PERNIX THERAPEUTICS HOLDINGS, INC.
Form 10-K
March 17, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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FORM 10-K

_____

R Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2013

o Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission file number: 001-14494

Pernix Therapeutics Holdings, Inc.
(Exact name of registrant as specified in its charter)

Maryland	33-0724736
(State or Other Jurisdiction of Incorporation)	(I.R.S. Employer Identification Number)
10863 Rockley Road Houston, TX 77099 (Address of principal executive offices) (Zip Code)	(832) 934-1825 (Telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common Stock, par value $0.01 per share	NASDAQ Global Market

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No R

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No R

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 R 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 R No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. R

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

Large accelerated filer	o	Accelerated filer	R
Non-accelerated filer	o	Smaller reporting company	o

(Do not check if a smaller reporting company)

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

The aggregate market value of the registrant's common stock held by non-affiliates as of June 28, 2013 (the last business day of the registrant's most recently completed second quarter) was approximately $76,331,000, based upon the $3.61 closing sales price of the registrant's common stock as reported on the Nasdaq Stock Market on such date. Shares of common stock held by each executive officer and director and by each person who owns 10 percent or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for any other purpose.

On March 12, 2014, the registrant had 37,354,335 shares of its common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A in connection with the registrant's 2014 Annual Meeting of Stockholders, which will be filed subsequent to the date hereof, are incorporated by reference into Part III of this Form 10-K. Such proxy statement will be filed with the Securities and Exchange Commission not later than 120 days following the end of the registrant's fiscal year ended December 31, 2013.

PERNIX THERAPEUTICS HOLDINGS, INC.
Annual Report on Form 10-K for the Year Ended December 31, 2013

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Cautionary Statement Regarding Forward-Looking Statements

This Annual Report on Form 10-K includes forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. For this purpose, any statements contained herein, other than statements of historical fact, including statements regarding the progress and timing of our product development programs and related trials; our future opportunities; our strategy, future operations, anticipated financial position, future revenues and projected costs; our management's prospects, plans and objectives; and any other statements about management's future expectations, beliefs, goals, plans or prospects constitute forward-looking statements. We may, in some cases, use words such as "anticipate," "believe," "could," "estimate," "expect," "intend," "may," "project," "should," "target," "will," "would" or other words that convey uncertainty of future events or outcomes to identify these forward-looking statements. Actual results may differ materially from those indicated by such forward-looking statements as a result of various important factors, including the risks described below in "Item 1A. Risk Factors." If one or more of these factors materialize, or if any underlying assumptions prove incorrect, our actual results, performance or achievements may vary materially from any future results, performance or achievements expressed or implied by these forward-looking statements. In addition, any forward-looking statements in this Annual Report on Form 10-K represent our views only as of the date of this Annual Report on Form 10-K and should not be relied upon as representing our views as of any subsequent date. We anticipate that subsequent events and developments will cause our views to change. However, while we may elect to update these forward-looking statements publicly at some point in the future, we specifically disclaim any obligation to do so, whether as a result of new information, future events or otherwise. Our forward-looking statements do not reflect the potential impact of any acquisitions, mergers, dispositions, business development transactions, joint ventures or investments we may enter into or make in the future.

PART I

ITEM 1. BUSINESS

Overview

We are a specialty pharmaceutical company that sells, markets, manufactures and develops a number of branded and generic pharmaceutical products primarily indicated for sleep, bacterial infections and cough and cold conditions. We intend to see continued growth through the promotion of our products to physicians, healthcare practitioners and consumers, as appropriate. Since inception, we have engaged in a number of acquisitions and licensing arrangements to expand our product offerings. As part of our ongoing expansion strategy, we plan to make strategic acquisitions of products and companies, as well as develop and in-license additional products, with the aim of adding chronic, non-seasonal, specialty products to our revenue base.

Our branded products include CEDAX®, an antibiotic for middle ear infections, and a family of prescription treatments for cough and cold (ZUTRIPRO®, REZIRA®, and VITUZ®). We also market SILENOR® (doxepin), which is approved for the treatment of insomnia characterized by difficulty with sleep maintenance and is not a controlled substance. We promote our branded products through our sales and marketing organization.

We also currently promote Omeclamox-Pak® through a License and Supply Agreement with GastroEntero-Logic, LLC. We recently entered into a promotion agreement with Cumberland Pharmaceuticals pursuant to which Cumberland began promoting Omeclamox-Pak to gastroenterologists.

We recently entered into an Exclusive License Agreement with Osmotica Pharmaceutical Corp. to promote its desvenlafaxine product, Khedezla™ Extended-Release Tablets, 50 and 100 mg.

We sell our generic products in the areas of cough and cold, pain, vitamins, dermatology, antibiotics and gastroenterology through our wholly-owned subsidiaries, Macoven Pharmaceuticals, LLC, or Macoven, and Cypress Pharmaceuticals, Inc., or Cypress.

Our wholly-owned subsidiary, Pernix Manufacturing, LLC, or Pernix Manufacturing, manufactures and packages products for the pharmaceutical industry in a range of dosage forms.

On September 11, 2013, we completed the sale of certain generic assets and Abbreviated New Drug Applications, or ANDAs, owned by our Cypress subsidiary to Breckenridge Pharmaceutical, Inc., or Breckenridge, pursuant to an Asset Purchase Agreement between Cypress and Breckenridge. The assets included seven previously marketed products, eight ANDAs filed at the FDA, and certain other ANDAs in various stages of development. Breckenridge paid us an aggregate of $29.55 million consisting of cash and two promissory notes, each in an amount of $4.85 million, with one due on September 11, 2014 and the other due on September 11, 2015.

On March 6, 2013, we acquired all of the outstanding common stock of Somaxon Pharmaceuticals, Inc., or Somaxon, pursuant to an agreement and plan of merger. As a result of the merger, we issued an aggregate of approximately 3,665,689 shares of our common stock to the former stockholders of Somaxon. We subsequently changed the name of Somaxon to Pernix Sleep, Inc.

On December 31, 2012, we completed the acquisition of Cypress Pharmaceuticals, Inc., a privately-owned, generic pharmaceutical company, and its branded pharmaceutical subsidiary, Hawthorn Pharmaceuticals, Inc., or Hawthorn. We paid an aggregate purchase price of up to $102.3 million. This purchase price included (i) $52 million in cash, (ii) the issuance of 4,427,084 shares of our common stock having an aggregate market value equal to approximately $34.3 million (based on the closing price of $7.75 per share of our common stock as reported on the NYSE MKT LLC on December 31, 2012), (iii) up to $6.5 million in holdback and contingent payments, (iv) $4.5 million that was to be deposited in escrow on December 15, 2013, and (v) the issuance of $5.0 million in shares of our common stock contingent upon the occurrence of a milestone event. The matter of the contingent consideration has been settled and is reflected at the estimated fair value at December 31, 2013.

On July 2, 2012, through our wholly-owned subsidiary, Pernix Manufacturing, we completed our acquisition of substantially all of the business assets of Great Southern Laboratories, or GSL, a pharmaceutical contract manufacturing company located in Houston, Texas, and on August 30, 2012 we completed our acquisition of the related land and buildings where GSL operated. We paid an aggregate of approximately $4.9 million (including $300,000 deposited to an escrow that was subsequently refunded to us in payment of unrecorded liabilities), and assumed certain liabilities totaling approximately $5.9 million.

