSHIPS

The Company sells its pharmaceutical products to generic pharmaceutical distributors, drug wholesalers, chain drug retailers, prime vendors, private label distributors, mail-order pharmacies, other pharmaceutical manufacturers, managed care, hospital buying groups and health maintenance organizations. It promotes its products through direct sales, the Internet, trade shows, trade publications, and bids. The Company also licenses the marketing of its products to other manufacturers and/or marketers in private label agreements.

In Fiscal 2003 and 2002, the Company's record sales levels can be attributed to growth in most market segments. The Company continued to expand its sales to the major chain drug stores, including CVS, Eckerd, Rite Aid and Walgreen's. The mail order segment continued to be one of the fastest growing classes of the Company's distribution efforts. Such companies, as Medco Health, Express Scripts, Caremark and AdvancePCS were leaders in the Company's sales growth. Lannett also increased its sales in the wholesaler segment led by AmerisourceBergen, Cardinal Health and McKesson Corporation. Lannett is recognized by its customers as a dependable supplier of high quality generic pharmaceuticals. The Company's policy of maintaining an adequate inventory and fulfilling orders in a timely manner has contributed to this reputation. The Company believes that retail-level consumer demand dictates the total volume of sales for various products. In the event that the Company's wholesale and retail customers adjust their purchasing volumes, the Company believes that consumer demand will be fulfilled by other wholesale or retail sources of supply. As such, Lannett attempts to obtain strong relationships with most of the major retail chains, wholesale distributors and mail-order wholesalers in order to facilitate the supply of the Company's products through whatever channel the consumer prefers. Although the Company has agreements with several customers governing the transaction terms of its sales, there are no agreements with customers which would require them to purchase any of the Company's products in the future.

MANAGEMENT

As the Company continues to grow, additional managers will be hired to complement the Company's skilled team. These new managers will serve in a variety of functions, including Research, Sales, Finance, Quality Control, Quality Assurance, Regulatory Compliance and Production. Ultimately, the execution of a sound business strategy requires a capable and knowledgeable management team.

PRODUCTS

As of the date of this filing, the Company manufactured and/or distributed twenty-three products:

NAME OF PRODUCT	MANUFACTURE SOURCE	MEDICAL INDICATION
1.) Butalbital, Aspirin and Caffeine Capsules	Lannett	Migraine Headache
2.) Butalbital, Aspirin, Caffeine with Codeine Capsules	JSP	Migraine Headache
3.) Digoxin 0.125 mg Tablets	JSP	Heart Failure
4.) Digoxin 0.25 mg Tablets	JSP	Heart Failure
5.) Primidone 50 mg Tablets	Lannett	Epilepsy
6.) Primidone 250 mg Tablets	Lannett	Epilepsy
7.) Dicyclomine 10 mg Capsules	Lannett	Irritable Bowels
8.) Dicyclomine 20 mg Tablets	Lannett	Irritable Bowels
9.) Acetazolamide 250 mg Tablets	Lannett	Glaucoma
10.) Prednisolone 5 mg Tablets	Lannett	Corticosteroid
11.) Diphenoxylate with Atropine Sulfate Tablets	Lannett	Diarrhea
12.) Isoniazid 300 mg Tablets	Lannett	Tuberculosis
13.) Levothyroxine Sodium 0.025 mg Tablets	JSP	Thyroid Deficiency
14.) Levothyroxine Sodium 0.050 mg Tablets	JSP	Thyroid Deficiency
15.) Levothyroxine Sodium 0.075 mg Tablets	JSP	Thyroid Deficiency
16.) Levothyroxine Sodium 0.088 mg Tablets	JSP	Thyroid Deficiency
17.) Levothyroxine Sodium 0.100 mg Tablets	JSP	Thyroid Deficiency
18.) Levothyroxine Sodium 0.112 mg Tablets	JSP	Thyroid Deficiency
19.) Levothyroxine Sodium 0.125 mg Tablets	JSP	Thyroid Deficiency
20.) Levothyroxine Sodium 0.150 mg Tablets	JSP	Thyroid Deficiency
21.) Levothyroxine Sodium 0.175 mg Tablets	JSP	Thyroid Deficiency
22.) Levothyroxine Sodium 0.200 mg Tablets	JSP	Thyroid Deficiency
23.) Levothyroxine Sodium 0.300 mg Tablets	JSP	Thyroid Deficiency

All of the products currently manufactured and/or sold by the Company are ethical, or prescription products. Of the products listed above, those containing butalbital, digoxin, primidone and levothyroxine sodium were the Company's key products, contributing to more than 95% of the Company's total net sales in Fiscal 2003.

The Company has two products containing butalbital. One of the products, Butalbital with Aspirin and Caffeine capsules has been manufactured and sold by Lannett for more than five years. The other butalbital product, Butalbital with Aspirin, Caffeine and Codeine Phosphate capsules is manufactured by JSP. Lannett began buying this product from JSP and selling it to its customers in December

2001. Both products, which are in orally-administered capsule dosage forms, are prescribed to treat tension headaches caused by contractions of the muscles in the neck and shoulder area and migraine. The drug is prescribed primarily for adults of various backgrounds. Migraine headache is an increasingly prevalent condition in the United States. As such conditions continue to grow, the demand for effective medical treatments will continue to grow. Common side effects of drugs which contain butalbital include dizziness and drowsiness. The Company notes that although new innovator drugs to treat migraine headache have been introduced by brand name drug companies, there is still a loyal following of doctors and consumers who prefer to use butalbital products for treatment. As the brand name companies continue to promote products containing butalbital, like Fiorinal(R), the Company expects to continue to produce and sell its generic butalbital products.

The Company has two products containing digoxin. These products are manufactured by JSP. Lannett began buying this product from JSP, and selling it to its customers in September 2002. Digoxin tablets are used to treat congestive heart failure in patients of various ages and demographic backgrounds. The beneficial effects of digoxin result from direct actions on cardiac muscle, as well as indirect actions on the cardiovascular system mediated by effects on the autonomic nervous system. Side effects of digoxin may include apathy, blurred vision, change in heartbeat, confusion, dizziness, headache, loss of appetite, nausea, vomiting and weakness.

The Company has two products containing primidone. These products were developed and manufactured by Lannett. Lannett has been manufacturing and selling primidone 250 milligram tablets for more than five years. Lannett began selling primidone 50 milligram tablets in June 2001. Both products, which are in orally-administered tablet dosage forms, are prescribed to treat convulsion and seizures in epileptic patients of all ages and backgrounds. Common side effects of primidone include lack of muscle coordination, vertigo and severe dizziness.

The Company has eleven products containing levothyroxine sodium. The levothyroxine sodium products are manufactured by JSP. Lannett began buying this product from JSP, and selling it to its customers in April 2003. Levothyroxine Sodium Tablets are used to treat hypothyroidism and other thyroid disorders. It is currently one of the most prescribed drugs in the United States with over 13 million patients of various ages and demographic backgrounds. Side effects from levothyroxine sodium are rare, but may include allergic reactions, such as rash or hives. With its distribution of this product, Lannett competes in a market which is currently controlled by two branded Levothyroxine Sodium tablet products--Abbott Laboratories' Synthroid(R) and Monarch Pharmaceutical's Levoxyl(R). JSP's Levothyroxine Sodium product, which JSP registered under the brand name Unithroid(R) was the first FDA approved (August 2000) Levothyroxine Sodium Tablet formulation. Both Synthroid(R) and Levoxyl(R) were approved by the FDA in the following years. Currently, Synthroid(R) and Levoxyl(R) control the majority of the market. However, JSP has applied to the FDA, through supplements to its NDA, to approve its product's bioequivalence to both Synthroid(R) and Levoxyl(R). If the FDA approves JSP's supplemental applications, Lannett expects the sales of its marketed Levothyroxine product to increase, relative to the market size of the two dominant brands.

