KEMET CORP
Form 10-Q
November 03, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2011

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

Commission File Number: 001-15491

KEMET CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE	**57-0923789**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2835 KEMET WAY, SIMPSONVILLE, SOUTH CAROLINA 29681

(Address of principal executive offices, zip code)

(864) 963-6300

(Registrant s telephone number, including area code)

Former name, former address and former fiscal year, if changed since last report: **N/A**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO o

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

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

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

The number of shares outstanding of the registrant s common stock, par value $0.01 per share, as of October 31, 2011 was 44,630,742.

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KEMET CORPORATION AND SUBSIDIARIES

Form 10-Q for the Quarter Ended September 30, 2011

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PART I - FINANCIAL INFORMATION

Item 1 - Financial Statements

KEMET CORPORATION AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(Amounts in thousands, except per share data)

	September 30, 2011 (Unaudited)	March 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 127,163	$ 152,051
Accounts receivable, net	114,499	150,370
Inventories, net	224,573	206,440
Restricted cash	36,497	
Prepaid expenses and other	31,477	28,097
Deferred income taxes	5,351	5,301
Total current assets	539,560	542,259
Property and equipment, net of accumulated depreciation of $762,380 and $740,773 as of September 30, 2011 and March 31, 2011, respectively	310,032	310,412
Goodwill and intangible assets, net	21,329	20,092
Other assets	10,765	11,546
Total assets	$ 881,686	$ 884,309
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 37,695	$ 42,101
Accounts payable, trade	74,424	90,997
Accrued expenses	77,036	88,291
Income taxes payable	3,044	4,265
Total current liabilities	192,199	225,654
Long-term debt, less current portion	229,611	231,215
Other non-current obligations	51,780	59,727
Deferred income taxes	8,559	7,960
Stockholders equity:		
Preferred stock, par value $0.01, authorized 10,000 shares, none issued		
Common stock, par value $0.01, authorized 175,000 and 300,000 shares, issued 46,508 and 39,508 shares, at September 30, 2011 and March 31, 2011, respectively	465	395
Additional paid-in capital	469,969	479,322
Retained deficit	(41,578)	(87,745)
Accumulated other comprehensive income	14,122	22,555
Treasury stock, at cost (1,880 and 2,370 shares at September 30, 2011 and March 31, 2011, respectively)	(43,441)	(54,774)
Total stockholders equity	399,537	359,753
Total liabilities and stockholders equity	$ 881,686	$ 884,309

See accompanying notes to the unaudited condensed consolidated financial statements.

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KEMET CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Operations

(Amounts in thousands, except per share data)

(Unaudited)

	Quarters Ended September 30,		Six Months Ended September 30,	
	2011	2010	2011	2010
Net sales	$ 265,514	$ 248,588	$ 555,370	$ 492,382
Operating costs and expenses:				
Cost of sales	203,319	178,870	413,823	361,756
Selling, general and administrative expenses	28,355	24,999	58,631	49,214
Research and development	7,362	6,224	14,448	12,255
Restructuring charges	1,605	2,303	2,630	4,095
Net (gain) loss on sales and disposals of assets	(40)	(1,770)	83	(1,435)
Total operating costs and expenses	240,601	210,626	489,615	425,885
Operating income	24,913	37,962	65,755	66,497
Other (income) expense:				
Interest income	(31)	(84)	(74)	(105)
Interest expense	7,282	7,334	14,682	14,792
Other (income) expense, net	1,297	(4,792)	1,202	(3,118)
Loss on early extinguishment of debt				38,248
Income before income taxes	16,365	35,504	49,945	16,680
Income tax expense	2,047	593	3,778	1,868
Net income	$ 14,318	$ 34,911	$ 46,167	$ 14,812
Net income per share:				
Basic	$ 0.32	$ 1.29	$ 1.10	$ 0.55
Diluted	$ 0.27	$ 0.68	$ 0.88	$ 0.29
Weighted-average shares outstanding:				
Basic	44,370	27,092	41,924	27,092
Diluted	52,230	51,194	52,307	50,529

See accompanying notes to the unaudited condensed consolidated financial statements.

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KEMET CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(Amounts in thousands)

(Unaudited)

	Six Months Ended September 30,	
	2011	**2010**
Sources (uses) of cash and cash equivalents Operating activities:		
Net income	$ 46,167	$ 14,812
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	23,011	28,642
Amortization of debt discount and debt issuance costs	2,056	2,754
Net (gain) loss on sales and disposals of assets	83	(1,435)
Stock-based compensation expense	2,175	482
Change in deferred income taxes	379	(418)
Change in operating assets	18,438	(39,109)
Change in operating liabilities	(42,517)	14,376
Other	1,197	(1,907)
Loss on early extinguishment of debt		38,248
Net cash provided by operating activities	50,989	56,445
Investing activities:		
Capital expenditures	(20,105)	(13,821)
Acquisition, net of cash received	(11,584)	
Proceeds from sales of assets		5,425
Net cash used in investing activities	(31,689)	(8,396)
Financing activities:		
Change in restricted cash	(36,497)	
Proceeds from issuance of debt		227,434
Payments of long-term debt	(4,084)	(228,543)
Net payments under other credit facilities	(3,153)	(1,779)
Proceeds from exercise of stock options	159	
Debt issuance costs	(29)	(7,461)
Debt extinguishment costs		(207)
Net cash used in financing activities	(43,604)	(10,556)
Net increase (decrease) in cash and cash equivalents	(24,304)	37,493
Effect of foreign currency fluctuations on cash	(584)	762
Cash and cash equivalents at beginning of fiscal period	152,051	79,199
Cash and cash equivalents at end of fiscal period	$ 127,163	$ 117,454

See accompanying notes to the unaudited condensed consolidated financial statements.

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Notes to Condensed Consolidated Financial Statements

Note 1. Basis of Financial Statement Presentation

The condensed consolidated financial statements contained herein are unaudited and have been prepared from the books and records of KEMET Corporation and its subsidiaries (KEMET or the Company). In the opinion of management, the condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results for the interim periods. The condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q, and therefore, do not include all information and footnotes necessary for a complete presentation of financial position, results of operations, and cash flows in conformity with U.S. generally accepted accounting principles (U.S. GAAP). Although the Company believes that the disclosures are adequate to make the information presented not misleading, it is suggested that these condensed consolidated financial statements be read in conjunction with the audited financial statements and notes thereto included in the Company s fiscal year ended March 31, 2011, Form 10-K (the Company s 2011 Annual Report).

Net sales and operating results for the three and six months ended September 30, 2011 are not necessarily indicative of the results to be expected for the full year. The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. In consolidation, all significant intercompany amounts and transactions have been eliminated. Certain prior year amounts have been reclassified to conform to current year presentation.

The significant accounting policies followed by the Company are presented in the Company s 2011 Annual Report.

Recently Issued Accounting Pronouncements

New accounting standards adopted

There were no accounting standards adopted in the six month period ended September 30, 2011.

New accounting standards issued but not yet adopted

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-05, Presentation of Comprehensive Income. ASU 2011-05 revises the manner in which entities present comprehensive income in their financial statements. The new guidance removes the presentation options in Accounting Standards Codification (ASC) 220, Comprehensive Income, and requires entities to report components of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. The ASU does not change the items that must be reported in other comprehensive income. ASU 2011-05 will be

effective for fiscal years and interim reporting periods within those years beginning after December 15, 2011.

In September 2011, the FASB issued ASU 2011-08, Guidance on Testing Goodwill for Impairment. ASU 2011-08 gives entities testing goodwill for impairment the option of performing a qualitative assessment before calculating the fair value of a reporting unit in Step 1 of the goodwill impairment test. If entities determine, on the basis of qualitative factors, that the fair value of a reporting unit is more likely than not less than the carrying amount, the two-step impairment test would be required. Otherwise, further testing would not be needed. ASU 2011-08 will be effective for fiscal and interim reporting periods within those years beginning after December 15, 2011.

The adoption of these accounting standards will not have a material effect on the Company s consolidated financial statements. There are currently no other accounting standards that have been issued that will have a significant impact on the Company s financial position, results of operations or cash flows upon adoption.

Restricted Cash

On August 15, 2011, the Company elected to have a restriction placed on a portion of the Company s cash balance as set forth in the Loan and Security Agreement (hereinafter defined). The restriction arose due to the Company s next potential principal payment on November 15, 2011 when the holders of the Convertible Notes (hereinafter defined) have the right to require the Company to repurchase for cash all or a portion of the Convertible Notes outstanding of $36.5 million. The $36.5 million is included in the line item Restricted cash on the Condensed Consolidated Balance Sheet as of September 30, 2011.

A guarantee was issued by a European bank on behalf of the Company in August 2006 in conjunction with the establishment of a Valued-Added Tax (VAT) registration in The Netherlands. The bank guarantee is in the amount of EUR 1.5 million ($2.0 million). An interest-bearing deposit was placed with a European bank for EUR 1.7 million ($2.2 million). The deposit is in KEMET s name, and KEMET receives all interest earned by this deposit. However, the deposit is pledged to the European bank, and the bank

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can use the money if a valid claim against the bank guarantee is made. The bank guarantee will remain valid until it is discharged by the beneficiary. Restricted cash of $2.2 million and $2.3 million is included in the line item Other assets on the Condensed Consolidated Balance Sheets as of September 30, 2011 and March 31, 2011, respectively.

Warrant Liability

Concurrent with the consummation of the tender offer as discussed in Note 2, Debt , the Company issued K Financing, LLC (K Financing) a warrant (the Platinum Warrant) to purchase up to 26.8 million shares of the Company s common stock, subject to certain adjustments, representing, at the time of issuance, approximately 49.9% of the Company s outstanding common stock on a post-Platinum Warrant basis. The Platinum Warrant was subsequently transferred to K Equity, LLC (K Equity). The Platinum Warrant was exercisable at a purchase price of $1.05 per share.

On December 20, 2010, in connection with a secondary offering in which K Equity was the selling security holder, K Equity exercised a portion of the Platinum Warrant representing the right to purchase 10.9 million shares of the Company s common stock to the underwriters of the secondary offering, who exercised their full portion of the warrant at a price of $12.80 per share in a cashless exercise and received a net settlement of 10.0 million shares of the Company s common stock. These shares were sold as part of the secondary offering and KEMET did not receive any of the proceeds from the transaction. K Equity retained the remaining portion of the warrant.

On May 31, 2011, K Equity sold a portion of the Platinum Warrant to Deutsche Bank Securities Inc., in connection with the offering of 7.0 million shares of the Company s common stock, at a public offering price of $14.60 per share. This transaction resulted in a 7.5 million share reduction to the outstanding warrants due to K Equity s cashless exercise. K Equity retains the remaining portion of the warrant, representing the right to purchase 8.4 million shares of the Company s common stock.

Fair Value Measurement

The Company utilizes three levels of inputs to measure the fair value of (a) nonfinancial assets and liabilities that are recognized or disclosed at fair value in the Company s consolidated financial statements on a recurring basis (at least annually) and (b) all financial assets and liabilities. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs.

The first two inputs are considered observable and the last is considered unobservable. The levels of inputs are as follows:

- Level 1 Quoted prices in active markets for identical assets or liabilities.

- Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

- Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Assets measured at fair value on a recurring basis as of September 30, 2011 and March 31, 2011 are as follows (amounts in thousands):

	Fair Value September 30, 2011	Fair Value Measurement Using Level 1	Level 2 (2)	Level 3	Fair Value March 31, 2011	Fair Value Measurement Using Level 1	Level 2 (2)	Level 3
Assets:								
Money markets (1)	$ 31,192	$ 31,192	$	$	$ 51,157	$ 51,157	$	$
Debt	283,635	280,274	3,361		307,543	301,379	6,164	

(1) Included in the line item Cash and cash equivalents on the Condensed Consolidated Balance Sheets.

(2) The valuation approach used to calculate fair value was a discounted cash flow for each respective debt facility.

Revenue Recognition

The Company recognizes revenue only when all of the following criteria are met: (1) persuasive evidence of an arrangement exists, (2) delivery has occurred or services have been rendered, (3) the seller s price to the buyer is fixed or determinable, and (4) collectability is reasonably assured.

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A portion of sales is related to products designed to meet customer specific requirements. These products typically have stricter tolerances making them useful to the specific customer requesting the product and to customers with similar or less stringent requirements. Products with customer specific requirements are tested and approved by the customer before the Company mass produces and ships the product. The Company recognizes revenue when title to the products transfers to the respective customer.

A portion of sales is made to distributors under agreements allowing certain rights of return and price protection on unsold merchandise held by distributors. The Company s distributor policy includes inventory price protection and ship-from-stock and debit (SFSD) programs common in the industry.

The SFSD program provides a mechanism for the distributor to meet a competitive price after obtaining authorization from the Company s local sales office. This program allows the distributor to ship its higher-priced inventory and debit the Company for the difference between KEMET s list price and the lower authorized price for that specific transaction. Management analyzes historical SFSD activity to determine the SFSD exposure on the global distributor inventory at the balance sheet date. The establishment of these reserves is recognized as a component of the line item Net sales on the Condensed Consolidated Statements of Operations, while the associated reserves are included in the line item Accounts receivable, net on the Condensed Consolidated Balance Sheets.

The Company provides a limited warranty to customers that the Company s products meet certain specifications. The warranty period is generally limited to one year, and the Company s liability under the warranty is generally limited to a replacement of the product or refund of the purchase price of the product. Warranty costs as a percentage of net sales were approximately 1% for the quarters and six month periods ended September 30, 2011 and 2010. The Company recognizes warranty costs when they are both probable and reasonably estimable.

Use of Estimates and Assumptions

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates, assumptions, and judgments. Estimates and assumptions are based on historical data and other assumptions that management believes are reasonable. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements. In addition, they affect the reported amounts of revenues and expenses during the reporting period.

The Company s judgments are based on management s assessment as to the effect certain estimates, assumptions, or future trends or events may have on the financial condition and results of operations reported in the unaudited condensed consolidated financial statements. It is important that readers of these unaudited financial statements understand that actual results could differ from these estimates, assumptions, and judgments.

Inventories

Inventories are stated at the lower of cost or market. The components of inventories are as follows (amounts in thousands):

	September 30, 2011	March 31, 2011
Raw materials and supplies	$ 96,059	$ 78,913
Work in process	69,532	78,681
Finished goods	76,240	64,310
	241,831	221,904
Inventory reserves	(17,258)	(15,464)
Total inventory	$ 224,573	$ 206,440

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Note 2. Debt

A summary of debt is as follows (amounts in thousands):

	September 30, 2011	March 31, 2011
10.5% Senior Notes, net of discount of $2,655 and $2,792 as of September 30, 2011 and March 31, 2011, respectively	$ 227,345	$ 227,208
Convertible Notes, net of discount of $344 and $1,569 as of September 30, 2011 and March 31, 2011, respectively	36,153	39,012
Other	3,808	7,096
Total debt	267,306	273,316
Current maturities	(37,695)	(42,101)
Total long-term debt	$ 229,611	$ 231,215

The line item Interest expense on the Condensed Consolidated Statements of Operations for the quarters and six months ended September 30, 2011 and 2010, is as follows (amounts in thousands):

	Quarters Ended September 30,		Six Months Ended September 30,	
	2011	2010	2011	2010
Contractual interest expense	$ 6,270	$ 6,504	$ 12,626	$ 12,038
Amortization of debt issuance costs	280	177	555	606
Amortization of debt discount	732	653	1,501	2,148
Total interest expense	$ 7,282	$ 7,334	$ 14,682	$ 14,792

10.5% Senior Notes

On May 5, 2010, the Company completed a private placement of $230.0 million in aggregate principal amount of the Company s 10.5% Senior Notes due 2018 (the 10.5% Senior Notes). The private placement of the 10.5% Senior Notes resulted in proceeds to the Company of $222.2 million. The Company used a portion of the proceeds of the private placement to repay all of the outstanding indebtedness under a credit facility with K Financing, a EUR 60 million credit facility and a EUR 35 million credit facility with UniCredit Corporate Banking S.pA. (UniCredit) and a term loan with a subsidiary of Vishay Intertechnology, Inc. The Company used a portion of the remaining proceeds to fund a previously announced tender offer to purchase $40.5 million in aggregate principal amount of the 2.25% Convertible Senior Notes and to pay costs incurred in connection with the private placement, the tender offer and the foregoing repayments. Debt issuance costs related to the 10.5% Senior Notes, net of amortization, were $5.8 million as of September 30, 2011; these costs are being amortized over the term of the 10.5% Senior Notes.

On October 26, 2010, the Company filed a Form S-4 to offer, in exchange for the outstanding 10.5% Senior Notes due 2018 (Old Notes), up to $230.0 million in aggregate principal amount of 10.5% Senior Notes due 2018 and the guarantees thereof which had been registered under the Securities Act of 1933, as amended. The Form S-4 was declared effective on December 14, 2010 and on January 13, 2011 the Company

completed the exchange for all of the Old Notes.

The Company had interest payable related to the 10.5% Senior Notes included in the line item Accrued expenses on its Condensed Consolidated Balance Sheets of $10.1 million at September 30, 2011 and March 31, 2011.

Revolving Line of Credit

On September 30, 2010, KEMET Electronics Corporation (KEC) and KEMET Electronics Marketing (S) Pte Ltd. (KEMET Singapore) (each a Borrower and, collectively, the Borrowers) entered into a Loan and Security Agreement (the Loan and Security Agreement), with Bank of America, N.A, as the administrative agent and the initial lender. The Loan and Security Agreement provides a $50 million revolving line of credit, which is bifurcated into a U.S. facility (for which KEC is the Borrower) and a Singapore facility (for which KEMET Singapore is the Borrower). The size of the U.S. facility and Singapore facility can fluctuate as long as the Singapore facility does not exceed $30 million and the total facility does not exceed $50 million. A portion of the U.S. facility and of the Singapore facility can be used to issue letters of credit. The facilities expire on September 30, 2014.

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Debt issuance costs related to the Loan and Security Agreement, net of amortization, were $1.1 million and $1.3 million as of September 30, 2011 and March 31, 2011, respectively. These costs are being amortized over the term of the Loan and Security Agreement. There were no borrowings against the Loan and Security Agreement as of September 30, 2011 or March 31, 2011.

Convertible Notes

In November 2006, the Company sold and issued its 2.25% Convertible Senior Notes due 2026 (the Convertible Notes) which are unsecured obligations and rank equally with the Company s existing and future unsubordinated and unsecured obligations and are junior to any of the Company s future secured obligations to the extent of the value of the collateral securing such obligations. In connection with the issuance and sale of the Convertible Notes, the Company entered into an indenture (the Convertible Notes Indenture) dated as of November 1, 2006, with Wilmington Trust Company, as trustee.

The Convertible Notes bear interest at a rate of 2.25% per annum, payable in cash semi-annually in arrears on each May 15 and November 15. The Convertible Notes are convertible into (i) cash in an amount equal to the lesser of the principal amount of the Convertible Notes and the conversion value of the Convertible Notes on the conversion date and (ii) cash or shares of the Company s common stock (Common Stock) or a combination of cash and shares of the Common Stock, at the Company s option, to the extent the conversion value at that time exceeds the principal amount of the Convertible Notes, at any time prior to the close of business on the business day immediately preceding the maturity date of the Convertible Notes, unless the Company has redeemed or purchased the Convertible Notes, subject to certain conditions. The conversion rate was 34.364 shares of common stock per $1,000 principal amount of the Convertible Notes, which represents a conversion price of approximately $29.10 per share, subject to adjustments. The Convertible Notes are currently not convertible.

The terms of the Convertible Notes are governed by the Convertible Notes Indenture. The Convertible Notes mature on November 15, 2026 unless earlier redeemed, repurchased or converted. The Company may redeem the Convertible Notes for cash, either in whole or in part, any time after November 20, 2011 at a redemption price equal to 100% of the principal amount of the Convertible Notes to be redeemed plus accrued and unpaid interest, including additional interest, if any, up to but not including the date of redemption. In addition, holders of the Convertible Notes will have the right to require the Company to repurchase for cash all or a portion of their Convertible Notes on November 15, 2011, 2016 and 2021, at a repurchase price equal to 100% of the principal amount of the Convertible Notes to be repurchased plus accrued and unpaid interest, if any, in each case, up to but not including, the date of repurchase. Currently there is $36.5 million of Convertible Notes outstanding.

On May 17, 2010, $40.5 million in aggregate principal amount of the Convertible Notes was extinguished. The extinguishment resulted in $1.6 million loss on early extinguishment of debt. The calculation of the loss is as follows (amounts in thousands):

Reacquisition price:		
Cash paid	$	37,867
Tender offer fees		207
		38,074
Extinguished debt:		
Carrying amount of debt		36,770
Unamortized debt cost		(248)
		36,522

Net loss	$ (1,552)

Platinum Credit Facility

On May 5, 2009, the Company executed a credit facility with K Financing, an affiliate of Platinum Equity Capital Partners II, L.P. (the Platinum Credit Facility). The Platinum Credit Facility consisted of a term loan of $37.8 million (Platinum Term Loan), a line of credit loan (Platinum Line of Credit Loan) that could be borrowed from time to time (but not reborrowed after being repaid) of up to $12.5 million and a working capital loan (Platinum Working Capital Loan) of up to $12.5 million. On May 5, 2010, the Company applied a portion of the proceeds of the 10.5% Senior Notes to extinguish the Platinum Term Loan, the Platinum Line of Credit Loan, and the Platinum Working Capital Loan. The extinguishment of the Platinum Credit Facility resulted in a $33.3 million loss on early extinguishment of debt due to the significant debt discount allocated to the Platinum Credit Facility upon issuance. The calculation of the loss is as follows (amounts in thousands):

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Reacquisition price:		
Cash paid	$	57,861
Success fee		5,000
		62,861
Extinguished debt:		
Carrying amount of debt		32,135
Carrying amount of success fee		2,001
Unamortized debt cost		(4,619)
		29,517
Net loss	$	(33,344)

UniCredit Credit Facility

As of March 31, 2010, the Company had two Senior Facility Agreements outstanding with UniCredit. As of March 31, 2010, Facility A had EUR 53.2 million ($71.7 million) outstanding and Facility B had EUR 33.0 million ($44.5 million) outstanding.

On May 5, 2010, the Company applied a portion of the proceeds of the 10.5% Senior Notes to extinguish Facility A and Facility B. The extinguishment resulted in a $3.4 million loss on early extinguishment of debt. The calculation of the loss is as follows (amounts in thousands):

Reacquisition price:		
Cash paid	$	104,683
Extinguished debt:		
Carrying amount of debt		104,674
Unamortized debt cost		(3,343)
		101,331
Net loss	$	(3,352)

Note 3. Restructuring Charges

A summary of the expenses aggregated on the Condensed Consolidated Statements of Operations line item Restructuring charges in the quarters and six months ended September 30, 2011 and 2010, is as follows (amounts in thousands):

	Quarters Ended September 30,		Six Months Ended September 30,	
	2011	2010	2011	2010
Manufacturing relocation costs	$ 637	$ 1,642	$ 1,385	$ 3,080
Personnel reduction costs	968	661	1,245	1,015
Restructuring charges	$ 1,605	$ 2,303	$ 2,630	$ 4,095

Six Months Ended September 30, 2011

In the second quarter of fiscal year 2010, the Company initiated the first phase of a plan to restructure the Film and Electrolytic Business Group (Film and Electrolytic) and to reduce overhead within the Company as a whole. The restructuring plan includes implementing programs to make the Company more competitive, removing excess capacity, moving production to lower cost locations and eliminating unnecessary costs throughout the Company. Restructuring charges in the six months ended September 30, 2011 relate to this plan and are primarily comprised of manufacturing relocation costs of $1.4 million for relocation of equipment to China and Mexico. In addition, the Company incurred $1.2 million in personnel reduction costs primarily due to headcount reductions in the Mexican operations of the Tantalum Business Group (Tantalum).

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Six Months Ended September 30, 2010

Restructuring expenses in the six month period ended September 30, 2010 are primarily comprised of manufacturing relocation costs of $3.1 million for relocation of equipment from various plants to Mexico or China as well as relocation of the European distribution center. In addition, the Company incurred $1.0 million in personnel reduction costs due primarily to headcount reductions within Film and Electrolytic.

Reconciliation of restructuring liability

A reconciliation of the beginning and ending liability balances for restructuring charges included in the line items Accrued expenses and Other non-current obligations on the Condensed Consolidated Balance Sheets are as follows (amounts in thousands):

	Quarter Ended September 30, 2011		Quarter Ended September 30, 2010	
	Personnel Reductions	Manufacturing Relocations	Personnel Reductions	Manufacturing Relocations
Beginning of period	$ 1,751	$	$ 6,696	$
Costs charged to expense	967	638	661	1,642
Costs paid or settled	(1,529)	(638)	(1,280)	(1,642)
Change in foreign exchange	(68)		662	
End of period	$ 1,121	$	$ 6,739	$

	Six Months Ended September 30, 2011		Six Months Ended September 30, 2010	
	Personnel Reductions	Manufacturing Relocations	Personnel Reductions	Manufacturing Relocations
Beginning of period	$ 1,825	$	$ 8,398	$
Costs charged to expense	1,245	1,385	1,015	3,080
Costs paid or settled	(1,904)	(1,385)	(2,770)	(3,080)
Change in foreign exchange	(45)		96	
End of period	$ 1,121	$	$ 6,739	$

Note 4. Accumulated Other Comprehensive Income

Comprehensive income for the quarters and six months ended September 30, 2011 and 2010 includes the following components (amounts in thousands):

	Quarters Ended September 30,		Six Months Ended September 30,	
	2011	2010	2011	2010
Net income	$ 14,318	$ 34,911	$ 46,167	$ 14,812
Amortization of postretirement benefit plan	(91)	(75)	(161)	(150)
	100	37	216	112

Amortization of defined benefit pension plans				
Currency translation gain (loss) (1)	(11,592)	15,942	(8,487)	5,168
Net income and other comprehensive income	$ 2,735	$ 50,815	$ 37,735	$ 19,942

(1) Due primarily to the Company s permanent re-investment assertion relating to foreign earnings, there was no significant deferred tax effect associated with the cumulative currency translation gains and losses during the quarters and six month periods ended September 30, 2011 and September 30, 2010.

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The components of Accumulated other comprehensive income on the Condensed Consolidated Balance Sheets are as follows (amounts in thousands):

	September 30, 2011	March 31, 2011
Foreign currency translation gain	$ 18,589	$ 27,076
Defined benefit postretirement plan adjustments	1,949	2,111
Defined benefit pension plans	(6,416)	(6,632)
Accumulated other comprehensive income	$ 14,122	$ 22,555

Note 5. Goodwill and Intangible Assets

On June 13, 2011, the Company completed its acquisition of Cornell Dubilier Foil, LLC (whose name was subsequently changed to KEMET Foil Manufacturing, LLC), a Tennessee based manufacturer of etched foils utilized as a core component in the manufacture of aluminum electrolytic capacitors. The purchase price was $15 million plus or minus an adjustment amount, of which $11.6 million (net of cash received) was paid at closing and $1.0 million is to be paid on each of the first, second and third anniversaries of the closing date. The Company recorded goodwill of $1.1 million and amortizable intangibles of $1.7 million. The allocation of the purchase price to specific assets and liabilities was based on the relative fair value of all assets and liabilities. Factors contributing to the purchase price which resulted in the goodwill (which is tax deductible) include the trained workforce. Pro forma results are not presented because the acquisition was not material.

The following table highlights the Company s intangible assets (amounts in thousands):

	September 30, 2011		March 31, 2011	
	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
Indefinite Lived Intangibles:				
Goodwill	$ 1,092	$	$	$
Trademarks	7,644		7,644	
Unamortized Intangibles	8,736		7,644	
Amortized Intangibles:				
Customer relationships, patents and other (3-18 years)	21,577	8,984	20,910	8,462
	$ 30,313	$ 8,984	$ 28,554	$ 8,462

The Company completed its annual impairment test on the indefinite lived intangible assets in the first quarter of fiscal year 2012 and concluded no impairment existed.

Note 6. Segment and Geographic Information

The Company is organized into three business groups: Tantalum, the Ceramic Business Group (Ceramic), and Film and Electrolytic. Each business group is responsible for the operations of certain manufacturing sites as well as all related research and development efforts. The sales and marketing functions are shared by the business groups and are allocated to each business group based on the business group s respective budgeted net sales. In addition, all corporate costs are allocated to the business groups based on the business group s respective budgeted net sales.

Tantalum

Tantalum operates in five manufacturing sites in the United States, Mexico, China, and Portugal. This business group produces tantalum and aluminum polymer capacitors. Tantalum shares with Ceramic the Company s product innovation center in the United States. Tantalum products are sold in all regions of the world.

Ceramic

Ceramic operates in two manufacturing sites in Mexico and a manufacturing site in China. The business group shares with Tantalum the Company s product innovation center in the United States. In addition, Ceramic maintains a design and manufacturing plant for electrical transformers, inductors, chokes, coils and filters in the United States. This business group produces ceramic capacitors. Ceramic products are sold in all regions of the world.

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Film and Electrolytic

Film and Electrolytic operates in sixteen manufacturing sites in Europe, Asia and North America. This business group produces film, paper, and electrolytic capacitors. In addition, the business group has a product innovation center in Sweden. Film and Electrolytic products are sold in all regions in the world.

The following table reflects each business group s net sales, operating income (loss), depreciation and amortization expenses and sales by region for the quarters and six months ended September 30, 2011 and 2010 (amounts in thousands):

	Quarters Ended September 30,		Six Months Ended September 30,	
	2011	2010	2011	2010
Net sales:				
Tantalum	$ 112,290	$ 123,873	$ 234,733	$ 237,441
Ceramic	56,112	56,730	115,491	111,054
Film and Electrolytic	97,112	67,985	205,146	143,887
	$ 265,514	$ 248,588	$ 555,370	$ 492,382
Operating income (1):				
Tantalum	$ 10,601	$ 27,466	$ 28,013	$ 44,972
Ceramic	10,553	13,324	21,409	24,354
Film and Electrolytic	3,759	(2,828)	16,333	(2,829)
	$ 24,913	$ 37,962	$ 65,755	$ 66,497
Depreciation and amortization expenses:				
Tantalum	$ 6,705	$ 8,788	$ 12,913	$ 17,106
Ceramic	2,002	4,653	3,805	6,922
Film and Electrolytic	3,145	691	6,293	4,614
	$ 11,852	$ 14,132	$ 23,011	$ 28,642
Sales by region:				
North and South America (Americas)	$ 81,662	$ 70,915	$ 154,422	$ 127,701
Europe, Middle East, Africa (EMEA)	106,897	85,651	209,609	172,023
Asia and Pacific Rim (APAC)	76,954	92,022	191,339	192,658
	$ 265,513	$ 248,588	$ 555,370	$ 492,382

(1) Restructuring charges included in Operating income are as follows (amounts in thousands):

	Quarters Ended September 30,		Six Months Ended September 30,	
	2011	2010	2011	2010
Total restructuring:				
Tantalum	$ 864	$ 322	$ 899	$ 779
Ceramic	49	93	88	187
Film and Electrolytic	692	1,888	1,643	3,129
	$ 1,605	$ 2,303	$ 2,630	$ 4,095

The following table reflects each business group s total assets as of September 30, 2011 and March 31, 2011 (amounts in thousands):

	September 30, 2011	March 31, 2011
Total assets:		
Tantalum	$ 369,352	$ 435,311
Ceramic	160,111	179,639
Film and Electrolytic	352,223	269,359
	$ 881,686	$ 884,309

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Note 7. Defined Benefit Pension and Other Postretirement Benefit Plans

The Company sponsors defined benefit pension plans which include seven in Europe, one in Singapore and two in Mexico and a postretirement plan in the United States. Costs recognized for these benefit plans are recorded using estimated amounts, which may change as actual costs for the fiscal year are determined.