We were incorporated in Maryland as Golf Trust of America, Inc., or GTA, in November 1996. Pernix is the surviving corporation of the March 2010 merger between GTA and Pernix Therapeutics, Inc. In connection with the merger, we changed our name to Pernix Therapeutics Holdings, Inc.

Our principal executive offices are located at 10863 Rockley Road, Houston, Texas 77099 and our telephone number is (832) 934-1825. Our website address is www.pernixtx.com. The information contained in or that can be accessed through our website is not part of this Annual Report on Form 10-K.

Unless the context indicates otherwise, as used in this Annual Report on Form 10-K, the terms “Pernix,” “Company,” “we,” “us” and “our” refer to Pernix Therapeutics Holdings, Inc., a Maryland corporation, and its subsidiaries taken as a whole.

We have identified in this Annual Report on Form 10-K our registered trademarks and service marks. In addition, this Annual Report on Form 10-K includes references to trademarks and service marks of other entities and those trademarks and service marks are the property of their respective owners.

Business Strategy

Our objective is to be a leader in developing, marketing and selling prescription branded pharmaceutical products in the U.S. for specialty indications. Our strategy to achieve this objective includes the following elements:

Leveraging our focused sales and marketing organization - We have built an effective sales and marketing organization consisting of approximately 90 sales professionals as of December 31, 2013 who are focused on promoting our sleep, depression, gastro, antibiotic and cough and cold medications. Over time we intend to add further chronic, non-seasonal products that we can promote to specialty audiences.

We believe the concentration of high volume prescribers within specialist physician audiences enables us to effectively promote our products with a smaller and more focused sales and marketing organization than would be

required for other markets. We intend to acquire or in-license products that will leverage the capacity of our sales and marketing organization, as well as the relationships we have established with our target physicians. Further, we believe fixed costs per representative are significantly better leveraged than those incurred by larger, more established pharmaceutical companies, due to our higher ratio of incentive based compensation. This aligns representative pay to sales performance, providing upside commission potential and attracting top sales performers.

Accessing parallel market channels through generic versions of selected branded products through our Macoven and Cypress subsidiaries - We intend to continue to utilize our Macoven and Cypress subsidiaries to diversify our product mix while leveraging this low-cost base business, without branding or sales force detailing. Our business goals for Macoven and Cypress include launching authorized generic products for branded pharmaceutical companies including generic equivalents of our own branded products and generic products for patented or niche branded products. We believe that our low-cost generics platform provides an attractive partner for branded pharmaceutical companies seeking to maximize the value of their product franchises via generic distribution.

Acquiring or in-licensing late-stage product development candidates - We also selectively seek to acquire or in-license late-stage product development candidates. We are focused on product development candidates that are ready for or have already entered Phase III clinical trials and should therefore present less development risk than product candidates at an earlier stage of development. We focus on product development candidates that would be prescribed by our target physicians. We believe that our established sales and marketing organization and our cash position make us an attractive commercialization partner for many biotechnology and pharmaceutical companies with late-stage product development candidates. We are actively pursuing the acquisition of rights to product candidates that, if successful, may require the use of a substantial portion of our capital resources.

Acquiring or in-licensing approved pharmaceuticals - We have historically grown our business by acquiring or in-licensing rights to market and sell prescription pharmaceutical products, and we intend to continue to grow in this manner. We are particularly focused on products that are prescribed by specialist physicians and that are under-promoted by large pharmaceutical companies. We believe that the revenue threshold for products that large pharmaceutical companies can promote effectively is increasing, potentially creating attractive opportunities for us to acquire additional products where the promotional audiences are smaller. We are actively pursuing the acquisition of rights to market and sell additional products which, if successful, may require the use of a substantial portion of our capital resources.

Products and Product Candidates

Key Promoted Products

Pernix markets a broad branded product portfolio. We also market generic products through our wholly-owned subsidiaries, Macoven and Cypress. The table below provides information on our current key branded product portfolio:

Marketed Products	Primary Indication	Rights	Launched by Pernix
SILENOR	Sleep maintenance	Pernix	Q2:2013
KHEDEZLA	Major depressive disorder	License from Osmotica Pharmaceuticals Cop.	Q2:2014 (Expected)
CEDAX	Bronchitis, ear and throat infections	Pernix	Q2:2010
ZUTRIPRO	Cough and nasal congestion	Pernix	Q3:2011
REZIRA	Cough and nasal congestion	Pernix	Q1:2013

VITUZ	Cough and nasal congestion	Pernix	Q2:2013
OMECLAMOX-PAK	H.pylori infection and duodenal ulcers	License from GastroEntero-Logic, LLC	Q2:2012

SILENOR. SILENOR is a prescription medicine available in oral tablet formulation of 3 mg and 6 mg dosages of doxepin used to treat insomnia characterized by difficulty with sleep maintenance. Doxepin binds to H1 receptors in the brain and blocks histamine, which is believed to play an important role in the regulation of sleep. Doxepin has been marketed and used for over 35 years at dosages from 75 mg to 300 mg for the treatment of anxiety and depression, but has historically not been used to treat insomnia due to undesirable next-day residual effects. However, we believe that SILENOR, which uses doxepin at low dosages of 3 mg and 6 mg, does not exhibit the same pharmacological effects as high-dose doxepin.

In four separate Phase III clinical trials, SILENOR demonstrated a favorable safety and tolerability profile, including a low dropout rate, an adverse event profile comparable to placebo, no clinically meaningful next-day residual effects and no evidence of amnesia, complex sleep behaviors, hallucinations, tolerance or withdrawal effects. SILENOR was approved by the FDA in March 2010 for the treatment of insomnia characterized by difficulty with sleep maintenance, and was launched commercially in the United States by Pernix Sleep, Inc. (f/k/a Somaxon Pharmaceuticals, Inc.), or Pernix Sleep, in September 2010. We acquired the SILENOR line as a result of our merger with Somaxon on March 6, 2013, and launched in the second quarter of 2013. We intend to market SILENOR to high-prescribing physicians of insomnia treatments.

Market Opportunity. It is estimated that approximately one-third, or 70 million, of adult Americans are affected by insomnia. One study has found that only approximately 20% of those who suffer from insomnia are currently treated with prescription medications. The current market-leading prescription products for the treatment of insomnia include GABA-receptor agonists, which are classified by the FDA as Schedule IV controlled substances, melatonin agonists, hypnotic benzodiazepines and sedating antidepressants. Pre-launch market research indicated that the market is underserved due in large part to characteristics associated with many of these products, such as next-day grogginess, memory impairment, amnesia, hallucinations, physical and psychological dependence, complex sleep behaviors such as sleep driving, hormonal changes and gastrointestinal effects.

We believe that SILENOR offers many benefits, including improved safety, tolerability and efficacy in the treatment of sleep maintenance. Additionally, unlike many of the other insomnia treatments currently available, SILENOR is not designated as a controlled substance, and according to its FDA-approved labeling, SILENOR does not appear to have any potential for dependency, addiction or abuse. Because SILENOR is not a Schedule IV controlled substance, it can be made available to physicians, facilitating initial physician and patient trial without the additional sampling regulation that applies to controlled substances.

As a result of the numerous benefits presented by SILENOR, the limitations of other current therapies, and because it is the first and only nonscheduled prescription sleep medication approved by the FDA for the treatment of insomnia characterized by difficulty with sleep maintenance, we believe that SILENOR has the potential for increased growth in the market. We plan to strategically invest in sales and marketing activities to maximize revenue and market share of this product, and intend to engage in life-cycle management activities relating to SILENOR, including potential OTC opportunities.