Additional products are currently under development. These products are all orally-administered, solid-dosage (i.e. tablet/capsule) products designed to be generic equivalents to brand named innovator drugs. The Company's developmental drug products are intended to treat a diverse range of indications. One of these developmental products, an orally-administered obesity product, represents a generic ANDA currently owned by the Company, but not currently manufactured and distributed for commercial consumption. As one of the

oldest generic drug manufacturers in the country, formed in 1942, Lannett currently owns several ANDAs for products which it does not manufacture and market. These ANDAs are simply dormant on the Company's records. Occasionally, the Company reviews such ANDAs to determine if the market potential for any of these older drugs has recently changed, so as to make it attractive for Lannett to reconsider manufacturing and selling it. If the Company makes the determination to introduce one of these products into the consumer marketplace, it must review the ANDA and related documentation to ensure that the approved product specifications, formulation and other features are feasible in the Company's current environment. Generally, in these situations, the Company must file a supplement to the FDA for the applicable ANDA, informing the FDA of any significant changes in the manufacturing process, the formulation, the raw material supplier or another major feature of the previously-approved ANDA. The Company would then redevelop the product and submit it to the FDA for supplemental approval. The FDA's approval process for ANDA supplements is similar to that of a new ANDA.

Another developmental product, also an orally-administered obesity product, is a new ANDA submitted to the FDA in July 2003 for approval. In a presentation to the Generic Pharmaceutical Association on March 2, 2004, Gary J. Buehler, R.Ph., and Director of the FDA's Office of Generic Drugs, said that the median approval time for a new ANDA for the FDA's Fiscal 2003 year was 17.3 months. Since the Company has no control over the FDA review process, management is unable to anticipate whether or when it will be able to begin commercially producing and shipping this product.

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

In addition to the efforts of its internal product development group, Lannett has contracted with two outside firms (Pharmatek Laboratories Inc. in California and The PharmaNetwork LLC in New Jersey) for the formulation and development of several new generic drug products. These outsourced R&D products are at various stages in the development cycle--formulation, analytical method development and testing and manufacturing scale-up. These products are orally-administered solid dosage products intended to treat a diverse range of medical indications. It is the Company's intention to ultimately transfer the formulation technology and manufacturing process for all of these R&D products to the Company's own commercial manufacturing sites. The Company initiated these outsourced R&D efforts to compliment the progress of its own internal R&D efforts.

The Company is also developing a drug product that does not require FDA approval. The FDA allows generic manufacturers to manufacture and sell products which are equivalent to innovator drugs which are grand-fathered, under FDA rules, prior to the passage of the Hatch-Waxman Act of 1984. The FDA allows generic manufacturers to produce and sell generic versions of such grand-fathered products by simply performing and internally documenting the

product's stability over a period of time. Under this scenario, a generic company can forego the time and costs related to a FDA-mandated ANDA approval process. The Company currently has one product under development in this category. The developmental drug is an orally-administered, prescription solid dosage product.

The Company has also contracted with Spectrum Pharmaceuticals Inc., based in California, to market generic products developed and manufactured by Spectrum and/or its partners. The first applicable product under this agreement is ciprofloxacin tablets, the generic version of Cipro(R), an anti-bacterial drug, marketed by Bayer Corporation, prescribed to treat infections. The Company has also initiated discussions with other firms for similar new product initiatives, in which Lannett will market and distribute products manufactured by third parties.

Lannett intends to use its strong customer relationships to build its market share for such products, and increase future revenues and income.

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

The following table summarizes key information related to the Company's R&D products. The column headings are defined as follows:

1.) Stage of R&D - Defines the current stage of the R&D product in the development process, as of the date of this filing.

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

3.) Number of Products - Defines the number of products in R&D at the stage noted. In this context, a product means any finished dosage form, including all potencies, containing the same API or combination of APIs and which represents a generic version of the same Reference Listed Drug (RLD) or innovator drug, identified in the FDA's Orange Book.

STAGE OF R&D	REGULATORY REQUIREMENT	NUMBER OF PRODUCTS
FDA Review	ANDA	7
FDA Review	ANDA supplement	1
Clinical Testing	ANDA	4
Scale-Up	Grand-fathered	1
Scale-Up	ANDA supplement	5
Scale-Up	ANDA	2
Formulation/Method Development	ANDA	9

RAW MATERIAL AND INVENTORY SUPPLIERS

The raw materials used by the Company in the production process consist of pharmaceutical chemicals in various forms, which are generally available from various sources. FDA approval is required in connection with the process of using active ingredient suppliers. In addition to the raw materials purchased for the production process, the Company purchases certain finished dosage inventories, including capsule and tablet products. The Company then sells these finished dosage products directly to its customers along with the finished dosage products internally manufactured.

Currently, the only finished product inventory supplier of the Company is Jerome Stevens Pharmaceuticals, Inc. (JSP), in Bohemia, New York. Purchases of finished goods inventory from JSP accounted for approximately 62% of the Company's inventory purchases in Fiscal 2003. During Fiscal 2003, the Company did not have a supply agreement with JSP.

Another supplier, Siegfried (USA) Inc., which supplies primidone and butalbital, the raw materials in the Company's commercial products containing the same ingredient name, to the Company, accounted for 12% of the Company's inventory purchases in Fiscal 2003. Purchases of

finished goods inventory from JSP accounted for approximately 26% of the Company's inventory purchases in Fiscal 2002. Siegfried (USA) Inc. supplied 30% of the Company's inventory purchases in Fiscal 2002. Generally, the raw materials purchased from suppliers are available from a number of vendors. The finished products purchased from JSP may not be available from other sources due to the limited number of FDA approvals of competitive products. If suppliers of a certain material or finished product are limited, the Company will generally take certain precautionary steps to avoid a disruption in supply. This includes building a satisfactory inventory level, and obtaining contractual supply commitments. The Company currently has an agreement with Siegfried (USA) Inc. for the supply of primidone. The agreement is a standard supply agreement evidencing the terms of the supply of material. There are no guaranteed purchase volume commitments; however the agreement does require Lannett to purchase 100% of its primidone raw material requirements from Siegfried. The price of the material may vary depending on the quantity of material purchased during the term of the agreement. The term of the agreement is October 1, 2002 through December 31, 2003. At the expiration of the term, the Company expects to renew the supply agreement for an additional period under terms similar to the old agreement. In the interim, Siegfried (USA) Inc. is continuing to supply raw materials to the Company under terms similar to the old agreement The agreement is included in the Exhibits of this Form 10-KSB.

CUSTOMERS AND MARKETING

The Company sells its products primarily to wholesale distributors, generic drug distributors, mail-order pharmacies, drug chains, and other pharmaceutical companies. Sales of the Company's pharmaceutical products are made on an individual order basis. One customer, Cardinal Health, one of the largest wholesale distributors in the country, accounted for approximately 13% of net sales in Fiscal 2003. Another customer, Qualitest Pharmaceuticals, a large private-label wholesale distributor, accounted for approximately 12% and 22% of net sales in Fiscal 2003 and Fiscal 2002, respectively. Another customer, United Research Laboratories, a large private-label wholesale distributor, accounted for 19% of net sales in Fiscal 2002. The Company performs ongoing

credit evaluations of its customers' financial condition, and has experienced no significant collection problems to date. Generally, the Company requires no collateral from its customers. As previously noted, a significant portion of Lannett's sales were to wholesale customers, such as Cardinal Health. Sales to these wholesale customers include "indirect sales," which represent sales to third-party entities, such as independent pharmacies, managed care organizations, hospitals, nursing homes and group purchasing organizations, collectively referred to as "indirect customers." Lannett enters into agreements with its indirect customers to establish pricing for certain products. The indirect customers then independently select a wholesaler from which to actually purchase the products at these agreed-upon prices. Lannett will provide credit to the wholesaler for the difference between the agreed-upon price with the indirect customer and the wholesaler's invoice price. This credit is called a chargeback. For more information on chargebacks, see the section entitled "Chargebacks" in Item 6, "Management's Discussion and Analysis of Financial Condition and Results of Operations, Significant Accounting Policies" of this Form 10-KSB. These indirect sale transactions are recorded on Lannett's books as sales to the wholesale customers. This has the effect of over-emphasizing the sales volume attributable to such wholesalers because it includes such "indirect sales." The Company believes that retail-level consumer demand dictates the total volume of sales for various products. In the event that the Company's wholesale and retail customers adjust their purchasing volumes, the Company believes that consumer demand will be fulfilled by other wholesale or retail sources of supply. As such, Lannett attempts to obtain strong relationships with most of the major retail chains, wholesale distributors and mail-order wholesalers in order to facilitate the supply of the Company's products through whatever channel the consumer prefers. Although the Company has agreements with several customers governing the transaction terms of its sales, there are no long-term supply agreements with customers which would require them to purchase the Company's products.