The components of net periodic benefit costs relating to the Company s pension and other postretirement benefit plans are as follows for the quarters ended September 30, 2011 and 2010 (amounts in thousands):

	Pension Quarters Ended September 30,		Postretirement Benefit Plans Quarters Ended September 30,	
	2011	2010	2011	2010
Net service cost	$ 331	$ 266	$	$
Interest cost	533	457	8	16
Expected return on net assets	(175)	(164)		
Amortization:				
Actuarial (gain) loss	96	31	(91)	(79)
Prior service cost	6	5		
Total net periodic benefit (income) costs	$ 791	$ 595	$ (83)	$ (63)

The components of net periodic benefit costs relating to the Company s pension and other postretirement benefit plans are as follows for the six month periods ended September 30, 2011 and 2010 (amounts in thousands):

	Pension Six Months Ended September 30,		Postretirement Benefit Plans Six Months Ended September 30,	
	2011	2010	2011	2010
Net service cost	$ 663	$ 532	$	$
Interest cost	1,067	914	22	31
Expected return on net assets	(350)	(328)		
Amortization:				
Actuarial (gain) loss	191	62	(162)	(158)
Prior service cost	12	10		
Total net periodic benefit (income) costs	$ 1,583	$ 1,190	$ (140)	$ (127)

In fiscal year 2012, the Company expects to contribute up to $4.5 million to the pension plans of which the Company has contributed $0.5 million as of September 30, 2011. The Company s policy is to pay benefits as costs are incurred for the postretirement benefit plans.

Note 8. Stock-based Compensation

Stock Options

At September 30, 2011, the Company had four stock option plans that reserved shares of common stock for issuance to executives and key employees: the 1992 Key Employee Stock Option Plan, the 1995 Executive Stock Option Plan, the 2004 Long-Term Equity Incentive Plan (collectively, the Prior Plans) and the 2011 Omnibus Equity Incentive Plan (the 2011 Incentive Plan). All of these plans were approved by the Company s stockholders. The 2011 Incentive Plan has authorized the grant of up to 4.8 million shares of the Company s common stock, which is comprised of 4.0 million shares under the new plan and 0.8 million shares which remained under the Prior Plans. The 2011 Incentive Plan authorizes the Company to provide equity-based compensation in the form of (1) stock options, including incentive stock options, entitling the optionee to favorable tax treatment under Section 422 of the Code; (2) stock appreciation rights; (3) restricted stock and restricted stock units; (4) other share-based awards; and (5) performance awards. Options issued under these plans usually vest in one or two years and expire ten years from the grant date. Stock options granted to the Company s Chief Executive Officer on January 27, 2010 vest 50% on September 30, 2014 and 50% on September 30, 2015.

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The compensation expense associated with stock-based compensation for the quarters and six month periods ended September 30, 2011 and 2010 were recorded on the Condensed Consolidated Statements of Operations as follows (amounts in thousands):

	Quarters Ended September 30,		Six Months Ended September 30,	
	2011	2010	2011	2010
Cost of sales	$ 207	$ 32	$ 455	$ 70
Selling, general and administrative expenses	777	301	1,720	412
Total stock-based compensation expense	$ 984	$ 333	$ 2,175	$ 482

In the Operating activities section of the Condensed Consolidated Statements of Cash Flows, stock-based compensation expense was treated as an adjustment to Net income for the six month periods ended September 30, 2011 and 2010. Approximately 52 thousand stock options were exercised in the six month period ended September 30, 2011. No stock options were exercised during the six month period ended September 30, 2010.

Restricted Stock

The Company grants shares of its common stock as restricted stock to members of the Board of Directors and the Chief Executive Officer. Restricted stock granted to the Board of Directors vests in one year while restricted stock granted to the Chief Executive Officer on January 27, 2010 vests 50% on September 30, 2014 and 50% on September 30, 2015. Once vested, restricted shares cannot be sold until 90 days after the Chief Executive Officer or the member of the Board of Directors resigns from his position. The contractual term on restricted stock is indefinite. In the second quarter of fiscal year 2011, 47 thousand shares of restricted stock were granted to the non-management members of the Board of Directors. As of September 30, 2011, there was $0.2 million in unrecognized compensation costs related to the unvested restricted stock share based compensation arrangements granted.

2012/2013 LTIP

During the first quarter of fiscal year 2012, the Board of Directors of the Company approved the 2012/2013 LTIP , a new long-term incentive plan based upon the achievement of an Adjusted EBITDA target for the two-year period comprised of fiscal years ending in March 2012 and 2013. At the time of the award, participants will receive restricted shares of the Company s common stock of up to 100% of the award earned. The Company assesses the likelihood of meeting the Adjusted EBITDA financial metric on a quarterly basis and recorded expense of $0.6 million and $1.3 million in the quarter ended and six month period ended September 30, 2011, respectively. For the first and second quarters of fiscal year 2012, the Company anticipated that the award will be paid out entirely in restricted shares; accordingly the equity component is reflected in the line item Additional paid-in capital on the Condensed Consolidated Balance Sheets for the quarter ended September 30, 2011, based on this assessment. The Company will continue to monitor the likelihood of whether the Adjusted EBITDA financial metric will be realized and will adjust compensation expense to match expectations.

2011/2012 LTIP

During the first quarter of fiscal year 2011, the Board of Directors of the Company approved the 2011/2012 LTIP , a long-term incentive plan based upon the achievement of an Adjusted EBITDA target for the two-year period comprised of fiscal years ending in March 2011 and 2012. At the time of the award, participants will receive at least 10% of the award in restricted shares of the Company s common stock; and the remainder will be realized in cash. The Company assesses the likelihood of meeting the Adjusted EBITDA financial metric on a quarterly basis and recorded expense of $1.3 million in the six month period ended September 30, 2011, based on this assessment. The Company recorded no expense for the quarter ended September 30, 2011. As of September 30, 2011, the Company has accrued $5.6 million and the related liability is reflected in the line item Accrued expenses on the Condensed Consolidated Balance Sheets and $0.6 million in the line item Additional paid-in capital on the Condensed Consolidated Balance Sheets. The Company will continue to monitor the likelihood of whether the Adjusted EBITDA financial metric will be realized and will adjust compensation expense to match expectations.

2010/2011 LTIP

During the second quarter of fiscal year 2010, the Board of Directors of the Company approved the 2010/2011 LTIP, a long-term incentive plan based upon the achievement of an Adjusted EBITDA target for the two-year period comprised of fiscal years ending in March 2010 and 2011. At the time of the award and at the sole discretion of the Compensation Committee, participants may receive up to 15% of the award in restricted shares of the Company s common stock, and the remainder of the award will be realized in cash. During the second quarter of fiscal year 2012, the Company paid the cash component of the award and issued 15% of the total award in restricted shares.

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Note 9. Income Taxes

During the second quarter of fiscal year 2012, the Company incurred $2.0 million of income tax expense which was comprised of $2.2 million of income tax expense from foreign operations and $0.2 million of state income tax benefit related to a prior year refund. There was no U.S. federal income tax expense in the quarter ended September 30, 2011 due to the utilization of net operating loss carryforward deductions and a valuation allowance on net deferred tax assets.

During the second quarter of fiscal year 2011, the net income tax expense of $0.6 million related to foreign operations. There was no federal or state income tax expense due to the utilization of net operating loss carryforward deductions and a valuation allowance on net deferred tax assets.

Income tax expense for the six month period ended September 30, 2011 was $3.8 million, comprised of $4.8 million related to foreign operations, a $0.9 million U.S. federal income tax benefit related to a prior year settlement, and $0.1 million of state income tax benefit.

During the six month period ended September 30, 2010, income tax expense was $1.9 million, comprised of a $1.8 million income tax expense related to foreign operations and $0.1 million of state income tax expense. No federal tax benefit was recognized from the loss on early extinguishment of debt due to the Company s position regarding its valuation allowance. The $1.8 million foreign income tax expense includes a $0.4 million tax expense as a result of a tax law change in Portugal.

The effective income tax rate was 7.6% and 11.2% for the six month periods ended September 30, 2011 and 2010, respectively.

Note 10. Reconciliation of Basic and Diluted Net Income Per Common Share

The following table presents a reconciliation of basic EPS to diluted EPS (amounts in thousands, except per share data):

	Quarters Ended September 30,		Six Months Ended September 30,	
	2011	2010	2011	2010
Numerator:				
Net income	$ 14,318	$ 34,911	$ 46,167	$ 14,812
Denominator:				
Weighted-average shares outstanding:				
Basic	44,370	27,092	41,924	27,092
Assumed conversion of employee stock options	299	305	335	260
Assumed conversion of Closing Warrant	7,561	23,797	10,048	23,177
Diluted	52,230	51,194	52,307	50,529

Net income per share:				
Basic	$ 0.32	$ 1.29	$ 1.10	$ 0.55
Diluted	$ 0.27	$ 0.68	$ 0.88	$ 0.29

Common stock equivalents that could potentially dilute net income per basic share in the future, but were not included in the computation of diluted earnings per share because the impact would have been antidilutive, are as follows (amounts in thousands):

	Quarters Ended September 30,		Six Months Ended September 30,	
	2011	2010	2011	2010
Assumed conversion of employee stock options	903	767	710	807

Note 11. Stockholders Equity

On May 31, 2011, K Equity sold a portion of the Platinum Warrant to Deutsche Bank Securities Inc., in connection with an offering of 7.0 million shares of the Company s common stock, at a public offering price of $14.60 per share. K Equity retained the remaining portion of the warrant, representing the right to purchase 8.4 million shares of the Company s common stock.

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At the July 27, 2011 annual meeting of stockholders, an amendment to the Company s Restated Certificate of Incorporation to reduce the number of authorized shares of common stock from 300,000,000 to 175,000,000 was approved. The amendment became effective August 1, 2011 pursuant to a Certificate of Amendment to the Company s Restated Certificate of Incorporation filed with the Secretary of State of Delaware.

Note 12. Concentrations of Risks

Sales and Credit Risks

The Company sells to customers globally. Credit evaluations of the Company s customers financial condition are performed periodically, and the Company generally does not require collateral from its customers. One customer, TTI, Inc., accounted for over 10% of the Company s net sales in the quarters and six month periods ended September 30, 2011 and 2010. There were no customers accounts receivable balances exceeding 10% of gross accounts receivable at September 30, 2011 or March 31, 2011.

Electronics distributors are an important distribution channel in the electronics industry and accounted for 44% and 51% of the Company s net sales in the six month periods ended September 30, 2011 and 2010, respectively. As a result of the Company s concentration of sales to electronics distributors, the Company may experience fluctuations in the Company s operating results as electronics distributors experience fluctuations in end-market demand or adjust their inventory stocking levels.

Employee Risks

As of September 30, 2011, KEMET had approximately 10,400 employees, of which 680 are located in the United States, 5,070 in Mexico, 2,520 in Asia and 2,130 in Europe. The number of employees represented by labor organizations at KEMET locations in each of the following countries is: 4,000 hourly employees in Mexico (as required by Mexican law), 700 employees in Italy, 690 employees in Indonesia, 300 employees in Portugal, 220 employees in China, 290 employees in Bulgaria, 220 employees in Finland and 90 employees in Sweden. For fiscal year 2011 and the current fiscal year to date, the Company has not experienced any major work stoppages. The Company s labor costs in Mexico, Asia and various locations in Europe are denominated in local currencies, and a significant depreciation or appreciation of the United States dollar against the local currencies would increase or decrease our labor costs.

Note 13. Condensed Consolidating Financial Statements

The 10.5% Senior Notes are fully and unconditionally guaranteed, jointly and severally, on a senior basis by certain of the Company s 100% owned domestic subsidiaries (Guarantor Subsidiaries) and secured by a first priority lien on 51% of the capital stock of certain of our foreign restricted subsidiaries (Non-Guarantor Subsidiaries). The Company s Guarantor Subsidiaries and Non-Guarantor Subsidiaries are not consistent with the Company s business groups or geographic operations; accordingly this basis of presentation is not intended to present the Company s financial condition, results of operations or cash flows for any purpose other than to comply with the specific requirements for subsidiary guarantor reporting. We are required to present condensed consolidating financial information in order for the subsidiary guarantors of the Company s public debt to be exempt from reporting under the Securities Exchange Act of 1934, as amended.

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Condensed consolidating financial statements for the Company s Guarantor Subsidiaries and Non-Guarantor Subsidiaries are presented in the following tables (amounts in thousands):

Condensed Consolidating Balance Sheet

September 30, 2011

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	$ 6,705	$ 92,255	$ 28,203	$	$ 127,163
Accounts receivable, net		45,596	68,903		114,499
Intercompany receivable	178,197	90,395	165,663	(434,255)	
Inventories, net		125,767	99,103	(297)	224,573
Restricted cash		36,497			36,497
Prepaid expenses and other	208	9,770	21,499		31,477
Deferred income taxes	(131)	1,204	4,278		5,351
Total current assets	184,979	401,484	387,649	(434,552)	539,560
Property and equipment, net	42	95,726	214,264		310,032
Investments in subsidiaries	399,546	346,081	(5,348)	(740,279)	
Intangible assets, net		10,902	10,427		21,329
Other assets	5,791	3,751	1,223		10,765
Long-term intercompany receivable	80,056	97,255		(177,311)	
Total assets	$ 670,414	$ 955,199	$ 608,215	$ (1,352,142)	$ 881,686
LIABILITIES AND STOCKHOLDERS EQUITY					
Current liabilities:					
Current portion of long-term debt	$ 36,153	$	$ 1,542	$	$ 37,695
Accounts payable, trade		29,302	45,122		74,424
Intercompany payable	2,237	331,916	100,399	(434,552)	
Accrued expenses	8,058	27,943	41,035		77,036
Income taxes payable	(2,790)	2,754	3,080		3,044
Total current liabilities	43,658	391,915	191,178	(434,552)	192,199
Long-term debt, less current portion	227,345		2,266		229,611
Other non-current obligations		5,486	46,294		51,780
Deferred income taxes	(131)	2,053	6,637		8,559
Long-term intercompany payable		80,056	97,255	(177,311)	
Stockholders equity	399,542	475,689	264,585	(740,279)	399,537
Total liabilities and stockholders equity	$ 670,414	$ 955,199	$ 608,215	$ (1,352,142)	$ 881,686

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Condensed Consolidating Balance Sheet

March 31, 2011

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	$ 6,417	$ 119,326	$ 26,308	$	$ 152,051
Accounts receivable, net		64,380	85,990		150,370
Intercompany receivable	190,973	176,233	197,329	(564,535)	
Inventories, net		113,908	92,830	(298)	206,440
Prepaid expenses and other	302	11,034	16,761		28,097
Deferred income taxes	(596)	1,373	4,524		5,301
Total current assets	197,096	486,254	423,742	(564,833)	542,259
Property and equipment, net	122	82,962	227,328		310,412
Investments in subsidiaries	347,997	333,801	(5,686)	(676,112)	
Intangible assets, net		8,666	11,426		20,092
Other assets	6,160	4,356	1,030		11,546
Long-term intercompany receivable	84,231	102,324		(186,555)	
Total assets	$ 635,606	$ 1,018,363	$ 657,840	$ (1,427,500)	$ 884,309
LIABILITIES AND STOCKHOLDERS EQUITY					
Current liabilities:					
Current portion of long-term debt	$ 39,012	$	$ 3,089	$	$ 42,101
Accounts payable, trade	40	32,762	58,195		90,997
Intercompany payable	732	419,043	145,058	(564,833)	
Accrued expenses	10,837	31,330	46,124		88,291
Income taxes payable	(1,380)	1,434	4,211		4,265
Total current liabilities	49,241	484,569	256,677	(564,833)	225,654
Long-term debt, less current portion	227,208		4,007		231,215
Other non-current obligations		7,989	51,738		59,727
Deferred income taxes	(596)	2,169	6,387		7,960
Long-term intercompany payable		84,231	102,324	(186,555)	
Stockholders equity	359,753	439,405	236,707	(676,112)	359,753
Total liabilities and stockholders equity	$ 635,606	$ 1,018,363	$ 657,840	$ (1,427,500)	$ 884,309

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Condensed Consolidating Statement of Operations

For the Quarter Ended September 30, 2011

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Consolidated
Net sales	$	$ 249,751	$ 245,315	$ (229,552)	$ 265,514
Operating costs and expenses:					
Cost of sales	124	200,097	225,122	(222,024)	203,319
Selling, general and administrative expenses	5,617	17,496	13,621	(8,379)	28,355
Research and development		5,276	2,086		7,362
Restructuring charges		1,357	248		1,605
Net (gain) loss on sales and disposals of assets		10	(50)		(40)
Total operating costs and expenses	5,741	224,236	241,027	(230,403)	240,601
Operating income (loss)	(5,741)	25,515	4,288	851	24,913
Other (income) expense:					
Interest income	(2)	(10)	(19)		(31)
Interest expense	7,031	84	167		7,282
Other (income) expense, net	(10,250)	15,833	(4,286)		1,297
Equity in earnings of subsidiaries	(16,584)			16,584	
Income before income taxes	14,064	9,608	8,426	(15,733)	16,365
Income tax expense (benefit)	(254)	(506)	2,807		2,047
Net income	$ 14,318	$ 10,114	$ 5,619	$ (15,733)	$ 14,318

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Condensed Consolidating Statement of Operations

For the Quarter Ended September 30, 2010

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Consolidated
Net sales	$	$ 242,856	$ 236,659	$ (230,927)	$ 248,588
Operating costs and expenses:					
Cost of sales		183,304	216,192	(220,626)	178,870
Selling, general and administrative expenses	11,925	15,031	6,949	(8,906)	24,999
Research and development		4,840	1,384		6,224
Restructuring charges		1,540	763		2,303
Net (gain) loss on sales and disposals of assets		(1,807)	37		(1,770)
Total operating costs and expenses	11,925	202,908	225,325	(229,532)	210,626
Operating income (loss)	(11,925)	39,948	11,334	(1,395)	37,962
Other (income) expenses:					
Interest income	(4)	(131)	(9)	60	(84)
Interest expense	7,093		301	(60)	7,334
Other (income) expense, net	(12,005)	3,145	3,742	326	(4,792)
Equity in earnings of subsidiaries	(41,920)			41,920	
Income before income taxes	34,911	36,934	7,300	(43,641)	35,504
Income tax expense		40	585	(32)	593
Net income	$ 34,911	$ 36,894	$ 6,715	$ (43,609)	$ 34,911

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Condensed Consolidating Statement of Operations

For the Six Months Ended September 30, 2011

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Consolidated
Net sales	$	$ 519,438	$ 525,337	$ (489,405)	$ 555,370
Operating costs and expenses:					
Cost of sales	286	426,505	459,690	(472,658)	413,823
Selling, general and administrative expenses	17,066	33,211	25,715	(17,361)	58,631
Research and development		10,303	4,145		14,448
Restructuring charges		1,838	792		2,630
Net loss on sales and disposals of assets	3	29	51		83
Total operating costs and expenses	17,355	471,886	490,393	(490,019)	489,615
Operating income (loss)	(17,355)	47,552	34,944	614	65,755
Other (income) expenses:					
Interest income	(6)	(27)	(41)		(74)
Interest expense	14,134	158	390		14,682
Other (income) expense, net	(21,794)	23,820	(893)	69	1,202
Equity in earnings of subsidiaries	(54,664)			54,664	
Income before income taxes	44,975	23,601	35,488	(54,119)	49,945
Income tax expense (benefit)	(1,192)	97	4,873		3,778
Net income	$ 46,167	$ 23,504	$ 30,615	$ (54,119)	$ 46,167

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Condensed Consolidating Statement of Operations

For the Six Months Ended September 30, 2010

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Consolidated
Net sales	$	$ 472,045	$ 484,838	$ (464,501)	$ 492,382
Operating costs and expenses:					
Cost of sales		364,608	441,000	(443,852)	361,756
Selling, general and administrative expenses	20,614	28,299	19,358	(19,057)	49,214
Research and development		9,162	3,093		12,255
Restructuring charges		3,072	1,023		4,095
Net (gain) loss on sales and disposals of assets		(1,783)	348		(1,435)
Total operating costs and expenses	20,614	403,358	464,822	(462,909)	425,885
Operating income (loss)	(20,614)	68,687	20,016	(1,592)	66,497
Other (income) expenses:					
Interest income	(13)	(137)	(15)	60	(105)
Interest expense	14,212	94	546	(60)	14,792
Loss on early extinguishment of debt	38,248				38,248
Other (income) expense, net	(14,680)	12,260	(795)	97	(3,118)
Equity in earnings of subsidiaries	(73,193)			73,193	
Income before income taxes	14,812	56,470	20,280	(74,882)	16,680
Income tax expense		107	1,761		1,868
Net income	$ 14,812	$ 56,363	$ 18,519	$ (74,882)	$ 14,812

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Condensed Consolidating Statement of Cash Flows

For the Six Months Ended September 30, 2011

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Consolidated
Sources (uses) of cash and cash equivalents					
Net cash provided by operating activities	$ 4,214	$ 32,545	$ 14,230	$	$ 50,989
Investing activities:					
Capital expenditures	(1)	(11,505)	(8,599)		(20,105)
Acquisitions		(11,584)			(11,584)
Net cash used in investing activities	(1)	(23,089)	(8,599)		(31,689)
Financing activities:					
Change in restricted cash		(36,497)			(36,497)
Payments of long-term debt	(4,084)				(4,084)
Net payments under other credit facilities			(3,153)		(3,153)
Proceeds from exercise of stock options	159				159
Debt issuance costs		(29)			(29)
Net cash used in financing activities	(3,925)	(36,526)	(3,153)		(43,604)
Net increase (decrease) in cash and cash equivalents	288	(27,070)	2,478		(24,304)
Effect of foreign currency fluctuations on cash			(584)		(584)
Cash and cash equivalents at beginning of fiscal period	6,417	119,326	26,308		152,051
Cash and cash equivalents at end of fiscal period	$ 6,705	$ 92,256	$ 28,202	$	$ 127,163

Condensed Consolidating Statement of Cash Flows

For the Six Months Ended September 30, 2010

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Consolidated
Sources (uses) of cash and cash equivalents					
Net cash provided by (used in) operating activities	$ (13,977)	$ 48,573	$ 21,849	$	$ 56,445
Investing activities:					
Capital expenditures		(4,524)	(9,297)		(13,821)
Proceeds from sales of assets		5,425			5,425
Net cash provided by (used in) investing activities		901	(9,297)		(8,396)
Financing activities:					
Proceeds from issuance of debt	226,976		458		227,434
Payments of long-term debt	(210,604)	(15,000)	(2,939)		(228,543)
Net payments under other credit facilities			(1,779)		(1,779)
Debt issuance costs	(7,461)				(7,461)

Debt extinguishment costs	(207)				(207)
Net cash provided by (used in) financing activities	8,704	(15,000)	(4,260)		(10,556)
Net increase (decrease) in cash and cash equivalents	(5,273)	34,474	8,292		37,493
Effect of foreign currency fluctuations on cash		(28)	790		762
Cash and cash equivalents at beginning of fiscal period	11,602	54,707	12,890		79,199
Cash and cash equivalents at end of fiscal period	$ 6,329	$ 89,153	$ 21,972	$	$ 117,454

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

This report contains certain statements that are forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Actual outcomes and results may differ materially from those expressed in, or implied by, our forward-looking statements. Words such as expects, anticipates, believes, estimates and other similar expressions or future or conditional verbs such as will, should , would and c intended to identify such forward-looking statements. Readers of this report should not rely solely on the forward-looking statements and should consider all uncertainties and risks throughout this report as well as those discussed under Part I, Item 1A of the Company s 2011 Annual Report. The statements are representative only as of the date they are made, and we undertook no obligation to update any forward-looking statement.

All forward-looking statements, by their nature, are subject to risks and uncertainties. Our actual future results may differ materially from those set forth in our forward-looking statements. We face risks that are inherent in the businesses and the market places in which we operate. While management believes these forward-looking statements are accurate and reasonable, uncertainties, risks and factors, including those described below, could cause actual results to differ materially from those reflected in the forward-looking statements.

Factors that may cause actual outcome and results to differ materially from those expressed in, or implied by, these forward-looking statements include, but are not necessarily limited to, the following: (i) adverse economic conditions could impact our ability to realize operating plans if the demand for our products declines, and such conditions could adversely affect our liquidity and ability to continue to operate; (ii) adverse economic conditions could cause the write down of long-lived assets; (iii) an increase in the cost or a decrease in the availability of our principal raw materials; (iv) changes in the competitive environment; (v) uncertainty of the timing of customer product qualifications in heavily regulated industries; (vi) economic, political, or regulatory changes in the countries in which we operate; (vii) difficulties, delays or unexpected costs in completing the restructuring plan; (viii) inability to attract, train and retain effective employees and management; (ix) inability to develop innovative products to maintain customer relationships and offset potential price erosion in older products; (x) exposure to claims alleging product defects; (xi) the impact of laws and regulations that apply to our business, including those relating to environmental matters; (xii) volatility of financial and credit markets affecting our access to capital; (xiii) needing to reduce the total costs of our products to remain competitive; (xiv) potential limitation on the use of net operating losses to offset possible future taxable income; (xv) restrictions in our debt agreements that limit our flexibility in operating our business; and (xvi) additional exercise of the warrant by K Equity which could potentially result in the existence of a significant stockholder who could seek to influence our corporate decisions.

Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations and could cause actual results to differ materially from those included, contemplated or implied by the forward-looking statements made in this report, and the reader should not consider the above list of factors to be a complete set of all potential risks or uncertainties.

ACCOUNTING POLICIES AND ESTIMATES

The following discussion and analysis of financial condition and results of operations are based on the unaudited condensed consolidated financial statements included herein. Our significant accounting policies are described in Note 1 to the consolidated financial statements in our 2011 Annual Report. Our critical accounting policies are described under the caption Critical Accounting Policies in Item 7 of our 2011 Annual Report.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (U.S. GAAP) requires management to make estimates, assumptions, and judgments. Estimates and assumptions are based on historical data and other assumptions that management believes are reasonable. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements. In addition, they affect the reported amounts of revenues and expenses during the reporting period.

Our judgments are based on management s assessment as to the effect certain estimates, assumptions, or future trends or events may have on the financial condition and results of operations reported in the unaudited condensed consolidated financial statements. It is important that readers of these unaudited financial statements understand that actual results could differ from these estimates, assumptions, and judgments.

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Business Overview

We are a leading global manufacturer of a wide variety of capacitors. Our product offerings include tantalum, multilayer ceramic, solid and electrolytic aluminum and film and paper capacitors. Capacitors are fundamental components of most electronic circuits and are found in communication systems, data processing equipment, personal computers, cellular phones, automotive electronic systems, defense and aerospace systems, consumer electronics, power management systems and many other electronic devices and systems. Capacitors are typically used to filter out interference, smooth the output of power supplies, block the flow of direct current while allowing alternating current to pass and for many other purposes. We manufacture a broad line of capacitors in many different sizes and configurations using a variety of raw materials. Our product line consists of over 250,000 distinct part configurations distinguished by various attributes, such as dielectric (or insulating) material, configuration, encapsulation, capacitance level and tolerance, performance characteristics and packaging. Most of our customers have multiple capacitance requirements, often within each of their products. Our broad product offering allows us to meet the majority of those needs independent of application and end use. In fiscal year 2011, we shipped approximately 35 billion capacitors and in the six month period ended September 30, 2011, we shipped approximately 18 billion capacitors. We believe the medium-to-long term demand for the various types of capacitors we offer will continue to grow on a regional and global basis due to a variety of factors, including increasing demand for and complexity of electronic products, growing demand for technology in emerging markets and the ongoing development of new solutions for energy generation and conservation.

We operate 23 production facilities and employ approximately 10,400 employees worldwide. We manufacture capacitors in Europe, Mexico, China, the United States and Indonesia. Commodity manufacturing in the United States has been substantially relocated to our lower-cost manufacturing facilities in Mexico and China. Production that remains in the United States focuses primarily on early-stage manufacturing of new products and other specialty products for which customers are predominantly located in North America. For the six month period ended September 30, 2011 and for fiscal year 2011, our consolidated sales were $555.4 million and $1,018.5 million, respectively.

We are organized into three business groups: Tantalum, Ceramic, and Film and Electrolytic. The Film and Electrolytic business group operates a machinery division located in Sasso Marconi, Italy that provides automation solutions for the manufacture, processing and assembly of metallized films, film/foil and electrolytic capacitors; and designs, assembles and installs automation solutions for the production of energy storage devices. Each business group is responsible for the operations of certain manufacturing sites as well as all related research and development efforts. The sales and marketing functions are shared by each of the business groups and the costs of which are allocated to the business groups. In addition, all corporate costs are allocated to the business groups.

Our Competitive Strengths

We believe that we benefit from the following competitive strengths:

Strong Customer Relationships. We have a large and diverse customer base. We believe that our persistent emphasis on quality control and history of performance establishes loyalty with OEMs, EMSs and distributors. Our customer base includes most of the world s major electronics original equipment manufacturers (OEMs) (including Alcatel-Lucent USA, Inc., Apple Inc., Bosch Group, Cisco Systems, Inc., Continental AG, Dell Inc., Hewlett-Packard Company, International Business Machines Corporation, Intel Corporation, Motorola, Inc., Nokia Corporation, and TRW Automotive), electronics manufacturing services providers (EMSs) (including Celestica Inc., Elcoteq SE, Flextronics International LTD, Jabil Circuit, Inc. and Sanmina-SCI Corporation) and distributors (including TTI, Inc., Arrow Electronics, Inc. and Avnet, Inc.). Our strong, extensive and efficient worldwide distribution network is one of our differentiating factors. We believe our ability to provide innovative and flexible service offerings, superior customer support and focus on speed-to-market result in a more rewarding customer experience, earning us a

high degree of customer loyalty.

Breadth of Our Diversified Product Offering and Markets. We believe that we have the most complete line of primary capacitor types, across a full spectrum of dielectric materials including tantalum, ceramic, solid and electrolytic aluminum, film and paper. As a result, we believe we can satisfy virtually all of our customers capacitance needs, thereby strengthening our position as their supplier of choice. We sell our products into a wide range of different end markets, including computing, industrial, telecommunications, transportation, consumer, defense and healthcare markets across all geographic regions. No single end market segment accounted for more than 30% and only one customer, TTI, Inc., accounted for more than 10% of our net sales in the six month period ended September 30, 2011. Our largest customer is a distributor, and no single end use customer accounted for more than 5% of our net sales in the six month period ended September 30, 2011. We believe that well-balanced product, geographic and customer diversification helps us mitigate some of the negative financial impact through economic cycles.

Leading Market Positions and Operating Scale. Based on net sales, we believe that we are the largest manufacturer of tantalum capacitors in the world and one of the largest manufacturers of direct current film capacitors in the world and have a significant market position in the specialty ceramic and custom wet aluminum electrolytic markets. We believe that our leading market positions and operating scale allow us to realize production efficiencies, leverage economies of scale and capitalize on growth opportunities in the global capacitor market.

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Strong Presence in Specialty Products. We engage in design collaboration with our customers in order to meet their specific needs and provide them with customized products satisfying their engineering specifications. During the six month periods ended September 30, 2011and 2010, respectively, specialty products accounted for 37.4% and 30.3% of our revenue. By allocating an increasing portion of our management resources and research and development investment to specialty products, we have established ourselves as one of the leading innovators in this fast growing emerging segment of the market, which includes healthcare, renewable energy, telecommunication infrastructure and oil and gas. For example, in August 2009, we were selected as one of thirty companies to receive a grant from the Department of Energy. Our $15.1 million award will enable us to produce film capacitors within the United States to support alternative energy products and emerging green technologies such as hybrid electric drive vehicles. Producing these parts in the United States will allow us to compete effectively in the alternative energy market domestically. We expect to begin production in the third quarter of fiscal year 2012.