Other Treatments. There are many competitive products in the market designed to treat insomnia. The current market-leading prescription products for the treatment of insomnia include GABA-receptor agonists such as Ambien, zolpidem, the generic form of Ambien, in various formulations, Ambien CR, a controlled-release formulation of Ambien, zolpidem ER, the generic form of Ambien CR, Lunesta, Sonata and zaleplon, the generic form of Sonata, in various formulations, melatonin agonists such as Rozerem, several hypnotic benzodiazepines such as temazapam (Restoril) and flurazepam (Dalmane), and sedating antidepressants such as trazodone (Desyrel).

Intellectual Property. SILENOR is covered by 3 patents currently held by ProCom One, Inc. related to the development and commercialization of low dosages of doxepin and other antidepressants for the treatment of insomnia. We are the exclusive licensee of these patents, which should restrict the ability of competitors to market doxepin with identical drug labeling until the last licensed patent expires, which is expected to occur no earlier than 2030. Additionally, we have an exclusive supply agreement with JRS Pharma L.P. for the exclusive use of ProSolv®HD90, an ingredient used in our formulation for SILENOR, in combination with doxepin. Please see the “Intellectual Property” section of this Item 1 for a more detailed description of the rights associated with the SILENOR.

KHEDEZLA. KHEDEZLA is a prescription medicine available in oral tablet formulations of 50 mg and 100 mg dosages of desvenlafaxine used to treat major depressive disorder. KHEDEZLA is a selective norepinephrine reuptake

inhibitor that has been shown to be bioequivalent to Pristiq (Pfizer). KHEDEZLA was approved by the FDA in July 2013 under section 505(b)(2) of the Federal Food, Drug, and Cosmetic Act. We expect to launch KHEDEZLA in the second quarter of 2014.

Market Opportunity. KHEDEZLA competes directly with Pristiq® (Pfizer) which had US sales in 2013 of approximately $700 million.

Other Treatments. KHEDEZLA also competes with other treatments for depression such as Effexor XR® (venlafaxine) (Pfizer), Cymbalta® (duloxetine) (Eli Lilly) and Lexapro® (escitalopram) (Forest). We believe that KHEDEZLA provides an economic alternative to Pristiq for patients and physicians for the treatment of major depressive disorder that can be promoted cost effectively, with simple market positioning.

Intellectual Property. We receive all of our rights to KHEDEZLA from our Exclusive License Agreement with Osmotica Pharmaceuticals Corp. Please see the "Acquisitions and License Agreements, Collaborations and Co-Promotions" section of this Item 1 for a more detailed description of our rights associated with KHEDEZLA.

CEDAX. CEDAX is a third generation oral cephalosporin indicated for the treatment of mild to moderate acute bacterial exacerbations of chronic bronchitis, middle ear infection due to haemophilus influenza or streptococcus pyogenes. We acquired the CEDAX product line from Shionogi Pharma, Inc., or Shionogi, in the first half of 2010, and launched our CEDAX product line in the second quarter of 2010. We sell a variety of dosages utilizing both capsule and oral suspension drug delivery methodologies.

Market Opportunity. According to the American Academy of Pediatrics, over 5 million cases of middle ear infections occur annually in children, which result in more than 10 million antibiotic prescriptions per year.

Other Treatments. Other branded and similar prescription treatments marketed in the U.S. that compete with our CEDAX line include Suprax, Amoxicillin, Omnicef, Cefzil, Ceclor and Ceftin.

Intellectual Property. We have a non-exclusive license to the patent used in our CEDAX product line. The patent expired on February 4, 2014; however, we do not expect the expiration of this patent to have a material adverse impact on sales of CEDAX. We also own a trademark on the name CEDAX in the U.S. Please see the "Intellectual Property" section of this Item 1 for a more detailed description of the rights associated with the CEDAX line of products.

ZUTRIPRO®. (Hydrocodone Bitartrate, Chlorpheniramine Maleate and Pseudoephedrine HCI) is an oral solution 5mg/4mg/60 mg per 5 mL indicated for the relief of cough and nasal congestion associated with the common cold and relief of upper respiratory allergy symptoms including nasal congestion in adults 18 years of age or older. ZUTRIPRO was launched in the third quarter of 2011.

Market Opportunity. Over the past several years, the cough and cold medicine manufacturing OTC industry has enjoyed stable growth. Demand for OTC cough and cold medicines is primarily linked to the occurrence and severity of cold and flu seasons, and changes in private health insurance coverage.

Since the FDA took action against unapproved hydrocodone products in October 2007, the options for prescribing physicians has been limited. In March 2011, the FDA pulled over 400 unapproved cough and cold products from the market leaving a significant void in the cough and cold marketplace. Currently there are only ten approved hydrocodone cough medications on the market. ZUTRIPRO is the only FDA approved cough medication containing a triple combination of hydrocodone (antitussive), pseudoephedrine (decongestant), and chlorpheniramine (antihistamine).

Hydrocodone is a narcotic antitussive. Two commonly prescribed narcotic cough medications containing hydrocodone are UCB's Tussionex® and Endo Pharma's Hycodan®. Each of these medications are also available in generic alternatives.

Other Treatments. Other branded and similar antihistamine, decongestant, and cough suppressants marketed in the U.S. include prescription and OTC cold, cough and allergy products.

Intellectual Property. We have a registered trademark for the ZUTRIPRO name in the U.S. We believe ZUTRIPRO's status as an FDA approved product provides us with a limited opportunity to operate in this market without direct branded competitors, although nothing precludes a competitor from entering the market after receiving FDA approval.

REZIRA. (Hydrocodone Bitartrate and Pseudoephedrine HCI) is an oral solution 5 mg/60 mg per 5 mL indicated for the relief of cough and nasal congestion associated with the common cold in adults 18 years of age or older. REZIRA was launched in the first quarter of 2013 through our Cypress and Hawthorn subsidiaries.

Market Opportunity. Over the past several years, the cough and cold medicine manufacturing over-the-counter, or OTC, industry has enjoyed stable growth. Demand for OTC cough and cold medicines is primarily linked to the occurrence and severity of cold and flu seasons, and changes in private health insurance coverage.

Since the FDA took action against unapproved hydrocodone products in October 2007, the options for prescribing physicians has been limited. Currently there are only ten approved hydrocodone cough medications on the market. REZIRA is the only FDA approved cough medication containing only hydrocodone and pseudoephedrine.

Hydrocodone is a narcotic antitussive. Two commonly prescribed narcotic cough medications containing hydrocodone are UCB's Tussionex® and Endo Pharma's Hycodan®. Each of these medications is also available in generic alternatives.

Two commonly used decongestants are phenylephrine and pseudoephedrine. Phenylephrine is found in OTC treatments, such as Johnson and Johnson's Sudafed PE, Pfizer's Robitussin® CF, McNeil-PPC, Inc.'s Tylenol® Sinus and Novartis Consumer Health Inc.'s Theraflu®. Pseudoephedrine is found in OTC treatments, such as Johnson and Johnson's Sudafed®, Burroughs Wellcome Fund's Actifed®, GlaxoSmithKline plc's Contac® and Schering-Plough HealthCare Products Inc.'s Claritin®-D.

Other Treatments. Other branded and similar antihistamine, decongestant, and cough suppressants marketed in the U.S. include prescription and OTC cold, cough and allergy products.