The Company promotes its products through direct sales, the Internet, trade shows, trade publications, and bids. The Company also markets its products through private label arrangements, whereby Lannett produces its products with a label containing the name and logo of a customer. This practice is commonly referred to as private label business. It allows the Company to expand on its own internal sales efforts by using the marketing services from other well-respected pharmaceutical dosage suppliers. The focus of the Company's sales efforts are the relationships it creates with its customer accounts. Strong customer relationships have created a positive platform for Lannett to increase its sales volumes. Advertising in the generic pharmaceutical industry is generally limited to trade publications, read by retail pharmacists, wholesale purchasing agents and other pharmaceutical decision-makers. Historically and in Fiscal 2003 and 2002, the Company's advertising expenses were immaterial. When the customer and the Company's sales representatives make contact, the Company will generally offer to supply the customer its products at fixed prices. If accepted, the customer's purchasing department will coordinate the purchase, receipt and distribution of the products throughout its distribution centers and retail outlets. Once a customer accepts the Company's supply of product, the customer generally expects a highs standard of service. This service standard includes shipping product in a timely manner on receipt of customer purchase orders, maintaining convenient and effective customer service functions and retaining a mutually-beneficial dialogue of communication. The Company believes that although the generic pharmaceutical industry is a commodity industry, where price is the primary factor for sales success, these additional service standards are equally important to the customers that rely on a consistent source of supply.

COMPETITION

The manufacture and distribution of generic pharmaceutical products is a highly competitive industry. Competition is based primarily on price, service and quality. The Company competes primarily on this basis, as well as by flexibility (reacting to customer needs quickly and decisively--for example shipping product via overnight delivery when the customer is in critical need of inventory), availability of inventory, and by the fact that the Company's products are available only from a limited number of suppliers. The modernization of its facilities, hiring of experienced staff, and implementation of inventory and quality control programs have improved the Company's competitive position over the past five years.

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

Product	Primary Competitors
Butalbital with Aspirin and Caffeine, with and without codeine phosphate capsules	Watson Pharmaceuticals Inc., Anabolic Laboratorie (marketed by Breckenridge Pharmaceutical, In
Digoxin tablets	GlaxoSmithKline, Amide Pharmaceutical, Inc. (mark Bertek Pharmaceuticals Inc.), Caraco Pharmaceut Laboratories, Inc.
Primidone tablets	Watson Pharmaceuticals Inc.
Levothyroxine Sodium tablets	Abbott Laboratories, Monarch Pharmaceutical

GOVERNMENT REGULATION

Pharmaceutical manufacturers are subject to extensive regulation by the federal government, principally by the FDA and the Drug Enforcement Agency ("DEA"), and, to a lesser extent, by other federal regulatory bodies and state governments. The Federal Food, Drug and Cosmetic Act, the Controlled Substance Act and other federal statutes and regulations govern or influence the testing, manufacture, safety, labeling, storage, record keeping, approval, pricing, advertising and promotion of the Company's generic drug products. Noncompliance with applicable regulations can result in fines, recall and seizure of products, total or partial suspension of production, personal and/or corporate prosecution and debarment, and refusal of the government to approve new drug applications. The FDA also has the authority to revoke previously approved drug products.

Generally, FDA approval is required before a prescription drug can be marketed. The approval procedures are quite extensive. A new drug is one not generally recognized by qualified experts as safe and effective for its intended use. New drugs are typically developed and submitted to the FDA by companies expecting to brand the product, and sell it as a new medical treatment. The FDA review process for new drugs is very extensive; and it requires a substantial investment to research and test the drug candidate. However, less burdensome approval procedures may be used for generic equivalents. Typically, the investment required to develop a generic drug is less costly than the brand innovator drug. There are currently three ways to obtain FDA approval of a drug:

NEW DRUG APPLICATIONS ("NDA"): Unless one of the two procedures discussed in the following paragraphs is available, a manufacturer must conduct and submit to the FDA complete clinical studies to establish a drug's safety and efficacy.

ABBREVIATED NEW DRUG APPLICATIONS ("ANDA"): An ANDA is similar to an NDA, except that the FDA waives the requirement of complete clinical studies of safety and efficacy, although it may require bioavailability and bioequivalence studies. The FDA has recently stated that the average review and approval time for a new ANDA is approximately 18 months. "Bioavailability" indicates the rate of absorption and levels of concentration of a drug in the bloodstream needed to produce a therapeutic effect. "Bioequivalence" compares one drug product with another, and indicates if the rate of absorption and the levels of concentration of a generic drug in the body are within prescribed statistical limits to those of a previously approved drug. Under the Drug Price Act, an ANDA may be submitted for a drug on the basis that it is the equivalent of an approved drug, regardless of when such other drug was approved. The Drug Price Act, in addition to establishing a new ANDA procedure, created statutory protections for approved brand name drugs. Under the Drug Price Act, an ANDA for a generic drug may not be made effective until all relevant product and use patents for the brand name drug have expired or have been determined to be invalid. Prior to enactment of the Drug Price Act, the FDA gave no consideration to the patent status of a previously approved drug. Additionally, the Drug Price Act extends for up to five years the term of a product or use patent covering a drug to compensate the patent holder for the reduction of the effective market life of a patent due to federal regulatory review. With respect to certain drugs not covered by patents, the Drug Price Act sets specified time periods of two to ten years during which ANDAs for generic drugs cannot become effective or, under certain circumstances, cannot be filed if the brand name drug was approved after December 31, 1981. Lannett, like most other generic drug companies, uses the ANDA process for the submission of their developmental generic drug candidates.

PAPER NEW DRUG APPLICATIONS ("PAPER NDA"): For a drug that is identical to a drug first approved after 1962, a prospective manufacturer need not go through the full NDA procedure. Instead, it may demonstrate safety and efficacy by relying on published literature and reports. The manufacturer must also submit, if the FDA so requires, bioavailability or bioequivalence data illustrating that the generic drug formulation produces the same effects, within an acceptable range, as the previously approved innovator drug. Because published literature to support the safety and efficacy of post-1962 drugs may not be available, this procedure is of limited utility to generic drug manufacturers. Moreover, the utility of Paper NDAs has been further diminished by the recently broadened availability of the ANDA process, as described above.

Among the requirements for new drug approval is the requirement that the prospective manufacturer's methods conform to the FDA's current good manufacturing practices ("CGMP Regulations"). The CGMP Regulations must be followed at all times during which the approved drug is manufactured. In complying with the standards set forth in the CGMP Regulations, the Company must continue to expend time, money and effort in the areas of production and quality control to ensure full technical compliance. Failure to comply with the CGMP Regulations risks possible FDA action such as the seizure of noncomplying drug products or, through the Department of Justice, enjoining the manufacture of such products.

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

operations when incurred. The Company incurred no monitoring costs during the years ended June 30, 2003 and 2002.

RESEARCH AND DEVELOPMENT

During Fiscal 2003 and Fiscal 2002, the Company incurred research and development costs of approximately $2,575,000 and $1,749,000, respectively.

EMPLOYEES

The Company currently has 160 employees, of which 158 are full-time.

SECURITIES EXCHANGE ACT REPORTS

The Company maintains an Internet website at the following address: www.lannett.com. The Company makes available on or through its Internet website certain reports and amendments to those reports that are filed with the SEC in accordance with the Securities Exchange Act of 1934. These include annual reports on Form 10-KSB, quarterly reports on Form 10-QSB and current reports on Form 8-K. This information is available on the Company's website free of charge as soon as reasonably practicable after the Company electronically files the information with, or furnishes it to, the SEC. The contents of the Company's website are not incorporated by reference in this Annual Report on Form 10-KSB and shall not be deemed "filed" under the Securities Exchange Act of 1934.

ITEM 2. DESCRIPTION OF PROPERTY

The Company's headquarters, administrative offices, quality control laboratory, and manufacturing and production facilities, consisting of approximately 31,000 square feet, are located at 9000 State Road, Philadelphia, Pennsylvania.

In December 1997, the Company entered into a three-year and three-month lease for a 23,500 square foot facility located at 500 State Road, Bensalem Bucks County, Pennsylvania. This facility houses laboratory research, warehousing and distribution operations. The leased facility is located approximately 1.5 miles from the Company headquarters in Philadelphia. In January 2001, the Company extended this lease through April 30, 2004. The Company does not expect to extend the term on this lease beyond April 30, 2004.