Low-Cost Production. We believe we have some of the lowest cost production facilities in the industry. Many of our key customers have relocated their production facilities to Asia, particularly China. We believe our manufacturing facilities in China have low production costs and are in close proximity to the large and growing Chinese market; in addition, we have the ability to increase capacity and change product mix to meet our customers needs. We believe our operations in Mexico are among the most cost-efficient in the world. In addition, we believe our manufacturing facility in Bulgaria has low production costs and we are expanding our manufacturing to Macedonia which we believe will also have low production costs.

Our Brand. Founded by Union Carbide in 1919 as KEMET Laboratories, we believe that we have established a reputation as a high quality, efficient and affordable partner that sets our customers needs as the top priority. This has allowed us to successfully attract loyal clientele and enabled us to expand our operations and market share over the past few years. We believe our commitment to addressing the needs of the industry in which we operate has differentiated us from our competitors and established us as the Easy-To-Buy-From company.

Our People. We believe that we have successfully developed a unique corporate culture based on innovation, customer focus and commitment. We have a strong, highly experienced and committed team in each of our markets. Many of our professionals have developed unparalleled experience in building leadership positions in new markets, as well as successfully integrating acquisitions. Our 16 member executive management team has an average of over 12 years of experience with us and an average of over 25 years of experience in the manufacturing industry.

Business Strategy

Our strategy is to use our position as a leading, high-quality manufacturer of capacitors to capitalize on the increasingly demanding requirements of our customers. Key elements of our strategy include:

One KEMET Campaign. We continue to focus on improving our business capabilities through various initiatives that all fall under our One KEMET campaign. The One KEMET campaign aims to ensure that we as a company are focused on the same goals and working with the same processes and systems to ensure consistent quality and service. This effort was launched to ensure that as we continue to grow we not only remain grounded in our core principles but that we use those principles, operating procedures and systems as the foundation from which to expand. These initiatives include our global Oracle software implementation which is proceeding on schedule, our Lean and Six Sigma culture evolution and our global customer accounts management system which is now in place and growing.

Develop Our Significant Customer Relationships and Industry Presence. We intend to continue to be responsive to our customers needs and requirements and to make order entry and fulfillment easier, faster, more flexible and more reliable for our customers, by focusing on building products around customers needs, by giving decision making authority to customer-facing personnel and by providing purpose-built systems and processes, such as our Easy-To-Buy-From order entry system.

Continue to Pursue Low-Cost Production Strategy. We continue to evaluate and are actively pursuing measures that will allow us to maintain our position as a low-cost producer of capacitors with facilities close to our customers. We have shifted and will continue to shift production to low cost locations in order to reduce material and labor costs. We plan to expand our manufacturing to Macedonia which we believe will have low production costs. Additionally, we are focused on developing more cost-efficient manufacturing equipment and processes, designing manufacturing plants for more efficient production and reducing work-in-process (WIP) inventory by building products from start to finish in one factory. Furthermore, we continue to implement the Lean and Six Sigma methodology to drive towards zero product defects so that quality remains a given in the minds of our customers.

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Leverage Our Technological Competence and Expand Our Leadership in Specialty Products. We continue to leverage our technological competence to introduce new products in a timely and cost-efficient manner and generate an increasing portion of our sales from new and customized solutions to meet our customers varied and evolving capacitor needs as well as to improve financial performance. We believe that by continuing to build on our strength in the higher growth and higher margin specialty segments of the capacitor market, we will be well positioned to achieve our long-term growth objectives while also improving our profitability. During the second quarter of fiscal year 2012, we introduced 197 new products of which 55 were first to market, and specialty products accounted for 38.8% of our revenue over this period. During the six month period ended September 30, 2011, we introduced 30,157 new products of which 2,066 were first to market, and specialty products accounted for 37.4% of our revenue over this period.

Further Expand Our Broad Capacitance Capabilities. We identify ourselves as The Capacitance Company and strive to be the supplier of choice for all our customers capacitance needs across the full spectrum of dielectric materials including tantalum, ceramic, solid and electrolytic aluminum, film and paper. While we believe we have the most complete line of capacitor technologies across these primary capacitor types, we intend to continue to research and pursue additional capacitance technologies and solutions in order to maximize the breadth of our product offerings.

Selectively Target Complementary Acquisitions. We expect to continue to evaluate and pursue strategic acquisition opportunities, some of which may be significant in size, which would enable us to enhance our competitive position and expand our market presence. Our strategy is to acquire complementary capacitor and other related businesses that would allow us to leverage our business model, potentially including those involved in other passive components that are synergistic with our customers technologies and our current product offerings. For example, on June 13, 2011, the Company completed its acquisition of Cornell Dubilier Foil, LLC (whose name was subsequently changed to KEMET Foil Manufacturing, LLC), a Tennessee based manufacturer of etched foils utilized as a core component in the manufacture of electrolytic capacitors.

Promote the KEMET Brand Globally. We are focused on promoting the KEMET brand globally by highlighting the high-quality and high reliability of our products and our superior customer service. We will continue to market our products to new and existing customers around the world in order to expand our business. We continue to be recognized by our customers as a leading global supplier. For example, in calendar year 2011, we received the Supplier of the Year Award from TTI, Inc. and from Arrow Electronics, Inc., both of which are electronics distributors.

Global Sales & Marketing Strategy. Our motto Think Global Act Local describes our approach to sales and marketing. Each of our three sales regions (North America and South America (Americas), Europe, Middle East and Africa (EMEA) and Asia and Pacific Rim (APAC)) has account managers, field application engineers and strategic marketing managers in the region. In addition, we also have local customer and quality-control support in each region. This organizational structure allows us to respond to the needs of our customers on a timely basis and in their native language. The regions are managed locally and report to a senior manager who is on the KEMET Leadership Team. Furthermore, this organizational structure ensures the efficient communication of our global goals and strategies and allows us to serve the language, cultural and other region-specific needs of our customers.

Recent Developments and Trends

Net sales for the quarter ended September 30, 2011 were $265.5 million, which is a 6.8% increase over the same quarter last fiscal year and an 8.4% decrease over the prior fiscal quarter ended June 30, 2011. Net sales for the six month period ended September 30, 2011 were $555.4 million, which is a 12.8% increase over the same six month period last fiscal year.

On May 31, 2011, K Equity sold a portion of the Platinum Warrant to Deutsche Bank Securities Inc., in connection with the offering of a total of 7.0 million shares of the Company s common stock, at a public offering price of $14.60 per share. K Equity retained the remaining portion of the warrant, representing the right to purchase 8.4 million shares of the Company s common stock.

On June 13, 2011, the Company completed its acquisition of Cornell Dubilier Foil, LLC (whose name was subsequently changed to KEMET Foil Manufacturing, LLC), a Tennessee based manufacturer of etched foils utilized as a core component in the manufacture of electrolytic capacitors. The purchase price was $15.0 million plus or minus an adjustment amount, of which $11.6 million (net of cash received) was paid at closing and $1.0 million is to be paid on each of the first, second and third anniversaries of the closing date. As a result of the acquisition, the Company recorded goodwill of $1.1 million and amortizable intangibles of $1.7 million. The allocation of the purchase price to specific assets and liabilities was based on the relative fair value of all assets and liabilities. Factors contributing to the purchase price which resulted in the goodwill (which is tax deductible) include the trained workforce.

In July 2011, we announced our plans to construct a new manufacturing facility in Skopje, Macedonia. This facility is a component of our long-term strategy of consolidating and maintaining manufacturing for our European customer base, while fulfilling our objective of lowering the cost structure associated with Film and Electrolytic. The initial facility will be 100,000 square feet of manufacturing and administrative office space and we expect to employ approximately 200 people when fully operational. The

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expected completion date of the facility is the second quarter of fiscal year 2013. The investment in this new facility, including transferred assets, is expected to be approximately 12 million ($17 million). The cost of the facility construction during the Company s current fiscal year is included in the previously announced capital plan for the year.

Outlook

For the third quarter of fiscal year 2012, we expect revenue to decline approximately 10% to 14% compared to the second quarter of fiscal year 2012 and gross margins in the range of 19 to 22%. The primary driver for this change is volume and mix, driven almost exclusively by the inventory adjustments occurring in the distribution channels. The accuracy of our forecast is subject to the effect of the floods occurring in Thailand and the uncertainty surrounding the unfortunate economic disaster that will affect many industries in the months ahead. We are working to fill the pipeline and support those affected by this situation and ramping up our operations to fill the expected supply shortages. The financial impact, possibly a benefit, of this situation on our operations during this current quarter which ends on December 31, 2011 is unknown at this time.

CONDENSED CONSOLIDATED RESULTS OF OPERATIONS

Comparison of the Second Quarter of Fiscal Year 2012 with the Second Quarter of Fiscal Year 2011

The following table sets forth the operating income for each of our business segments for the quarters ended September 30, 2011 and 2010. The table also sets forth each of the segments net sales as a percent to total net sales and the net income components as a percent to total net sales (dollars in thousands):

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	Quarters Ended			
	September 30, 2011		September 30, 2010	
	Amount	% to Total Sales	Amount	% to Total Sales
Net sales				
Tantalum	$ 112,290	42.3%	$ 123,873	49.8%
Ceramic	56,112	21.1%	56,730	22.8%
Film and Electrolytic	97,112	36.6%	67,985	27.4%
	$ 265,514	100.0%	$ 248,588	100.0%
Gross margin				
Tantalum	$ 26,747		$ 41,752	
Ceramic	18,387		19,416	
Film and Electrolytic	17,061		8,550	
	62,195	23.4%	69,718	28.0%
SG&A expenses				
Tantalum	11,659		10,981	
Ceramic	6,083		6,000	
Film and Electrolytic	10,613		8,018	
	28,355	10.7%	24,999	10.1%
R&D expenses				
Tantalum	3,623		3,104	
Ceramic	1,702		1,654	
Film and Electrolytic	2,037		1,466	
	7,362	2.8%	6,224	2.5%
Restructuring charges				
Tantalum	864		322	
Ceramic	49		93	
Film and Electrolytic	692		1,888	
	1,605	0.6%	2,303	0.9%
(Gain) loss on sales and disposals of assets				
Tantalum			(121)	
Ceramic			(1,655)	
Film and Electrolytic	(40)		6	
	(40)		(1,770)	-0.7%
Operating income (loss)				

Net revenues

	Year Ended December 31,		Change	
	2017	2016	Dollars	%
	(in thousands)			
Net revenues				
Finished pharmaceutical products	$ 230,139	$ 240,221	$ (10,082)	(4) %
API	10,036	14,944	(4,908)	(33) %
	$ 240,175	$ 255,165	$ (14,990)	(6) %

Total net revenues				
Cost of revenues				
Finished pharmaceutical products	$ 133,622	$ 127,592	$ 6,030	5 %
API	16,044	23,377	(7,333)	(31) %
Total cost of revenues	$ 149,666	$ 150,969	$ (1,303)	(1) %
Gross profit	$ 90,509	$ 104,196	$ (13,687)	(13) %
as % of net revenues	38 %	41 %		

The decrease in net revenues of finished pharmaceutical products for 2017 was primarily due to the following changes:

	Year Ended December 31,		Change	
	2017	2016	Dollars	%
	(in thousands)			
Finished pharmaceutical products net revenues				
Enoxaparin	$ 36,593	$ 59,320	$ (22,727)	(38) %
Lidocaine	37,602	36,600	1,002	3 %
Naloxone	42,342	47,532	(5,190)	(11) %
Phytonadione	37,946	33,315	4,631	14 %
Epinephrine	25,914	25,661	253	1 %
Other finished pharmaceutical products	49,742	37,793	11,949	32 %
Total finished pharmaceutical products net revenues	$ 230,139	$ 240,221	$ (10,082)	(4) %

The decrease in sales of enoxaparin was driven by lower unit volumes, which resulted in a decrease of approximately $13.1 million, as well as by lower average selling prices, which resulted in a decrease of approximately $9.6 million. We expect that the average selling price and unit volumes of enoxaparin will continue to fluctuate in the near term as a result of competition.

Lower unit volumes of naloxone led to a decrease in sales of approximately $3.8 million, while lower average selling price caused a decrease in sales of approximately $1.4 million. We anticipate that sales of this product may fluctuate due to increased competition driven by future competitor launches.

Higher unit volumes of phytonadione led to an increase in sales of approximately $2.4 million, while higher average selling price caused an increase in sales of approximately $2.2 million. An increase in average selling prices of epinephrine caused an increase of approximately $10.4 million in net revenues, which was offset by the decrease in unit volumes which was primarily a result of the discontinuation of our epinephrine injection, USP vial product in the second quarter of 2017 in accordance with the FDA's request. Our epinephrine injection, USP vial product, was marketed under the "grandfather" exception to the FDA's "Prescription Drug Wrap-Up" program. During 2017, we recognized $17.8 million in net revenues for the sale of the discontinued vial product. The remainder of our epinephrine sales was from the pre-filled syringe, which remains on the market. Other finished pharmaceutical products increased in unit volumes due to a temporary competitor shortage.

Sales of RHI API decreased primarily because of lower shipments to MannKind in 2017.

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We anticipate that sales of insulin API will continue to fluctuate and will likely decrease due to the inherent uncertainties related to sales of RHI API to MannKind. In addition, most of our API sales are denominated in euros, and the fluctuation in the value of the euro versus the dollar has had, and will continue to have, an impact on API sales revenues in the near term. In November 2016, we amended the Supply Agreement, or the Supply Agreement Amendment, with MannKind, whereby MannKind's aggregate total commitment of RHI API under the Supply Agreement was not reduced; however, the annual minimum purchase commitments of RHI API under the Supply Agreement were modified and extended through 2023, which timeframe would have previously lapsed after calendar year 2019. The Supply Agreement Amendment can be renewed for additional, successive two-year terms upon 12 months' written notice given prior to the end of the initial term or any additional two-year term.

Concurrently with the amendment of the Supply Agreement, we amended the Option Agreement with MannKind to, among other things, extend the timing for payment of the capacity cancellation fee for 2017 and decrease the amounts payable as capacity cancellation fees for 2018 and 2019 in the event MannKind fails to exercise its minimum annual purchase option for any given year. We recognized the cancellation fees for 2018 of $0.9 million and for 2017 of $1.5 million in net revenues in our consolidated statement of operations for the years ended December 31, 2017 and December 31, 2016.

Cost of revenues

Cost of revenues decreased in dollar terms due to declines in units sold, primarily related to enoxaparin and RHI API declines. Gross margins declined due to lower selling prices for enoxaparin and naloxone. In addition, for 2017, a charge of $8.5 million was recorded to adjust certain inventory to their net realizable value, including $5.5 million for enoxaparin inventory due to a decrease in the forecasted average selling price. For 2016, a charge of $7.3 million was recorded to adjust certain inventory items to their net realizable value, including $3.1 million for enoxaparin inventory items and $3.3 million for epinephrine injection, USP vial inventory items and related firm inventory purchase commitments.

Declining average selling prices and unit volume of enoxaparin and the discontinuance of our epinephrine injection, USP vial product will continue to put downward pressure on our gross margins. However, we believe that this trend will be offset by new product launches, including neostigmine methylsulfate, medroxyprogesterone acetate and sodium nitroprusside.

Selling, distribution, and marketing, and general and administrative

	Year Ended December 31,		Change	
	2017	2016	Dollars	%
	(in thousands)			
Selling, distribution, and marketing	$ 6,460	$ 5,466	$ 994	18 %
General and administrative	44,458	41,832	2,626	6 %

The increase in general and administrative expense was primarily due to an increase in legal expenses relating to our July 2017 patent trial (see Note 19 to the consolidated financial statements for more information).

We expect that general and administrative expenses will increase on an annual basis due to increased costs associated with ongoing compliance with public company reporting obligations.

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Research and development

	Year Ended December 31,		Change		
	2017	2016	Dollars	%	
	(in thousands)				
Salaries and personnel-related expenses	$ 15,973	$ 15,157	$ 816	5	%
Pre-launch inventory	2,002	1,096	906	83	%
Clinical trials	2,591	1,599	992	62	%
FDA fees	130	2,764	(2,634)	(95)	%
Testing, operating and lab supplies	13,571	12,310	1,261	10	%
Depreciation	5,044	4,857	187	4	%
Other expenses	4,192	3,739	453	12	%
Total research and development expenses	$ 43,503	$ 41,522	$ 1,981	5	%

Research and development costs consist primarily of costs associated with the research and development of our product candidates, such as salaries and other personnel related expenses for employees involved with research and development activities, manufacturing pre-launch inventory, clinical trials, FDA fees, testing, operating and lab supplies, depreciation and other related expenses. We expense research and development costs as incurred.

Testing, operating and lab supplies increased due to expenditures on materials for our pipeline products, particularly production of APIs for our pipeline at our ANP facility. FDA fees decreased in 2017 due to the NDA filing of our intranasal naloxone product candidate that was submitted in the second quarter of 2016. Pre-launch inventory increased due to pre-approval purchases of APIs for medroxyprogesterone acetate and sodium nitroprusside. Clinical trials expense increased due to spending on pilot trials for inhalation products.

Gain on sale of intangible assets

	Year Ended December 31,		Change	
	2017	2016	Dollars	%
	(in thousands)			
Gain on sale of intangible assets	$ (2,643)	$ —	$ (2,643)	N/A

In February 2017, we sold certain ANDAs that we acquired in March 2016 and recognized a gain of $2.6 million (see Note 3 and Note 9 to the consolidated financial statements for more information).

Provision for income tax expense (benefit)

	Year Ended December 31, 2017	2016	Change Dollars	%
	(in thousands)			
Income tax expense (benefit)	$ (2,398)	$ 4,810	$ (7,208)	(150) %
Effective tax rate	(192) %	33 %		

The difference in income tax expense (benefit) in 2017 compared to 2016 was primarily due to changes in pre-tax income positions and excess share-based compensation benefits directly recorded as income tax benefit in 2017.

Liquidity and Capital Resources

Cash Requirements and Sources

We need capital resources to maintain and expand our business. We expect our cash requirements to increase significantly in the foreseeable future as we sponsor clinical trials for, seek regulatory approvals of, and develop, manufacture and market our current development stage product candidates and pursue strategic acquisitions of businesses or assets. Our future capital expenditures include projects to upgrade, expand and improve our manufacturing facilities in the United States, China, and France. Our cash obligations include the principal and interest payments due on our existing loans and lease payments, as described below and throughout this Annual Report on Form 10-K. As of December 31, 2018, our foreign subsidiaries collectively held $37.8 million in cash and cash equivalents. Cash or cash equivalents held at foreign subsidiaries are not available to fund the parent company’s operations in the United States.

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We believe that our cash reserves, operating cash flows, and borrowing availability under our credit facilities will be sufficient to fund our operations for at least the next 12 months. We expect additional cash flows to be generated in the longer term from future product introductions, although there can be no assurance as to the receipt of regulatory approval for any product candidates that we are developing or the timing of any product introductions, which could be lengthy or ultimately unsuccessful.

In July 2018, our Chinese subsidiary, ANP, completed a private placement of its common equity interest to accredited investors for aggregate gross proceeds of approximately $57 million, of which $38.0 million had been received by ANP as of December 31, 2018. While investors were initially required to complete their contributions in cash by December 31, 2018, ANP granted an extension to certain investors. Subsequently, including the funds from the extension, the proceeds ANP received from the private placement totaled $56.3 million. The proceeds from this private placement will be used to fund the cash requirements of the expansion of our manufacturing facility in China.

We maintain a shelf registration statement on Form S-3 pursuant to which we may, from time to time, sell up to an aggregate of $250 million of our common stock, preferred stock, depositary shares, warrants, units, or debt securities. If we require or elect to seek additional capital through debt or equity financing in the future, we may not be able to raise capital on terms acceptable to us or at all. To the extent we raise additional capital through the sale of equity or convertible debt securities, the issuance of such securities will result in dilution to our stockholders. If we are required and unable to raise additional capital when desired, our business, operating results and financial condition may be adversely affected.

Working capital decreased $7.1 million to $113.5 million at December 31, 2018, compared to $120.6 million at December 31, 2017.

Cash Flows from Operations

The following table summarizes our cash flows from operating, investing, and financing activities for the years ended December 31, 2018, 2017 and 2016.

	Year Ended December 31,		
	2018	2017	2016
	(in thousands)		
Statement of Cash Flow Data:			
Net cash provided by (used in)			
Operating activities	$ 38,191	$ 39,209	$ 38,560
Investing activities	(42,182)	(36,890)	(39,501)
Financing activities	25,008	(7,718)	7,140
Effect of exchange rate changes on cash	(274)	504	81

Net increase (decrease) in cash, cash equivalents, and restricted cash	$ 20,743	$ (4,895)	$ 6,280

Sources and Use of Cash

Operating Activities

Net cash provided by operating activities was $38.2 million for the year ended December 31, 2018, which included net loss of $6.7 million. Non-cash items were primarily comprised of $16.5 million of depreciation and amortization, and $16.7 million of share-based compensation expense.

Additionally, there was a net cash inflow from changes in operating assets and liabilities of $12.1 million which resulted from the increase in accounts payable and accrued liabilities offset by an increase in accounts receivable and inventory. The increase in accounts receivable was due to an increase in sales. An increase in inventory, due to increased purchases of raw materials for Primatene® Mist, enoxaparin and other products in the U.S., was partially offset by a decrease in finished RHI API at AFP. Accounts payable and accrued liabilities increased, primarily due to the timing of payments.

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Investing Activities

Net cash used in investing activities was $42.2 million for the year ended December 31, 2018, primarily as a result of $46.8 million in purchases of property, plant, and equipment, which included $15.7 million incurred in the United States, $9.3 million in France, and $21.8 million in China. The cash used was partially offset by the $4.4 million receipt of the remaining consideration of the sale of the various ANDAs in February 2017 (see Note 9 to the consolidated financial statements for more information).

Financing Activities

Net cash provided by financing activities was $25.0 million for the year ended December 31, 2018, primarily as a result of $38.0 million received from the ANP private placement and $8.9 million of proceeds received from our equity plans, which was partially offset by $25.0 million used to purchase treasury stock. Additionally, we received proceeds of $8.4 million primarily from borrowings on an equipment line of credit, and made $5.7 million in principal payments on our long-term debt.

Debt and Borrowing Capacity

Our outstanding debt obligations are summarized as follows:

	December 31,		
	2018	2017	Change
	(in thousands)		
Short-term debt and current portion of long-term debt	$ 18,229	$ 6,312	$ 11,917
Long-term debt	31,984	40,844	(8,860)
Total debt	$ 50,213	$ 47,156	$ 3,057

As of December 31, 2018, we had $35.0 million in unused borrowing capacity under revolving lines of credit with Cathay Bank and East West Bank. At December 31, 2018, we were in compliance with our debt covenants, which include a minimum current ratio, minimum debt service coverage, minimum tangible net worth, maximum debt-to-effective-tangible-net-worth ratio, and minimum deposit requirement computed on a consolidated basis. The profitability requirements for loans with Cathay Bank were not effective as of December 31, 2018. Such requirements will become effective as of December 31, 2019.

Lines of credit bear variable interest rates and are secured by inventory, accounts receivable, intangible assets, and equipment. The weighted average interest rates on lines of credit as of December 31, 2018 and 2017 were 5.6% and 3.9%, respectively. We have also entered into or refinanced certain mortgage and equipment loans with Cathay Bank and East West Bank, which bear variable or fixed interest rates and are secured by buildings and equipment. On certain loans with East West Bank, we have entered into fixed interest rate swap contracts to exchange the variable interests for fixed interest rates without the exchange of underlying notional debt amounts.

For more information regarding our outstanding indebtedness, see “Part II – Item 8. Financial Statements and Supplementary Data – Notes to Consolidated Financial Statements – Debt.”

Critical Accounting Policies

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States, or GAAP. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. In some cases, changes in the accounting estimates are reasonably likely to occur from period to period. Accordingly, actual results could differ materially from our estimates. To the extent that there are material differences between these estimates and actual results, our financial condition and results of operations will be affected. We base our estimates on past experience and other assumptions that we believe are reasonable under the circumstances, and we evaluate these estimates on an ongoing basis. We refer to accounting estimates of this type as critical accounting policies, which we discuss further below. While our significant accounting policies are more fully described in Note 2 to our audited consolidated financial statements, we believe that

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the following accounting policies are critical to the process of making significant judgments and estimates in the preparation of our audited consolidated financial statements.

Revenue Recognition

In 2018, we adopted ASC 606, Revenue from Contracts with Customers, or ASC 606, using the modified retrospective transition method. The adoption of ASC 606 did not have a material impact on our revenues recognition or on the consolidated financial statements and related disclosures. According to ASC 606, revenue is recognized at the time that our customers obtain control of the promised goods. Revenues derived from contract manufacturing services are recognized when third-party products are shipped to customers, after customers have accepted test samples of the products to be shipped. The results for the reporting period beginning after January 1, 2018, are presented in accordance with the new standard, although comparative information continues to be reported under the accounting standards and policies in effect for those periods.

Our net revenues consist principally of revenues generated from the sale of our pharmaceutical products. We also generate a small amount of revenues from contract manufacturing services. Generally, we recognize revenues at the time of product delivery to our customers. In some cases, revenues are recognized at the time of shipment when stipulated by the terms of the sale agreements. Revenues derived from contract manufacturing services are recognized when third party products are shipped to customers, after the customer has accepted test samples of the products to be shipped.

We only record revenues to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved, by estimating and recording reductions to revenue for discounts, product returns, and pricing adjustments, such as wholesaler chargebacks and retailer rebates, in the same period that the related revenue is recorded.

If actual future payments for the discounts, returns, fees, rebates and chargebacks exceed the estimates we made at the time of sale, our financial position, results of operations and cash flows would be negatively impacted. As discussed under “Accrual for Product Returns” below, we are generally obligated to accept from our customers the return of pharmaceuticals that have reached or will soon reach their expiration dates. We establish reserves for such amounts based on historical experience and other information available at the time of sale, but the actual returns will not occur until several years after the sale. Although we believe that our estimates and assumptions are reasonable as of the date when made, actual results may differ significantly from these estimates. Our financial position, results of operations and cash flows may be materially and negatively impacted if actual returns exceed our estimated allowances for returns.

We establish allowances for estimated chargebacks, rebates and product returns based on a number of qualitative and quantitative factors, including:

- contract pricing and return terms of our agreements with customers;
- wholesaler inventory levels and turnover;
- historical chargeback and product return rates;
- shelf lives of our products, which is generally two years, as is the case with enoxaparin;
- direct communication with customers;
- anticipated introduction of competitive products or authorized generics; and
- anticipated pricing strategy changes by us and/or our competitors.

Provision for Chargebacks and Rebates

The provision for chargebacks and rebates is a significant estimate used in the recognition of revenue. Wholesaler chargebacks relate to sales terms under which we agree to reimburse wholesalers for differences between the gross sales prices at which we sell our products to wholesalers and the actual prices of such products that wholesalers resell them

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under our various contractual arrangements with third parties such as hospitals and group purchasing organizations in the United States. Rebates include primarily amounts paid to retailers, payers, and providers in the United States, including those paid to state Medicaid programs, and are based on contractual arrangements or statutory requirements. We estimate chargebacks and rebates using the expected value method at the time of sale to wholesalers based on wholesaler inventory stocking levels, historic chargeback and rebate rates, and current contract pricing.

The provision for chargebacks and rebates is reflected in net revenues. The following table is an analysis of the chargeback and rebate provision:

	Year Ended December 31,	
	2018	2017
	(in thousands)	
Beginning balance	$ 18,470	$ 39,709
Provision for chargebacks and rebates	125,112	152,011
Credits and payments issued to third parties	(121,159)	(173,250)
Ending balance	$ 22,423	$ 18,470

Changes in the chargeback provision from period to period are primarily dependent on our sales to wholesalers, the level of inventory held by wholesalers, and the wholesaler's customer mix. Changes in the rebate provision from period to period are primarily dependent on retailers' and other indirect customers' purchases. The approach that we use to estimate chargebacks and rebates has been consistently applied for all periods presented. Variations in estimates have been historically small. We continually monitor the provision for chargebacks and rebates and make adjustments when we believe that the actual chargebacks and rebates may differ from the estimates. The settlement of chargebacks and rebates generally occurs within 30 days to 60 days after the sale to wholesalers. Accounts receivable and/or accounts payable and accrued liabilities are reduced and/or increased by the chargebacks and rebate amounts depending on whether we have the right to offset with the customer. Of the provision for chargebacks and rebates as of December 31, 2018 and 2017, $12.0 million and $6.8 million were included in accounts receivable, net, on the consolidated balance sheets, respectively. The remaining provision as of December 31, 2018 and 2017, was $10.4 million and $11.7 million, respectively, which were included in accounts payable and accrued liabilities.

Accrual for Product Returns

We offer most customers the right to return qualified excess or expired inventory for partial credit; however, API product sales are generally non returnable. Our product returns primarily consist of the returns of expired products from sales made in prior periods. Returned products cannot be resold. At the time product revenue is recognized, we record an accrual for product returns estimated using the expected value method. The accrual is based, in part, upon the historical relationship of product returns to sales and customer contract terms. We also assess other factors that could affect product returns including market conditions, product obsolescence and the introduction of new competition. Although these factors do not normally give our customers the right to return products outside of the regular return policy, we realize that such factors could ultimately lead to increased returns. We analyze these situations on a case by case basis and make adjustments to the product return reserve as appropriate.

The provision for product returns is reflected in net revenues. The following table is an analysis of our product return liability:

	Year Ended December 31,	
	2018	2017
	(in thousands)	
Beginning balance	$ 6,522	$ 3,143
Provision for product returns	4,149	5,754
Credits issued to third parties	(2,641)	(2,375)
Ending balance	$ 8,030	$ 6,522

Of the provision for product returns as of December 31, 2018 and 2017, $5.3 million and $4.1 million were included in accounts payable and accrued liabilities on the consolidated balance sheets, respectively. The remaining provision of

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$2.7 million and $2.4 million were included in other long-term liabilities, respectively. For the years ended December 31, 2018 and 2017, our aggregate product return rate was 1.3% and 1.3% of qualified sales, respectively.

Inventory

Inventories consist of currently marketed products and products manufactured under contract. Inventories are stated using the first in, first out method, on a consistent basis. Inventory is stated at the lower of cost and net realizable value. We adjust inventories to their net realizable value: (i) if a launch of a new product is delayed and inventory may not be fully utilized and could be subject to impairment, (ii) when a product is close to expiration and not expected to be sold, (iii) when a product has reached its expiration date, (iv) when a product is not expected to be sellable, and (v) when the net realizable value is below cost. In determining the net realizable value of an inventory item, we consider factors such as the amount of inventory on hand, its remaining shelf life, its regulatory approval status, and current and expected market conditions, including management forecasts and levels of competition.

Impairment of Intangible and Long Lived Assets

We review long lived assets and definite-lived identifiable intangible assets or asset groups for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Such events and circumstances include decisions by the FDA regarding evidence of effectiveness of proprietary drug candidates or bioequivalence (sameness) of our generic product candidates as compared to the reference drug, communication with the regulatory agencies regarding the safety and efficacy of our products under review, the use of the asset in current research and development projects, any potential alternative uses of the asset in other research and development projects in the short to medium term, clinical trial results and research and development portfolio management options. Determination of recoverability is based on an estimate of undiscounted future cash flows resulting from the use of the asset or asset groups and its eventual disposition. If the sum of the expected future undiscounted cash flows is less than the carrying amount of the asset or asset groups, further impairment analysis is performed. An impairment loss is measured as the amount by which the carrying amount exceeds the fair value of the asset or asset groups (assets to be held and used) or fair value less cost to sell (assets to be disposed of). All of our impairments relate primarily to the isolated write off of certain manufacturing equipment related to abandoned projects. Since we periodically assess our product candidates and make changes to product development plans, we incur impairment charges from time to time which can fluctuate significantly from period to period.