Intellectual Property. We have a registered trademark for the REZIRA name in the U.S. We believe REZIRA's status as an FDA approved product provides us with a limited opportunity to operate in this market without direct branded competitors, although nothing precludes a competitor from entering the market after receiving FDA approval.

VITUZ. VITUZ is our proprietary hydrocodone bitartrate and chlorpheniramine maleate combination oral solution indicated for the treatment of patients with cough and allergies associated with the common cold. VITUZ was launched in the second quarter of 2013.

Market Opportunity. Over the past several years, the cough and cold medicine manufacturing OTC industry has enjoyed stable growth. Demand for OTC cough and cold medicines is primarily linked to the occurrence and severity of cold and flu seasons, and changes in private health insurance coverage.

Since the FDA took action against unapproved hydrocodone products in October 2007, the options for prescribing physicians has been limited. In March 2011, the FDA pulled over 400 unapproved cough and cold products from the market leaving a significant void in the cough and cold marketplace. Currently there are only ten approved hydrocodone cough medications on the market. Hydrocodone is a narcotic antitussive. Two commonly prescribed narcotic cough medications containing hydrocodone are UCB's Tussionex® and Endo Pharma's Hycodan®. Each of these medications are also available in generic alternatives.

Other Treatments. Other branded and similar antihistamine, decongestant, and cough suppressants marketed in the U.S. include prescription and OTC cold, cough and allergy products.

Intellectual Property. We have a registered trademark for the VITUZ name in the U.S. We believe VITUZ's status as an FDA approved product provides us with a limited opportunity to operate in this market without direct branded competitors, although nothing precludes a competitor from entering the market after receiving FDA approval.

OMECLAMOX-PAK. OMECLAMOX-PAK is indicated for the treatment of patients with H.pylori infection and duodenal ulcer disease (active or one-year history of duodenal ulcer disease) to eradicate H.pylori. Eradication of H.pylori has been shown to reduce the risk of duodenal ulcer recurrence. Each OMECLAMOX-PAK box contains a full 10-day course of therapy, and 10 individual daily dose cards – one card for each day of therapy. Each daily card contains the clearly-marked AM and PM dose of: one 20 mg Omeprazole delayed-release capsule, one 500 mg Clarithromycin tablet, and two 500 mg Amoxicillin capsules. Patients should take one OMECLAMOX-PAK dose in the AM and one dose in the PM, as indicated on the daily dose card, before meals. OMECLAMOX-PAK was launched by us in the second quarter of 2012.

Market Opportunity. H. pylori is a gram negative bacterium that colonizes in the stomach and duodenum. When present, this bacterial infection has been proven to be the cause of over 90% of duodenal ulcers. These ulcers commonly cause abdominal pain and may lead to serious bleeding. The U.S. prevalence of H.pylori is approximately 30%-40% in adults.

Other Treatments. Other treatments include PrevPac, Helidac, and Pylera.

Intellectual Property. We receive all of our rights to OMECLAMOX-PAK from our License and Supply Agreement with GastroEntero-Logic, LLC. Please see the "Acquisitions and License Agreements, Collaborations and Co-Promotions" section of this Item 1 for a more detailed description of our rights associated with OMECLAMOX-PAK.

Other Product Candidates.

We are working on several other product candidates, including a prescription product for the pediatrics market. In March 2012, we entered into a product development agreement with a private company for this product. Under the terms of the agreement, we obtained exclusive marketing rights to this late-stage development product in the United States in consideration for our agreement to pay the costs related to the development of the product. As of December 31, 2013, we have invested approximately $1.6 million, and we expect to make an additional investment of approximately $1.0 million over the next 18 months, for development and regulatory expenses related to this product candidate. Under the terms of the product development agreement, our development partner will manage the development program. We and our development partner expect to commence pivotal phase III studies in 2015 after a thorough review of our phase II data and consultation with the FDA.

Sales and Marketing

Our sales force, consisting of approximately 90 sales professionals as of December 31, 2013, promotes our branded products primarily to high-prescribing physicians that are in the top decile of physicians that prescribe our products. We believe that this highly specialized approach provides us with the opportunity for greater access to this group of health care professionals and increases our market coverage and frequency of visits to this target audience. The compensation of our sales representatives is heavily weighted in commissions which attracts a competitive type of personnel that we believe are highly effective in competing against larger companies and also mitigates cost exposure by tying sales representation compensation primarily to revenue generation instead of base salary. In addition to our sales team, our corporate staff includes a sales management team consisting of pharmaceutical industry veterans experienced in management, business development, and sales and marketing, and has an average of seven years of sales management experience. We may choose to expand our sales force through hiring additional personnel.

We seek to differentiate our products from our competitors by emphasizing the clinical advantages and favorable side effect profiles. Our marketing programs to support our products include: patient co-payment assistance, health care provider education, information to further support patient compliance and participation in national medical conventions. In addition, we are establishing a key opinion leader advisory board with varying specialties to assist in developing our corporate strategy for both our promoted products and product candidates.

Manufacturing

We utilize our manufacturing capabilities for certain of our promoted products and product candidates but we also continue to outsource some of the manufacturing of our promoted products and product candidates. Either way, we maintain internal quality standards, regulatory compliance and a committed level of resources to administer the operations of these outsourcing relationships. We currently depend on outsourcing relationships for the supply of the active ingredients in our pharmaceutical products and product candidates, the manufacture of the finished product and the packaging needed. To date, we have established relationships with several manufacturers to manufacture our products. This may increase the risk that we will not have sufficient quantities of our products or product candidates or that such quantities if available can be acquired at an acceptable cost, which could result in development and commercialization of our product candidates being delayed, prevented or impaired. Where possible and commercially reasonable, we qualify more than one source for manufacturing and packaging of our products to mitigate the risk of supply disruptions. In such circumstances, if one of our manufacturers or packagers were unable to supply our needs, we would have an alternative source available for those products.

Our products and product candidates are manufactured using established processes in a reduced number of steps. There are no complex chemistry designs or unusual manufacturing equipment used in the processes. We plan to continue to develop product candidates that can be manufactured in a cost effective manner at third-party

manufacturing facilities or internally at Pernix Manufacturing.

We and all of our other manufacturers and suppliers are subject to the FDA's current Good Manufacturing Practices, or cGMP, requirements. Certain of our manufacturers are also subject to the United States Drug Enforcement Administration, or DEA, regulations and other rules and regulations stipulated by other regulatory bodies.

Acquisitions and License Agreements, Co-Promotions and Collaborations

We have in the past and will continue on a strategic basis to grow our business through the use of acquisitions, license agreements, co-promotions and collaborations. We enter into acquisition, license and co-promotion agreements to acquire, develop, commercialize and market products and product candidates. In certain of these agreements, we market the products of others and remit a specified profit share to them. In certain other agreements, the contracted third party under the agreement markets products to which we have rights and remits a specified profit share to us. Collaborative agreements often include research and development efforts and/or capital funding requirements of the parties necessary to bring a product candidate to market. License, co-promotion and collaboration agreements may require royalty or profit share payments, contingent upon the occurrence of certain future events linked to the success of the product, as well as expense reimbursements or payments to third-party licensors.

Acquisitions, License and Co-Promotion Agreements

We have acquired a majority of our products, product candidates and technology through acquisitions, license and co-promotion agreements.