On July 1, 2003, the Company entered into a lease for a 62,000 square foot facility at 9001 Torresdale Avenue, Philadelphia, Pennsylvania, approximately 1 mile from the Company's headquarters. The lease expires on November 30, 2003; and the Company has the contractual right and option to purchase the facility at any time during the lease term. The Company currently expects to exercise this purchase option prior to the lease termination date of November 30, 2003. Prior to the expiration of the lease term at 500 State Road, the Company is planning to move all operations currently performed at 500 State Road to 9001 Torresdale Avenue. In addition to the laboratory research, warehousing and distribution operations currently performed at 500 State Road, other operational functions may be moved from the Company headquarters to 9001 Torresdale Avenue. This move will occur gradually, and will allow the Company to maximize its FDA approved production facility at 9000 State Road for production output.

ITEM 3. LEGAL PROCEEDINGS

REGULATORY PROCEEDINGS

The Company is engaged in an industry which is subject to considerable

government regulation relating to the development, manufacturing and marketing of pharmaceutical products. Accordingly, incidental to its business, the Company periodically responds to inquiries or engages in administrative and judicial proceedings involving regulatory authorities, particularly the FDA and the DEA.

EMPLOYEE CLAIMS

A claim of retaliatory discrimination has been filed by a former employee with the Pennsylvania Human Relations Commission ("PHRC") and the Equal Employment Opportunity Commission ("EEOC"). The Company was notified of the complaint in March 1997. The Company has denied liability in this matter. The PHRC has made a determination that the complaint against the Company should be dismissed because the facts do not establish probable cause of the allegations of discrimination. The matter is still pending before the EEOC. At this time, management is unable to estimate a range of loss, if any, related to this action. Management believes that the outcome of this claim will not have a material adverse impact on the financial position or results of operations of the Company.

A claim of discrimination has been filed against the Company with the EEOC and the PHRC. The Company was notified of the complaint in June 2001. The Company has filed an answer with the EEOC denying the allegations. The EEOC has made a determination that the complaint against the Company should be dismissed because the facts do not establish probable cause of the allegations of discrimination. The matter is still pending before the PHRC. At this time, management is unable to estimate a range of loss, if any, related to this action. Management believes that the outcome of this claim will not have a material adverse impact on the financial position or results of operations of the Company.

A claim of discrimination has been filed against the Company with the PHRC and the EEOC. The Company was notified of the complaint in July 2001. The Company has filed an answer with the PHRC denying the allegations. The PHRC has made a determination that the complaint against the Company should be dismissed because the facts do not establish probable cause of the allegations of discrimination. The matter is still pending before the EEOC. At this time, management is unable to estimate a range of loss, if any, related to this action. Management believes that the outcome of this claim will not have a material adverse impact on the financial position or results of operations of the Company.

DES CASES

The Company is currently engaged in several civil actions as a co-defendant with many other manufacturers of Diethylstilbestrol ("DES"), a synthetic hormone. Prior litigation established that the Company's pro rata share of any liability is less than one-tenth of one percent. The Company was represented in many of these actions by the insurance company with which the Company maintained coverage during the time period that damages were alleged to have occurred. The insurance company denies coverage for actions alleging involvement of the Company filed after January 1, 1992. With respect to these actions, the Company paid nominal damages or stipulated to its pro rata share of any liability. The Company has either settled or had dismissed approximately 250 claims. An additional 283 claims are currently being defended. At this time, management is unable to estimate a range of loss, if any, related to these actions. Prior settlements had been in the $500 to $3,500 range. Management believes that the outcome of these cases will not have a material adverse impact on the financial position or results of operations of the Company.

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

No matters have been submitted to a vote of the Company's security holders

during the quarter ended June 30, 2003.

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

MARKET INFORMATION

On April 15, 2002, the Company's common stock began trading on the American Stock Exchange. Prior to this, the Company's common stock traded in the over-the-counter market through the use of the inter-dealer "pink-sheets" published by Pink Sheets LLC. The following table sets forth certain information with respect to the high and low daily closing prices of the Company's common stock during Fiscal 2003 and 2002, as quoted by the American Stock Exchange (on and after April 15, 2002) and Pink Sheets LLC (prior to April 15, 2002). Such quotations reflect inter-dealer prices without retail mark-up, markdown or commission and may not represent actual transactions. All share and per share amounts on this Annual Report and Form 10-KSB have been adjusted to reflect a three-for-two stock split, which was effective on February 14, 2003.

FISCAL YEAR ENDED JUNE 30, 2003

	HIGH	LOW
First quarter	$ 7.41	$ 4.63
Second quarter	$ 13.97	$ 5.67
Third quarter	$ 15.52	$ 11.05
Fourth quarter	$ 23.44	$ 11.36

FISCAL YEAR ENDED JUNE 30, 2002

	HIGH	LOW
First quarter	$ 1.33	$ 0.69
Second quarter	$ 2.69	$ 1.13
Third quarter	$ 3.77	$ 2.13
Fourth quarter	$ 8.00	$ 3.50

HOLDERS

As of August 26, 2003, there were approximately 302 holders of record of the Company's common stock.

DIVIDENDS

The Company did not pay cash dividends in Fiscal 2003 or 2002. The Company intends to use available funds for working capital, plant and equipment additions, and various product extension ventures. It does not anticipate paying cash dividends in the foreseeable future.

EQUITY COMPENSATION PLAN INFORMATION

The following table summarizes the equity compensation plans as of June 30, 2003.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted average exercise price of outstanding options, warrants and rights (b)
Equity Compensation plans approved by security holders	411,939	$7.48
Equity Compensation plans not approved by security holders	-	-
Total	411,939	$7.48

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

In addition to historical information, this Form 10-KSB contains forward-looking information. The forward-looking information is subject to certain risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. Important factors that might cause such a difference include, but are not limited to, those discussed in the following section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations." Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date of this Form 10-KSB. The Company undertakes no obligation to publicly revise or update these forward-looking statements to reflect events or circumstances, which arise later. Readers should carefully review the risk factors described in other documents the Company files from time to time with the Securities and Exchange Commission, including the Quarterly reports on Form 10-Q to be filed by the Company in Fiscal 2004, and any Current Reports on Form 8-K filed by the Company. All share and per share amounts on this Annual Report and Form 10-KSB have been adjusted to reflect a three-for-two stock split, which was effective on February 14, 2003.

CRITICAL ACCOUNTING POLICIES

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

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

REVENUE RECOGNITION

The Company recognizes revenue when its products are shipped. At this point, title and risk of loss have transferred to the customer, and provisions for estimates, including rebates, promotional adjustments, price adjustments, returns, chargebacks, and other potential adjustments are reasonably determinable. Accruals for these provisions are presented in the Consolidated Financial Statements as reductions to net sales and accounts receivable. Accounts receivable are presented net of allowances relating to these provisions, which were approximately $2,772,000 and $630,000 at June 30, 2003 and June 30, 2002, respectively. The change in the reserves for various sales adjustments was not proportionally equal to the change in sales from Fiscal 2002 to Fiscal 2003 because of changes in the product mix and the customer mix. Provisions for rebates, promotional and other credits are estimated based on historical payment experience, estimated customer inventory levels and contract terms. Provisions for other customer credits, such as price adjustments, returns and chargebacks require management to make subjective judgments. Unlike branded innovator companies, Lannett does not use information about product levels in distribution channels from third-party sources, such as IMS Health and NDC Health in estimating future returns and other credits. These provisions are discussed in more detail below and in the Notes to the Consolidated Financial Statements.

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

REBATES - Rebates are offered to the Company's key customers to promote customer loyalty and encourage greater product sales. These rebate programs provide customers with rebate credits upon attainment of pre-established volumes or attainment of net sales milestones for a specified period. Other promotional programs are incentive programs offered to the customers.

At the time of shipment, the Company estimates reserves for rebates and other promotional credit programs based on the specific terms in each agreement. The reserve for rebates increases as sales to certain wholesale and retail customers increase. However, these rebate programs are tailored to the customers' individual programs. Hence, the reserve will depend on the mix of customers that comprise such rebate programs.