The indefinite lived intangible asset, the Primatene® trademark acquired in June 2008, and goodwill are tested for impairment annually, in the fourth quarter, or more frequently if indicators of impairment are present. An impairment loss is recorded if the asset's fair value is less than its carrying value. We also periodically review the Primatene® trademark to determine if events and circumstances continue to support an indefinite useful life. When we choose to perform a qualitative assessment, we evaluate economic, industry and company-specific factors as an initial step. If we determine it is more likely than not that the Primatene® trademark is impaired or the fair value of a reporting unit is less than its carrying amount, further quantitative impairment process is then performed; otherwise, no further testing is required. If the life is no longer indefinite, the asset is tested for impairment, and the carrying value, after recognition of any impairment loss, is amortized over its remaining useful life. No impairment of indefinite-lived intangible asset and goodwill was recorded during the years ended December 31, 2018, 2017, or 2016, respectively.

Deferred Income Taxes

We utilize the liability method of accounting for income taxes under which deferred taxes are determined based on the temporary differences between the financial statements and the tax basis of assets and liabilities using enacted tax rates. A valuation allowance is recorded when it is more likely than not that the deferred tax assets will not be realized.

A number of years may elapse before an uncertain tax position for which we have established a tax reserve is audited and finally resolved. The number of years for which we can be subject to audit varies depending on the tax jurisdiction. While it is often difficult to predict the final outcome or the timing of the resolution of an audit, we believe that our reserves for uncertain tax benefits reflect the outcome of tax positions that is more likely than not to occur. The resolution of a matter could be recognized as an adjustment to our provision for income taxes and our effective tax rate in the period of resolution, and may also require a use of cash.

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Share-Based Compensation

Options issued under our 2015 Equity Incentive Award Plan, or the 2015 Plan, and our Amended and Restated 2005 Equity Incentive Award Plan, or 2005 Plan, are granted at exercise prices equal to or greater than the fair value of the underlying common shares on the date of grant and vest based on continuous service. There have been no awards with performance conditions and no awards with market conditions. The options have a contractual term of five to ten years and generally vest over a three to five year period. We use the Black Scholes option pricing model to determine the fair value of options awards. The Black Scholes option pricing model has various inputs such as the common share price on the date of grant, exercise price, the risk free interest rate, volatility, expected life and dividend yield, all of which are estimates. We used the risk free rate on U.S. Treasury securities at the time of grant for instruments with maturities commensurate with the expected term of the stock option. Our volatility estimate was based on the weighted average historical volatility of our stock price since IPO and the stock price from a set of peer companies, since our shares do not have sufficient trading history. We consider factors such as stage of life cycle, competitors, size, market capitalization and financial leverage in the selection of similar entities. Our dividend yield was assumed to be 0%, because we have no plans to pay dividends. We estimate the expected term of options with consideration of vesting date, contractual term, and historical experience for employee exercise and post-vesting employment termination behavior after our common stock has been publicly traded. The expected term of “plain vanilla” options is estimated based on the midpoint between the vesting date and the end of the contractual term under the simplified method.

The fair value of each share-based compensation award is amortized into compensation expense on a straight line basis between the grant date for the option and the vesting date net of expected forfeitures. We estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual numbers differ from such estimates. The change of any of these inputs could significantly impact the determination of the fair value of our options as well as significantly impact our results of operations.

Effective January 1, 2017, we prospectively adopted certain requirements of Auditing Standards Update, or ASU No. 2016-09. As a result, cash flows related to excess tax benefits are classified in operating activities and all excess tax benefits and tax deficiencies are directly included in income tax expense or benefit in the consolidated statement of operations without adjusting prior periods. Additionally, ASU No. 2016-09 eliminated the requirement that excess tax benefits from share-based compensation reduce taxes payable prior to being recognized in the financial statements. Upon adoption of ASU No. 2016-09, the cumulative excess benefits of stock compensation of $0.9 million that was not previously recognized was established on the balance sheet resulting in an increase in deferred tax assets and retained earnings.

Common Stock Valuation Prior to Our Initial Public Offering

For all equity grants prior to our initial public offering on June 25, 2014, we were required to estimate the fair value of the common stock underlying our share based awards when performing the fair value calculations with the Black Scholes option pricing model. The fair values of the common stock underlying our share based awards were determined by our Board of Directors, with input from management and contemporaneous third party valuations. We believe that our Board of Directors had the relevant experience and expertise to determine the fair value of our common stock. As described below, the exercise price of our share based awards was determined by our Board of Directors based on a number of factors, including the most recent third party valuation report as of the grant date.

Given the absence of a public trading market of our common stock prior to our initial public offering, and in accordance with the American Institute of Certified Public Accountants Practice Guide, Valuation of Privately Held Company Equity Securities Issued as Compensation, our Board of Directors exercised reasonable judgment and considered numerous objective and subjective factors to determine the best estimate of the fair value of

our common stock.

The dates of our valuation reports, which were prepared on a quarterly basis, were not always contemporaneous with the grant dates of our share based awards. Therefore, in those cases where the report was not contemporaneous with the grant date of the stock based awards, we considered the amount of time between the valuation report date and the grant date to determine whether to use the latest common stock valuation report for the purposes of determining the fair value of our common stock for financial reporting purposes. If share based awards were granted in a short period of time preceding the date of a valuation report, we assessed the fair value of such share based awards used for financial reporting purposes after considering the fair value reflected in the subsequent valuation report and other facts and circumstances on the date of grant as discussed below. There were significant judgments and estimates inherent in these

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valuations, which included assumptions regarding our future operating performance, the time to completing an initial public offering or other liquidity event and the determinations of the appropriate valuation methods to be applied.

In valuing our common stock, our Board of Directors determined the equity value of our business using generally accepted valuation methodologies including discounted cash flow analysis and comparable public company analysis.

Once calculated, the Board determined the midpoint of the results of the discounted cash flow and the market comparable approach and then weighted the two methodologies to determine an estimated enterprise value.

Once an enterprise value was determined, we utilized the option pricing method, or OPM, to allocate the equity value to our common stock. The OPM values each equity class by creating a series of call options on our equity value, with exercise prices based on the strike prices of derivatives. This method is generally preferred when future outcomes are difficult to predict and dissolution or liquidation is not imminent. The inability to readily sell shares of a company increases the owner's exposure to changing market conditions and increases the risk of ownership. Because of the lack of marketability and the resulting increased risk associated with ownership of a privately held stock, an investor typically demands a higher return or yield in comparison to a similar but publicly traded stock. An indication of the discount for lack of marketability can be developed using a put option model. A put option model values what the illiquid security holder lacks, the ability to sell his or her shares. Theoretically, a holder of an illiquid security and a put option, and a holder of an identical, but liquid security, are in the same financial position. The put option model has the benefit of being company specific (through the use of a company specific volatility rate), verifiable and has relatively few inputs (risk free rate, term and volatility).

Business Combinations

If an acquired set of activities and assets is capable of being operated as a business consisting of inputs and processes from the viewpoint of a market participant, the assets acquired and liabilities assumed are a business. Business combinations are accounted for using the acquisition method of accounting, which requires an acquirer to recognize the assets acquired and the liabilities assumed at the acquisition date measured at their fair value as of that date. Fair value determinations are based on discounted cash flow analyses or other valuation techniques. In determining the fair value of the assets acquired and liabilities assumed in a material acquisition, we may utilize appraisals from third party valuation firms to determine fair values of some or all of the assets acquired and liabilities assumed, or may complete some or all of the valuations internally. In either case, we take full responsibility for the determination of the fair value of the assets acquired and liabilities assumed. The value of goodwill reflects the excess of the fair value of the consideration conveyed to the seller over the fair value of the net assets received.

Acquisition-related costs that we incur to effect a business combination are expensed in the periods in which the costs are incurred. When the operations of the acquired businesses were not material to our consolidated financial statements, no pro forma presentations were disclosed.

JOBS Act Accounting Election

Under the JOBS Act, emerging growth companies can delay adopting new or revised accounting standards issued subsequent to the enactment of the JOBS Act until such time as those standards apply to private companies. We have irrevocably elected not to avail ourselves of this exemption from new or revised accounting standards and, therefore, will be subject to the same new or revised accounting standards as other public companies that are not emerging growth companies.

Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board, or FASB, issued ASU No. 2016-02, Leases, which is aimed at making leasing activities more transparent and comparable, and which requires substantially all leases be recognized by lessees on their balance sheets as a right-of-use asset and corresponding lease liability, including leases currently accounted for as operating leases. The ASU and the related clarifications subsequently issued by the FASB will become effective for our interim and annual reporting periods during the year ending December 31, 2019, and all annual and interim reporting periods thereafter. Early adoption is permitted. In July 2018, the FASB further amended the standard to allow for a new transition method that offers the option to use the effective date as the date of initial application. We intend to elect this alternative transition method and therefore will not adjust comparative-period

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financial information. We are finalizing our assessment related to policies, processes and internal controls to comply with the guidance. We estimate the right-of-use assets and lease obligations for our lease portfolio as of December 31, 2018 to be within the range of approximately $13.4 million and $14.3 million, which would be recorded on our consolidated balance sheet, primarily related to real estate. We anticipate that we will elect the available practical expedients at transition including the package of expedients whereby we will not reassess our prior conclusion related to whether a contact contains a lease, the underlying lease classification or accounting for initial direct cost in a lease, in addition to electing the hindsight practical expedient in determining the lease term and the short-term lease exception such that we will not recognize a right-of-use asset or lease liability for leases with a term of 12 months or less. The new standard also provides practical expedients for the ongoing accounting and we currently expect to elect the practical expedient to not separate lease and non-lease components for our asset classes. Note 17 provides details on our current operating lease arrangements. The adoption of ASC 842 is not expected to have a material impact on our results of operations or cash flows.

In June 2016, the FASB issued ASU No. 2016-13 Financial Instruments – Credit Losses, which is aimed at providing financial statement users with more useful information about the expected credit losses on financial instruments and other commitments to extend credit. The standard update changes the impairment model for financial assets measured at amortized cost, requiring presentation at the net amount expected to be collected. The measurement of expected credit losses requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Available-for-sale debt securities with unrealized losses will be recorded through an allowance for credit losses. The guidance is effective for our interim and annual reporting periods during the year ending December 31, 2020. Early adoption is permitted for interim or annual periods after December 31, 2019. We will be required to apply the standard’s provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. We do not believe the adoption of this accounting guidance will have a material impact on our consolidated financial statements and related disclosures.

In January 2017, the FASB issued ASU No. 2017-04 simplifying the Test for Goodwill Impairment, which eliminates the requirement to calculate the implied fair value of goodwill. An entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The update also eliminated the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. An entity is required to disclose the amount of goodwill allocated to each reporting unit with a zero or negative carrying amount of net assets. The guidance is effective for our interim and annual reporting periods during the year ending December 31, 2020, and applied on a prospective basis. Early adoption is permitted for interim and annual goodwill impairment testing dates after January 1, 2017. We currently do not believe that the adoption of this accounting guidance will have a material impact on our consolidated financial statements and related disclosures.

In August 2017, the FASB issued ASU No. 2017-12 Targeted Improvements to Accounting for Hedging Activities, which amends the hedge accounting model in ASC 815 to enable entities to better portray the economics of their risk management activities in the financial statements and enhance the transparency and understandability of hedge results. The amendments also simplify the application of hedge accounting in certain situations. The new guidance is effective for our interim and annual reporting periods during the year ending December 31, 2019. Early adoption is permitted.

We do not believe that the adoption of this accounting guidance will have a material impact on our consolidated financial statements and related disclosures.

In February 2018, the FASB issued ASU No. 2018-02 Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which allows entities to reclassify from accumulated other comprehensive income to retained earnings stranded tax effects resulting from the Tax Act. The guidance is effective for our interim and annual reporting periods during the year ending December 31, 2019. Early adoption is permitted. We do not believe that the adoption of this accounting guidance will have a material impact on our consolidated financial statements and related disclosures.

In June 2018, the FASB issued ASU No. 2018-07, Improvements to Non-employee Share-Based Payment Accounting, which simplifies the accounting for share-based payments to non-employees by aligning it with the accounting for share-based payments to employees. We early adopted the guidance on July 1, 2018. The adoption did not have a material impact on our consolidated financial statements and related disclosures.

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In August 2018, the FASB issued ASU No. 2018-13, Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement, which removes, modifies, and adds certain disclosure requirements to ASC 820, Fair Value Measurement. The guidance is effective for our interim and annual reporting periods during the year ending December 31, 2020. Early adoption is permitted. We do not believe that the adoption of this accounting guidance will have a material impact on our consolidated financial statements and related disclosures.

In August 2018, the FASB issued ASU No. 2018-14, Disclosure Framework – Changes to the Disclosure Requirements for Defined Benefit Plans, which removes, modifies, and adds certain disclosure requirements to ASC 715-20, Defined Benefit Plans. The guidance is effective for our interim and annual reporting periods during the year ending December 31, 2021. Early adoption is permitted. We do not believe that the adoption of this accounting guidance will have a material impact on our consolidated financial statements and related disclosures.

In October 2018, the FASB issued ASU No. 2018-17, Targeted Improvements to Related Party Guidance for Variable Interest Entities, which requires indirect interests held through related parties in common control arrangements be considered on a proportional basis for determining whether fees paid to decision makers and service providers are variable interests. The guidance is effective for our interim and annual reporting periods during the year ending December 31, 2020. Early adoption is permitted. We currently do not believe that the adoption of this accounting guidance will have a material impact on our consolidated financial statements and related disclosures.

In November 2018, the FASB issued ASU No. 2018-18, Clarifying the Interaction between Topic 808 and Topic 606, which requires transactions in collaborative arrangements to be accounted for under ASC 606, Revenue from Contracts with Customers, or ASC 606, if the counterparty is a customer for a good or service that is a distinct unit of account. The amendments also preclude entities from presenting consideration from transactions with a collaborator that is not a customer together with revenue recognized from contracts with customers. The guidance is effective for our interim and annual reporting periods during the year ending December 31, 2020. Early adoption is permitted, including in any interim period. We are currently evaluating the impact that the adoption of this guidance will have on our consolidated financial statements and related disclosures.

Non-GAAP Financial Measures

We report our financial results in accordance with accounting principles generally accepted in the United States, or GAAP.

Collaboration Agreements with Medical Device Manufacturers

In August 2014, we entered into a collaboration agreement with a medical device manufacturer to develop a drug delivery system to be used by us for one of our pipeline products. As of December 31, 2018, we have paid an upfront payment of $0.5 million and $1.7 million in milestone payments under this agreement, which were classified as research and development expense as the milestones were met. We are obligated to pay up to an additional $0.4 million if certain research and development milestones are met. As of December 31, 2018, no such obligation existed. Pursuant to the collaboration agreement, if the medical device manufacturer is successful in the development of this drug delivery system and our pipeline products receive appropriate regulatory approval, we intend to enter into a commercial supply agreement with such medical device manufacturer for a minimum purchase of 1.0 million units during the first 12 months.

In October 2017, we entered into a collaboration agreement with a medical device manufacturer to develop a drug delivery system to be used by us for one of our pipeline products for a total of $1.6 million. As of December 31, 2018, we have paid and expensed an upfront payment of $0.4 million and $0.2 million in milestone payments under this agreement, which were classified as research and development expenses as the milestones were met. We are obligated to pay up to an additional $1.0 million, if certain research and development milestones are met. As of December 31, 2018, no such obligation existed for the milestones. In addition, pursuant to the collaboration agreement, if the medical device manufacturer is successful in the development of this drug delivery system and our pipeline products receive appropriate regulatory approval, we intend to enter into a commercial supply agreement with such medical device manufacturer under which we are obligated to pay an additional $1.0 million, if certain commercial development milestones are met and to purchase a minimum of 100,000 units per year for three years.

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Contractual Obligations

Set forth below are our contractual payment obligations (including interest obligations but excluding intercompany obligations) as of December 31, 2018:

Contractual Obligations(1)	Total	Less than 1 year	1 - 3 years	3 - 5 years	More than 5 years
	(in thousands)				
Long-term debt(2)	$ 58,520	$ 19,841	$ 12,880	$ 4,816	$ 20,983
Operating leases	9,985	3,712	5,098	1,175	—
Capital leases	1,204	385	656	163	—
Facility construction in Nanjing, China(3)	10,500	10,500	—	—	—
Purchase obligations(4)	59,512	58,782	564	166	—
	$ 139,721	$ 93,220	$ 19,198	$ 6,320	$ 20,983

(1) The table above excludes our liability for uncertain tax position of $7.0 million because the timing of any related payments cannot be reasonably estimated.

(2) Long term debt includes accrued and unpaid interest. As of December 31, 2018, the principal amount of long-term debt with variable interest exposure was $13.4 million. As of December 31, 2018, the weighted average variable interest rate on our long term debt was 5.2%.

(3) Obligation to develop a facility in Nanjing, China. Please see "— Investment in China" below for further discussion.

(4) The purchase obligations principally relate to inventory and pharmaceutical manufacturing and laboratory equipment. We anticipate meeting these purchase obligations through a combination of cash on hand, future cash flows from operations and debt and lease facilities.

Off Balance Sheet Arrangements

We do not have any relationships or financial partnerships with unconsolidated entities, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off balance sheet arrangements or other contractually narrow or limited purposes. In addition, we do not engage in trading activities involving non exchange traded contracts.

Investment in China

In accordance with certain agreements between ANP and the Chinese government, in January 2010 and November 2012, we acquired certain land-use rights for $1.2 million and $1.3 million, respectively. As required by these agreements, we have committed to spending approximately $15.0 million in the related land development, which primarily includes the construction of fixed assets according to a specified timetable. As of December 31, 2018, we have spent $4.5 million on such construction. We anticipate that this spending commitment will be met by the end of 2019.

Government Regulation

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

From April 19, 2018 to April 27, 2018, two contract laboratories that provide testing services for heparin sodium raw materials were inspected. The first inspection was for the laboratory providing testing services for our current heparin supplier. There was one Form 483 observation issued. The current heparin supplier has responded to the Form 483 and we expect the response to satisfy the requirements of the FDA and that no further actions will be necessary. The second inspection was for the laboratory providing testing services of heparin sodium for the pending submission for our facility in Nanjing China. These vendors are related to our filing for the heparin sodium. There were no Form 483 observations issued. The inspections covered compliance with Good Laboratory Practice regarding the analytical testing performed for heparin sodium release.

From June 26, 2018 to June 29, 2018, our French subsidiary, AFP, had a routine inspection performed by the FDA. The routine inspection covered compliance with Current Good Manufacturing Practices. There were five Form 483 observations issued. A response was sent to the FDA within the 15 working day requirement which we expect will satisfy the requirements of the FDA and that no further actions will be necessary.

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From February 5, 2019 through February 12, 2019, our Amphastar facility in Rancho Cucamonga, California was subject to a preapproval inspection by the FDA. The inspection included a review of our corrective actions taken from the previous cGMP inspection in March 2017, as well as review of data to support our pending applications. The inspections resulted in multiple observations on Form 483. We fully responded to those observations on March 6, 2019. We believe that our responses to the observations will satisfy the requirements of the FDA and that no significant further actions will be necessary.

From February 25 through March 1, 2019, our IMS facility in South El Monte, California was subject to a preapproval inspection by the FDA. The inspection included a review of our corrective actions taken from the 2017 inspection as well as review of data to support our pending applications. The inspection resulted in multiple observations on Form 483. We plan to respond to those observations by March 22, 2019. We believe that our responses to the observations will satisfy the requirements of the FDA and that no significant further actions will be necessary.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

The following discussion provides forward-looking quantitative and qualitative information about our potential exposure to market risk. Market risk represents the potential loss arising from adverse changes in the value of financial instruments. The risk of loss is assessed based on the likelihood of adverse changes in fair values, cash flows or future earnings. We are exposed to market risk for changes in the market values of our investments (Investment Risk), the impact of interest rate changes (Interest Rate Risk), and the impact of foreign currency exchange changes (Foreign Currency Exchange Risk).

Investment Risk

We regularly review the carrying value of our investments and identify and recognize losses, for income statement purposes, when events and circumstances indicate that any declines in the fair values of such investments below our accounting basis are other than temporary. As of December 31, 2018, we did not have any such investments. We do not enter into investments for trading or speculative purposes.

As of December 31, 2018, we had $31.4 million deposited in seven banks located in China, $5.5 million deposited in one bank located in France, and $1.0 million deposited in one bank located in the United Kingdom. We also maintained $40.9 million in cash equivalents that include money market accounts, as of December 31, 2018. The remaining amounts of our cash equivalent as of December 31, 2018, are in non-interest bearing accounts.

As of December 31, 2017, we had $8.8 million deposited in six banks located in China, $4.7 million deposited in one bank located in France, and $0.1 million deposited in one bank located in the United Kingdom. We also maintained $45.8 million in cash equivalents that include money market accounts, as of December 31, 2017. The remaining amounts of our cash equivalent as of December 31, 2017, are in non-interest bearing accounts.

Interest Rate Risk

Our primary exposure to market risk is interest rate sensitive investments and credit facilities, which are affected by changes in the general level of U.S. interest rates. Due to the nature of our short-term investments, we believe that we are not subject to any material interest rate risk with respect to our short-term investments.

As of December 31, 2018, we had $50.2 million in long-term debt and capital leases outstanding. Of this amount, $13.4 million had variable interest rates that were not locked in through fixed interest rate swap contracts. The debt with variable interest rate exposure had a weighted-average interest rate of 5.2% at December 31, 2018. An increase in the index underlying these rates of 1% (100 basis points) would increase our annual interest expense on the debt with variable interest rate exposure by approximately $0.1 million per year.

As of December 31, 2017, we had $47.2 million in long-term debt and capital leases outstanding. Of this amount, $15.1 million had variable interest rates that were not locked in through fixed interest rate swap contracts. The debt with variable interest rate exposure had a weighted-average interest rate of 4.5% at December 31, 2017.

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Foreign Currency Exchange Risk

Our finished pharmaceutical products are primarily sold in the U.S. domestic market, and have little exposure to foreign currency price fluctuations. However, as a result of our acquisition of the API manufacturing business in Éragny-sur-Epte, France, we are exposed to market risk related to changes in foreign currency exchange rates. Specifically, our insulin sales contracts are frequently denominated in euros, which are subject to fluctuations relative to the U.S. dollar, or USD.

Our Chinese subsidiary, ANP, maintains its books of record in Chinese yuan. These books are remeasured into the functional currency of USD using the current or historical exchange rates. The resulting currency remeasurement adjustments and other transactional foreign exchange gains and losses are reflected in our statement of operations.

Our French subsidiary, AFP, maintains its books of record in euros. Our U.K. subsidiary, IMS UK, maintains its books of record in Great British pounds. These books are translated to USD at the average exchange rates during the period. Assets and liabilities are translated at the rate of exchange prevailing on the balance sheet date. Equity is translated at the prevailing exchange rate at the date of the equity transactions. Translation adjustments are reflected in stockholders' equity and are included as a component of other comprehensive income (loss).

We are also exposed to the potential earnings effects from intercompany foreign currency assets and liabilities that arise from normal trade receivables and payables and other intercompany loans.

We do not undertake hedging transactions to cover our foreign currency exposure. As of December 31, 2018, a 10% unfavorable change in the exchange rate of the U.S. dollar strengthening against the foreign currencies to which we have exposure would result in approximately $2.7 million reduction of foreign currency gains, and approximately $4.7 million reduction in other comprehensive income.

As of December 31, 2018 and 2017, our foreign subsidiaries had cash balances denominated in foreign currencies in the amount of $17.6 million and $5.7 million, respectively.

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Item 8. Financial Statements and Supplementary Data.

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Amphastar Pharmaceuticals, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Amphastar Pharmaceuticals, Inc. (the Company) as of December 31, 2018 and 2017, the related consolidated statements of operations, comprehensive income (loss), stockholders' equity and cash flows for each of the three years in the period ended December 31, 2018, and the related notes (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018, in conformity with U.S. generally accepted accounting principles.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Ernst & Young LLP

We have served as the Company's auditor since 1998.

Los Angeles, California

March 15, 2019

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AMPHASTAR PHARMACEUTICALS, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	December 31, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 86,337	$ 65,594
Short-term investments	2,831	2,635
Restricted cash and short-term investments	4,155	4,155
Accounts receivable, net	52,163	35,996
Inventories	69,322	63,609
Income tax refunds and deposits	49	6,036
Prepaid expenses and other assets	5,485	9,753
Total current assets	220,342	187,778
Property, plant, and equipment, net	210,418	180,545
Goodwill and intangible assets, net	42,267	45,140
Other assets	9,918	8,663
Deferred tax assets	30,618	28,946
Total assets	$ 513,563	$ 451,072
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 87,418	$ 57,555
Income taxes payable	1,187	3,325
Current portion of long-term debt and capital leases	18,229	6,312
Total current liabilities	106,834	67,192
Long-term reserve for income tax liabilities	415	879
Long-term debt and capital leases, net of current portion	31,984	40,844
Deferred tax liabilities	1,031	1,361
Other long-term liabilities	8,940	7,060
Total liabilities	149,204	117,336
Commitments and contingencies:		
Stockholders’ equity:		
Preferred stock: par value $0.0001; 20,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock: par value $0.0001; 300,000,000 shares authorized; 51,438,675 and 46,631,118 shares issued and outstanding as of December 31, 2018 and 50,039,212 and 46,623,581 shares issued and outstanding as of December 31, 2017, respectively	5	5

Additional paid-in capital	344,434	313,891
Retained earnings	67,485	72,642
Accumulated other comprehensive loss	(4,013)	(2,100)
Treasury stock	(75,476)	(50,702)
Total Amphastar Pharmaceuticals, Inc. stockholders' equity	332,435	333,736
Non-controlling interests	31,924	—
Total equity	364,359	333,736
Total liabilities and stockholders' equity	$ 513,563	$ 451,072

See accompanying notes to consolidated financial statements.

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AMPHASTAR PHARMACEUTICALS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Year Ended December 31,		
	2018	2017	2016
Net revenues	$ 294,666	$ 240,175	$ 255,165
Cost of revenues	187,681	149,666	150,969
Gross profit	106,985	90,509	104,196
Operating (income) expenses:			
Selling, distribution, and marketing	8,156	6,460	5,466
General and administrative	49,888	44,458	41,832
Research and development	57,564	43,503	41,522
Gain on sale of intangible assets	—	(2,643)	—
Total operating expenses	115,608	91,778	88,820
Income (loss) from operations	(8,623)	(1,269)	15,376
Non-operating income (expenses):			
Interest income	456	425	270
Interest expense	(243)	(826)	(1,024)
Other income (expenses), net	(1,516)	2,919	8
Total non-operating income (expenses), net	(1,303)	2,518	(746)
Income (loss) before income taxes	(9,926)	1,249	14,630
Income tax expense (benefit)	(3,266)	(2,398)	4,810
Net income (loss)	$ (6,660)	$ 3,647	$ 9,820
Net loss attributable to non-controlling interests	$ (922)	$ —	$ —
Net income (loss) attributable to Amphastar Pharmaceuticals, Inc.	$ (5,738)	$ 3,647	$ 9,820
Net income (loss) per share attributable to Amphastar Pharmaceuticals, Inc. shareholders:			
Basic	$ (0.12)	$ 0.08	$ 0.22
Diluted	$ (0.12)	$ 0.08	$ 0.21
Weighted-average shares used to compute net income (loss) per share attributable to Amphastar Pharmaceuticals, Inc. shareholders:			

Basic	46,395	46,107	45,375
Diluted	46,395	48,367	47,504

See accompanying notes to consolidated financial statements.

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AMPHASTAR PHARMACEUTICALS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in thousands)

	Year Ended December 31,		
	2018	2017	2016
Net income (loss) attributable to Amphastar Pharmaceuticals, Inc.	$ (5,738)	$ 3,647	$ 9,820
Other comprehensive income (loss) attributable to Amphastar Pharmaceuticals, Inc., net of income taxes			
Foreign currency translation adjustment	(1,957)	2,713	(1,800)
Change in pension obligations	44	(117)	(421)
Total other comprehensive income (loss) attributable to Amphastar Pharmaceuticals, Inc.	(1,913)	2,596	(2,221)
Total comprehensive income (loss) attributable to Amphastar Pharmaceuticals, Inc.	$ (7,651)	$ 6,243	$ 7,599

See accompanying notes to consolidated financial statements.

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Amphastar Pharmaceuticals, Inc.

Consolidated Statements of Stockholders' Equity

(in thousands, except share data)

	Common Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive Income	Treasury Stock		Total Amphastar Stockholders'	Non-contro
	Shares	Amount	Capital	Earnings	(loss)	Shares	Amount	Equity	Intere
Balance as of December 31, 2015	45,960,206	5	247,829	58,303	(2,475)	(761,715)	(10,172)	293,490	—
Net income attributable to Amphastar Pharmaceuticals, Inc.	—	—	—	9,820	—	—	—	9,820	—
Other comprehensive loss attributable to Amphastar Pharmaceuticals, Inc.	—	—	—	—	(2,221)	—	—	(2,221)	—
Purchase of treasury stock	—	—	—	—	—	(759,067)	(9,908)	(9,908)	—
Issuance of treasury stock in connection with the Company's equity plans	—	—	(48)	—	—	4,255	48	—	—
Issuance of common stock in connection with the Company's equity plans	1,804,943	—	20,639	—	—	—	—	20,639	—
Share-based compensation expense	—	—	15,124	—	—	—	—	15,124	—
Tax effect of settlement of share-based awards	—	—	(421)	—	—	—	—	(421)	—
Balance as of December 31, 2016	47,765,149	5	283,123	68,123	(4,696)	(1,516,527)	(20,032)	326,523	—
Beginning balance adjustment to retained earnings as	—	—	—	872	—	—	—	872	—

a result of the adoption of ASU No. 2016-09									
Net income attributable to Amphastar Pharmaceuticals, Inc.	—	—	—	3,647	—	—	—	3,647	—
Other comprehensive income attributable to Amphastar Pharmaceuticals, Inc.	—	—	—	—	2,596	—	—	2,596	—
Purchase of treasury stock	—	—	—	—	—	(1,905,653)	(30,747)	(30,747)	—
Issuance of treasury stock in connection with the Company's equity plans	—	—	(77)	—	—	6,549	77	—	—
Issuance of common stock in connection with the Company's equity plans	2,274,063	—	13,758	—	—	—	—	13,758	—
Share-based compensation expense	—	—	17,087	—	—	—	—	17,087	—
Balance as of December 31, 2017	50,039,212	5	313,891	72,642	(2,100)	(3,415,631)	(50,702)	333,736	—
Beginning balance adjustment as a result of the adoption of new accounting standards	—	—	—	582	—	—	—	582	—
Net loss attributable to Amphastar Pharmaceuticals, Inc.	—	—	—	(5,738)	—	—	—	(5,738)	—
Other comprehensive loss attributable to Amphastar Pharmaceuticals, Inc.	—	—	—	—	(1,913)	—	—	(1,913)	—
Proceeds from the private placement of ANP	—	—	5,190	—	—	—	—	5,190	32,8
Net loss attributable to non-controlling	—	—	—	—	—	—	—	—	(92

interest									
Purchase of treasury stock	—	—	—	—	—	(1,414,924)	(25,047)	(25,047)	—
Issuance of treasury stock in connection with the Company's equity plans	—	—	(273)	—	—	22,998	273	—	—
Issuance of common stock in connection with the Company's equity plans	1,399,463	—	8,946	—	—	—	—	8,946	—
Share-based compensation expense	—	—	16,680	—	—	—	—	16,680	—
Balance as of December 31, 2018	51,438,675	$ 5	$ 344,434	$ 67,485	$ (4,013)	(4,807,557)	$ (75,476)	$ 332,435	$ 31,9

See accompanying notes to consolidated financial statements.