Exclusive License Agreement. On February 27, 2014, we entered into an exclusive license agreement with Osmotica Pharmaceutical Corporation to promote KHEDEZLA (desvenlafaxine) Extended-Release (ER) Tablets, 50 mg and 100 mg. The sales and marketing of KHEDEZLA will be supported by our team of sales professionals, promoting the product to high desvenlafaxine prescribing physicians. The New Drug Application, or NDA, for KHEDEZLA Tablets was approved by the U.S. Food and Drug Administration pursuant to section 505(b)(2) of the Federal Food, Drug, and Cosmetic Act in July 2013. KHEDEZLA is indicated for the treatment of major depressive disorder, or MDD. Pursuant to the agreement, we agreed to make an upfront payment for existing inventory of Khedezla, certain milestone payments payable upon the achievement of certain cumulative sales milestones and royalty payments for sales achieved for promoting the product. Subject to certain earlier termination rights, the initial term of the agreement expires in February 2024, with two year automatic renewals.

Gastroenterology Product License and Supply Agreement. In January 2012, we entered into a license and supply agreement with a private company for OMECLAMOX-PAK, an FDA-approved prescription product designed to treat gastroenterology disease. Under the terms of the agreement, we obtained exclusive marketing rights to this product in the United States. We paid an up-front license fee of $2.0 million and an additional fee of $2.0 million upon commercial launch of the product in July 2012. In addition to these license fees, the agreement calls for us to pay royalties and milestone payments based on the sales of the product. Also, we recently entered into a promotion agreement with Cumberland Pharmaceuticals, or Cumberland, for OMECLAMOX-PAK in order to increase the sales force and expand our ability to promote OMECLAMOX-PAK to physicians. Under the terms of the agreement, Cumberland will promote the product to gastroenterologists across the United States through its field sales force which also promotes its Kristalose brand. We will promote the product through our specialty sales force focusing on select primary care physicians. Pernix and Cumberland will cooperate in the marketing and other activities needed to support the commercialization of the brand.

CEDAX. On March 24, 2010, we acquired from Shionogi substantially all of the assets and rights relating to CEDAX, a prescription antibiotic used to treat mild to moderate infections of the throat, ear and respiratory tract, for an aggregate purchase price of $6.1 million. In connection with our acquisition of CEDAX, we acquired a non-exclusive license to an oral suspension formulation patent used in CEDAX products for the remaining life of the patent, which expired on February 4, 2014.

Collaborations

Development of Late-state Pediatric Product. In March 2012, we entered into a product development agreement with a private company for a prescription product for the pediatrics market. Under the terms of the agreement, Pernix obtained exclusive marketing rights to this late-stage development product in the United States, and in consideration for our agreement to pay the costs related to the development of the product. As of December 31, 2013, we have invested approximately $1.6 million, and we expect to make an additional investment of approximately $1.0 million over the next 18 months, for development and regulatory expenses related to this product candidate. Under the terms of the product development agreement, our development partner will manage the development program. We and our development partner expect to commence pivotal phase III studies in 2015 after a thorough review of our phase II data and consultation with the FDA.

Intellectual Property

Our performance relies partly on our capacity to achieve and maintain proprietary protection for our products and product candidates, technology and know-how to function without infringing on the ownership rights of others and to defend against others from infringing on our ownership rights. Most of our products face competition from generics. Our key intellectual property is described below.

Patents

The following table shows the U.S. patents relating to our products. We own or license the rights to the intellectual property in these patents described in more detail below.

Product(s) / Product Candidate(s)	Patent Owners	Patent Description	Expiration
SILENOR	ProCom One, Inc.(1)	Use of doxepin and other antidepressants in low dosages for treatment of insomnia(1)	February 17, 2020, June 5, 2020; April, 2030
	JRS Pharma, L.P.(2)	Use of ProSolv®HD90 in combination with Doxepin(5)	January 9, 2015;
	Pernix Sleep, Inc.(3)	Methods of application to improve the pharmacokinetics of doxepin use for treatment of insomnia(6)	August 24, 2027

(1) In a license agreement dated August 2003 and amended and restated in September 2010, our wholly-owned subsidiary, Pernix Sleep, Inc. (f/k/a Somaxon Pharmaceuticals), acquired the exclusive, worldwide license from ProCom One, Inc., or ProCom, to certain patents to develop and commercialize low dosages of doxepin for the treatment of insomnia. Although patent protection for the current dosage form is limited to the United States, our license to these low-dose doxepin patents is a worldwide license. The term of the license extends until the last licensed patent expires, which is expected to occur no earlier than 2030. The license agreement is terminable at any time by us with 30 days' notice if we believe that the use of the product poses an unacceptable safety risk or if it fails to achieve a satisfactory level of efficacy. Either party may terminate the agreement with 30 days' notice if the other party commits a material breach of its obligations and fails to remedy the breach within 90 days, or upon the filing of bankruptcy, reorganization, liquidation, or receivership proceedings relating to the other party. Under the terms of the agreement, we pay a royalty of five percent (5%) of net sales (as defined in the license agreement) to ProCom. Our predecessor-in-interest made upfront and milestone payments upon certain development milestones and regulatory approvals, all of which were satisfied prior to our acquisition of Somaxon.

(2) Pernix Sleep, Inc. is subject to an exclusive supply agreement with JRS Pharma, L.P. under which it purchases all of its requirements for ProSolv®HD90, an ingredient used in the formulation of SILENOR, from JRS. In August 2008, this agreement was amended to provide Pernix Sleep, Inc. with the exclusive right to use ProSolv®HD90 and any successor product in combination with doxepin, as well as the right to list the U.S. patents owned by JRS and covering ProSolv®HD90 in the FDA's Approved Drug Products with Therapeutic Equivalence Evaluations resource, commonly known as the Orange Book, with respect to the listing of SILENOR. The term of this agreement runs through January 1, 2014 and will automatically renew for one-year periods unless action is taken by us or JRS to terminate the agreement. All ProSolv®HD90 patents related to the manufacture of SILENOR are listed in the Orange Book with respect to SILENOR, and expire on January 9, 2015.

(3) In March 2011, Pernix Sleep, Inc. received a patent, which expires on August 24, 2027 entitled "Methods of Improving the Pharmacokinetics of Doxepin." This patent generally relates to the varied effects that occur when dosing SILENOR 3 mg and 6 mg formulation tablets at least three hours after a meal, as compared to such dosing within three hours of a meal. These effects have important implications relating to the efficacy and safety of SILENOR and are reflected and described in SILENOR's prescribing information.

Companies in our industry tend to own or license patent portfolios that are generally uncertain and involve complicated legal and factual issues. To maintain and solidify our rights to our technology, we must obtain effective

claims and enforce those claims once granted. Any patents we have obtained or will obtain in the future might be found invalidated and/or unenforceable, or may be circumvented by third parties. If any challenges are successful, competitors might be able to market products substantially similar to ours. Additionally, the competition may separately develop similar technologies to ours and the rights granted under issued patents may not provide us with a meaningful competitive advantage against these competitors. Furthermore, because of the extensive amount of time required to bring products to market, it is possible that any related patents may expire or be close to expiring before our products can be commercialized, thus reducing any advantage of the patents. One way that we mitigate the impact of generics that enter the market on our products when we no longer have patent protection is to have Macoven or Cypress launch an authorized generic of our brand product in the market potentially ahead of others.