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

PRICE ADJUSTMENTS - Price adjustments, also known as "shelf stock adjustments," are credits issued to reflect decreases in the selling prices of the Company's products that customers have remaining in their inventories at the time of the price reduction. Decreases in selling prices are discretionary decisions made by management to reflect competitive market conditions. Amounts recorded for estimated shelf stock adjustments are based upon specified terms with direct customers, estimated declines in market prices and estimates of inventory held by customers. The Company regularly monitors these and other factors and evaluates the reserve as additional information becomes available.

The following table identifies the reserves for each major category of revenue allowance:

Reserve Category/ Period Ended	Chargebacks	Rebates	Returns	Other	Total
June 30, 2003	$ 1,638,079	$ 889,808	$ 210,000	$ 33,800	$ 2,771,687
September 30, 2003	$ 3,127,799	$ 1,283,924	$ 230,000	$ 500,000	$ 5,141,723
December 31, 2003	$ 2,236,466	$ 1,294,170	$ 260,000	$ 150,000	$ 3,940,636
March 31, 2004	$ 2,181,185	$ 1,283,815	$ 285,000	$ 50,000	$ 3,800,000

The Company ships its products to the warehouses of its wholesale and retail chain customers. When the Company and a customer come to an agreement for the supply of a product, the customer will generally continue to purchase the product, stock its warehouse(s) and resell the product to its own customers. The Company's customer will continually reorder the product as its warehouse is depleted. Lannett generally has no minimum size orders for its customers. Additionally, most warehousing customers prefer not to stock excess inventory levels due to the additional carrying costs and inefficiencies created by holding extra inventory. As such, Lannett's

customers continually reorder the Company's products. It is common for Lannett's customers to order the same products on a monthly basis. For generic

pharmaceutical manufacturers, it is critical to ensure that customers' warehouses are adequately stocked with its products. This is important due to the fact that several generic competitors compete for the consumer demand for a given product. Availability of inventory ensures that a manufacturer's product is considered. Otherwise, retail prescriptions would be filled with competitors' products. For this reason, the Company periodically offers incentives to its customers to purchase its products. These incentives are generally up-front discounts off its standard prices at the beginning of a generic campaign launch for a newly-approved or newly-introduced product, or when a customer purchases a Lannett product for the first time. Customers generally inform the Company that such purchases represent an estimate of expected resales for a period of time. This period of time is generally up to three months. The Company records this revenue, net of any discounts offered and accepted by its customers, and net of any estimated returns and other credits, at the time of shipment. The Company's products have either 24 months or 36 months shelf-life at the time of manufacture. The Company monitors its customers' purchasing trends to attempt to identify any significant lapses in purchasing activity. If the Company observes a lack of recent activity, inquiries will be made to such customer regarding the success of the customer's resale efforts. The Company will attempt to minimize any potential return (or shelf life issues) by maintaining an active dialogue with the customers.

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

ACCOUNTS RECEIVABLE

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

INVENTORIES

The Company values its inventory at the lower of cost or market and regularly reviews inventory quantities on hand and records a provision for excess and obsolete inventory based primarily on estimated forecasts of product demand and production requirements. The Company's estimates of future product demand may prove to be inaccurate, in which case it may have understated or overstated the provision required for excess and obsolete inventory. In the future, if the Company's inventory is determined to be overvalued, the Company

would be required to recognize such costs in cost of goods sold at the time of such determination. Likewise, if inventory is determined to be undervalued, the Company may have recognized excess cost of goods sold in previous periods and would be required to recognize such additional operating income at the time of sale.

RESULTS OF OPERATIONS - FISCAL 2003 TO FISCAL 2002

Net sales increased by 69%, from $25,126,214 in Fiscal 2002 to $42,486,758 in Fiscal 2003. Sales increased as a result of additions to the Company's prescription line of products, including Prednisolone tablets, first marketed in October 2001, Butalbital with Aspirin, Caffeine and Codeine Phosphate capsules, first marketed in December 2001, Isoniazid tablets, first marketed in January 2002, Digoxin tablets, first marketed in September 2002 and Levothyroxine Sodium tablets, first marketed in April 2003. These product additions had the effect of increasing the total annual sales in Fiscal 2003, compared to Fiscal 2002, due to the fact that the Company sold the products for longer periods of time in Fiscal 2003, compared to Fiscal 2002. Of these product additions, Butalbital with Aspirin, Caffeine and Codeine Phosphate capsules, Digoxin tablets and Levothyroxine Sodium tablets accounted for approximately $9.7 million of the increase in net sales from Fiscal 2002 to Fiscal 2003. Additionally, sales of a portion of the Company's previously marketed products, including Primidone tablets and Butalbital with Aspirin and Caffeine capsules, increased due to new customer accounts, increased unit sales, and higher unit sales prices. The Company raised its sales prices for Primidone 50 milligram tablets in Fiscal 2003 subsequent to an increase in the price of the brand named drug. Generally, the Company sells its products at the accepted market prices for such products. If the competitive environment changes, the Company monitors such changes to determine the effect on the market prices for its products. Such changes may include new competitors, fewer competitors, or an increase in the price of the innovator drug. The increase in sales of a portion of the Company's products was offset by a decrease of approximately $2.6 million in net sales of certain other products, including pseudoephedrine hydrochloride tablets and guaifenesin/ephedrine hydrochloride tablets. Due to increased competition for these two products, and the Company's decision to allocate its production capacity to higher margin prescription products, the Company discontinued its production, marketing and distribution of these two products in Fiscal 2003. Such higher margin products included Primidone 50 and 250 milligram tablets and Butalbital with Aspirin and Caffeine capsules.

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

Customer Category	Fiscal 2003 Net Sales	Fiscal 2002 Net Sales	Fiscal 2001 Net Sales
Wholesaler/Distributor	$20.6 million	$10.4 million	$ 6.9 million
Retail Chain	$ 9.9 million	$ 3.3 million	$ 800,000
Mail-Order Pharmacy	$ 2.6 million	$ 1.1 million	$ 300,000
Private Label	$ 9.4 million	$10.3 million	$ 4.1 million
Total	$42.5 million	$25.1 million	$12.1 million

Sales in every category, with the exception of `Private Label,' increased during the past two years. This is a result of the factors described in the previous paragraph. Sales to `Private Label' customers decreased in Fiscal 2003 as a

result of the Company's successful efforts in growing the Lannett label accounts. Increasing sales to customers that purchased the Lannett label products (i.e. the `Wholesale,' `Retail' and `Mail-Order' customer categories) had the effect of reducing sales to `Private Label' customers.

Cost of sales increased by 92%, from $8,452,677 in Fiscal 2002 to $16,257,794 in Fiscal 2003. The cost of sales increase is due to an increase in direct variable costs and certain indirect overhead costs as a result of the increase in sales volume and related production activities. These costs include raw materials/cost of finished goods purchased and resold, which increased by approximately $6,308,000, labor and benefits expenses, which increased by approximately $1,126,000, depreciation expense, which increased by approximately $140,000 and other miscellaneous production-related expenses, which increased in total by approximately $231,000. Gross profit margins for Fiscal 2003 and Fiscal 2002 were 62% and 66%, respectively. The decrease in the gross profit percentage is due to the product sales mix. Incremental sales in Fiscal 2003 of some or all of the Company's new products were at gross profit percentages less than the Company's average gross profit percentage from Fiscal 2002. This is a result of more competition for such drugs, and an erosion in generic market pricing for such drugs. During Fiscal 2003, a larger percentage of the Company's total net sales were of JSP-manufactured products, as compared to the percentage of the Company's total net sales during Fiscal 2002. The Company's average gross profit margin for the JSP products is less than the average gross profit margin for products internally manufactured. As such, the change in product sales mix reduced the gross profit percentage in Fiscal 2003. Depending on future market conditions for each of the Company's products, changes in the future sales product mix may occur. These changes may affect the gross profit percentage in future periods.

Research and development expenses increased by 47%, from $1,748,631 in Fiscal 2002 to $2,575,178 in Fiscal 2003. This increase is a result of an increase in the cost of clinical bioequivalence testing fees, which increased by approximately $261,000, outsourced product development consulting services, which increased by approximately $300,000, payroll and benefits expenses, which increased by approximately $202,000, raw materials used in the development and formulation of new products not yet approved by the FDA, which increased by approximately $22,000 and miscellaneous other R&D expenses, which increased by a total of approximately $41,000.