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AMPHASTAR PHARMACEUTICALS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year Ended December 31,		
	2018	2017	2016
Cash Flows From Operating Activities:			
Net income (loss)	$ (6,660)	$ 3,647	$ 9,820
Reconciliation to net cash provided by operating activities:			
Loss (gain) on disposal and impairment of long-lived assets	1,429	(2,337)	1,242
Depreciation of property, plant, and equipment	14,529	12,954	12,161
Amortization of product rights, trademarks, and patents	1,987	2,856	2,517
Share-based compensation expense	16,680	17,087	15,124
Reserve for uncertain tax positions	(464)	34	347
Changes in deferred taxes	(1,414)	4,386	(3,222)
Changes in operating assets and liabilities:			
Accounts receivable, net	(16,295)	(8,102)	6,377
Inventories	(5,984)	18,650	(9,715)
Prepaid expenses and other assets	1,375	(4,817)	1,331
Income tax refund, deposits, and payable	3,849	(11,836)	3,329
Accounts payable and accrued liabilities	29,159	6,687	(751)
Net cash provided by operating activities	38,191	39,209	38,560
Cash Flows From Investing Activities:			
Business Acquisitions	—	—	(12,461)
Purchases and construction of property, plant, and equipment	(46,808)	(35,099)	(21,382)
Proceeds from the sale of property, plant and equipment	245	—	—
Sale of intangible assets	4,400	2,000	—
Purchase of short-term investments	(308)	(5,645)	(3,602)
Maturity of short-term investments	91	3,650	3,075
Changes in restricted short-term investments	—	(900)	(105)
Payment of deposits and other assets	198	(896)	(5,026)
Net cash used in investing activities	(42,182)	(36,890)	(39,501)
Cash Flows From Financing Activities:			
Proceeds from the private placement of ANP	38,036	—	—
Proceeds from equity plans, net of withholding tax payments	8,946	13,758	21,502
Purchase of treasury stock	(25,047)	(30,747)	(9,908)
Proceeds from borrowing under lines of credit	347	—	—
Proceeds from issuance of long-term debt	8,431	18,983	10,198
Principal payments on long-term debt	(5,705)	(9,712)	(14,652)
Net cash provided by (used in) financing activities	25,008	(7,718)	7,140
Effect of exchange rate changes on cash	(274)	504	81

Net increase (decrease) in cash, cash equivalents, and restricted cash	20,743	(4,895)	6,280
Cash, cash equivalents, and restricted cash at beginning of period	67,459	72,354	66,074
Cash, cash equivalents, and restricted cash at end of period	$ 88,202	$ 67,459	$ 72,354
Noncash Investing and Financing Activities:			
Equipment acquired under capital leases	$ 14	$ —	$ 1,238
Supplemental Disclosures of Cash Flow Information:			
Interest paid, net of capitalized interest	$ 2,376	$ 1,877	$ 1,722
Income taxes paid	$ 339	$ 4,876	$ 3,397

See accompanying notes to consolidated financial statements

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AMPHASTAR PHARMACEUTICALS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. General

Amphastar Pharmaceuticals, Inc., a California corporation, was incorporated in February 1996 and merged with and into Amphastar Pharmaceuticals, Inc., a Delaware corporation, in July 2004 (together with its subsidiaries, hereinafter referred to as "the Company"). The Company is a specialty pharmaceutical company that develops, manufactures, markets, and sells generic and proprietary injectable, inhalation, and intranasal products, including products with high technical barriers to market entry. Additionally, the Company sells insulin active pharmaceutical ingredient, or API, products. Most of the Company's products are used in hospital or urgent care clinical settings and are primarily contracted and distributed through group purchasing organizations and drug wholesalers. The Company's insulin API products are sold to other pharmaceutical companies for use in their own products and are being used by the Company in the development of injectable finished pharmaceutical products. The Company's inhalation products are primarily distributed through drug retailers.

Note 2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, and are prepared in accordance with accounting principles generally accepted in the United States, or GAAP. All significant intercompany activity has been eliminated in the preparation of the consolidated financial statements. Effective January 1, 2017, the Company prospectively adopted certain requirements of Accounting Standards Update, or ASU, No. 2016-09 to classify cash flows related to excess tax benefits in operating activities and directly record all excess tax benefits and tax deficiencies in income tax expense or benefit in the consolidated statement of operations without adjusting prior periods.

The Company's subsidiaries include: (1) International Medication Systems, Limited, or IMS, (2) Armstrong Pharmaceuticals, Inc., or Armstrong, (3) Amphastar Nanjing Pharmaceuticals Inc., or ANP, (4) Nanjing Letop Fine Chemistry Co., Ltd., or Letop, (5) Nanjing Hanxin Pharmaceutical Technology Co., Ltd., or Hanxin, (6) Nanjing Baixin Trading Co., Ltd., or Baixin, (7) Amphastar France Pharmaceuticals, S.A.S., or AFP, (8) Amphastar UK Ltd., or AUK, and (9) International Medication Systems (UK) Limited, or IMS UK.

In July 2018, the Company's Chinese subsidiary, ANP, completed a private placement of its common equity interest to accredited investors for aggregate gross proceeds of approximately $57 million, of which $38.0 million had been received by ANP as of December 31, 2018. While investors were initially required to complete their contributions in cash by December 31, 2018, ANP granted an extension to certain investors. Subsequently, including the funds from the extension, the proceeds ANP has received from the private placement totaled $56.3 million. The Company has retained approximately 58% of the equity interest in ANP immediately after the private placement and continues to consolidate the financial results of ANP with the Company's results of operations. ANP's net income or loss after July 2, 2018, was attributed to the Company in accordance with the Company's equity interest of approximately 58% in ANP.

In 2018, the Company identified errors in its accounting primarily related to the depreciation of certain leasehold improvements within property, plant and equipment. The errors were not material to any of the Company's prior period annual financial statements. However, for comparative purposes, the Company has revised the prior period consolidated financial statements included herein. As a result, the net income for the years ended December 31, 2017 and 2016 was reduced by $0.9 million and $0.7 million, respectively. The errors resulted in a change to the basic and diluted net income per share for the year ended December, 2017, which was reduced by $0.02 and $0.01, respectively. The error resulted in a change to the basic and diluted net income per share for the year ended December 31, 2016, which was reduced by $0.01 and $0.01, respectively. The balances of property, plant, and equipment, net and retained earnings as of December 31, 2017, were reduced by $4.8 million and $3.6 million, respectively. The error did not result in a change to the net cash provided by operating activities in the Company's consolidated statement of cash flows for the years ended December 31, 2017 and 2016.

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AMPHASTAR PHARMACEUTICALS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Use of Estimates

The preparation of consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The principal accounting estimates include: determination of allowances for doubtful accounts and discounts, provision for chargebacks and rebates, provision for product returns, adjustment of inventory to their net realizable values, impairment of long-lived and intangible assets and goodwill, self-insured claims, workers' compensation liabilities, litigation reserves, stock price volatilities for share-based compensation expense, valuation allowances for deferred tax assets, and liabilities for uncertain income tax positions.

Foreign Currency

The functional currency of the Company, its domestic subsidiaries, its Chinese subsidiary ANP, and its U.K. subsidiary, AUK, is the U.S. dollar, or USD. ANP maintains its books of record in Chinese yuan. These books are remeasured into the functional currency of USD using the current or historical exchange rates. The resulting currency remeasurement adjustments and other transactional foreign currency exchange gains and losses are reflected in the Company's statements of operations.

The Company's French subsidiary, AFP, maintains its book of record in euros. Its other Chinese subsidiaries, maintain their books of record in Chinese yuan. Its U.K. subsidiary, IMS UK, maintains its book of record in Great British pounds. These local currencies have been determined to be the subsidiaries' respective functional currencies. These books of record are translated into USD using average exchange rates during the period. Assets and liabilities are translated at the rate of exchange prevailing on the balance sheet date. Equity is translated at the prevailing rate of exchange at the date of the equity transactions. Translation adjustments are reflected in stockholders' equity and are included as a component of other accumulated comprehensive income (loss). The unrealized gains or losses of intercompany foreign currency transactions that are of a long-term investment nature are reported in other accumulated comprehensive income (loss). The unrealized gains and losses of intercompany foreign currency transactions that are of a long-term investment nature for the years ended December 31, 2018, 2017, and 2016 were a $1.5 million gain, a $4.3 million gain, and a $1.5 million loss, respectively.

The Company does not undertake hedging transactions to cover its foreign currency exposure.

Comprehensive Income (Loss)

For the years ended December 31, 2018, 2017 and 2016, the Company included its foreign currency translation gain or loss and change in pension obligation of its defined benefit pension plan as part of its comprehensive income (loss). There was no material income tax expense (benefit) allocated to other comprehensive loss for the year ended December 31, 2018. Income tax expense of $1.5 million was allocated to other comprehensive income for the year ended December 31, 2017. There was no material income tax expense (benefit) allocated to other comprehensive loss for the year ended December 31, 2016.

Shipping and Handling Costs

For the years ended December 31, 2018, 2017, and 2016, the Company included shipping and handling costs of approximately $3.7 million, $3.0 million, and $2.4 million, respectively, in selling, distribution and marketing expenses in the accompanying consolidated statements of operations.

Research and Development Costs

Research and development costs are charged to expense as incurred and consist of costs incurred to further the Company’s research and development activities. These include salaries and related employee benefits, costs associated

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AMPHASTAR PHARMACEUTICALS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

with clinical trials, nonclinical research and development activities, regulatory activities, research related overhead expenses and fees paid to external service providers.

The Company may produce or purchase inventories prior to or with the expectation of receiving marketing authorization in the near term, based on operational decisions about the most effective use of existing resources. This inventory is referred to as pre launch inventory. It is the Company's accounting policy that the pre-launch inventory is capitalized if it has a probable future economic benefit. If marketing authorization is received and previously expensed pre launch inventory is sold, such sales may contribute up to a 100% margin to the Company's operating results. Pre launch inventory costs include cost of work in process, materials, and finished drug products. As of December 31, 2018, 2017, and 2016, the Company did not have material capitalized pre-launch inventory.

Financial Instruments

The carrying amounts of cash and cash equivalents, short-term investments, restricted cash and short-term investments, accounts receivable, accounts payable, accrued expenses, and short-term borrowings approximate fair value due to the short maturity of these items. The majority of the Company's long-term obligations consist of variable rate debt, and their carrying value approximates fair value as the stated borrowing rates are comparable to rates currently offered to the Company for instruments with similar maturities. The Company at times enters into fixed interest rate swap contracts to exchange the variable interest rates for fixed interest rates without the exchange of the underlying notional debt amounts. Such interest rate swap contracts are recorded at their fair values.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash, money market accounts, certificates of deposit and highly liquid investments purchased with original maturities of three months or less.

Short-Term Investments

Short-term investments as of December 31, 2018 consisted of certificates of deposit with original expiration dates within 12 months.

Restricted Cash and Short-Term Investments

Restricted cash and short-term investments are collateral required for the Company to effect a standby letter of credit and to qualify for workers' compensation self-insurance and are available to meet the Company's workers' compensation obligations on a current basis, as needed. As of December 31, 2018, restricted cash and short-term investments included $1.9 million in cash and $2.3 million in certificates of deposit. As of December 31, 2017, restricted cash and short-term investments included $1.9 million in cash and $2.3 million in certificates of deposit. The certificates of deposit have original maturities greater than three months and are classified as short-term investments.

Allowance for Doubtful Accounts Receivable

The Company evaluates the collectability of accounts receivable based on a combination of factors. When the Company is aware of circumstances that may impair a customer's ability to pay subsequent to the original sale, the Company records a specific allowance to reduce the amounts receivable to the amount that the Company reasonably believes to be collectable. For all other customers, the Company recognizes an allowance for doubtful accounts based on factors that include the length of time the receivables are past due, industry and geographic concentrations, the current business environment and historical collection experience. As of December 31, 2018 and 2017, the Company's allowance for doubtful accounts was $0.5 million and $0.3 million, respectively.

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Inventories

Inventories consist of currently marketed products and products manufactured under contract. Inventories are stated using the first-in, first-out method, on a consistent basis. The Company states inventory at the lower of cost and net realizable value. Provisions are made for slow moving, unsellable, or obsolete items. Net realizable value is determined using the estimated selling price, in the ordinary course of business, less estimated costs to complete and dispose.

Property, Plant and Equipment

Property, plant and equipment are stated at cost or, in the case of assets acquired in a business combination, at fair value on the purchase date. Depreciation and amortization expense is computed using the straight line method over the estimated useful lives of the related assets as follows:

Buildings	20 - 31 years
Machinery and equipment	3 - 12 years
Furniture and fixtures	3 - 7 years
Automobiles	4 - 5 years
Leasehold improvements	Lesser of remaining lease term or useful life

Intangible Assets

Intangible assets with finite lives are amortized using the straight-line method over the period the asset is expected to contribute directly or indirectly to the future cash flows of the Company as follows:

Product rights	10 - 15 years
Patents	10 - 20 years
Land-use rights	37 - 50 years

Impairment of Long Lived Assets, including Identifiable Definite-Lived Intangible Assets

The Company reviews long-term and identifiable definite-lived intangible assets or asset groups for impairment when events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. If the sum of the expected future undiscounted cash flows is less than the carrying amount of the asset or an asset group, further impairment analysis is performed. An impairment loss is measured as the amount by which the carrying amount of the asset or asset groups exceeds the fair value (assets to be held and used) or fair value less cost to sell (assets to be disposed of). The Company also reviews the useful lives of its assets periodically to determine whether events and circumstances warrant a revision to the remaining useful life. Changes in the useful life are adjusted prospectively by revising the remaining period over which the asset is amortized.

Deferred Income Taxes

The Company utilizes the liability method of accounting for income taxes, under which deferred taxes are determined based on the temporary differences between the financial statements and the tax basis of assets and liabilities using enacted tax rates. A valuation allowance is recorded when it is more likely than not that the deferred tax assets will not be realized.

Impairment of Indefinite-Lived Intangible Asset and Goodwill

The Company reviews indefinite lived intangible asset and goodwill for impairment in the fourth quarter of each year or more frequently if indicators of impairment are present. When the Company chooses to perform a qualitative assessment, it evaluates economic, industry and company-specific factors as an initial step. If the Company determines it is more

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likely than not that the indefinite-lived intangible asset is impaired or the fair value of a reporting unit is less than its carrying amount, further quantitative impairment process is then performed; otherwise, no further testing is required. An impairment loss is recorded if the asset's fair value is less than its carrying value. The Company also periodically reviews the indefinite-lived intangible asset to determine if events and circumstances continue to support an indefinite useful life. If the life is no longer indefinite, the asset is tested for impairment. The carrying value, after recognition of any impairment loss, is amortized over its remaining useful life.

Self-Insured Claims

The Company is primarily self-insured, up to certain limits, for workers' compensation claims. The Company has purchased stop-loss insurance, which will reimburse the Company for individual claims in excess of $350,000 annually or aggregate claims exceeding $2.9 million annually. Operations are charged with the cost of claims reported and an estimate of claims incurred but not reported. A liability for unpaid claims and the associated claim expenses, including incurred but not reported losses, is actuarially determined and reflected in accrued liabilities in the accompanying consolidated balance sheets. Total expense under the program was approximately $2.6 million, $1.5 million, and $1.6 million, for the years ended December 31, 2018, 2017 and 2016, respectively. The self-insured claims liability was $5.6 million and $4.1 million at December 31, 2018 and 2017, respectively. The determination of such claims and expenses and the appropriateness of the related liability is reviewed periodically and updated, as necessary. Changes in estimates are recorded in the period identified.

Business Combinations

If an acquired set of activities and assets is capable of being operated as a business consisting of inputs and processes from the viewpoint of a market participant, the assets acquired and liabilities assumed are a business. Business combinations are accounted for using the acquisition method of accounting, which requires an acquirer to recognize the assets acquired and the liabilities assumed at the acquisition date measured at their fair values as of that date. Fair value determinations are based on discounted cash flow analyses or other valuation techniques. In determining the fair value of the assets acquired and liabilities assumed in a material acquisition, the Company may utilize appraisals from third party valuation firms to determine fair values of some or all of the assets acquired and liabilities assumed, or may complete some or all of the valuations internally. In either case, the Company takes full responsibility for the determination of the fair value of the assets acquired and liabilities assumed. The value of goodwill reflects the excess of the fair value of the consideration conveyed to the seller over the fair value of the net assets received.

Acquisition-related costs that the Company incurs to effect a business combination are expensed in the periods in which the costs are incurred. When the operations of the acquired businesses were not material to the Company's consolidated financial statements, no pro forma presentations were disclosed.

Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board, or FASB, issued ASU No. 2016-02, Leases, which is aimed at making leasing activities more transparent and comparable and requires substantially all leases be recognized by lessees on their balance sheets as a right-of-use asset and corresponding lease liability, including leases currently accounted for as operating leases. The ASU and the related clarifications subsequently issued by the FASB will become effective for the Company's interim and annual reporting periods during the year ending December 31, 2019, and all annual and interim reporting periods thereafter. Early adoption is permitted. In July 2018, the FASB further amended the standard to allow for a new transition method that offers the option to use the effective date as the date of initial application. The Company intends to elect this alternative transition method and therefore will not adjust comparative-period financial information. The Company is finalizing its assessment related to policies, processes and internal controls to comply with the guidance. The Company estimates the right-of-use assets and lease obligations for its lease portfolio as of December 31, 2018 to be within the range of approximately $13.4 million and $14.3 million, which would be recorded on its consolidated balance sheet, primarily related to real estate. The Company anticipates that it will elect the available practical expedients at transition including the package of expedients whereby the Company will not

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reassess its prior conclusion related to whether a contact contains a lease, the underlying lease classification or accounting for initial direct cost in a lease, in addition to electing the hindsight practical expedient in determining the lease term and the short-term lease exception such that it will not recognize a right-of-use asset or lease liability for leases with a term of 12 months or less. The new standard also provides practical expedients for the ongoing accounting and the Company currently expects to elect the practical expedient to not separate lease and non-lease components for its asset classes. Note 17 provides details on the Company's current operating lease arrangements. The adoption of ASC 842 is not expected to have a material impact on the Company's results of operations or cash flows.

In June 2016, the FASB issued ASU No. 2016-13 Financial Instruments – Credit Losses, which is aimed at providing financial statement users with more useful information about the expected credit losses on financial instruments and other commitments to extend credit. The standard update changes the impairment model for financial assets measured at amortized cost, requiring presentation at the net amount expected to be collected. The measurement of expected credit losses requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Available-for-sale debt securities with unrealized losses will be recorded through an allowance for credit losses. The guidance is effective for the Company's interim and annual reporting periods during the year ending December 31, 2020. Early adoption is permitted for interim or annual periods after December 31, 2019. The Company will be required to apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. The Company does not believe the adoption of this accounting guidance will have a material impact on its consolidated financial statements and related disclosures.

In January 2017, the FASB issued ASU No. 2017-04 simplifying the Test for Goodwill Impairment, which eliminates the requirement to calculate the implied fair value of goodwill. An entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The update also eliminated the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. An entity is required to disclose the amount of goodwill allocated to each reporting unit with a zero or negative carrying amount of net assets. The guidance is effective for the Company's interim and annual reporting periods during the year ending December 31, 2020, and applied on a prospective basis. Early adoption is permitted for interim and annual goodwill impairment testing dates after January 1, 2017. The Company currently does not believe that the adoption of this accounting guidance will have a material impact on its consolidated financial statements and related disclosures.

In August 2017, the FASB issued ASU No. 2017-12 Targeted Improvements to Accounting for Hedging Activities, which amends the hedge accounting model in ASC 815 to enable entities to better portray the economics of their risk management activities in the financial statements and enhance the transparency and understandability of hedge results.

The amendments also simplify the application of hedge accounting in certain situations. The new guidance is effective for the Company's interim and annual reporting periods during the year ending December 31, 2019. Early adoption is permitted. The Company does not believe that the adoption of this accounting guidance will have a material impact on its consolidated financial statements and related disclosures.

In February 2018, the FASB issued ASU No. 2018-02 Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which allows entities to reclassify from accumulated other comprehensive income to retained earnings stranded tax effects resulting from the Tax Act. The guidance is effective for the Company's interim and annual reporting periods during the year ending December 31, 2019. Early adoption is permitted. The Company does not believe that the adoption of this accounting guidance will have a material impact on its consolidated financial statements and related disclosures.

In June 2018, the FASB issued ASU No. 2018-07, Improvements to Non-employee Share-Based Payment Accounting, which simplifies the accounting for share-based payments to non-employees by aligning it with the accounting for share-based payments to employees. The Company early adopted the guidance on July 1, 2018. The adoption did not have a material impact on its consolidated financial statements and related disclosures.

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In August 2018, the FASB issued ASU No. 2018-13, Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement, which removes, modifies, and adds certain disclosure requirements to ASC 820, Fair Value Measurement. The guidance is effective for the Company's interim and annual reporting periods during the year ending December 31, 2020. Early adoption is permitted. The Company does not believe that the adoption of this accounting guidance will have a material impact on its consolidated financial statements and related disclosures.

In August 2018, the FASB issued ASU No. 2018-14, Disclosure Framework – Changes to the Disclosure Requirements for Defined Benefit Plans, which removes, modifies, and adds certain disclosure requirements to ASC 715-20, Defined Benefit Plans. The guidance is effective for the Company's interim and annual reporting periods during the year ending December 31, 2021. Early adoption is permitted. The Company does not believe that the adoption of this accounting guidance will have a material impact on its consolidated financial statements and related disclosures.

In October 2018, the FASB issued ASU No. 2018-17, Targeted Improvements to Related Party Guidance for Variable Interest Entities, which requires indirect interests held through related parties in common control arrangements be considered on a proportional basis for determining whether fees paid to decision makers and service providers are variable interests. The guidance is effective for the Company's interim and annual reporting periods during the year ending December 31, 2020. Early adoption is permitted. The Company currently does not believe that the adoption of this accounting guidance will have a material impact on its consolidated financial statements and related disclosures.

In November 2018, the FASB issued ASU No. 2018-18, Clarifying the Interaction between Topic 808 and Topic 606, which requires transactions in collaborative arrangements to be accounted for under ASC 606, Revenue from Contracts with Customers, or ASC 606, if the counterparty is a customer for a good or service that is a distinct unit of account. The amendments also preclude entities from presenting consideration from transactions with a collaborator that is not a customer together with revenue recognized from contracts with customers. The guidance is effective for the Company's interim and annual reporting periods during the year ending December 31, 2020. Early adoption is permitted, including in any interim period. The Company is currently evaluating the impact that the adoption of this guidance will have on its consolidated financial statements and related disclosures.

Note 3. Business Acquisitions

Acquisition of International Medication Systems (UK) Limited from UCB PHARMA GmbH

In August 2016, the Company's UK subsidiary, AUK, acquired IMS UK, a UK-based subsidiary of UCB PHARMA GmbH, including its trademarks, assets related to the products, as well as marketing authorizations for 33 products in the UK, Ireland, Australia, and New Zealand, representing 11 different injectable chemical entities. The Company paid $7.7 million in cash as consideration for the transaction. The Company is in the process of transferring the manufacturing of the purchased products to its facilities in California. The transfer will require approval of the UK Medicines and Healthcare products Regulatory Agency and other related regulatory agencies before the products can be sold by the Company. The transaction is accounted for as a business combination in accordance with ASC 805.

The fair values of the assets acquired and liabilities assumed include marketing authorizations of $9.2 million, manufacturing equipment of $0.1 million, and deferred tax liability of $1.6 million. The acquired marketing authorizations intangible assets are subject to a straight-line amortization over a useful life of approximately 10 years.

Acquisition of fourteen injectable products from Hikma Pharmaceuticals PLC

In March 2016, the Company acquired 14 abbreviated new drug applications, or ANDAs, representing 11 different injectable chemical entities from Hikma Pharmaceuticals PLC, or Hikma, for $4.0 million. This transaction was accounted for as a business combination in accordance with ASC 805. The ANDAs were estimated to have a fair value of $4.0 million, and were subject to a straight-line amortization over a useful life of approximately 15 years.

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In February 2017, the Company sold these products to an unrelated party. (See note 9)

Acquisition of Nanjing Letop Medical Technology Co. Ltd.

In January 2016, the Company's Chinese subsidiary, ANP, acquired Nanjing Letop Medical Technology Co. Ltd. for $1.7 million consisting of $0.8 million in cash and a deposit of $0.9 million that ANP had previously paid to Letop and was effectively eliminated upon the consummation of the transaction. The Company accounted for this transaction as a business combination in accordance with ASC 805. The Company recognized $1.4 million of acquired assets, $0.1 million of assumed liabilities, and $0.4 million of goodwill. Letop had previously supplied ANP with intermediates used in making various APIs. In March 2016, the acquired subsidiary was renamed Nanjing Letop Fine Chemistry Co., Ltd.

Note 4. Revenue Recognition

In 2018, the Company adopted ASC 606 using the modified retrospective transition method. The adoption of ASC 606 did not have a material impact on the Company's revenue recognition or on the consolidated financial statements and related disclosures. According to ASC 606, revenue is recognized at the time that the Company's customers obtain control of the promised goods. The results for the reporting period beginning after January 1, 2018, are presented in accordance with the new standard, although comparative information continues to be reported under the accounting standards and policies in effect for those periods.

Generally, revenue is recognized at the time of product delivery to the Company's customers. In some cases, revenue is recognized at the time of shipment when stipulated by the terms of the sale agreements. Revenues derived from contract manufacturing services are recognized when third-party products are shipped to customers, after the customer has accepted test samples of the products to be shipped. On June 30, 2016, the Company and Actavis Inc., or Actavis, amended a distribution agreement, which terminated the agreement in December 2016. Profit-sharing revenue under this agreement was recognized at the time Actavis sold the products to its customers.

The Company only records revenue to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved, by estimating and recording reductions to revenue for discounts, product returns, and pricing adjustments, such as wholesaler chargebacks and retailer rebates, in the same period that the related revenue is recorded.

The Company’s accounting policy is to review each agreement involving contract development and manufacturing services to determine if there are multiple revenue-generating activities that constitute more than one unit of accounting. Revenues are recognized for each unit of accounting based on revenue recognition criteria relevant to that unit. The Company does not have any revenue arrangements with multiple performance obligations.

Provision for Chargebacks and Rebates

The provision for chargebacks and rebates is a significant estimate used in the recognition of revenue. Wholesaler chargebacks relate to sales terms under which the Company agrees to reimburse wholesalers for differences between the gross sales prices at which the Company sells its products to wholesalers and the actual prices of such products that wholesalers resell under the Company’s various contractual arrangements with third parties such as hospitals and group purchasing organizations in the United States. Rebates include primarily amounts paid to retailers, payers, and providers in the United States, including those paid to state Medicaid programs, and are based on contractual arrangements or statutory requirements. The Company estimates chargebacks and rebates using the expected value method at the time of sale to wholesalers based on wholesaler inventory stocking levels, historic chargeback and rebate rates, and current contract pricing.

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The provision for chargebacks and rebates is reflected in net revenues. The following table is an analysis of the chargeback and rebate provision:

	Year Ended December 31,	
	2018	2017
	(in thousands)	
Beginning balance	$ 18,470	$ 39,709
Provision for chargebacks and rebates	125,112	152,011
Credits and payments issued to third parties	(121,159)	(173,250)
Ending balance	$ 22,423	$ 18,470

Changes in the chargeback provision from period to period are primarily dependent on the Company's sales to its wholesalers, the level of inventory held by wholesalers, and the wholesaler's customer mix. Changes in the rebate provision from period to period are primarily dependent on retailer's and other indirect customers' purchases. The approach that the Company uses to estimate chargebacks has been consistently applied for all periods presented. Variations in estimates have been historically small. The Company continually monitors the provision for chargebacks and rebates and makes adjustments when it believes that the actual chargebacks and rebates may differ from the estimates. The settlement of chargebacks and rebates generally occurs within 30 days to 60 days after the sale to wholesalers. Accounts receivable and/or accounts payable and accrued liabilities are reduced and/or increased by the chargebacks and rebate amounts depending on whether the Company has the right to offset with the customer. Of the provision for chargebacks and rebates as of December 31, 2018 and 2017, $12.0 million and $6.8 million were included in accounts receivable, net, on the consolidated balance sheets, respectively. The remaining provision as of December 31, 2018 and 2017 was $10.4 million and $11.7 million, respectively, which were included in accounts payable and accrued liabilities.

Accrual for Product Returns

The Company offers most customers the right to return qualified excess or expired inventory for partial credit; however, API product sales are generally non-returnable. The Company's product returns primarily consist of the returns of expired products from sales made in prior periods. Returned products cannot be resold. At the time product revenue is recognized, the Company records an accrual for product returns estimated using the expected value method. The accrual is based, in part, upon the historical relationship of product returns to sales and customer contract terms. The Company also assesses other factors that could affect product returns including market conditions, product obsolescence, and the introduction of new competition. Although these factors do not normally give the Company's customers the right to return products outside of the regular return policy, the Company realizes that such factors

could ultimately lead to increased returns. The Company analyzes these situations on a case-by-case basis and makes adjustments to the product return reserve as appropriate.

The provision for product returns is reflected in net revenues. The following table is an analysis of product return liability:

	Year Ended December 31,	
	2018	2017
	(in thousands)	
Beginning balance	$ 6,522	$ 3,143
Provision for product returns	4,149	5,754
Credits issued to third parties	(2,641)	(2,375)
Ending balance	$ 8,030	$ 6,522

Of the provision of product returns as of December 31, 2018 and 2017, $5.3 million and $4.1 million were included in accounts payable and accrued liabilities on the consolidated balance sheets, respectively. The remaining provision of $2.7 million and $2.4 million were included in other long-term liabilities, respectively. For the years ended

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December 31, 2018 and 2017, the Company's aggregate product return rate was 1.3% and 1.3% of qualified sales, respectively.

Note 5. Income (Loss) per Share Attributable to Amphastar Pharmaceuticals, Inc. Shareholders

Basic income (loss) per share attributable to Amphastar Pharmaceuticals Inc. shareholders is calculated based upon the weighted-average number of shares outstanding during the period. Diluted net income (loss) per share attributable to Amphastar Pharmaceuticals, Inc. shareholders gives effect to all potential dilutive shares outstanding during the period, such as stock options, non-vested restricted stock units, and shares issuable under the Company's Employee Stock Purchase Plan, or ESPP.

As the Company reported a net loss for the year ended December 31, 2018, the diluted net loss per share attributable to Amphastar Pharmaceuticals, Inc. shareholders, as reported, equals the basic net loss per share attributable to Amphastar Pharmaceuticals, Inc. shareholders since the effect of the assumed exercise of stock options, vesting of non-vested RSUs, and issuance of common shares under the Company's ESPP are anti-dilutive. Total stock options, non-vested RSUs, and shares issuable under the Company's ESPP excluded from the year ended December 31, 2018, net loss per share were 10,105,565 stock options, 1,206,661 non-vested RSUs, and 51,792 shares issuable under the ESPP.

For the year ended December 31, 2017, options to purchase 839,651 shares of stock with a weighted-average exercise price of $26.43 per share, were excluded in the computation of diluted net income per share attributable to Amphastar Pharmaceuticals, Inc. shareholders because the effect from the assumed exercise of these options would be anti-dilutive.

For the year ended December 31, 2016, options to purchase 2,379,984 shares of stock with a weighted-average exercise price of $22.46 per share, were excluded in the computation of diluted net income per share attributable to Amphastar Pharmaceuticals, Inc. shareholders because the effect from the assumed exercise of these options would be anti-dilutive.