Trademarks

We own trademark interests in most of our current products and believe that having distinguishing marks is an important factor in marketing these products. We currently own 34 trademarks registered on the principal register of the United States Patent and Trademark Office. These registered marks include ALDEX, ALLRES, ARBINOXA, BROVEX (WORD MARK), BROVEX (STYLIZED), CARDEC, CEDAX, COCO-COF, CYPRESS PHARMACEUTICALS, INC. (DESIGN), DYTAN (STYLIZED), ELIPHOS (STYLIZED), GRANISOL (STYLIZED), HYLIRA (STYLIZED), ICAR (STYLIZED), NODOLOR, PEDIATEX, PERNIX, PERNIX THERAPEUTICS (DESIGN), QUINZYME, REZIRA, REZYST, SILENOR, SOMAXON PHARMACEUTICALS, TCT (STYLIZED) , TCT (WORD MARK), TCT TANNATE CONVERSION TECHNOLOGY, TUSSINAC, VERIPRED (DESIGN), VITUZ, XIRATUSS (STYLIZED), ZAMICET (STYLIZED), Z-COF (STYLIZED), ZEMA-PAK and ZUTRIPRO. In addition to the 34 registered marks listed above, we own 7 intent-to-use trademark applications filed with the United States Patent and Trademark Office that can be registered as use-in-commerce trademarks as soon as we can file a statement of use illustrating use of the marks in commerce. The 7 unregistered trademark applications are, ALLANHIST PDX, ENCINTA, INFAHIST, INFAPRED, INFATUSS, PAINERGY, and PEDIAHIST. We expect that having distinctive marks for any additional products that we develop will also be an important marketing characteristic. U.S. trademark registrations generally are for fixed, but renewable, terms.

Trade Secrets

In some circumstances, we may depend on trade secrets to protect our technology. We try to protect our own technology by entering into confidentiality agreements with our employees, independent contractors, consultants, and advisors. We also aim to protect the confidentiality and integrity of our technology by maintaining physical security of our facilities and physical and electronic security of our data systems. While we have confidence in these security measures, they may be breached and we may not have appropriate responses to manage those breaches.

Customers, Distribution, and Reimbursement

Customers and Distribution

Our customers consist of drug wholesalers, retail drug stores, mass merchandisers and grocery store pharmacies in the U.S. We primarily sell products directly to drug wholesalers, which in turn distribute the products to retail drug stores, mass merchandisers and grocery store pharmacies. Our top four customers which represented 82%, 81% and 84% of gross product sales in 2013, 2012 and 2011, respectively, are all drug wholesalers and are listed below:

Customer	2013		2012		2011	
Cardinal Health	24	%	39	%	37	%
McKesson Corporation	35	%	26	%	23	%
AmerisourceBergen Drug Corporation	20	%	10	%	11	%
Morris and Dickson	3	%	6	%	13	%

Consistent with industry practice, we maintain a returns policy that allows our customers to return products within a specified period prior and subsequent to the expiration date. Occasionally, we may also provide additional discounts to some customers to ensure adequate distribution of our products.

We actively market our products to authorized distributors through regular sales calls. We have many years of experience working with various industry distribution channels. We believe that this significantly enhances our performance in the following ways:

ensuring product stocking in major channels in the geographic areas where we do business;

continually following up with accounts and monitoring product performance;

developing successful product launch strategies; and

partnering with customers on other value-added programs.

Our active marketing effort is designed to ensure appropriate distribution of our products so that patients' prescriptions can be filled with our products.

In the acquisition of Cypress, we acquired the lease of their 51,830 square foot warehouse in Madison, Mississippi from which Cypress distributes all but one of its products. While we distribute certain of Pernix's products from our warehouse in Magnolia, Texas, we currently rely on DDN/Obergfel, LLC, or DDN, a third-party logistics provider, for the distribution of the majority of the Pernix and Macoven products to drug wholesalers, retail drug stores, mass merchandisers and grocery store pharmacies. DDN ships our products from its warehouse in Memphis, Tennessee to our customers throughout the U.S. In an effort to consolidate all distribution operations, we have recently entered into an agreement with Cardinal to be our exclusive third-party logistics provider. We expect to have all of our products moved to the Cardinal facility by the end of April 2014. We then plan to close our office/warehouse facilities in Magnolia, Texas and Madison, Mississippi by June 30, 2014 which is expected to result in a net cost savings.

Reimbursement

In the U.S. market, sales of pharmaceutical products depend in part on the availability of reimbursement to the patient from third-party payors, such as government health administration authorities, managed care organizations, or MCOs, and private insurance plans. Most of our products are generally covered by managed care and private insurance plans. The status or tier within each plan varies, but coverage for our products is similar to other products within the same class of drugs. We also participate in the Medicaid Drug Rebate Program with the Centers for Medicare & Medicaid Services and submit substantially all of our products for inclusion in this program. Coverage of our products under individual state Medicaid plans varies from state to state. Third-party payors are increasingly challenging the prices charged for pharmaceutical products and reviewing different cost savings efforts, which could affect the reimbursement available for our products and ultimately the net proceeds realized from the sales of our products.

Competition

The pharmaceutical industry is defined by rapidly advancing technologies, extreme competition and a focus on proprietary products. We face competition from numerous sources, including other commercial pharmaceutical companies and biotechnology organizations, academic institutions, government agencies and private and public research institutions. Our current products compete with existing and new therapies that may become available in the future.

Our competition may have greater financial resources and more sophisticated expertise in research and development, manufacturing, clinical trials, regulatory pathways and marketing approved products than we do. Usually, competition to our currently marketed products and product candidates have distinguished brand names, are distributed by large pharmaceutical companies with sizable amounts of resources and have achieved widespread acknowledgement in the healthcare market. Small or early stage companies may also prove to be serious competition, predominantly through collaborative agreements with large and established companies.

Issues influencing the success of our products and product candidates, if approved, are and should continue to be efficacy, safety, convenience, price, the availability of patent protection or regulatory marketing exclusivity, generic competition, position and availability within the wholesale trade and the availability of reimbursement from government and other third-party payors.

Our competitive position could be adversely affected if the competition develops and commercializes products that are more effective, safer, have fewer or less severe side effects, are more convenient or are less expensive than our products. Our competitors may also obtain FDA or other regulatory approval faster than we do. Additionally, our ability to compete may be diminished by insurance companies or other third-party payors seeking to promote generic products, which could result in branded products becoming unattractive to consumers from a cost perspective.

The products we currently market face substantial competition from a variety of similar therapeutic branded and generic products. We are potentially subject to competition from generic versions of our branded products if a loss of regulatory marketing exclusivity or patent protection is recognized or as a result of regulatory pathway engineering strategies that provide for generic product introduction before key product patent expirations. Generics typically have lower prices than branded products and, therefore, may erode prescription demand and sales of our branded products, which we have mitigated through the acquisition of our generic subsidiary, Macoven Pharmaceuticals LLC.

Government Regulation

In the U.S. and other countries, federal, state, and local government authorities comprehensively regulate the research, development, testing, manufacture, packaging, storage, recordkeeping, labeling, advertising, promotion, distribution,

marketing, importing and exporting of pharmaceutical products that we market, sell and develop.

FDA Regulation of Drug Products

The FDA regulates drugs under the Federal Food, Drug, and Cosmetic Act, or FDCA, and regulations in the U.S. Obtaining regulatory approvals and the additional compliance with appropriate federal, state and local statutes and regulations requires the use of significant time and financial resources. Noncompliance with applicable FDA requirements during the development, approval or post approval process may subject an applicant to a range of judicial or administrative penalties, such as the FDA's refusal to approve pending applications, withdrawal of an approval, a clinical hold, warning letters, product recalls, product seizures, suspension of production or distribution, fines, refusals of contracts, restitution, disgorgement or civil or criminal sanctions.