Selling, general and administrative expenses increased by 31%, from $3,298,564 in Fiscal 2002 to $4,337,558 in Fiscal 2003. This increase is a result of an increase in the following expenses: payroll and benefits, which increased by approximately $746,000, consulting services, which increased by approximately $180,000, travel and entertainment expenses, which increased by approximately $95,000, investor relations/marketing expenses, which increased by approximately $166,000, advertising expenses, which increased by approximately $102,000, professional services fees, which increased by approximately $244,000, computer support expenses, which increased by approximately $119,000 and miscellaneous other administrative expenses, which increased by a total of approximately $430,000. These increases were due to the hiring of additional administrative employees and a general increase in administrative expenses due to the growth of the Company in terms of employees, production volume and sales. These increases were partially offset by a decrease in commissions expense to outside sales

representatives of approximately $1,043,000. In Fiscal 2002, the Company created

its own internal sales and marketing department, replacing the service previously performed by outside sales brokers. At this time, the Company's infrastructure includes employee resources for all of the major administrative functions, with the exception of a general counsel. As the Company continues to grow in the future, it may consider hiring an employee to fulfill this role, which is currently performed by outside professional services firms. During Fiscal 2003, the Company has surpassed its historical highs in terms of net sales, gross profit, operating income, net income and total market capitalization value. This growth is a result of additions to the Company's line of generic products, new customers, higher unit sales, increased product prices and a management focus on minimizing unnecessary overhead and administrative costs. Some of the new generic products sold by Lannett during Fiscal 2003 and Fiscal 2002 were developed and manufactured by Lannett while others are manufactured by JSP, one of Lannett's primary suppliers. The products manufactured by Lannett and those manufactured by JSP are identified in the section entitled "PRODUCTS" in Item 1 of this Form 10-KSB.

As a result of the foregoing, the Company increased its operating income by 67%, from $11,425,483 in Fiscal 2002 to $19,060,106 in Fiscal 2003.

The Company's income tax expense increased from $3,984,135 in Fiscal 2002 to $7,334,740 in Fiscal 2003 as a result of the increase in taxable income.

The Company reported net income of $11,666,887 for Fiscal 2003, or $0.58 basic and diluted income per share, compared to net income of $7,195,990 for Fiscal 2002, or $0.36 basic and diluted income per share.

LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities of $6,652,406 in Fiscal 2003 was attributable to net income of $11,666,887, as adjusted for the effects of non-cash items (primarily depreciation and amortization) of $1,399,700 and changes in operating assets and liabilities totaling ($6,414,181). Significant changes in operating assets and liabilities were comprised of:

1. an increase in accounts receivable of $4,050,596 due to the increase in the Company's net sales. The days sales in accounts receivable increased primarily due to changes in the customer and product mix. In Fiscal 2003, a portion of the Company's sales were of over-the-counter products, including pseudoephedrine hydrochloride tablets and guaifenesin/ephedrine hydrochloride tablets. Sales of these products were made to small distribution companies that focused on convenience store outlets. The Company's payment terms for these customers were primarily payment on delivery of goods, as opposed to extended payment terms offered to larger customers. As a result of the decrease in sales to these smaller customers in 2003, the average days sales in accounts receivable increased;

2. an increase in inventories of $3,238,591 due to increases in raw materials and finished goods inventory. Due to the Company's sales growth, additional investments were made in raw material and finished goods inventory. It is the Company's goal to stock an adequate inventory of finished goods and raw materials. Such a strategy will allow the Company to minimize stock-outs and back-orders, and to provide a high level of customer order fulfillment. Additionally, the Company has increased its inventory carrying amounts of certain raw materials and finished products to ensure supply continuity;

3. an increase in accounts payable, net of the decrease in accrued expenses, of $1,799,171 due to the growth of the Company's purchasing activities to support the overall Company growth, and the Company's receipt of finished goods inventories in the last quarter of Fiscal 2003. In April 2003, the Company launched its distribution campaign for

Levothyroxine Sodium tablets. Due to the timing of the Company's receipt of finished goods inventory related to this new product launch and beneficial credit payment terms, the Company's accounts payable balance increased accordingly.

The net cash used in investing activities of $2,243,933 for Fiscal 2003 was attributable to $2,618,936 expended for equipment and building additions, offset by $375,003 in proceeds received from the sale of equipment. The Company's anticipated budget for capital expenditures in Fiscal 2004 is approximately $9,300,000. The anticipated capital expenditure requirements will support the Company's growth related to new product introductions and increased production output due to expected higher sales levels. As of June 30, 2003, none of the financing proceeds received from the bonds issued during Fiscal 1999 were available for future capital expenditures; however approximately $352,000 was paid by the Company prior to June 30, 2003 for production equipment expected to arrive, and be placed in service in Fiscal 2004. This balance is included in Other Assets, as a long-term asset, at June 30, 2003.

The Company had a $4,250,000 revolving line of credit from a shareholder, William Farber, who is also the Chairman of the Board ("Shareholder Line of Credit"). The maturity date on the Shareholder Line of Credit was December 1, 2002. The Company did not renew this line of credit because the cash available from its current and prospective loan agreements and the cash generated from its operations were estimated to be sufficient to support the Company's anticipated growth, in terms of cash requirements. The line of credit had a stated interest rate equal to the prime interest rate plus 1%. At June 30, 2003, the Company had no amount outstanding and $4,250,000 available under this line of credit. There was no accrued interest at June 30, 2003 and June 30, 2002.

In April 1999, the Company entered into a loan agreement (the "Agreement") with a governmental authority, the Philadelphia Authority for Industrial Development, (the "Authority") to finance future construction and growth projects of the Company. The Authority issued $3,700,000 in tax-exempt variable rate demand and fixed rate revenue bonds to provide the funds to finance such growth projects pursuant to a trust indenture ("the "Trust indenture"). A portion of the Company's proceeds from the bonds was used to pay for bond issuance costs of approximately $170,000. The remainder of the proceeds was deposited into a money market account, which was restricted for future plant and equipment needs of the Company, as specified in the Agreement. The Trust Indenture requires that the Company repay the Authority loan through installment payments beginning in May 2003 and continuing through May 2014, the year the bonds mature. The bonds bear interest at the floating variable rate determined by the organization responsible for selling the bonds (the "remarketing agent"). The remarketing agent sets the interest rate, based on its judgment, in order to sell the bonds at a price (interest rate) equal to the principal amount thereof. If for any reason the interest rate is not determined by the remarketing agent, or a court holds the interest rate invalid or unenforceable, the interest rate will be the rate per annum equal to 85% of the interest rate per annum for 30 day commercial paper having a rating of A-2/P-2 as reported in The Wall Street Journal on the determination date. The interest rate fluctuates on a weekly basis. The effective interest rate at June 30, 2003 was 1.2%. At June 30, 2003, the Company has $3,097,802 outstanding on the Authority loan, of which $718,333 is classified as currently due. The remainder is classified as a long-term liability. In April 1999, an irrevocable letter of credit of $3,770,000 was issued by a bank, First Union National Bank (First Union), to secure payment of the Authority Loan and a portion of the related accrued interest. At June 30, 2003, no portion of the letter of credit has been utilized.

In April 1999, the Company authorized and directed the issuance of $2,300,000 in taxable variable rate demand and fixed rate revenue bonds pursuant to a trust indenture between the Company and First Union, as trustee (the "Trust Indenture"). From the proceeds of the bonds, $750,000 was utilized to pay deferred interest owed to Mr. Farber, the Chairman of the Board of Directors and Chief Executive Officer of the Company, and approximately $1,440,000 was paid to a bank to refinance a mortgage term loan and equipment term loans. The remainder of the proceeds was used to pay bond issuance costs of approximately $109,000. The Trust Indenture required that the Company repay the bonds through installment payments beginning in June 1999 and continuing through May 2003, the year the bonds matured. The bonds bear interest at the floating variable rate determined by the organization responsible for selling the bonds (the "remarketing agent"). The interest rate fluctuates on a weekly basis. At June 30, 2003, the Company has no balance outstanding on the bonds.