The following table provides the calculation of basic and diluted net income (loss) per share attributable to Amphastar Pharmaceuticals, Inc. shareholders for each of the periods presented:

	Year Ended December 31,		
	2018	2017	2016
	(in thousands, except per share data)		
Basic and dilutive numerator:			
Net income (loss) attributable to Amphastar Pharmaceuticals, Inc.	$ (5,738)	$ 3,647	$ 9,820
Denominator:			
Weighted-average shares outstanding — basic	46,395	46,107	45,375
Net effect of dilutive securities:			
Incremental shares from equity awards	—	2,260	2,129
Weighted-average shares outstanding — diluted	46,395	48,367	47,504
Net income (loss) per share attributable to Amphastar Pharmaceuticals, Inc. shareholders — basic	$ (0.12)	$ 0.08	$ 0.22
Net income (loss) per share attributable to Amphastar Pharmaceuticals, Inc. shareholders — diluted	$ (0.12)	$ 0.08	$ 0.21

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Note 6. Segment Reporting

The Company's business is the development, manufacture, and marketing of pharmaceutical products. The Company has established two reporting segments that each report to the Chief Operating Decision Maker, or CODM, as defined in ASC 280, Segment Reporting. The Company's performance is assessed and resources are allocated by the CODM based on the following two reportable segments:

- Finished pharmaceutical products
- API

The finished pharmaceutical products segment manufactures, markets and distributes enoxaparin, naloxone, phytonadione, lidocaine, medroxyprogesterone acetate, Primatene® Mist, as well as various other critical and non-critical care drugs. The API segment manufactures and distributes recombinant human insulin API and porcine insulin API for external customers and internal product development.

Selected financial information by reporting segment is presented below:

	Year Ended December 31,		
	2018	2017	2016
	(in thousands)		
Net revenues:			
Finished pharmaceutical products	$ 271,059	$ 230,139	$ 240,221
API	23,607	10,036	14,944
Total net revenues	294,666	240,175	255,165
Gross profit:			
Finished pharmaceutical products	113,220	96,517	106,107
API	(6,235)	(6,008)	(1,911)
Total gross profit	106,985	90,509	104,196
Operating expenses	115,608	91,778	88,820

Income (loss) from operations	(8,623)	(1,269)	15,376
Non-operating income	(1,303)	2,518	(746)
Income (loss) before income taxes	$ (9,926)	$ 1,249	$ 14,630

The Company manages its business segments to the gross profit level and manages its operating and other costs on a company-wide basis. The Company does not identify total assets by segment for internal purposes, as the Company's CODM does not assess performance, make strategic decisions, or allocate resources based on assets.

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The amount of net revenues in the finished pharmaceutical product segment is presented below:

	Year Ended December 31,		
	2018	2017	2016
	(in thousands)		
Finished pharmaceutical products net revenues:			
Enoxaparin	$ 53,371	$ 36,593	$ 59,320
Lidocaine	43,328	37,602	36,600
Phytonadione	41,897	37,946	33,315
Naloxone	37,195	42,342	47,532
Medroxyprogesterone	24,071	—	—
Epinephrine	10,055	25,914	25,661
Primatene® Mist	3,574	—	—
Other finished pharmaceutical products	57,568	49,742	37,793
Total finished pharmaceutical products net revenues	$ 271,059	$ 230,139	$ 240,221

Discontinuation of Epinephrine Injection, USP Vial Product

In February 2017, the U.S. Food and Drug Administration, or FDA, requested the Company to discontinue the manufacturing and distribution of its epinephrine injection, USP vial product, which had been marketed under the “grandfather” exception to the FDA’s “Prescription Drug Wrap-Up” program. The Company discontinued selling this product in the second quarter of 2017. For the years ended December 31, 2017 and 2016, the Company recognized $17.8 million and $18.6 million in net revenues for the sale of this product, respectively.

Net revenues and carrying values of long-lived assets of enterprises by geographic regions are as follows:

	Net Revenue Year Ended December 31,			Long-Lived Assets December 31,	
	2018	2017	2016	2018	2017
	(in thousands)				
United States	$ 279,122	$ 234,321	$ 249,007	$ 109,331	$ 105,441
China	—	—	—	58,059	41,078
France	15,544	5,854	6,158	43,028	34,026
United Kingdom	—	—	—	—	—

Total	$ 294,666	$ 240,175	$ 255,165	$ 210,418	$ 180,545

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Note 7. Customer and Supplier Concentration

Customer Concentrations

Three large wholesale drug distributors, AmerisourceBergen Corporation, or AmerisourceBergen, Cardinal Health, Inc., or Cardinal, and McKesson Corporation, or McKesson, are all distributors of the Company's products, as well as suppliers of a broad range of health care products. Actavis had exclusive marketing rights of the Company's enoxaparin product to the U.S. retail pharmacy market until December 2016. The Company considers these four customers to be its major customers, as each individually and these customers collectively, represented a significant percentage of the Company's net revenue for the years ended December 31, 2018, 2017, and 2016, and accounts receivable as of December 31, 2018 and 2017, respectively. The following table provides accounts receivable and net revenue information for these major customers:

	% of Total Accounts Receivable		% of Net Revenue		
	December 31,	December 31,	Year Ended December 31,		
	2018	2017	2018	2017	2016
McKesson	28 %	22 %	27 %	27 %	21 %
AmerisourceBergen	19 %	33 %	27 %	28 %	21 %
Cardinal Health	21 %	12 %	21 %	23 %	22 %
Actavis(1)	—	—	—	—	14 %

(1) The agreement with Actavis was terminated in December 2016.

Supplier Concentrations

The Company depends on suppliers for raw materials, APIs, and other components that are subject to stringent FDA requirements. Some of these materials may only be available from one or a limited number of sources. Establishing additional or replacement suppliers for these materials may take a substantial period of time, as suppliers must be approved by the FDA. Furthermore, a significant portion of raw materials may only be available from foreign sources. If the Company is unable to secure, on a timely basis, sufficient quantities of the materials it depends on to manufacture and market its products, it could have a materially adverse effect on the Company's business, financial condition, and results of operations.

Note 8. Fair Value Measurements

The accounting standards of the FASB define fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability at the measurement date (an exit price). These standards also establish a hierarchy that prioritizes observable and unobservable inputs used in measuring fair value of an asset or liability, as described below:

· Level 1 – Inputs to measure fair value are based on quoted prices (unadjusted) in active markets on identical assets or liabilities;

· Level 2 – Inputs to measure fair value are based on the following: a) quoted prices in active markets on similar assets or liabilities, b) quoted prices for identical or similar instruments in inactive markets, or c) observable (other than quoted prices) or collaborated observable market data used in a pricing model from which the fair value is derived; and

· Level 3 – Inputs to measure fair value are unobservable and the assets or liabilities have little, if any, market activity; these inputs reflect the Company’s own assumptions about the assumptions that market participants would use in pricing the assets or liabilities based on best information available in the circumstances.

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As of December 31, 2018, cash equivalents include money market accounts. Short-term investments consist of certificates of deposit with original expiration dates within 12 months. These certificates of deposit are carried at amortized cost in the Company's consolidated balance sheet, which approximates their fair value determined based on Level 2 inputs. The restrictions on restricted cash and short-term investments have a negligible effect on the fair value of these financial assets.

The Company does not hold any Level 2 or Level 3 instruments that are measured for fair value on a recurring basis.

Nonfinancial assets and liabilities are not measured at fair value on a recurring basis but are subject to fair value adjustments in certain circumstances. These items primarily include long-lived assets, goodwill, and intangible assets for which the fair value of assets is determined as part of the related impairment test. As of December 31, 2018 and 2017, there were no significant adjustments to fair value for nonfinancial assets or liabilities.

Note 9. Goodwill and Intangible Assets

The table below shows the weighted-average life, original cost, accumulated amortization, and net book value by major intangible asset classification:

	Weighted-Average Life (Years)	Original Cost	Accumulated Amortization	Net Book Value
		(in thousands)		
Definite-lived intangible assets				
Cortrosyn® product rights	12	$ 27,134	$ 27,134	$ —
IMS (UK) international product rights	10	8,911	2,153	6,758
Patents	12	486	213	273
Land-use rights	39	2,540	486	2,054
Other intangible assets	4	69	63	6
Subtotal	12	39,140	30,049	9,091
Indefinite-lived intangible assets				

Trademark	*	29,225	—	29,225
Goodwill - Finished pharmaceutical products	*	3,951	—	3,951
Subtotal	*	33,176	—	33,176
As of December 31, 2018	*	$ 72,316	$ 30,049	$ 42,267

	Weighted-Average Life (Years) (in thousands)	Original Cost	Accumulated Amortization	Net Book Value
Definite-lived intangible assets				
Cortrosyn® product rights	12	$ 27,134	$ 26,243	$ 891
IMS (UK) international product rights	10	9,440	1,337	8,103
Patents	12	486	170	316
Land-use rights	39	2,540	419	2,121
Other intangible assets	4	69	46	23
Subtotal	12	39,669	28,215	11,454
Indefinite-lived intangible assets				
Trademark	*	29,225	—	29,225
Goodwill - Finished pharmaceutical products	*	4,461	—	4,461
Subtotal	*	33,686	—	33,686
As of December 31, 2017	*	$ 73,355	$ 28,215	$ 45,140

*Intangible assets with indefinite lives have an indeterminable average life.

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Sale of Fourteen Injectable ANDAs

In February 2017, the Company sold the 14 ANDAs it acquired in March 2016 from Hikma to an unrelated party. The consideration included a purchase price of $6.4 million of which $1.0 million was received upon closing, $1.0 million was received in the second quarter of 2017 and the remaining $4.4 million was received in January 2018. In addition to the purchase price, the purchaser agreed to pay the Company a royalty fee equal to 2% of net sales derived from purchaser's sales of the products for the period from February 2017 through February 2027. The Company has not recognized any royalty fee revenue. The Company recognized a gain of $2.6 million within operating (income) expenses on its consolidated statement of operations for the year ended December 31, 2017.

Goodwill

The changes in the carrying amounts of goodwill were as follows:

	December 31,	
	2018	2017
	(in thousands)	
Beginning balance	$ 4,461	$ 3,976
Currency translation	(510)	485
Ending balance	$ 3,951	$ 4,461

Primatene® Trademark

In January 2009, the Company acquired the exclusive rights to the trademark, domain name, website and domestic marketing, distribution and selling rights related to Primatene® Mist, an over-the-counter bronchodilator product, recorded at the allocated fair value of $29.2 million, which is its carrying value as of December 31, 2018.

The trademark was determined to have an indefinite life. In determining its indefinite life, the Company considered the following: the expected use of the intangible; the longevity of the brand; the legal, regulatory and contractual

provisions that affect their maximum useful life; the Company's ability to renew or extend the asset's legal or contractual life without substantial costs; effects of the regulatory environment; expected changes in distribution channels; maintenance expenditures required to obtain the expected future cash flows from the asset; and considerations for obsolescence, demand, competition and other economic factors.

As a result of environmental concerns about chlorofluorocarbons, or CFCs, the FDA required the CFC formulation of Primatene® Mist to be phased out on December 31, 2011.

In 2013, the Company filed a new drug application, or NDA, for Primatene® Mist, which utilizes a non-CFC propellant. In November 2018, the FDA granted over-the-counter approval of the NDA for Primatene® Mist, and the Company re-launched in December 2018. No impairment charge was required as of December 31, 2018.

Amortization

Included in cost of revenues for the years ended December 31, 2018, 2017 and 2016 is product rights amortization expense of $1.8 million, $2.7 million, and $2.4 million, respectively.

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As of December 31, 2018, the expected amortization expense for all amortizable intangible assets during the next five fiscal years ended December 31 and thereafter is as follows:

	(in thousands)
2019	$ 870
2020	864
2021	864
2022	844
2023	835
Thereafter	4,814
Total amortizable intangible assets	9,091
Indefinite-lived intangibles	33,176
Total intangibles (net of accumulated amortization)	$ 42,267

Note 10. Inventories

Inventories consist of the following:

	December 31,	
	2018	2017
	(in thousands)	
Raw materials and supplies	$ 30,153	$ 19,973
Work in process	30,272	22,469
Finished goods	8,897	21,167
Total inventories	$ 69,322	$ 63,609

Charges of $12.9 million, $8.5 million, and $7.3 million were included in the cost of revenues in the Company's consolidated statements of operations for the years ended December 31, 2018, 2017, and 2016, respectively, to adjust the Company's inventory and related purchase commitments to their net realizable value. For the year ended December 31, 2018, the charge included $9.1 million related to enoxaparin inventory due to a decrease in the forecasted average selling price. For the year ended December 31, 2017, the charge included $5.5 million related to enoxaparin inventory due to a decrease in the forecasted average selling price. For the year ended December 31, 2016, the charge included $3.1 million related to enoxaparin inventory due to a decrease in the forecasted average selling price and $3.3 million related to epinephrine injection, USP vial inventory items due to the anticipated discontinuation of the product.

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Note 11. Property, Plant, and Equipment

Property, plant, and equipment consist of the following:

	December 31, 2018	2017
	(in thousands)	
Buildings	$ 96,287	$ 89,124
Leasehold improvements	26,755	29,847
Land	7,628	7,110
Machinery and equipment	143,299	118,056
Furniture, fixtures, and automobiles	19,151	16,385
Construction in progress	66,390	58,145
Total property, plant, and equipment	359,510	318,667
Less accumulated depreciation	(149,092)	(138,122)
Total property, plant, and equipment, net	$ 210,418	$ 180,545

The Company incurred depreciation expense of $14.5 million, $13.0 million, and $12.2 million for the years ended December 31, 2018, 2017, and 2016, respectively.

Interest expense capitalized was approximately $2.2 million, $1.1 million, and $0.8 million, for the years ended December 31, 2018, 2017, and 2016, respectively.

As of December 31, 2018 and 2017, the purchase of property, plant, and equipment of $8.4 million and $6.7 million, respectively, were included in accounts payable and accrued liabilities.

Note 12. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities consisted of the following:

	December 31,	
	2018	2017
	(in thousands)	
Accrued customer fees and rebates	$ 15,215	$ 15,981
Accrued payroll and related benefits	19,430	15,680
Accrued product returns, current portion	5,349	4,133
Reserve for net loss on firm purchase commitments	5,355	320
Other accrued liabilities	10,746	4,812
Total accrued liabilities	56,095	40,926
Accounts payable	31,323	16,629
Total accounts payable and accrued liabilities	$ 87,418	$ 57,555

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Note 13. Debt

Debt consists of the following:

	December 31,	
	2018	2017
	(in thousands)	
Loans with East West Bank		
Equipment loan paid off January 2019	$ 128	$ 1,668
Line of credit facility due December 2020	—	—
Mortgage payable due February 2021	3,491	3,577
Equipment loan due June 2021	3,061	4,286
Equipment loan due December 2022	8,000	—
Mortgage payable due October 2026	3,463	3,524
Mortgage payable due June 2027	8,801	8,936
Loans with Cathay Bank		
Acquisition loan due April 2019	13,025	15,073
Line of credit facility due May 2020	—	—
Mortgage payable due August 2027	7,627	7,795
Loans with Bank of Nanjing		
Working capital loan due June 2019	347	—
Loans with Seine-Normandie Water Agency		
French government loan 1 paid March 2018	—	17
French government loan 2 due June 2020	55	85
French government loan 3 due July 2021	172	239
French government loan 4 due December 2026	22	—
French government loan 5 due December 2026	414	—
Payment Obligation to Merck	552	599

Equipment under Capital Leases	1,055	1,357
Total debt and capital leases	50,213	47,156
Less current portion of long-term debt and capital leases	18,229	6,312
Long-term debt and capital leases, net of current portion	$ 31,984	$ 40,844

Loans with East West Bank

Equipment Loan—Paid off January 2019

In July 2013, the Company entered into an $8.0 million line of credit facility. In January 2015, the Company drew down $6.2 million from the line of credit facility. Subsequently, the facility was converted into a term equipment loan with an outstanding principal balance of $6.2 million and a maturity date of January 2019. Borrowings under the facility are secured by equipment. As of December 31, 2018, the fair value of the loan approximates its book value. The interest rate used in the fair value estimation was determined to be a Level 2 input. The Company entered into a fixed interest rate

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swap contract on this facility to exchange the variable interest rate for a fixed interest rate of 4.48% over the life of the facility without the exchange of the underlying notional debt amount. The interest rate swap contract does not qualify for hedge accounting, and is recorded at fair value for an immaterial amount based on Level 2 inputs. In January 2019, the Company repaid all outstanding amounts due under this loan.

Line of Credit Facility—Due December 2020

In March 2012, the Company entered into a $10.0 million line of credit facility, which bears a variable interest rate at the prime rate as published by The Wall Street Journal. Borrowings under the facility are secured by inventory and accounts receivable. In March 2016, the facility was amended to increase the line of credit to $15.0 million. This facility matured in December 2018.

As of December 31, 2018, the Company did not have any amounts outstanding under this facility. In January 2019, the Company amended the facility to extend the maturity date to December 2020.

Mortgage Payable—Due February 2021

The Company refinanced the mortgage term loan in January 2016, which had an outstanding principal balance of $3.7 million at December 31, 2015, and a maturity date of February 2021. The refinanced loan is payable in monthly installments with a final balloon payment of $3.3 million. The refinanced loan is secured by one of the buildings at the Company’s Rancho Cucamonga, California, headquarters complex. The refinanced loan has a variable interest rate at the prime rate as published by The Wall Street Journal. As of December 31, 2018, the fair value of the loan approximates its book value. The interest rate used in the fair value estimation was determined to be a Level 2 input. The Company has entered into a fixed interest rate swap contract on this loan to exchange the variable interest rate for a fixed interest rate of 4.39% over the life of the loan without the exchange of the underlying notional debt amount. The interest rate swap contract does not qualify for hedge accounting, and is recorded at fair value of approximately $0.1 million based on Level 2 inputs.

Equipment Loan–Due June 2021

In March 2016, the Company entered into a $5.0 million equipment credit facility. In May 2017, the Company converted the outstanding balance of $5.0 million into a term equipment loan that matures in June 2021. Borrowings under the loan are secured by equipment. The loan bears a variable interest rate at the prime rate as published by The Wall Street Journal. As of December 31, 2018, the fair value of the loan approximates its book value. The interest rate used in the fair value estimation was determined to be a Level 2 input. The Company has entered into a fixed interest rate swap contract on this facility to exchange the variable interest rate for a fixed interest rate of 4.86% over the life of the facility without the exchange of the underlying notional debt amount. The interest rate swap contract does not qualify for hedge accounting and is recorded at fair value for an immaterial amount based on Level 2 inputs.

Equipment Loan—Due December 2022

In June 2017, the Company entered into an $8.0 million equipment credit line with an 18-month draw down period. Interest payments are due monthly through December 2018 at the prime rate as published by The Wall Street Journal. After the draw down period, the outstanding principal balance converts into a 48-month term loan which bears a variable interest rate at the prime rate as published by The Wall Street Journal. The loan matures in December 2022, and the principal and interest payments are due monthly. Borrowings under the facility are secured by equipment.

In June 2018, the Company drew down $8.0 million on the equipment credit line and in December 2018, the credit line converted into an equipment loan. As of December 31, 2018, the fair value of the loan approximates its book value. The interest rate used in the fair value estimation was determined to be a Level 2 input. The Company entered into a fixed interest rate swap contract on this facility to exchange the variable interest rate for a fixed interest rate of 5.87% over the

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life of the facility without the exchange of the underlying notional debt amount. The interest rate swap contract does not qualify for hedge accounting and is recorded at fair value for an immaterial amount based on Level 2 inputs.

Mortgage Payable—Due October 2026

In September 2006, the Company entered into a mortgage term loan in the principal amount of $2.8 million, which matured in September 2016. The Company refinanced the mortgage term loan in September 2016, which increased the principal amount to $3.6 million and extended the maturity date to October 2026. The refinanced loan is payable in monthly installments with a final balloon payment of $2.9 million. The refinanced loan was secured by one of the buildings at the Company's Rancho Cucamonga, California, headquarters complex. The refinanced loan bears a variable interest rate at the one-month LIBOR rate plus 2.75%. As of December 31, 2018, the fair value of the loan approximates its book value. The interest rate used in the fair value estimation was determined to be a Level 2 input. Subsequently, the Company entered into a fixed interest rate swap contract on this loan to exchange the variable interest rate for a fixed interest rate of 4.15% until October 2021 without the exchange of the underlying notional debt amount. The interest rate swap contract does not qualify for hedge accounting, and is recorded at fair value for an immaterial amount based on Level 2 inputs.

Mortgage Payable—Due June 2027

In May 2017, the Company entered into a mortgage term loan in the principal amount of $9.0 million, which matures in June 2027. The loan is payable in monthly installments with a final balloon payment of $7.4 million plus interest. The loan is secured by one of the buildings at the Company's Rancho Cucamonga, California, headquarters complex and two buildings at the Company's Chino, California, facility. The loan bears a variable interest rate at the one-month LIBOR rate plus 2.5%. As of December 31, 2018, the fair value of the loan approximates its book value. The interest rate used in the fair value estimation was determined to be a Level 2 input. The Company entered into a fixed interest rate swap contract on this loan to exchange the variable interest rate for a fixed interest rate of 4.79% until June 2024 without the exchange of the underlying notional debt amount. The interest rate swap contract does not qualify for hedge accounting, and is recorded at fair value of approximately $0.1 million based on Level 2 inputs.

Loans with Cathay Bank

Acquisition Loan with Cathay Bank—Due April 2019

On April 22, 2014, in conjunction with the Merck API Transaction, the Company entered into a secured term loan with Cathay Bank as lender. The principal amount of the loan is $21.9 million and bears a variable interest rate at the prime rate as published by The Wall Street Journal, with a minimum interest rate of 4.00%. Beginning on June 1, 2014, and through the maturity date April 22, 2019, the Company must make monthly payments of principal and interest based on the then outstanding amount of the loan amortized over a 120-month period. On April 22, 2019, all amounts outstanding under the loan become due and payable, which would be approximately $12.0 million based upon an interest rate of 4.00%. The loan is secured by 65% of the issued and outstanding shares of stock in AFP and certain assets of the Company, including accounts receivable, inventory, certain investment property, goods, deposit accounts, and general intangibles but not including the Company's equipment and real property. As of December 31, 2018, the fair value of the loan approximates its book value. The interest rate used in the fair value estimation was determined to be a Level 2 input.

The loan includes customary restrictions on, among other things, the Company's ability to incur additional indebtedness, pay dividends in cash or make other distributions in cash, make certain investments, create liens, sell assets, and make loans. The loan also includes customary events of defaults, the occurrence and continuation of any of which provide Cathay Bank the right to exercise remedies against the Company and the collateral securing the loan. These events of default include, among other things, the Company's failure to pay any amounts due under the loan, the Company's insolvency, the occurrence of any default under certain other indebtedness or material agreements, and a final judgment against the Company that is not discharged in 30 days.

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Line of Credit Facility—Due May 2020

In April 2012, the Company entered into a $20.0 million revolving line of credit facility. Borrowings under the facility are secured by inventory, accounts receivable, and intangibles held by the Company. The facility bears a variable interest rate at the prime rate as published by The Wall Street Journal with a minimum interest rate of 4.00%. In July 2018, the Company amended the facility to extend the maturity date from May 2018 to May 2020. As of December 31, 2018, the Company did not have any amounts outstanding under this facility.

Mortgage Payable—Due August 2027

In August 2017, the Company refinanced the mortgage term loan that had been entered into on April 2014, with a principal balance outstanding of $7.9 million. The loan is payable in monthly installments and is secured by the building at the Company’s Canton, Massachusetts location. The loan bears interest at a fixed rate of 4.70% for the first five years of the loan; thereafter, the loan bears a variable interest rate at the prime rate as published by The Wall Street Journal and matures in June 2027. As of December 31, 2018, the fair value of the loan approximates its book value. The interest rate used in the fair value estimation was determined to be a Level 2 input.

Loan with Bank of Nanjing

Working Capital Loan —Due June 2019

In June 2018, the Company entered into a working capital loan of RMB 10.0 million, or $1.5 million, subject to currency exchange rate fluctuations. The loan bears a variable interest rate at the benchmark interest rate of the People’s Bank of China. Interest payments are due monthly. Repayment of the principal amount is due in June 2019. As of December 31, 2018, the Company had RMB 2.4 million, or $0.3 million outstanding under this loan.

Loans with Seine-Normandie Water Agency

In January 2015, the Company entered into three French government loans with the Seine-Normandie water agency in the aggregate amount of €0.6 million, or $0.7 million, subject to currency exchange fluctuations. The life of the loans range between three to six years, and includes annual equal payments and bears no interest over the life of the loans.

In December 2018, the Company entered into two additional French government loans with the Seine-Normandie water agency in the aggregate amount of €0.5 million, or $0.5 million, subject to currency exchange fluctuations. The loans have 8 year lives, and include annual equal payments and bear no interest.

As of December 31, 2018, the payment obligation had an aggregate book value of €0.6 million, or $0.7 million, subject to currency exchange rate fluctuations, which approximates fair value. The fair value of the payment obligation was determined by using the interest rate associated with the Company's acquisition loan with Cathay Bank that bears a variable interest rate at the prime rate as published by The Wall Street Journal, with a minimum interest rate of 4.00%. Such interest rate is deemed to be a Level 2 input for measuring fair value.

Payment Obligation to Merck

On April 30, 2014, in conjunction with the Merck API Transaction, the Company entered into a commitment obligation with Merck, in the principal amount of €11.6 million, or $16.0 million, subject to currency exchange rate fluctuations. The terms of the purchase price include annual payments over four years and bear a fixed interest rate of 3.00%.

As of December 31, 2018, the payment obligation had a balance of €0.5 million, or $0.6 million, which approximates fair value. The fair value of the payment obligation was determined by using the interest rate associated with the

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Company's acquisition loan with Cathay Bank that bears a variable interest rate at the prime rate as published by The Wall Street Journal, with a minimum interest rate of 4.00%. Such interest rate is deemed to be a Level 2 input for measuring fair value.

Covenants

At December 31, 2018 and 2017, the Company was in compliance with its debt covenants, which include a minimum current ratio, minimum debt service coverage, minimum tangible net worth, maximum debt-to-effective-tangible-net-worth ratio, and minimum deposit requirement computed on a consolidated basis. The profitability requirements for loans with Cathay Bank were not effective as of December 31, 2018. Such requirements will become effective as of December 31, 2019.

Equipment under Capital Leases

The Company entered into leases for certain equipment under capital leasing arrangements, which will expire at various times through 2023. The cost of equipment under capital leases was $1.6 million and $1.6 million at December 31, 2018 and 2017, respectively.

Long-Term Debt Maturities

As of December 31, 2018, the principal amounts of long-term debt maturities during each of the next five fiscal years ending December 31 are as follows:

	Debt	Capital Leases	Total
	(in thousands)		
2019	$ 17,886	$ 343	
2020	3,856	342	
2021	6,452	272	
2022	2,475	159	
2023	458	1	
Thereafter	17,969	—	

$ 49,096	$ 1,117	$ 50,213

Note 14. Income Taxes

The Tax Cuts and Jobs Act, or the Tax Act, was enacted on December 22, 2017. The Tax Act, among other things, reduces the statutory U.S. federal corporate income tax rate from 35% to 21% and requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred. As of December 31, 2017, the Company recorded a provisional expense amount of $0.6 million related to the remeasurement of certain deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future, which is generally 21%. During the year ended December 31, 2018, the Company completed its determination of the accounting implications of the Tax Act resulting in no material changes to the provisional amounts recorded as of December 31, 2017.

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The Company’s income (loss) before income taxes generated from its United States and foreign operations were:

	Year Ended December 31,		
	2018	2017	2016
	(in thousands)		
Income (loss) before income taxes:			
United States	$ 3,580	$ 6,892	$ 20,572
Foreign	(13,506)	(5,643)	(5,942)
Total income (loss) before taxes	$ (9,926)	$ 1,249	$ 14,630

The Company’s provision (benefit) for income taxes consisted of the following:

	Year Ended December 31,		
	2018	2017	2016
	(in thousands)		
Current provision (benefit):			
Federal	$ 32	$ (6,380)	$ 7,279
State	343	133	344
Foreign	773	643	787
Total current provision (benefit)	1,148	(5,604)	8,410
Deferred provision (benefit):			
Federal	(687)	6,340	(2,383)
State	(3,900)	(2,169)	(1,100)
Foreign	173	(965)	(117)
Total deferred provision (benefit)	(4,414)	3,206	(3,600)
Total provision (benefit) for income taxes	$ (3,266)	$ (2,398)	$ 4,810

A reconciliation of the statutory federal income tax rate to the Company’s effective tax rate is as follows:

	Year Ended December 31,		
	2018	2017	2016
Statutory federal income tax (benefit)	21.0 %	35.0 %	35.0 %

State tax expense, net of federal tax benefit	28.3	(106.0)	(3.3)
Foreign tax rate differences	4.0	3.9	4.1
Foreign valuation allowance	(42.0)	129.1	14.7
Qualified production activities deduction	—	89.6	(8.9)
Research and development credits	28.0	(250.1)	(12.0)
Share-based compensation	5.1	(166.2)	4.4
Executive compensation	(12.4)	17.1	—
Deferred tax remeasurement	1.0	49.5	—
Employee-related expenses	(0.4)	6.3	0.4
Other	0.3	(0.2)	(1.5)
Effective tax rate (benefit)	32.9 %	(192.0) %	32.9 %

Deferred Tax Assets and Liabilities

Deferred income taxes reflect the tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes, tax credit carryforwards, and the tax effects of net operating loss carryforwards.

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The significant components of the Company's deferred tax assets and liabilities are as follows:

	December 31,	
	2018	2017
	(in thousands)	
Deferred tax assets:		
Net operating loss carryforward	$ 9,951	$ 7,356
State income taxes	26	221
Inventory capitalization and reserve	6,212	5,333
Deferred revenue	2	—
Accrued payroll and benefits	1,344	1,233
Share-based compensation	6,162	6,504
Research and development credits	22,690	21,550
Alternative minimum tax	742	656
Accrued professional fees	1,289	344
Product return allowance	2,314	1,879
Accrued chargebacks	3,103	1,856
Bad debt reserve	115	60
Intangibles	2,124	2,022
Accrued for workers' compensation insurance	1,401	1,063
Others	971	52
Total deferred tax assets	58,446	50,129
Deferred tax liabilities:		
Depreciation/amortization	9,684	7,568
Intangibles	6,303	6,992
Federal impact of state deferred taxes	3,769	3,077
Total deferred tax liabilities	19,756	17,637
Valuation allowance	(9,103)	(4,907)
Net deferred tax assets	$ 29,587	$ 27,585

Effective January 1, 2017, the Company adopted ASU No. 2016-09, under which differences between the tax deduction for share-based awards and the related compensation expenses recognized under ASC 718 are prospectively accounted for as a component of the provision for income taxes. In addition, ASU No. 2016-09 eliminated the requirement that excess tax benefits from share-based compensation reduce taxes payable prior to being recognized in the financial statements. As a result of the adoption of ASU No. 2016-09, the cumulative excess benefits of stock compensation of $0.9 million that was not previously recognized was established on the balance sheet resulting in an increase in deferred tax assets and retained earnings.

Effective January 1, 2018, the Company adopted ASU No. 2016-16, Intra-Entity Transfers of Assets Other Than Inventory, pursuant to which the income tax consequences of intra-entity transfer of an asset other than inventory is required to be recognized in the period in which the transfer occurs. The Company adopted the standard on a modified retrospective basis resulting in an increase of deferred tax assets and the beginning balance of retained earnings by $0.5 million, respectively.