Before a drug may be marketed in the U.S., the FDA requires a process that generally involves the following:

performance of preclinical laboratory tests, animal studies and formulation studies in compliance with the FDA's Good Laboratory Practice, or GLP, regulations;

an investigational new drug application, or IND, submitted to the FDA, which must become effective before human clinical trials may commence;

an independent institutional review board (IRB) approval at each clinical site before each trial may begin;

completion of approved, well-controlled human clinical trials in accordance with Good Clinical Practices, or GCP, to establish the safety and efficacy of the proposed drug for its intended use;

submission of a new drug application, or NDA, to the FDA;

adequate completion of an FDA advisory committee review, if applicable;

satisfactory completion of an FDA inspection of clinical trial sites to ensure clinical trials were conducted in accordance with GCPs;

satisfactory completion of an FDA inspection of the manufacturing facilities at which the product is produced to evaluate compliance with current Good Manufacturing Practices, or cGMP, and to assure that the facilities, methods and controls are satisfactory to preserve the drug's identity, strength, quality and purity; and

FDA review and approval of the NDA.

Preclinical Studies. Product candidates that undergo preclinical studies are subject to extensive laboratory evaluations of product chemistry, toxicity, formulation and stability, as well as animal studies. The preclinical test results must be submitted by an IND sponsor, along with a clinical trial protocol, manufacturing information, analytical data and any available clinical data and literature to the FDA as part of the IND. Even after the IND is submitted, some preclinical testing may continue. Unless the FDA raises concerns or questions related to proposed clinical trials and places the clinical trials on a clinical hold, an IND automatically becomes effective 30 days after receipt by the FDA. If the FDA issues a clinical hold, the IND sponsor and the FDA must settle any pending concerns before the clinical trial can begin. Thus, submission of an IND may result in the FDA not allowing the commencement of clinical trials. In addition, the FDA can impose clinical holds at any time before or during trials due to safety concerns or non-compliance.

Clinical Trials. In accordance with GCP requirements, which include the requirement that all research subjects provide their informed consent in writing for their participation in any clinical trial, clinical trials involve the administration of the investigational new drug to human subjects under the supervision of qualified investigators.

Clinical trials are performed in accordance with protocols detailing, among other things, the objectives of the study, dosing procedures and the parameters to be used to monitor subject safety and the effectiveness criteria to be evaluated. Additionally, each institution participating in the clinical trial must have an IRB review and approve the plan for any clinical trial before it commences at that institution. Once an IND is in effect, each new clinical protocol and any amendments to the protocol must be submitted for FDA review and to the IRBs for approval.

Clinical trials performed on humans are generally conducted in three consecutive phases, which may coincide or be combined:

Phase I: The product is initially introduced into healthy human subjects or, in certain circumstances, patients with the target disease or condition, and is tested for safety, dosage tolerance, absorption, metabolism, distribution and excretion.

Phase II: A limited patient population is administered the drug to identify possible adverse effects and safety risks, to preliminarily evaluate the efficacy of the product for specific targeted diseases and to determine dosage tolerance and optimal dosage and schedule.

Phase III: An expanded patient population is administered the drug, generally at geographically unique clinical trial sites, to further evaluate dosage, clinical efficacy and safety, to establish the overall risk-benefit ratio of the drug, and to provide an adequate basis for regulatory approval and product labeling.

The FDA must receive progress reports annually, detailing the results of the clinical trials, and IND sponsors must submit reports of serious and unexpected adverse events. Phase I, II, and III trials might not be successfully completed within a specified period of time, or at all. Moreover, clinical trials may be suspended or terminated by the FDA or sponsor at any time on a variety of grounds, including findings that the research subjects are being exposed to an unacceptable health risk. Similarly, an IRB can suspend or terminate approval of a clinical trial at its institution if the trial is not being conducted in accordance with the IRB's requirements or if the drug has been connected to unanticipated serious harm to patients.

Special Protocol Assessment. The SPA process was created to facilitate the FDA's review and approval of drug products by permitting the FDA to assess the proposed design and size of clinical trials that are intended to form the primary basis for determining a drug product's efficacy. If a clinical trial sponsor specifically requests, the FDA will evaluate the protocol and respond to a sponsor's questions regarding primary efficacy endpoints, trial conduct and data analysis within 45 days of receipt of the request. The FDA ultimately decides whether the protocol design and planned analysis of the trial adequately address objectives in support of a regulatory submission. An SPA letter or the minutes of a meeting between the sponsor and the FDA must clearly document all agreements and disagreements between the sponsor and FDA regarding the SPA.

The FDA may revoke or alter its agreement, even if it agrees to the design, execution, and analysis proposed in protocols reviewed under the SPA, under the following circumstances:

a substantial scientific issue essential to determining the safety or efficacy of the drug has been identified after testing has begun;

the protocol that was agreed upon with the FDA has not been followed by a sponsor;

the relevant data, assumptions, or information provided by a sponsor in a request for SPA change are found to be false or misleading, or are found to exclude important facts; or

the FDA and sponsor agree in writing to modify the protocol and such modification is intended to improve the study.

Marketing Approval. If the required clinical testing is completed successfully, the results of the preclinical and clinical studies, along with descriptions of the manufacturing process, analytical tests conducted on the drug, proposed labeling and other relevant information are submitted as part of an NDA to the FDA, requesting approval to market the product for one or more indications. The submission of an NDA is subject to a substantial application fee in most cases.

Additionally, an NDA or supplement to an NDA must contain data that is acceptable to properly assess the safety and effectiveness of the drug for the claimed indications in all relevant pediatric subpopulations, and to support dosing and administration for each pediatric subpopulation for which the drug is safe and effective, according to the Pediatric Research Equity Act of 2003, or PREA, as amended and reauthorized by the Food and Drug Administration Amendment Act of 2007, or FDAAA. The Food and Drug Administration Safety and Innovation Act of 2012, or FDASIA, requires manufacturers of drugs that include a new active ingredient, new indication, new dosage form, new dosing regimen, or new route of administration to submit a pediatric study plan to the IND. The plan must be submitted not later than 60 days after the end-of-phase 2 meeting with FDA; if there is no such meeting, before the

initiation of any phase 3 studies or a combined phase 2 and phase 3 study; or if a phase 3 study or a combined phase 2 and phase 3 study will not be conducted, no later than 210 days before a marketing application or supplement is submitted. The FDA is also authorized, under the FDAAA, to require sponsors of currently marketed drugs to perform pediatric studies if the drug is used for a substantial number of pediatric patients for the labeled indication and adequate pediatric labeling could benefit such patients, there is reason to believe the drug would provide a "meaningful therapeutic benefit" for pediatric patients, or the absence of pediatric labeling could pose a risk to pediatric patients. At the request of an applicant or by its own initiative, the FDA may grant deferrals for submission of some or all pediatric data until after approval of the drug for use in adults, or, may grant full or partial waivers from the pediatric data requirements. The pediatric data requirements do not apply to products with orphan designation, unless otherwise required by regulation.

Sixty days after its receipt of an NDA, the FDA has to determine whether the application will be accepted for filing based on the agency's threshold determination that it is adequately complete to permit substantive review. Rather than accept an NDA for filing, the FDA may request additional information. In such an event, the NDA must be resubmitted with the additional information and is subject to additional fees. Before the FDA accepts the resubmitted application for filing, it is also subject to review. Once the submission is accepted for filing, the FDA commences a detailed substantive review. The FDA may refer the NDA to an advisory committee for review, evaluation and a recommendation as to whether the application should be approved and under what conditions. The FDA considers such recommendations when making decisions but is not bound by the recommendations of the advisory committee.