The Company has a $3,000,000 line of credit from First Union which bears interest at the prime interest rate less 0.25%. The line of credit was renewed and extended to November 30, 2003, at which time the Company expects to renew and extend the due date. At June 30, 2003, the Company had $0 outstanding and $3,000,000 available under the line of credit. The Company does not currently expect to borrow cash under this line of credit in the future due to the available cash on hand, and the cash expected to be provided by its results of operations in the future. The line of credit is collateralized by substantially all Company assets. Further, the line of credit and a related letter of credit contain certain financial covenants (see Notes to Financial Statements, Number 6), including the attainment of standard financial liquidity and net worth ratios. As of June 30, 2003, the Company successfully met these covenants. Additionally, it is the Company's opinion that such covenants are not material in nature.

The Company believes that cash generated from its operations and the balances available under the Company's existing loans and line of credit as of June 30, 2003, are sufficient to finance its level of operations, and currently anticipated capital expenditures. However, to benefit from the low interest rates in the current financial markets, the Company is planning to finance some or all of the capital expenditures in Fiscal 2004.

Except as set forth in this report, the Company is not aware of any trends, events or uncertainties that have or are reasonably likely to have a material adverse impact on the Company's short-term or long-term liquidity or financial condition.

PROSPECTS FOR THE FUTURE

The Company has several generic products under development. These products are all orally-administered, solid-dosage (i.e. tablet/capsule) products designed to be generic equivalents to brand named innovator drugs. The Company's developmental drug products are intended to treat a diverse range of indications. One of these developmental products, an orally-administered obesity product, represents a generic ANDA currently owned by the Company, but not currently manufactured and distributed for commercial consumption. As one of the oldest generic drug manufacturers in the country, formed in 1942, Lannett currently owns several ANDAs for products which it does not manufacture and market. These ANDAs are simply dormant on the Company's records. Occasionally, the Company reviews such ANDAs to determine if the market potential for any of these older drugs has recently changed, so as to make it attractive for Lannett to reconsider manufacturing and selling it. If the Company makes the determination to introduce one of these

products into the consumer marketplace, it must review the ANDA and related documentation to ensure that the approved product specifications, formulation and other features are feasible in the Company's current environment. Generally, in these situations, the Company must file a supplement to the FDA for the applicable ANDA, informing the FDA of any significant changes in the manufacturing process, the formulation, the raw material supplier or another major feature of the previously-approved ANDA. The Company would then redevelop the product and submit it to the FDA for supplemental approval. The FDA's approval process for ANDA supplements is similar to that of a new ANDA.

Another developmental product, also an orally-administered obesity product, is a new ANDA submitted to the FDA in July 2003 for approval. The FDA has recently disclosed that the average amount of time to review and approve a new ANDA is approximately eighteen months. Since the Company has no control over the FDA review process, management is unable to anticipate whether or when it will be able to begin commercially producing and shipping this product.

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

In addition to the efforts of its internal product development group, Lannett has contracted with two outside firms (Pharmatek Laboratories Inc. in California and The PharmaNetwork LLC in New Jersey) for the formulation and development of several new generic drug products. These outsourced R&D products are at various stages in the development cycle--formulation, analytical method development and testing and manufacturing scale-up. These products are orally-administered solid dosage products intended to treat a diverse range of medical indications. It is the Company's intention to ultimately transfer the formulation technology and manufacturing process for all of these R&D products to the Company's own commercial manufacturing sites. The Company initiated these outsourced R&D efforts to compliment the progress of its own internal R&D efforts.

The Company is also developing a drug product that does not require FDA approval. The FDA allows generic manufacturers to manufacture and sell products which are equivalent to innovator drugs which are grand-fathered, under FDA rules, prior to the passage of the Hatch-Waxman Act of 1984. The FDA allows generic manufacturers to produce and sell generic versions of such grand-fathered products by simply performing and internally documenting the product's stability over a period of time. Under this scenario, a generic company can forego the time and costs related to a FDA-mandated ANDA approval process. The Company currently has one product under development in this category. The developmental drug is an orally-administered, prescription solid dosage product.

The Company has also contracted with Spectrum Pharmaceuticals Inc., based in California, to market generic products developed and manufactured by Spectrum and/or its partners. The first applicable product under this agreement is ciprofloxacin tablets, the generic version of Cipro(R), an anti-bacterial drug,

marketed by Bayer Corporation, prescribed to treat infections. The Company has also initiated discussions with other firms for similar new product initiatives, in which Lannett will market and distribute products manufactured by third parties. Lannett intends to use its strong customer relationships to build its market share for such products, and increase future revenues and income.

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

ITEM 7. FINANCIAL STATEMENTS

The Consolidated Financial Statements for the years ended June 30, 2003 and 2002 and Independent Auditor Report filed as a part of this Form 10-KSB are listed in the Exhibit Index filed herewith.

ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

ITEM 8A. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in its Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Management necessarily applies its judgment in assessing the costs and benefits of such controls and procedures, which, by their nature, can provide only reasonable assurance regarding management's control objectives.

With the participation of management, the Company's Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures at the conclusion of the year ended June 30, 2003. Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective in ensuring that material information required to be disclosed is included in the reports that it files with the Securities and Exchange Commission.

CHANGES IN INTERNAL CONTROLS

There were no significant changes in the Company's internal controls or, to the knowledge of management of the Company, in other factors that could significantly affect internal controls subsequent to the date of the Company's most recent evaluation of its disclosure controls and procedures utilized to compile information included in this filing.

PART III

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT

DIRECTORS AND EXECUTIVE OFFICERS

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

	Age	Position
Directors:		
William Farber	71	Chairman of the Board and Chief Executive Officer
Marvin Novick	72	Director
Ronald A. West	69	Director
Myron Winkelman	65	Director
Executive Officers:		
Arthur P. Bedrosian	57	President
Larry Dalesandro	31	Chief Financial Officer

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

MARVIN NOVICK was elected a Director of the Company in February 2000. Mr. Novick has been an advisor, consultant and financial planner for multiple companies in the past thirty-five years. He is currently President of R&M Resources, Inc., an investment and consulting services company. He has served in this position of this private company since 1988. From 1984 to 1987, he served as Vice Chairman of Dura Corporation, a major automotive supplier. From 1969 to 1971, he served as Chief Financial Officer of Meadowbrook Insurance Company. In addition to these positions, he served as Partner of international accounting firms, J.K. Lasser & Co., and Touche Ross & Co, and Senior Vice President of Michigan Blue Shield, a major healthcare organization. Mr. Novick holds Bachelor's and Master's Degrees, and is a member of the American Institute of Certified Public Accountants.

RONALD A. WEST was elected a Director of the Company in January 2002. Mr. West is currently a Director of Beecher Associates, an industrial real estate investment company, R&M Resources, an investment and consulting services company and North East Staffing, Inc., an employee services company. Prior to this, from 1983 to 1987, Mr. West served as Chairman and Chief Executive Officer of Dura Corporation, an original equipment manufacturer of automotive products and other engineered equipment components. In 1987, Mr. West sold his ownership position in Dura Corporation, at which time he retired from active management positions. Mr. West was employed at Dura Corporation since 1969. Prior to this, he served

in various financial management positions with TRW, Inc., Marlin Rockwell Corporation and National Machine Products Group, a division of Standard Pressed Steel Company. Mr. West studied Business Administration at Michigan State University and the University of Detroit.

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

ARTHUR P. BEDROSIAN, J.D. was elected President of the Company in May 2002. Prior to this, he served as the Company's Vice President of Business Development from January 2002 to April 2002, and as a Director from February 2000 to January 2002. Mr. Bedrosian has operated generic drug manufacturing, sales, and marketing businesses in the healthcare industry for many years. Prior to joining the Company, from 1999 to 2001, Mr. Bedrosian served as President and Chief Executive Officer of Trinity Laboratories, Inc., a medical device and drug manufacturer. Mr. Bedrosian also operated Pharmaceutical Ventures Ltd, a healthcare consultancy and Interal Corporation, a computer consultancy to Fortune 100 companies. Mr. Bedrosian holds a Bachelor of Arts Degree in Political Science from Queens College of the City University of New York and a Juris Doctorate from Newport University in California.