Net Operating Loss Carryforwards and Tax Credits

At December 31, 2018, the Company had approximately $5.6 million California net operating loss, or NOL, carryforwards and no material U.S. federal or other state NOL carryforwards. The California NOL carryforwards begins to expire in 2031. The Company had foreign NOL carryforwards of approximately $34.1 million which can be used annually with certain limitations and have an indefinite carryforward period.

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At December 31, 2018, the Company had federal and California research and development tax credit carryforwards of approximately $10.6 million and $18.8 million, respectively. The federal research and development tax credit begins to expire in 2036. The California research and development tax credit has an indefinite carryforward period. The Company also had a U.S. federal alternative minimum tax, or AMT, credit carryforward of $0.5 million which can be used to offset future regular tax to the extent of the current AMT; the credit has an indefinite carryforward period.

The utilization of NOL and credit carryforwards and other tax attributes could be subject to an annual limitation under Sections 382 and 383 of the Internal Revenue Code of 1986, or the Code, whereby they could be limited in the event a cumulative change in ownership of more than 50% occurs within a three-year period as defined in the Code.

Valuation Allowance

In assessing the need for a valuation allowance, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. Ultimately, the realization of deferred tax assets depends on the existence of future taxable income. Management considers sources of taxable income such as income in prior carryback periods, future reversal of existing deferred taxable temporary differences, tax-planning strategies, and projected future taxable income.

As of December 31, 2015, the Company assessed the realizability of the deferred tax assets of AFP and determined that it was not more likely than not that the net deferred tax assets of AFP would be realized. Therefore, the Company established a full valuation allowance of $0.9 million as of December 31, 2015. The Company has discontinued recognizing AFP income tax benefits until it is determined that it is more likely than not that AFP will generate sufficient taxable income to realize its deferred income tax assets. As of December 31, 2018 and 2017, the Company had a full valuation allowance against the net deferred tax assets of AFP, which totaled $9.1 million and $4.9 million, respectively.

Undistributed Earnings from Foreign Operations

As of December 31, 2018 and 2017, deferred income taxes have not been provided on foreign operations. The foreign subsidiaries have accumulated losses of approximately $30.7 million and $15.9 million, respectively, and as such there are no earnings in which to provide taxes. It is the Company’s plan not to repatriate future foreign earnings to the

U.S.

Uncertain Income Tax Positions

A reconciliation of the beginning and ending balances of unrecognized tax benefits is as follows:

	December 31, 2018	2017	2016
	(in thousands)		
Balance at the beginning of the year	$ 7,438	$ 6,686	$ 5,595
Additions based on tax positions related to prior years	—	—	188
Deductions based on tax positions related to prior years	(1,566)	—	—
Additions based on tax positions related to the current year	1,304	1,300	903
Deductions based on tax audit settlement	(126)	—	—
Deductions based on statute of limitations	(56)	(548)	—
Balance at the end of the year	$ 6,994	$ 7,438	$ 6,686

Included in the balance of unrecognized tax benefits as of December 31, 2018, was $6.8 million that represents the portion that would impact the effective income tax rate if recognized. During the year ended December 31, 2018, the Company reduced unrecognized tax benefits for tax positions related to prior years by $1.6 million and for tax audit settlement by $0.1 million as the result of a state tax audit resolution.

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The Company recognizes accrued interest and penalties related to unrecognized tax benefits in its income tax provision. For the years ended December 31, 2018 and 2017, the Company recognized accrued interest of approximately $0.1 million and $0.1 million, respectively, related to its uncertain tax positions.

The Company and/or one or more of its subsidiaries filed income tax returns in the U.S. federal jurisdiction and various U.S. states and foreign jurisdictions. As of December 31, 2018, the Company is not subject to U.S. federal, state, and foreign income tax examinations for years before 2008. In June 2017, the Internal Revenue Service, or IRS, commenced an audit of the Company's 2015 income tax return. In February 2018, the IRS completed the examination resulting in no changes to reported tax. In August 2011, the California Franchise Tax Board commenced an audit of the Company's 2007, 2008, and 2009 tax returns. In June 2018, the Franchise Tax Board completed the examination resulting in no material tax liability. The Company is subject to income tax audit by tax authorities for tax years 2015 to 2017 for federal and 2014 to 2017 for states.

Note 15. Stockholders' Equity

Common and Preferred Stock

The Company's Certificate of Incorporation, as amended and restated in June 2014 in connection with the closing of its initial public offering, authorizes the Company to issue 300,000,000 shares of common stock, $0.0001 par value per share, and 20,000,000 shares of preferred stock, $0.0001 par value per share. As of December 31, 2018 and 2017, there were no shares of preferred stock issued or outstanding.

Equity Plans

As of December 31, 2018, the Company has two equity plans: the 2015 Equity Incentive Plan, or 2015 Plan, and the 2014 Employee Stock Purchase Plan or ESPP. Prior to the adoption of these plans, the Company granted options pursuant to the Amended and Restated 2005 Equity Incentive Award Plan and the 2002 Amended and Restated Stock Option/Stock Issuance Plan. Upon termination of the predecessor plans, the shares available for grant at the time of termination, and shares subsequently returned to the plans upon forfeiture or option termination, were transferred to the successor plan in effect at the time of share return. The Company issues new shares of common stock upon exercise of stock options, vesting of restricted stock units, or RSU, and settlement of ESPP, with the exception of the awards granted to employees at AFP, which are settled through re-issuance of the Company's treasury shares.

The 2015 Equity Incentive Plan

In March 2015, the Board of Directors adopted the Company's 2015 Equity Incentive Plan, or the 2015 Plan, which was approved by the Company's stockholders in May 2015 and is set to expire in March 2025. The 2015 Plan is designed to meet the needs of a publicly traded company, including the requirements for granting "performance based compensation" under Section 162(m) of the Internal Revenue Code. The 2015 Plan provides for the grant of incentive stock options, nonstatutory stock options, restricted stock, restricted stock units, stock appreciation rights, performance units, performance shares, and other stock or cash awards to employees of the Company and its subsidiaries, members of the Board of Directors and consultants.

The Company initially reserved 5,000,000 shares of common stock for issuance under the 2015 Plan. This number will be increased by the number of shares available for issuance under the Company's prior equity incentive plans or arrangements that are not subject to options or other awards, plus the number of shares of common stock related to options or other awards granted under the Company's prior equity incentive plans or arrangements that are repurchased, forfeited, expired, or cancelled on or after the effective date of the 2015 Plan. The 2015 Plan also contains an "evergreen provision" that allows for an annual increase in the number of shares available for issuance on January 1 of each year during the 10 year term of the 2015 Plan, beginning January 1, 2016. The annual increase in the number of shares shall be the lesser of (i) 3,000,000 shares, (ii) two and one-half percent (2.5%) of the outstanding shares on the last day of the

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immediately preceding fiscal year, or (iii) such number of shares as determined by the Board of Directors. As of the effective date, there were 5,300,296 shares available for grant under the 2015 Plan.

As of December 31, 2018, the Company reserved an aggregate of 5,521,732 shares of common stock for future issuance under the 2015 Plan. In January 2019, an additional 1,165,778 shares were reserved under the 2015 Plan pursuant to the evergreen provision.

Amended and Restated 2005 Equity Incentive Award Plan

The Amended and Restated 2005 Equity Incentive Award Plan, or 2005 Plan, provided for the grant of incentive stock options, or ISOs, nonqualified stock options, or NQSOs, restricted stock awards, restricted stock unit awards, stock appreciation rights, or SARs, dividend equivalents and stock payments to the Company’s employees, members of the Board of Directors and consultants. Stock options under the 2005 Plan were granted with a term of up to ten years and at prices no less than the fair market value of the Company’s common stock on the date of grant. To date, stock options granted to existing employees generally vest over three to five years and stock options granted to new employees vest over four years. Stock options granted to Board of Directors and consultants generally vested over one year.

As of March 2015, consequent to the 2015 Plan becoming effective, awards were no longer granted under the 2005 Plan.

2014 Employee Stock Purchase Plan

In June 2014, the Company adopted the ESPP in connection with its initial public offering. A total of 2,000,000 shares of common stock are reserved for issuance under this plan. The Company’s ESPP permits eligible employees to purchase common stock at a discount through payroll deductions during defined offering periods. Under the ESPP, the Company may specify offerings with durations of not more than 27 months, and may specify shorter purchase periods within each offering. Each offering will have one or more purchase dates on which shares of its common stock will be purchased for employees participating in the offering. An offering may be terminated under certain circumstances. The price at which the stock is purchased is equal to 85% of the lower of the fair market value of the common stock at the beginning of an offering period or on the date of purchase.

As of December 31, 2018, the Company has issued 525,417 shares of common stock under the ESPP and 1,474,583 shares of its common stock remains available for issuance under the ESPP.

For the year ended December 31, 2018, 2017, and 2016, the Company recorded ESPP expense of $0.7 million, $0.6 million, and $0.5 million, respectively.

Share Buyback Program

In November 2014, the Company's Board of Directors authorized a $10.0 million share buyback program, which was completed in December 2015. In November 2015, the Company's Board of Directors authorized an additional $10.0 million to the Company's share buyback program, which was completed in December 2016. In November 2016, the Company's Board of Directors authorized an increase of $20.0 million to the Company's share buyback program, which was completed in August 2017. In August 2017, the Company's Board of Directors authorized an additional $20.0 million to the Company's share buyback program, which was completed in April 2018. In May 2018, the Company's Board of Directors authorized an increase of $20.0 million to the Company's share buyback program, which is expected to continue for an indefinite period of time. The primary goal of the program is to offset dilution created by the Company's equity compensation programs.

Purchases are made through open market and private block transactions pursuant to Rule 10b5-1 plans, privately negotiated transactions or other means as determined by the Company's management and in accordance with the requirements of the SEC. The timing and actual number of treasury share purchases will depend on a variety of factors including price, corporate and regulatory requirements, and other conditions. These treasury share purchases are

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accounted for under the cost method and are included as a component of treasury stock in the Company's consolidated balance sheets.

Pursuant to the Company's share buyback program, the Company purchased 1,414,924 shares, 1,905,653 shares, and 759,067, shares of its common stock during the years ended December 31, 2018, 2017 and 2016, totaling $25.0 million, $30.7 million, and $9.9 million, respectively.

Share-Based Award Activity and Balances

The Company accounts for share based compensation payments in accordance with ASC 718, which requires measurement and recognition of compensation expense at fair value for all share based payment awards made to employees and directors. Under these standards, the fair value of option awards and the option components of the ESPP awards are estimated at the grant date using the Black-Scholes option-pricing model. The fair value of RSUs is estimated at the grant date using the Company's common share price. Prior to the adoption of ASU No. 2018-07, Improvements to Non-employees Share-Based Payment Accounting, non vested stock options held by non-employees are revalued at each balance sheet date. As a result of the Company's early adoption of the guidance on July 1, 2018, stock options held by non-employees are no longer revalued after grant. The portion that is expected to vest is amortized and recognized in compensation expense on a straight-line basis over the requisite service period, generally from the grant date to the vesting date.

Options issued under the Company's 2015 Plan and 2005 Plan, are granted at exercise prices equal to or greater than the fair value of the underlying common shares on the date of grant and vest based on continuous service. There have been no awards with performance conditions and no awards with market conditions. The options have a contractual term of five to ten years and generally vest over a three- to five year period. The Black Scholes option pricing model has various inputs such as the common share price on the date of grant, exercise price, the risk free interest rate, volatility, expected life and dividend yield, all of which are estimates. The Company records share based compensation expense net of expected forfeitures. The change of any of these inputs could significantly impact the determination of the fair value of the Company's options as well as significantly impact its results of operations.

The significant assumptions used in the Black-Scholes option-pricing are as follows:

· Determination of Fair Value of the Underlying Common Stock. For options and ESPP awards granted after the completion of the Company's initial public offering, the fair value for its underlying common stock is determined using the closing price on the date of grant as reported on the Nasdaq Global Select Market.

Since the Company's common stock was not traded in a public stock market exchange prior to June 25, 2014, prior to such date the Board of Directors considered numerous factors including recent cash sales of the Company's common stock to third-party investors, new business and economic developments affecting the Company and independent appraisals, when appropriate, to determine the fair value of the Company's common stock. Independent appraisal reports were prepared using conventional valuation techniques, such as discounted cash flow analyses and the guideline company method using revenue and earnings multiples for comparable publicly traded companies, and a calculation of total option proceeds, from which a discount factor for lack of marketability was applied. This determination of the fair value of the common stock was performed on a contemporaneous basis. Prior to the Company's initial public offering, the Board of Directors determined the Company's common stock fair market value on a quarterly basis and in some cases more frequently when appropriate.

· Expected Volatility. The Company has limited data regarding company specific historical or implied volatility of its share price. Consequently, the Company estimates its volatility based on the weighted average historical volatility of our stock price since IPO and the stock price from a set of peer companies,

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since our shares do not have sufficient trading history. Management considers factors such as stage of life cycle, competitors, size, market capitalization and financial leverage in the selection of similar entities.

- Expected Term. The expected term represents the period of time in which the options granted are expected to be outstanding. The Company estimates the expected term of options with consideration of vesting date, contractual term, and historical experience for exercise and post-vesting employment or contractual termination behavior after its common stock has been publicly traded. The expected term of "plain vanilla" options is estimated based on the midpoint between the vesting date and the end of the contractual term under the simplified method permitted by the SEC implementation guidance. The weighted average expected term of the Company's options is approximately five years.

- Risk Free Rate. The risk free interest rate is selected based upon the implied yields in effect at the time of the option grant on U.S. Treasury zero coupon issues with a term approximately equal to the expected life of the option being valued.

- Dividends. The Company does not anticipate paying cash dividends in the foreseeable future. Consequently, the Company uses an expected dividend yield rate of zero.

The Company estimates forfeitures at the time of grant and revises those estimates in subsequent periods if actual experience differs from those estimates. For the years ended December 31, 2018, 2017 and 2016, the Company estimated an average overall forfeiture rate of 5%, 7%, and 7%, respectively, based on historical experience. Forfeiture rates are separately estimated for its (1) directors and officers, (2) management personnel and (3) other employees. Share based compensation is recorded net of expected forfeitures. The Company periodically assesses the forfeiture rate and the amount of expense recognized based on estimated historical forfeitures as compared to actual forfeitures. Changes in estimates are recorded in the period they are identified.

Tax benefits resulting from tax deductions in excess of the share based compensation cost recognized (excess tax benefits) are recorded in the statements of cash flows as financing activities.

The weighted-averages for key assumptions used in determining the fair value of options granted during the years ended December 31, 2018, 2017, and 2016 are as follows:

	Year Ended December 31,		
	2018	2017	2016
Average volatility	39.9 %	37.0 %	30.4 %
Risk-free interest rate	2.7 %	2.1 %	1.5 %
Weighted-average expected life in years	5.7	5.5	5.5
Dividend yield rate	— %	— %	— %

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Stock Options

A summary of option activity under all plans for the year ended December 31, 2018, is presented below:

	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value(1) (in thousands)
Outstanding as of December 31, 2017	10,898,701	$ 14.65		
Options granted	1,096,832	20.16		
Options exercised	(1,357,865)	13.14		
Options cancelled	(143,724)	13.84		
Options expired	(388,379)	34.81		
Outstanding as of December 31, 2018	10,105,565	$ 14.69	4.80	$ 53,472
Exercisable as of December 31, 2018	6,826,539	$ 14.31	3.57	$ 38,217

(1) The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the Company's common stock for those awards that have an exercise price below the estimated fair value at December 31, 2018.

During the years ended December 31, 2018, 2017, and 2016, the Company recorded expense of $8.2 million, $8.3 million, and $8.7 million, respectively, related to stock options granted under all plans.

Information relating to option grants and exercises is as follows:

	Year Ended December 31,		
	2018	2017	2016
	(in thousands, except per share data)		
Weighted-average grant date fair value per option share	$ 7.80	$ 4.98	$ 3.42
Intrinsic value of options exercised	7,372	17,247	7,446

Cash received from options exercised	11,753	19,098	20,338
Total fair value of the options vested during the year	7,972	7,263	8,654

A summary of the status of the Company's nonvested options as of December 31, 2018, and changes during the year ended December 31, 2018, are presented below:

	Options	Weighted-Average Grant Date Fair Value
Non-vested as of December 31, 2017	4,310,241	$ 4.21
Options granted	1,096,832	7.80
Options vested	(1,984,323)	4.02
Options forfeited	(143,724)	5.20
Non-vested as of December 31, 2018	3,279,026	5.47

As of December 31, 2018, there was $11.3 million of total unrecognized compensation cost, net of forfeitures, related to nonvested stock option based compensation arrangements granted under all plans. The cost is expected to be recognized over a weighted-average period of 2.2 years and will be adjusted for future changes in estimated forfeitures.

Restricted Stock Units

The Company grants restricted stock units, or RSUs, to certain employees and members of the Board of Directors with a vesting period of up to five years. The grantee receives one share of common stock at a specified future date for each

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RSU awarded. The RSUs may not be sold or otherwise transferred until certificates of common stock have been issued, recorded, and delivered to the participant. The RSUs do not have any voting or dividend rights prior to the issuance of certificates of the underlying common stock. The share-based expense associated with these grants was based on the Company's common stock fair value at the time of grant and is amortized over the requisite service period, which generally is the vesting period, using the straight-line method. During the years ended December 31, 2018, 2017, and 2016, the Company recorded expenses of $7.7 million, $7.7 million, and $5.9 million, respectively, related to RSU awards granted under all plans.

As of December 31, 2018, there was $12.3 million of total unrecognized compensation cost, net of forfeitures, related to non-vested RSU-based compensation arrangements granted under all plans. The cost is expected to be recognized over a weighted-average period of 2.2 years and will be adjusted for future changes in estimated forfeitures.

Information relating to RSU grants and deliveries is as follows:

	Total RSUs Issued	Total Fair Market Value of RSUs Issued as Compensation(1) (in thousands)
RSUs outstanding at December 31, 2017	1,392,781	
RSUs granted	439,980	$ 8,560
RSUs forfeited	(55,514)	
RSUs vested(2)	(570,586)	
RSUs outstanding at December 31, 2018	1,206,661	

(1) The total FMV is derived from the number of RSUs granted times the current stock price on the date of grant.
(2) Of the vested RSUs, 363,640 shares of common stock were surrendered to fulfil tax withholding obligations

Equity Awards to Consultants and Advisory Board Members

The Company pays certain consultants and advisory board members in the form of share-based awards. Prior to the adoption of ASU No. 2018-07, Improvements to Non-employees Share-Based Payment Accounting, non-vested stock options held by non-employees were revalued at each balance sheet date. As a result of the Company's early adoption of the guidance on July 1, 2018, stock options held by non-employees are no longer revalued after grant. During the

years ended December 31, 2018, 2017, and 2016 the Company recorded $0.2 million, $0.5 million, and $0.1 million, respectively, in share-based compensation related to the issuance of equity awards for services rendered by consultants.

The Company recorded share-based compensation expense under all plans and is included in the Company's consolidated statement of operations as follows:

	Year Ended December 31,		
	2018	2017	2016
	(in thousands)		
Cost of revenues	$ 3,923	$ 3,756	$ 2,967
Operating expenses:			
Selling, distribution, and marketing	383	302	220
General and administrative	10,853	11,643	10,865
Research and development	1,521	1,386	1,072
Total share-based compensation	$ 16,680	$ 17,087	$ 15,124

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AMPHASTAR PHARMACEUTICALS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 16. Employee Benefits

401(k) Plan

The Company has a defined contribution 401(k) plan, or the Plan, whereby eligible employees voluntarily contribute up to a defined percentage of their annual compensation. The Company matches contributions at a rate of 50% on the first 6% of employee contributions, and pays the administrative costs of the Plan. Total employer contributions for the years ended December 31, 2018, 2017, and 2016 were approximately $1.3 million, $1.1 million, and $1.0 million, respectively.

Defined Benefit Pension Plan

In connection with the Merck API Transaction, the Company assumed an obligation associated with a defined-benefit plan for eligible employees of AFP. This plan provides benefits to the employees from the date of retirement and is based on the employee’s length of time employed by the Company. The calculation is based on a statistical calculation combining a number of factors that include the employee’s age, length of service, and AFP employee turnover rate.

The liability under the plan is based on a discount rate of 1.70% and 1.60% as of December 31, 2018 and 2017, respectively. The liability is included in accrued liabilities in the accompanying consolidated balance sheets. The plan is currently unfunded, and the benefit obligation under the plan was $2.2 million and $2.1 million at December 31, 2018 and 2017, respectively. Expense under the plan was $0.3 million, $0.2 million, and $0.2 million for the years ended December 31, 2018, 2017, and 2016, respectively. Gain or loss due to change in actuarial valuation of the Company’s defined benefit pension plan is recorded in other comprehensive income (loss).

Note 17. Commitments and Contingencies

Collaboration Agreements with Medical Device Manufacturers

In August 2014, the Company entered into a collaboration agreement with a medical device manufacturer to develop a drug delivery system to be used by the Company for one of its pipeline products. As of December 31, 2018, the Company has paid an upfront payment of $0.5 million and $1.7 million in milestone payments under this agreement, which were classified as research and development expense, as the milestones were met. The Company is obligated to pay up to an additional $0.4 million if certain research and development milestones are met. As of December 31, 2018, no such obligation existed. Pursuant to the collaboration agreement, if the medical device manufacturer is successful in the development of this drug delivery system and the Company's pipeline products receive appropriate regulatory approval, the Company intends to enter into a commercial supply agreement with such medical device manufacturer for a minimum purchase of 1.0 million units during the first 12 months.

In October 2017, the Company entered into a collaboration agreement with a medical device manufacturer to develop a drug delivery system to be used by the Company for one of its pipeline products for a total of $1.6 million. As of December 31, 2018, the Company has paid and expensed an upfront payment of $0.4 million and $0.2 million in milestone payments under this agreement, which were classified as research and development expenses as the milestones were met. The Company is obligated to pay up to an additional $1.0 million, if certain research and development milestones are met. As of December 31, 2018, no such obligation existed for the milestones. In addition, pursuant to the collaboration agreement, if the medical device manufacturer is successful in the development of this drug delivery system and the Company's pipeline products receive appropriate regulatory approval, the Company intends to enter into a commercial supply agreement with such medical device manufacturer under which the Company is obligated to pay an additional $1.0 million, if certain commercial development milestones are met and to purchase a minimum of 100,000 units per year for three years.

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Operating Lease Agreements

The Company leases real and personal property, in the normal course of business, under various non-cancelable operating leases. The Company, at its option, can renew a substantial portion of its leases, at the market rate, for various renewal periods ranging from one to six years. Rental expense under these leases for the years ended December 31, 2018, 2017, and 2016, was approximately $4.2 million, $3.5 million, and $3.4 million, respectively.

Future minimum rental payments under operating leases that have initial or remaining non-cancelable lease terms in excess of 12 months for fiscal years ending December 31 are as follows:

	Operating Leases (in thousands)
2019	$ 3,712
2020	3,131
2021	1,967
2022	1,050
2023	125
	$ 9,985

Purchase Commitments

As of December 31, 2018, the Company has entered into commitments to purchase equipment and raw materials for an aggregate amount of approximately $59.5 million. The Company anticipates that most of these commitments with remaining term in excess of one year will be fulfilled by 2020.

The Company entered into agreements with a Chinese governmental entity to acquire land-use rights to real property in Nanjing, China. Under the terms of these agreements, the Company committed to invest capital in its wholly-owned subsidiary, ANP, and to develop these properties as an API manufacturing facility for the Company’s pipeline products. In conjunction with these agreements, ANP modified its business license on July 3, 2012, to increase its

authorized capital. As of December 31, 2016, the Company had completed its investment of total registered capital commitment of $61.0 million to ANP. This investment in ANP resulted in cash being transferred from the U.S. parent company to ANP.

In accordance with certain agreements between ANP and the Chinese government, in January 2010 and November 2012, the Company acquired certain land-use rights for $1.2 million and $1.3 million, respectively. As required by these agreements, the Company committed to spend approximately $15.0 million in the related land development, which primarily includes the construction of fixed assets according to a specific timetable. As of December 31, 2018, the Company has spent $4.5 million on such construction. The Company anticipates that this spending commitment will be met by the end of 2019.

Note 18. Related-Party Transactions

ANP Private Placement

In July 2018, ANP completed a private placement of its common equity interest to accredited investors for aggregate gross proceeds of approximately $57 million. While investors were initially required to complete their contributions in cash by December 31, 2018, ANP granted an extension to certain investors. In connection with the private placement, all of the executive officers of the Company, Stephen Shohet, Howard Lee, and Richard Koo, directors of the Company, and certain employees of ANP entered into subscription agreements (each, a “Subscription Agreement”) for the indirect investment in ANP. These Subscription Agreements were transacted either through an investment in Amphastar Cayman, a Cayman Islands limited liability company, or Qianqia or Zhongpan, Chinese partnerships. The aggregate gross proceeds received from management and directors were approximately $29.7 million.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 19. Litigation

Enoxaparin Patent Litigation

In September 2011, Momenta Pharmaceuticals, Inc., or Momenta, a Boston based pharmaceutical company, and Sandoz Inc., or Sandoz, the generic division of Novartis, initiated litigation against the Company for alleged patent infringement of two patents related to testing methods for batch release of enoxaparin, which the Company refers to as the "'886 patent" and the "'466 patent." The lawsuit was filed in the United States District Court for the District of Massachusetts, or the Massachusetts District Court. In October 2011, the Massachusetts District Court issued a preliminary injunction barring the Company from selling its generic enoxaparin product and also requiring Momenta and Sandoz to post a $100.1 million bond. The preliminary injunction was stayed by the United States Court of Appeals for the Federal Circuit, or the Federal Circuit, in January 2012, and reversed by the Federal Circuit in August 2012.

In January 2013, the Company moved for summary judgment of non-infringement of both patents. Momenta and Sandoz withdrew their allegations as to the '466 patent, and in July 2013, the Massachusetts District Court granted the Company's motion for summary judgment of non-infringement of the '886 patent and denied Momenta and Sandoz's motion for leave to amend their infringement contentions. On January 24, 2014, the Massachusetts District Court judge entered final judgment in the Company's favor on both patents. Momenta and Sandoz also filed a motion to collect attorneys' fees and costs relating to a discovery motion, which the Massachusetts District Court granted. On May 9, 2016, the Massachusetts District Court issued an order imposing fees and costs of approximately $0.4 million in relation to this discovery motion. This amount has been accrued in the general and administrative expense for the quarter ended March 31, 2016. On January 30, 2014, Momenta and Sandoz filed a notice of appeal to the Federal Circuit appealing the court's final judgment including summary judgment denying Momenta and Sandoz's motion for leave to amend their infringement contentions.

Following appeal briefing filed by the parties, the Federal Circuit held oral argument on May 4, 2015. On November 10, 2015, the Federal Circuit panel affirmed-in-part and vacated-in-part the decision of the Massachusetts District Court granting summary judgment of non-infringement as to the Company, and it remanded the case to the Massachusetts District Court for further proceedings consistent with its opinion. The Federal Circuit panel affirmed the Massachusetts District Court's holding in the Company's favor that the Company does not infringe under 35 U.S.C. 271(g), and the panel vacated the grant of summary judgment to the extent it was based on the determination that the Company's activities fall within the 35 U.S.C. 271(e)(1) safe harbor. The Federal Circuit panel also left to the

Massachusetts District Court's discretion whether to reconsider on remand its denial of leave for Momenta and Sandoz to amend their infringement contentions. On January 11, 2016, the Company filed a Petition for Rehearing En Banc with the Federal Circuit. On February 17, 2016, the Federal Circuit denied the Company's Petition, and the Federal Circuit issued its mandate on February 24, 2016, whereby the case returned to the Massachusetts District Court for further proceedings.

On March 18, 2016, the parties filed a joint status report with the Massachusetts District Court. On June 21, 2016, the Massachusetts District Court granted Momenta and Sandoz's Motion for Leave to Amend its Infringement Contentions. In light of Momenta and Sandoz's Amended Infringement Contentions and recent changes in Supreme Court precedent since the case was stayed in 2012, the Company sought to amend its Non-Infringement and Invalidity Contentions.

On July 18, 2016, the Company submitted its Motion for Leave to Amend Its Non-Infringement and Invalidity Contentions and Momenta and Sandoz responded on July 25, 2016. In light of the new arguments made in their response, the Company further filed a Motion For Leave to Reply in Further Support of Defendants' Motion for Leave to Amend Non-Infringement and Invalidity Contentions, which was granted. A hearing was held on August 23, 2016, where the Magistrate Judge ordered the Company to file its proposed amended contentions, which it filed on August 31, 2016. On February 4, 2017, the Magistrate Judge issued an order denying the Company leave to amend its contentions. The Company filed objections to this order with the District Court on February 21, 2017. On April 13, 2017, the District Court rejected the determination of the Magistrate Judge with respect to the Company's amended non-infringement contentions, and allowed the Company to amend its non-infringement contentions. With respect to the Company's amended invalidity

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contentions, the District Court accepted the Magistrate Judge's determination; however, the District Court specifically stated that the Company can argue changes in law at the summary judgment stage or at trial.

In parallel with the Massachusetts District Court proceedings, the Company appealed the Federal Circuit's decision to vacate the grant of the Company's summary judgment to the extent it was based on the determination that the Company's activities are protected under the Safe Harbor. The Company filed a Petition for a Writ of Certiorari with the Supreme Court on May 17, 2016. Momenta and Sandoz initially waived their right to respond to the petition; however, on May 31, 2016, the Supreme Court requested a response from Momenta and Sandoz. The response from Momenta and Sandoz was initially due on June 30, 2016, but they requested an extension. Momenta and Sandoz filed their response on August 1, 2016. On October 3, 2016, the Supreme Court declined the Petition for a Writ of Certiorari.

Fact discovery in the Massachusetts District Court proceedings closed on November 22, 2016, and the parties proceeded with expert discovery and exchanged opening and rebuttal expert reports. Expert discovery closed on March 24, 2017. On April 14, 2017, Plaintiffs filed a Motion for Summary Judgment seeking to dismiss the Company's equitable defenses. On April 14, 2017, the Company filed Defendants' Motion for Summary Judgment of Invalidity and Noninfringement. In the Motion, the Company moved for the District Court to grant summary judgment in favor of the Company on the following issues: (1) the '886 patent is invalid under 35 U.S.C. § 101 as claiming non-patentable subject matter; (2) the '886 patent is invalid under 35 U.S.C. § 112 because the claims are indefinite; and (3) the Company's tests do not infringe the claims of the '886 patent. Oppositions to the motions for summary judgment were filed on May 5, 2017. Replies in support of the motions for summary judgment were filed on May 19, 2017. On June 16, 2017, the District Court issued an order denying the summary judgment motions. The District Court also denied Plaintiffs' motion for summary judgment dismissing the Company's defenses of implied waiver and equitable estoppel, and denied Plaintiffs' alternative request for a separate hearing on the implied waiver and equitable estoppel defenses holding that the defenses would be submitted to the jury for an advisory verdict.

Trial in the Massachusetts District Court on all claims and defenses began on July 10, 2017. On July 21, 2017, the jury returned a unanimous verdict finding that although the Company's tests infringed the asserted patent, the patent was invalid for lack of enablement and lack of written description and the jury further found that Plaintiffs are entitled to zero ($0) damages. As for the Company's defenses of implied waiver and equitable estoppel, the jury found that Plaintiffs waived their right to recover for infringement of the asserted patent and that Plaintiffs are estopped from enforcing the asserted patent against the Company. The verdict on these equitable defenses was briefed by the parties and submitted to the Court. In the post-trial briefing, the Company requested the Court to adopt the findings of the jury on the equitable defenses, and to set aside the jury's finding of infringement. In Plaintiffs' post-trial briefing, Plaintiffs requested a new trial, and requested the Court to set aside the jury's finding that the asserted patent was invalid for lack of enablement and lack of written description. In a February 7, 2018 Memorandum and Order and with respect to the equitable defenses, the Court found that Plaintiffs waived their right to enforce the '866 patent

against the Company for its use of one of its test, and are equitably estopped from enforcing the ’866 patent against the Company for its use of that same test. The Court also found that Plaintiffs have not waived their right to enforce the ’866 patent against the Company for its use of a second test, and are not equitable estopped from enforcing the ’866 patent against the Company for its use of that same second test. On February 7, 2018, the Court also denied all other post-trial motions. On March 20, 2018, the Court entered final judgment in this matter reflecting the jury’s verdict and the Court’s February 7, 2018 Memorandum and Order.

On March 23, 2018, the Company filed a motion to enforce liability on the bonds related to the preliminary injunction issued in October 2011, stayed in January 2012, and reversed by the Federal Circuit in August 2012. On March 27, 2018, Plaintiffs filed a notice of appeal with the Federal Circuit. On April 3, 2018, Plaintiffs filed a motion with the District Court to defer decision on the Company’s motion to enforce liability on the bonds pending their appeal. On July 13, 2018, the District Court allowed Plaintiffs motion to defer consideration of the Company’s motion to enforce liability on the bonds until the appeal is resolved. The Plaintiffs filed their Opening Brief on July 30, 2018, the Company filed its Response Brief on September 21, 2018, and Plaintiffs filed their Reply Brief on November 19, 2018. The briefing in the appeal has concluded and the parties are waiting for the Federal Circuit to set a date for oral arguments. On February 28, 2019, the Plaintiffs filed a motion to stay this appeal, and the Company’s opposition to their motion to stay is due March 21, 2019.

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Plaintiffs filed a motion for sanctions on January 14, 2019. The Company filed its opposition brief to the motion for sanctions on February 4, 2019. Plaintiffs filed a reply on February 14, 2019 and the Company filed a sur-reply on February 22, 2019. The Company's opposition to the motion for relief from the final judgment is currently due on March 20, 2019. The Company intends to vigorously defend against these motions and will continue to vigorously defend the jury's verdict, including against any appeal by the Plaintiffs. The Company intends to continue to pursue its attempt to collect the $100.1 million bond posted by Momenta and Sandoz.

False Claims Act Litigation

In January 2009, the Company filed a qui tam complaint in the U.S. District Court for the Central District of California, or the California District Court, alleging that Aventis Pharma S.A., or Aventis, through its acquisition of a patent through false and misleading statements to the U.S. Patent and Trademark Office, as well as through false and misleading statements to the FDA, overcharged the federal and state governments for its Lovenox® product. If the Company is successful in this litigation, it could be entitled to a portion of any damage award that the government ultimately may recover from Aventis. In October 2011, the California District Court unsealed the Company's complaint.

On February 28, 2014, Aventis filed a motion for summary judgment on the issue of the adequacy of the Company's notice letter to the government, and the California District Court denied Aventis' motion for summary judgment in a final order it issued on May 12, 2014. On June 9, 2014, at Aventis' request, the California District Court issued an order certifying for appeal its order denying Aventis' motion for summary judgment. On June 9, 2014, Aventis filed with the United States Court of Appeals for the Ninth Circuit, or the Ninth Circuit, a petition for permission to appeal the California District Court's denial of Aventis' motion for summary judgment, and the Company filed an opposition to Aventis' petition on June 19, 2014. On August 22, 2014, the Ninth Circuit granted Aventis' petition. The parties filed their respective appeal briefs with the Ninth Circuit. On November 10, 2016, the Ninth Circuit heard oral argument on the appeal.

The California District Court set an evidentiary hearing for July 7, 2014 on the "original source" issue, a key element under the False Claims Act. The evidentiary hearing was conducted as scheduled, from July 7, 2014 through July 10, 2014. On July 13, 2015, the California District Court issued a ruling concluding that the Company is not an original source under the False Claims Act, and entered final judgment dismissing the case for lack of subject matter jurisdiction.

On July 20, 2015, the Company filed with the Ninth Circuit a notice of appeal of the California District Court's dismissal of the case, and Aventis filed a notice of cross-appeal on August 5, 2015. On November 12, 2015, Aventis filed a pleading asking that the California District Court impose various monetary penalties and fines against the Company, including disgorgement of enoxaparin revenues and attorneys' fees expended by Aventis in this action, based on Aventis' allegations that the Company engaged in sanctionable conduct. On November 23, 2015, the California District Court issued an order setting forth a procedure for sanctions proceedings as to the Company as well as its outside counsel. On December 24, 2015, the Company filed a pleading with the California District Court opposing the imposition of sanctions, and on January 20, 2016, Aventis filed a response pleading further pressing for the imposition of sanctions. On May 4, 2016, the California District Court issued three orders requesting that the Company and its outside counsel file a document showing cause as to why sanctions should not be imposed and to set up a conference call with the parties and the Court to discuss whether any discovery and/or a hearing is necessary. On June 13, 2016, the Company and its outside counsel each filed responses to the Court's order to show cause as to why sanctions should not be imposed. On July 21, 2016, Aventis filed a response contending that the Court should impose sanctions. On February 10, 2017, the Court held a show cause hearing regarding the potential imposition of sanctions and took the matter under submission. On September 18, 2017, the District Court issued its decision that no sanctions will be imposed on either the Company or its counsel.

On March 28, 2016, the Company filed its opening brief with the Ninth Circuit Court of Appeals setting forth detailed arguments as to why the False Claims Act litigation should not have been dismissed by the California District Court. On June 20, 2016, Aventis filed its principal brief in the appeal, responding to the Company's arguments regarding dismissal of the False Claims Act litigation, and setting forth Aventis' argument that it should be awarded attorneys' fees and

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expenses. On September 19, 2016, the Company filed its reply brief to Aventis's principal brief. On October 3, 2016, Aventis filed its reply brief in support of its cross-appeal of the District Court's denial of attorneys' fees. On November 10, 2016, the Ninth Circuit heard oral argument on the appeals.

On May 11, 2017, the Ninth Circuit issued an opinion affirming the California District Court's dismissal of the action for lack of subject matter jurisdiction; dismissing as moot Aventis' appeal of the District Court's denial of its motion for summary judgment on the issue of the adequacy of the Company's notice letter to the government; reversing the District Court's denial of Aventis' motion for attorneys' fees; and remanding the case to the District Court for resolution of the attorneys' fees issue. On July 14, 2017, Aventis filed an application with the District Court for entitlement to attorneys' fees and expenses. On November 20, 2017, the District Court issued its order granting Aventis' application for fees, stating that it would refer the matter to a magistrate judge for a report and recommendation regarding the amount of the award to be made. On November 21, 2017, the District Court referred the matter to a magistrate judge.

On August 7, 2018, Aventis filed its Application for Fees and Expenses. On November 26, 2018, the Company filed Opposition to Aventis's Application for Fees and Expenses. On February 12, 2019, following further briefing on the attorneys' fee issue, the District Court approved of the parties' consent for the Magistrate Judge to conduct all further proceedings in this matter at the district court level, including determining the amount of attorneys' fees to be awarded and entering a final judgment. The Magistrate Judge set a hearing on the application, for May 8, 2019. The Company intends to continue to vigorously defend against any imposition of attorneys' fees and expenses in this case.

Momenta/Sandoz Antitrust Litigation

On September 17, 2015, the Company initiated a lawsuit by filing a complaint in the California District Court against Momenta and Sandoz, or the Defendants. The Company's complaint generally asserts that Defendants have engaged in certain types of illegal, monopolistic, and anticompetitive conduct giving rise to various causes of action against them. On December 9, 2015, Defendants filed a motion to dismiss and a motion to transfer the case to the District of Massachusetts. On January 4, 2016, the Company filed oppositions to both motions. On January 26, 2016, the California District Court granted Defendants' motion to transfer and did not rule on Defendants' motion to dismiss. Accordingly, the case was transferred to the District of Massachusetts. On February 9, 2016, the Company filed a writ of mandamus with the Ninth Circuit to attempt to appeal the California District Court's granting of Defendants' motion to transfer to the District of Massachusetts. The Ninth Circuit denied this petition on May 20, 2016, and as such the case will remain before the District of Massachusetts. On July 27, 2016, the Massachusetts District Court granted Defendants' motion to dismiss based on antitrust immunity doctrine, without addressing the substantive merits of the claims.

On August 25, 2016, the Company filed with the First Circuit Court of Appeals a notice of appeal of the Massachusetts District Court's dismissal of the antitrust case. On October 31, 2016, the Company filed its appeal brief with the First Circuit Court of Appeals. On December 5, 2016, Defendants filed their response brief with the First Circuit Court of Appeals. On December 19, 2016, the Company filed its rely brief with the First Circuit Court of Appeals, which concluded the briefing on this appeal. On February 9, 2017, the First Circuit Court of Appeals heard oral arguments. On March 6, 2017, the First Circuit Court of Appeals issued its decision, in which it held 3 to 0 that the District Court of Massachusetts erred in dismissing the Company's antitrust case and sent the case back to the District Court to consider additional arguments.

On April 20, 2017, Defendants filed their supplemental motion to dismiss and the Company filed its opposition on May 4, 2017. On March 19, 2018, the District Court entirely denied the Defendants' motion to dismiss. On April 19, 2018, the Defendants filed a motion to seek interlocutory appeal of the District Court's motion to dismiss opinion. The Company filed its opposition to interlocutory appeal on May 1, 2018. On June 1, 2018, the District Court denied Defendants' motion seeking interlocutory appeal.

On August 23, 2018, the Massachusetts District Court granted the parties' joint motion to extend the schedule as to fact and expert discovery and accepted their proposed dates. Fact discovery closed on November 30, 2018 and expert discovery will close on April 12, 2019. On February 19, 2019, the Company filed a Motion for Partial Summary

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Judgment on Issues Previously Litigated in the Patent Action. Defendants' opposition is due on April 9, 2019, and the Company's reply is due on May 3, 2019. Any additional summary judgment motions are due on April 26, 2019, oppositions are due on June 14, 2019, and replies are due on July 10, 2019.

Additionally, Momenta and Sandoz filed motions for sanctions on January 14, 2019 and January 22, 2019, respectively. The Company filed its opposition briefs to both motions on February 4, 2019 and February 5, 2019, respectively. Momenta and Sandoz filed replies to both motions on February 14, 2019. The Company filed sur-replies to both motions on February 22, 2019. The Company intends to vigorously defend against both motions as it prepares for trial. Trial is scheduled for September 9, 2019.

Epinephrine Injection, 0.1 mg/mL Litigation

On June 28, 2018, Belcher Pharmaceuticals, LLC, or Belcher initiated a lawsuit by filing a complaint against IMS for infringement of U.S. Patent No. 9,283,197 with regard to IMS's New Drug Application No. 211363, filed under 21 U.S.C. § 355(b)(2) of the Hatch-Waxman Act, for FDA approval to manufacture and sell 0.1 mg/mL epinephrine injections. On July 20, 2018, the Company filed a motion to dismiss Belcher's complaint for patent infringement under Federal Rule of Civil Procedure 12(b)(6). The briefing concluded on October 2, 2018. The District Court has not yet ruled on the motion to dismiss. The Company intends to vigorously defend this patent lawsuit.

Vasopressin (20 units/mL) Patent Litigation

On December 20, 2018, Par Pharmaceutical, Inc., Par Sterile Products, LLC and Endo Par Innovation Company (collectively, "Par") initiated a patent lawsuit by filing a Complaint against the Company for infringement of U.S. Patent Nos. 9,375,478 ("the '478 Patent"), 9,687,526 ("the '526 Patent"), 9,744,209 ("the '209 Patent"), 9,744,239 ("the '239 Patent"), 9,750,785 ("the '785 Patent") and 9,937,223 ("the '223 Patent") (collectively, "Par Patents") with regard to the Company's Abbreviated New Drug Application No. 211,857 for FDA approval to manufacture and sell Vasopressin (20 units/mL). The Company filed its Answer to this Complaint on February 19, 2019. The Company intends to vigorously defend this patent lawsuit.

Other Litigation

The Company is also subject to various other claims and lawsuits from time to time arising in the ordinary course of business.

The Company records a provision for contingent losses when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. In the opinion of management, the ultimate resolution of any such matters is not expected to have a material adverse effect on its financial position, results of operations, or cash flows; however, the results of litigation and claims are inherently unpredictable and the Company's view of these matters may change in the future. Regardless of the outcome, litigation can have an adverse impact on the Company because of defense and settlement costs, diversion of management resources, and other factors.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 20. Quarterly Financial Data (Unaudited)

	2018 Quarters			
	First	Second	Third	Fourth
	(in thousands, except per share data)			
Net revenues				
Finished pharmaceutical products	$ 53,117	$ 63,241	$ 71,767	$ 82,934
API	5,276	7,799	3,776	6,756
Total net revenues	$ 58,393	$ 71,040	$ 75,543	$ 89,690
Gross profit				
Finished pharmaceutical products	$ 19,636	$ 27,649	$ 30,571	$ 35,364
API	(2,664)	(1,585)	(1,311)	(675)
Total gross profit	$ 16,972	$ 26,064	$ 29,260	$ 34,689
Net income (loss) attributable to Amphastar Pharmaceuticals, Inc.	$ (7,141)	$ (2,853)	$ 2,389	$ 1,867
Weighted-average shares used to compute net income (loss) per share attributable to Amphastar Pharmaceuticals, Inc. shareholders:				
Basic	46,514	46,557	46,241	46,268
Diluted	46,514	46,557	48,281	49,181
Net income (loss) per share attributable to Amphastar Pharmaceuticals, Inc. shareholders:				
Basic	$ (0.15)	$ (0.06)	$ 0.05	$ 0.04
Diluted	$ (0.15)	$ (0.06)	$ 0.05	$ 0.04

	2017 Quarters			
	First	Second	Third	Fourth
	(in thousands, except per share data)			
Net revenues				
Finished pharmaceutical products	$ 55,934	$ 63,765	$ 54,455	$ 55,985
API	736	1,422	3,461	4,417
Total net revenues	$ 56,670	$ 65,187	$ 57,916	$ 60,402

Gross profit				
Finished pharmaceutical products	$ 24,289	$ 28,778	$ 21,222	$ 22,228
API	(1,482)	(2,119)	(669)	(1,738)
Total gross profit	$ 22,807	$ 26,659	$ 20,553	$ 20,490
Net income attributable to Amphastar Pharmaceuticals, Inc.	$ 861	$ 1,900	$ 99	$ 787
Weighted-average shares used to compute net income per share attributable to Amphastar Pharmaceuticals, Inc. shareholders:				
Basic	46,069	46,025	46,101	46,233
Diluted	48,057	47,866	48,215	49,330
Net income per share attributable to Amphastar Pharmaceuticals, Inc. shareholders:				
Basic	$ 0.02	$ 0.04	$ 0.00	$ 0.02
Diluted	$ 0.02	$ 0.04	$ 0.00	$ 0.02

Net income (loss) per share amounts for the fiscal quarters have been calculated independently and may not in the aggregate equal the amount for the full year.

In 2018, the Company identified immaterial errors in each of its previously reported quarters of 2017 as well as the first

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and second quarters of 2018, primarily related to the depreciation of certain leasehold improvements within property, plant and equipment. The Company corrected the immaterial errors in the third quarter of 2018, resulting in a decrease to the net loss of approximately $0.1 million, for the first quarter of 2018 and an increase to the net loss of approximately $0.1 million for the second quarter of 2018. Net income for each of the first, second, and third quarters of 2017 decreased by $0.1 million and the immaterial error correction for the fourth quarter of 2017 resulted in a decrease to net income of approximately $0.7 million. The errors did not have an effect on basic or diluted net income (loss) per share, except that the basic and diluted earnings per share for the fourth quarter of 2017 was reduced by $0.01 and the basic and diluted loss per share for the first quarter of 2018 was reduced by $0.01. Based on management's evaluation of the materiality of the error from a qualitative and quantitative perspective as required by authoritative guidance, the Company concluded that correcting the error had no material impact on any of the Company's previously issued interim financial statements and had no effect on the trend of financial results.

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Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Our management, under the supervision and with the participation of our Chief Executive Officer and our Chief Financial Officer, our principal executive and principal financial officers, respectively, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act of 1934, as amended, as of the end of the period covered by this Annual Report on Form 10-K. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures were effective (a) to ensure that information that we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and (b) to include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in reports filed or submitted under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Management’s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) under the Exchange Act. Under the supervision and with the participation of senior management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of our internal control over financial reporting based on the framework in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013. Based on the evaluation under that framework and applicable SEC rules, our management concluded that our internal control over financial reporting was effective as of December 31, 2018.

This Annual Report on Form 10-K does not include an attestation report of our registered public accounting firm on our internal control over financial reporting due to an exemption established pursuant to the JOBS Act for “emerging growth companies.”

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2018, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act).

Inherent Limitations of Internal Controls

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management overriding of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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Item 9B. Other Information.

None.

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PART III

Item 10. Directors, Executive Officers and Corporate Governance.

Information required by this item will be included in our Proxy Statement for our 2019 Annual Meeting of Stockholders to be filed within 120 days after our fiscal year end of December 31, 2018, or 2019 Proxy Statement, and is incorporated by reference into this Annual Report on Form 10-K.

Item 11. Executive Compensation.

Information required by this item will be included in our 2019 Proxy Statement and is incorporated by reference into this Annual Report on Form 10-K.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Information required by this item will be included in our 2019 Proxy Statement and is incorporated by reference into this Annual Report on Form 10-K.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

Information required by this item will be included in our 2019 Proxy Statement and is incorporated by reference into this Annual Report on Form 10-K.

Item 14. Principal Accountant Fees and Services.

Information required by this item will be included in our 2019 Proxy Statement and is incorporated by reference into this Annual Report on Form 10-K.

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PART IV

Item 15. Exhibits and Financial Statement Schedules.

(a)(1) Financial Statements filed as part of this report are listed in Part II, Item 8 of this report.

(2) No other financial schedules have been included because they are not applicable, not required or because required information is included in the consolidated financial statements or notes thereto.

(b)The following exhibits are filed as part of, or incorporated by reference into, this Annual Report on Form 10-K.

HIDDEN_ROW

Exhibit No.	Description
3.1	Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed with the SEC on July 1, 2014)
3.2	Amended and Restated Bylaws (incorporated by reference to Exhibit 3.4 to the Company's Registration Statement on Form S-1 filed with the SEC on May 20, 2014)
4.1	Specimen common stock certificate (incorporated by reference to Exhibit 4.1 to Amendment No. 1 to the Company's Registration Statement on Form S-1 filed with the SEC on June 5, 2014)
10.1+	Form of Notice of Stock Option Grant under the Amended 2002 Stock Option/Stock Issuance Plan (incorporated by reference to Exhibit 10.3 to the Company's Registration Statement on Form S-1 filed with the SEC on May 20, 2014)
10.2+	Amended and Restated 2005 Equity Incentive Award Plan (incorporated by reference to Exhibit 10.4 to the Company's Registration Statement on Form S-1 filed with the SEC on May 20, 2014)
10.3+	Form of Stock Option Grant Notice and Stock Option Agreement under the Amended and Restated 2005 Equity Incentive Award Plan (incorporated by reference to Exhibit 10.5 to the Company's Registration Statement on Form S-1 filed with the SEC on May 20, 2014)
10.4+	Form of Deferred Stock Unit Notice of Grant and Deferred Stock Unit Agreement under the Amended and Restated 2005 Equity Incentive Award Plan (incorporated by reference to Exhibit 10.6 to the Company's Registration Statement on Form S-1 filed with the SEC on May 20, 2014)
10.5	Business Loan Agreement, dated December 31, 2010, between International Medication Systems, Limited and East West Bank, as amended (incorporated by reference to Exhibit 10.8 to the Company's Registration Statement on Form S-1 filed with the SEC on May 20, 2014)
10.6	Revolving Loan and Security Agreement, dated April 10, 2012, between Amphastar Pharmaceuticals, Inc. and Cathay Bank (incorporated by reference to Exhibit 10.9 to the

	Company's Registration Statement on Form S-1 filed with the SEC on May 20, 2014)
10.7	Business Loan Agreement, dated July 5, 2013, between International Medication Systems, Limited, Amphastar Pharmaceuticals, Inc. and East West Bank (incorporated by reference to Exhibit 10.10 the Company's Registration Statement on Form S-1 filed with the SEC on May 20, 2014)
10.8	Standard offer, Agreement and Escrow Instructions for Purchase of Real Estate, dated October 2, 2012, among Amphastar Pharmaceuticals, Inc., Jack Y. Zhang and Mary Z. Luo (incorporated by reference to Exhibit 10.12 to the Company's Registration Statement on Form S-1 filed with the SEC on May 20, 2014)
10.9◊	Transfer Contract for the Right to the Use of State-owned Land, dated December 29, 2009, between Amphastar Nanjing Pharmaceuticals Co., Ltd. and Nanjing Xingang Hi-Tech Company Limited (incorporated by reference to Exhibit 10.13 to the Company's Registration Statement on Form S-1 filed with the SEC on May 20, 2014)
10.10◊	Investment Agreement, dated July 5, 2010, between Amphastar Nanjing Pharmaceuticals Co., Ltd. and the Management Committee of the Nanjing Economic and Technological Development Zone (incorporated by reference to Exhibit 10.14 to the Company's Registration Statement on Form S-1 filed with the SEC on May 20, 2014)

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10.11◊	Transfer Contract for the Right to the Use of State-owned Land, dated December 31, 2010, between Amphastar Nanjing Pharmaceuticals Co., Ltd. and Nanjing Xingang Hi-Tech Company Limited. (incorporated by reference to Exhibit 10.15 to the Company's Registration Statement on Form S-1 filed with the SEC on May 20, 2014)
10.12†	Long-Term Supply Agreement, dated November 30, 2008, between Qingdao Jiulong Biopharmaceutical Co., Ltd. and International Medication Systems, Limited (incorporated by reference to Exhibit 10.16 to the Company's Registration Statement on Form S-1 filed with the SEC on May 20, 2014)
10.13+	2014 Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.17 to the Company's Registration Statement on Form S-1 filed with the SEC on May 20, 2014)
10.14	Asset Purchase Agreement, dated April 30, 2014, among Diosynth France, Amphastar France Pharmaceuticals SAS and Schering-Plough (incorporated by reference to Exhibit 10.18 to the Company's Registration Statement on Form S-1 filed with the SEC on May 20, 2014)
10.15	Loan Agreement, dated April 22, 2014, between Amphastar Pharmaceuticals, Inc. and Cathay Bank (incorporated by reference to Exhibit 10.19 to the Company's Registration Statement on Form S-1 filed with the SEC on May 20, 2014)
10.16	Promissory Note, dated April 22, 2014, by Amphastar Pharmaceuticals, Inc. payable to Cathay Bank in the original principal sum of $21,900,000 (incorporated by reference to Exhibit 10.20 to the Company's Registration Statement on Form S-1 filed with the SEC on May 20, 2014)
10.17+	Employment Agreement, dated May 19, 2014, between Amphastar Pharmaceuticals, Inc. and Jack Zhang (incorporated by reference to Exhibit 10.21 to the Company's Registration Statement on Form S-1 filed with the SEC on May 20, 2014)
10.18+	Employment Agreement, dated May 19, 2014, between Amphastar Pharmaceuticals, Inc. and Mary Luo (incorporated by reference to Exhibit 10.22 to the Company's Registration Statement on Form S-1 filed with the SEC on May 20, 2014)
10.19+	Employment Agreement, dated May 19, 2014, between Amphastar Pharmaceuticals, Inc. and Jason Shandell (incorporated by reference to Exhibit 10.23 to the Company's Registration Statement on Form S-1 filed with the SEC on May 20, 2014)
10.20+	Employment Agreement, dated March 11, 2014, between Amphastar Pharmaceuticals, Inc. and William Peters (incorporated by reference to Exhibit 10.25 to the Company's Registration Statement on Form S-1 filed with the SEC on May 20, 2014)
10.21†	Supply Agreement, dated July 31, 2014, between MannKind Corporation and Amphastar France Pharmaceuticals, S.A.S. (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed with the SEC on November 13, 2014)
10.22	First Amendment to Supply Agreement, dated October 31, 2014, by and between MannKind Corporation, Amphastar France Pharmaceuticals, S.A.S., and Amphastar Pharmaceuticals, Inc. (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed with the SEC on November 13, 2014)

10.23+	2015 Equity Incentive Plan and forms of agreement thereunder (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on June 1, 2015)
10.24	Business Loan Agreement, dated January 28, 2016, between Amphastar Pharmaceuticals, Inc. and East West Bank in the original principal sum of $3,724,841. (incorporated by reference to Exhibit 10.28 to the Company's Annual Report on Form 10-K filed with the SEC on March 15, 2016)
10.25	Equipment Line of Credit Agreement, dated March 7, 2016, between International Medication Systems, Limited and East West Bank in the principal sum of $5,000,000. (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed with the SEC on May 10, 2016)
10.26	Fifth Modification to the Revolving Line of Credit Agreement, dated March 7, 2016, between International Medication Systems, Limited and East West Bank in the principal sum of $15,000,000. (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed with the SEC on May 10, 2016)

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10.27	Seventh Amendment and Termination Agreement by and between the Company and Actavis Laboratories FL, Inc. (f/k/a Watson Laboratories, Inc. – Florida and as Andrx Pharmaceuticals, Inc.) dated June 30, 2016. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on July 7, 2016)
10.28	Fourth Modification to the Revolving Line of Credit Agreement, dated June 23, 2016, between Amphastar Pharmaceuticals, Inc. and Armstrong Pharmaceuticals, Inc. and Cathay Bank in the principal sum of $20,000,000. (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed with the SEC on August 9, 2016)
10.29	Business Loan Agreement, dated September 8, 2016, between Amphastar Pharmaceuticals, Inc. and East West Bank in the original principal sum of $3,591,250. (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed with the SEC on November 9, 2016)
10.30†	Second Amendment to Supply Agreement, dated November 9, 2016, by and between MannKind Corporation, Amphastar France Pharmaceuticals, S.A.S., and Amphastar Pharmaceuticals, Inc. (incorporated by reference to Exhibit 10.34 to the Company's Annual Report on Form 10-K filed with the SEC on March 15, 2017)
10.31	Business Loan Agreement, dated May 11, 2017, between International Medication Systems, Limited and East West Bank in the original principal sum of $5,000,000. (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed with the SEC on August 9, 2017)
10.32	Business Loan Agreement, dated May 18, 2017, between Amphastar Pharmaceuticals, Inc. and East West Bank in the original principal sum of $9,000,000. (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed with the SEC on August 9, 2017)
10.33	Sixth Modification to the Revolving Line of Credit Agreement, dated May 3, 2017, between International Medication Systems, Limited and East West Bank in the principal sum of $15,000,000. (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q filed with the SEC on August 9, 2017)
10.34	Equipment Line of Credit, dated June 28, 2017, between International Medication Systems, Limited and East West Bank in the original principal sum of $8,000,000. (incorporated by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q filed with the SEC on August 9, 2017)
10.35	Business Loan Agreement, dated August 14, 2017, between Armstrong Pharmaceuticals, Inc. and Cathay Bank in the original principal sum of $7,865,000. (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed with the SEC on November 9, 2017)
10.36	Subscription Agreement between Amphastar Cayman, LLC and Jason B. Shandell dated June 28, 2018. (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed with the SEC on August 9, 2018)
10.37	Subscription Agreement between Amphastar Cayman, LLC and William J. Peters dated June 28, 2018. (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed with the SEC on August 9, 2018)
10.38	

	Subscription Agreement between Amphastar Cayman, LLC and Rong Zhou dated June 28, 2018. (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q filed with the SEC on August 9, 2018)
10.39	Subscription Agreement between Amphastar Cayman, LLC and Yakob Liawatidewi dated June 28, 2018. (incorporated by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q filed with the SEC on August 9, 2018)
10.40	Subscription Agreement between Amphastar Cayman, LLC and Stephen B. Shohet dated June 28, 2018. (incorporated by reference to Exhibit 10.5 to the Company's Quarterly Report on Form 10-Q filed with the SEC on August 9, 2018)
10.41	Subscription Agreement between Amphastar Cayman, LLC and Chieh-Lin J. Lee dated June 28, 2018. (incorporated by reference to Exhibit 10.6 to the Company's Quarterly Report on Form 10-Q filed with the SEC on August 9, 2018)

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10.42	Subscription Agreement between Amphastar Cayman, LLC and Yu-Chieh W. Lee dated June 28, 2018. (incorporated by reference to Exhibit 10.7 to the Company's Quarterly Report on Form 10-Q filed with the SEC on August 9, 2018)
10.43	Subscription Agreement between Amphastar Cayman, LLC and KYW Investment partnership dated June 28, 2018. (incorporated by reference to Exhibit 10.8 to the Company's Quarterly Report on Form 10-Q filed with the SEC on August 9, 2018)
10.44	Partnership Agreement by and between Zhang Chongqing, Bill Zhang and Applied Physics & Chemistry Laboratories, Inc. dated July 27, 2018. (incorporated by reference to Exhibit 10.9 to the Company's Quarterly Report on Form 10-Q filed with the SEC on August 9, 2018)
10.45	Fourth Amendment to Supply Agreement, dated December 24, 2018, by and between MannKind Corporation and Amphastar Pharmaceuticals, Inc.
21.1	Subsidiaries of the Company
23.1	Consent of Independent Registered Public Accounting Firm
31.1	Certification of Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1#	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2#	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definitions Linkbase Document

#The information in Exhibits 32.1 and 32.2 shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), or otherwise subject to the liabilities of that section, nor shall they be deemed incorporated by reference in any filing under the Securities Act of 1933, as amended, or the Exchange Act (including this Report), unless the Registrant specifically incorporates the foregoing information into those documents by reference.

+Indicates a management contract or compensatory plan or arrangement.

◊English translation of original Chinese document.

†Confidential treatment requested as to portions of the exhibit. Confidential materials omitted and file separately with the SEC.

Item 16. Form 10-K Summary.

None.

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SIGNATURES

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

AMPHASTAR PHARMACEUTICALS, INC.
(Registrant)
By: /s/ JACK Y. ZHANG
Jack Y. Zhang
Chief Executive Officer
(Principal Executive Officer)

Date: March 15, 2019

AMPHASTAR PHARMACEUTICALS, INC.
(Registrant)
By: /s/ WILLIAM J. PETERS
William J. Peters
Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: March 15, 2019

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POWER OF ATTORNEY

Each person whose signature appears below constitutes and appoints Jack Y. Zhang and William J. Peters, and each of them, as his or her true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution, for him or her and in his or her name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them, or their or his substitutes, may lawfully do or cause to be done by virtue thereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated:

Signature	Title	Date
/s/ JACK Y. ZHANG Jack Yongfeng Zhang	Chief Executive Officer and Director (Principal Executive Officer)	March 15, 2019
/s/ MARY Z. LUO Mary Z. Luo	Chairman, Chief Operating Officer and Director	March 15, 2019
/s/ WILLIAM J. PETERS William J. Peters	Chief Financial Officer (Principal Financial and Accounting Officer)	March 15, 2019
/s/ JASON B. SHANDELL Jason B. Shandell	President and Director	March 15, 2019
/s/ RICHARD KOO Richard Koo	Director	March 15, 2019
/s/ HOWARD LEE Howard Lee	Director	March 15, 2019
/s/ FLOYD PETERSEN Floyd Petersen	Director	March 15, 2019
/s/ RICHARD PRINS Richard Prins	Director	March 15, 2019
/s/ STEPHEN SHOHET Stephen Shohet	Director	March 15, 2019
/s/ MICHAEL A. ZASLOFF Michael A. Zasloff	Director	March 15, 2019

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