LARRY DALESANDRO was elected Chief Financial Officer of the Company in June 2003. Prior to this, he served as the Company's Chief Operating Officer from November 1999 to June 2003. Mr. Dalesandro joined the Company in January 1999 to manage the Company's financial operations. Previously, he was the Controller and Director of Financial Reporting of Criterion Communications, Inc., a technology and new media services firm, Controller of Crown Contractors, Inc., a contract construction company, and Senior Auditor of Grant Thornton LLP, an international professional services firm. Mr. Dalesandro graduated Magna Cum Laude with a Bachelor's of Science Degree in Accountancy from Villanova University, and is a Certified Public Accountant.

SIGNIFICANT EMPLOYEES

In addition to the directors and executive officers, the following table identifies certain key employees of the Company.

Name	Age	Position
Kevin Smith	43	Vice President of Sales and Marketing
Bernard Sandiford	74	Vice President of Operations

KEVIN SMITH joined the Company in January 2002 as Vice President of Sales and Marketing. Prior to this, from 2000 to 2001, he served as Director of National Accounts for Bi-Coastal Pharmaceutical, Inc., a pharmaceutical sales representation company. Prior to this, from 1999 to 2000, he served as National Accounts Manager for Mova Laboratories Inc., a pharmaceutical manufacturer. Prior to this, from 1991 to 1999, Mr. Smith served as National Sales Manager at Sidmak Laboratories, a pharmaceutical manufacturer. Kevin has extensive experience in the generic sales market, and brings to the Company a vast network of customers, including retail chain pharmacies, wholesale distributors, mail-order wholesalers and generic distributors. Mr. Smith has a Bachelors' Degree in Business Administration from Gettysburg College.

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

To the best of the Company's knowledge, there have been no events under any bankruptcy act, no criminal proceedings and no judgments or injunctions that are material to the evaluation of the ability or integrity of any director, executive officer, or significant employee during the past five years.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's directors, officers, and persons who own more than 10% of a registered class of the Company's equity securities to file with the SEC reports of ownership and changes in ownership of common stock and other equity securities of the Company. Officers, directors and greater-than-10% stockholders are required by SEC regulations to furnish the Company with copies of all Section 16(a) forms they file.

Based solely on review of the copies of such reports furnished to the Company or written representations that no other reports were required, the Company believes that during Fiscal 2003, all filing requirements applicable to its officers, directors and greater-than-10% beneficial owners were complied with, except for the following:

On August 15, 2003, Ronald West reported a purchase of shares in May 2002, a purchase of shares in July 2002, a sale of shares in November 2002, and a purchase of shares in January 2003.

On August 15, 2003, Marvin Novick reported a sale of shares in November 2002, a bona-fide gift of shares in December 2002, a sale of shares in January 2003, and a sale of shares in May 2003. The shares transacted on the above dates were owned by Margaret Novick, spouse of Marvin Novick.

ITEM 10. EXECUTIVE COMPENSATION

SUMMARY COMPENSATION TABLE

The following table summarizes all compensation paid to or earned by the named executive officers of the Company for Fiscal 2003, Fiscal 2002 and Fiscal 2001.

		Annual Compensation			Long Term Compens	
					Awards	
(a) Name and Principal Position	(b) Fiscal Year	(c) Salary	(d) Bonus	(e) Other Annual Compensation	(f) Restricted Stock Award(s)	(g) Securities Under-lying Options/ SARs
William Farber	2003	0	0	0	0	37,5
	2002	0	0	0	0	
Chairman of the Board of Directors and Chief Executive Officer	2001	0	0	0	0	
Arthur P. Bedrosian(2)	2003	179,175(1)	77,500	0	0	114,6
	2002	64,385	0	0	0	
President	2001	0	0	0	0	
Larry Dalesandro(3)	2003	134,984(1)	59,675	0	0	74,5
	2002	116,698(1)	25,000	0	0	
Chief Financial Officer	2001	102,049(1)	5,000	0	0	15,0
Eugene Livshits(4)	2003	67,706(1)	38,874	0	0	7,5
	2002	126,715(1)	25,000	0	0	
Vice President of Technical Affairs	2001	109,669(1)	5,000	0	0	18,0
Kevin Smith(6)	2003	167,187(1)	46,500	0	0	38,7
Vice President	2002	66,769	0	0	0	15,0
of Sales & Marketing	2001	0	0	0	0	

(1) Includes matching contribution payments made to the Company's 401(k) Plan (3% of eligible compensation) for the benefit of the employee noted.

(2) Mr. Bedrosian joined the Company on January 24, 2002 as Vice President of Business Development. On May 5, 2002, he was elected President of the Company.

(3) Mr. Dalesandro joined the Company on January 11, 1999 as Controller.

He was elected Chief Operating Officer on November 1, 1999. On June 18, 2003, he was elected Chief Financial Officer, and voluntarily resigned the position of Chief Operating Officer.

(4) Mr. Livshits joined the Company on February 20, 1997 as Director of Analytical Services. He was elected Vice President of Technical Affairs on November 1, 1999. On January 6, 2003, his employment with the Company was terminated. The Company agreed to pay him severance pay at his current rate through December 31, 2003. See footnote (5).

(5) This amount represents $76,230 in severance compensation paid from January 1, 2003 through June 30, 2003, plus $64,790 in severance compensation accrued at June 30, 2003.

(6) Mr. Smith joined the Company on January 21, 2002 as Vice President of Sales and Marketing.

(7) These amounts represent payments to Mr. Farber for participation and attendance at Board of Director Meetings.

OPTION/SAR GRANTS IN FISCAL 2003

(a) NAME	(b) NUMBER OF SECURITIES UNDERLYING OPTIONS/SARS GRANTED (#)	(c) % OF TOTAL OPTIONS/SARS GRANTED TO EMPLOYEES IN FISCAL YEAR	(d) EXERCISE OR BASE PRICE ($/SHARE)	(e EXPIRAT
William Farber Chairman of the Board of Directors and Chief Executive Officer	37,500	10%	$ 7.97	10/2
Arthur Bedrosian President	18,000	3%	$ 4.63	7/2
Arthur Bedrosian President	96,900	25%	$ 7.97	10/2
Larry Dalesandro Chief Financial Officer	74,595	19%	$ 7.97	10/2
Eugene Livshits Vice President of Technical Affairs	7,500	2%	$ 7.97	10/2
Kevin Smith Vice President of Sales and Marketing	38,760	10%	$ 7.97	10/2

AGGREGATED OPTIONS/SAR EXERCISES AND FISCAL YEAR-END OPTIONS/SAR VALUES

(a) NAME	(b) SHARES ACQUIRED ON EXERCISE	(c) VALUE REALIZED	(d) NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS AT FY-END EXERCISABLE/ UNEXERCISABLE	VA UNE IN-T OPT F EXER UNEXE
William Farber Chairman of the Board of Directors and Chief Executive Officer	0	$ 0	37,500/ 0	$ $
Arthur Bedrosian President	0	$ 0	0/ 114,900	$ $ 1,
Larry Dalesandro Chief Financial Officer	5,001	$ 48,860	0/ 74,595	$ $ 1,
Eugene Livshits Vice President - of Technical Affairs	13,500	$108,520	0/ 0	
Kevin Smith Vice President of Sales and Marketing	5,000	$ 46,495	0/ 48,761	$ $

COMPENSATION OF DIRECTORS

Directors received compensation of $1,000 per Board meeting attended during Fiscal 2003. There were three Board meetings held in Fiscal 2003. Audit Committee members received compensation of $1,000 per Audit Committee meeting attended during Fiscal 2003. There were four Audit Committee meetings held in Fiscal 2003. Directors are reimbursed for expenses incurred in attending Board meetings. Directors also receive a monthly allowance of $1,350 to cover the cost of medical benefits insurance, and automobile expenses. Directors also received stock options during Fiscal 2003 as compensation for their services. The following table identifies the stock options granted to directors in Fiscal 2003.

(a) NAME	(b) NUMBER OF SECURITIES UNDERLYING OPTIONS/SARs GRANTED (#)	(c) % OF TOTAL OPTIONS/SARS GRANTED TO RECIPIENTS IN FISCAL YEAR	(d) EXERCISE OR BASE PRICE ($/SHARE)	EXP
William Farber Chairman of the Board of Directors and Chief Executive Officer	37,500	10%	$7.97	
Marvin Novick	22,500	6%	$7.97	

Director			
Ronald West Director	22,500	6%	$7.97
Myron Winkelman Director	-	-	-

EMPLOYMENT AGREEMENTS

The Company has entered