The FDA will also examine the facility or facilities where the product is manufactured before approving an NDA. The FDA will not approve an application if it determines that the manufacturing processes and facilities do not comply with cGMP requirements and are unsatisfactory to assure consistent production within required specifications. In addition, the FDA will typically inspect one or more clinical sites to assure compliance with GCP before approving an NDA.

The approval process is lengthy and difficult and the FDA may refuse to approve an NDA if the applicable regulatory criteria are not satisfied or may require additional clinical data or other data and information. Even if such data and information are submitted, the FDA may ultimately decide that the NDA does not satisfy the criteria for approval. Data obtained from clinical trials are not always conclusive and the FDA may interpret data differently than we interpret the same data. The FDA will issue a complete response letter if the agency decides not to approve the NDA in its present form. The complete response letter usually describes all of the specific deficiencies that the FDA identified in the NDA. The deficiencies identified may be minor, for example, requiring labeling changes, or major, for example, requiring additional clinical trials. Additionally, the complete response letter may include recommended actions that the applicant might take to place the application in a condition for approval. If a complete response letter is issued, the applicant may resubmit the NDA, addressing all of the deficiencies identified in the letter, withdraw the application, or request an opportunity for a hearing.

If a product receives regulatory approval, the approval may be significantly limited to specific diseases and dosages or the indications for use may otherwise be limited, which could restrict the commercial value of the product. Further, the FDA may require that certain contraindications, warnings or precautions be included in the product labeling. As a condition of approval, FDA may require a risk evaluation and mitigation strategy, or REMS, to help ensure that the benefits of the drug outweigh the potential risks. REMS can include medication guides, communication plans for healthcare professionals, and elements to assure safe use, or ETASU. ETASU can include, but are not limited to, special training or certification for prescribing or dispensing, dispensing only under certain circumstances, special monitoring, and the use of patient registries. The requirement for a REMS can materially affect the potential market and profitability of the drug. Once adopted, REMS are subject to periodic assessment and modification. In addition, the FDA may require Phase IV testing which involves clinical trials designed to further assess a drug's safety and effectiveness after NDA approval and may require testing and surveillance programs to monitor the safety of approved products that have been commercialized. Based on the results of post-market studies or surveillance programs, the FDA may prevent or limit further marketing of a product. Some types of changes to the approved product, such as adding new indications, manufacturing changes, and additional labeling claims, are subject to further FDA review and approval even after initial approval has been granted.

FDA Expedited Development and Review Programs. To expedite or simplify the process for the development and FDA review of drug products that are intended for the treatment of life threatening or other serious conditions and demonstrate the potential to address unmet medical needs, the FDA has a variety of programs, including fast track designations, accelerated approval and priority review. The purpose of these expedited review and approval programs is to provide important new drugs to patients faster than the standard FDA review procedures.

New drug products are eligible for fast track designation if they are intended to treat a life threatening or serious condition and demonstrate the potential to address unmet medical needs for the condition. Fast track designation applies to the combination of the product and the specific indication for which it is being studied. Unique to a fast track product, the FDA may consider for review sections of the NDA on a rolling basis before the complete application is submitted, if the sponsor provides a schedule for the submission of the sections of the NDA, the FDA agrees to accept sections of the NDA and determines that the schedule is acceptable, and the sponsor pays any required user fees upon submission of the first section of the NDA.

Any product is eligible for priority review if it has the potential to provide safe and effective therapy where no satisfactory alternative therapy exists or a significant improvement in the treatment, diagnosis or prevention of a disease compared to marketed products. The FDA will attempt to direct additional resources to the evaluation of an application for a new drug designated for priority review in an effort to facilitate the review. Additionally, a product may be eligible for accelerated approval. Drug products studied for their safety and effectiveness in treating serious or life-threatening illnesses and that provide meaningful therapeutic benefit over existing treatments may receive accelerated approval, which means that they may be approved on the basis of adequate and well-controlled clinical studies establishing that the product has an effect on a surrogate endpoint that is reasonably likely to predict a clinical benefit, or on the basis of an effect on a clinical endpoint other than survival or irreversible morbidity. As a condition of approval, the FDA may require that a sponsor of a drug receiving accelerated approval perform adequate and well-controlled post-marketing clinical studies. In addition, the FDA currently requires as a condition for accelerated approval pre-approval of promotional materials, which could adversely impact the timing of the commercial launch of the product. Fast track designation, priority review and accelerated approval do not change the standards for approval but may expedite the development or approval process. The FDA may later decide that the drug no longer meets the conditions for qualification or decide that the time period for FDA review or approval will not be shortened even if a drug product qualifies for one or more of these programs.

In addition, FDASIA amended the FDCA to require FDA to expedite the development and review of a breakthrough technology. A drug can be designated as a breakthrough technology if it is intended to treat a serious or life-threatening disease or condition and preliminary clinical evidence indicates that it may demonstrate substantial improvement over existing therapies on one or more clinically significant endpoints. A sponsor may request that a drug be designated as a breakthrough therapy at any time during the clinical development of the product. If so designated, FDA shall act to expedite the development and review of the product's marketing application, including by meeting with the sponsor throughout the product's development, providing timely advice to the sponsor to ensure that the development program to gather preclinical and clinical data is as efficient as practicable, involving senior managers and experienced review staff in a cross-disciplinary review, assigning a cross-disciplinary project lead for the FDA review team to facilitate an efficient review of the development program and to serve as a scientific liaison between the review team and the sponsor, and taking steps to ensure that the design of the clinical trials is as efficient as practicable.

Post-approval Requirements. Drugs that receive FDA approval remain subject to continuing regulation by the FDA, including reporting of adverse experiences with the product, providing the FDA with updated safety and efficacy information, advertising and promotion, product sampling and distribution, complying with certain electronic records and signature requirements, periodic reporting and requirements relating to recordkeeping. The FDA strictly regulates labeling, advertising, promotion and other types of information on products that are placed on the market. Drugs may be promoted only for the approved indications and in accordance with the provisions of the approved label. An organization that is found to have improperly promoted off label uses may be subject to significant liability imposed by the FDA and other agencies that actively enforce laws and regulations prohibiting the promotion of off label uses. The Federal Trade Commission regulates advertising for OTC drug products. Advertising for these products must be truthful, not misleading and adequately substantiated.

Additionally, drug manufacturers and other organizations involved in the distribution and manufacture of approved drugs are required to register their organizations with the FDA and state agencies, and are subject to periodic unannounced inspections by the FDA and state agencies for compliance with cGMP requirements. Changes to the manufacturing process generally require prior FDA approval before implementation. The cGMP requirements apply to all stages of the manufacturing process, including the production, processing, sterilization, packaging, labeling, storage and shipment of the drug. Manufacturers must establish validated systems to ensure that products meet specifications and regulatory standards, and test each product batch or lot prior to its release. Future FDA and state inspections may identify compliance issues at our manufacturing facilities or the facilities of our contract manufacturers that may disrupt production or distribution or may require substantial resources to correct. Accordingly, we and our contract manufacturers must continue to spend time, money, and effort in the area of quality control and production to maintain cGMP compliance.

The FDA may withdraw an approval, once granted, if compliance with regulatory requirements and standards is not maintained or if problems arise after the product reaches the market. Later discovery of previously unknown problems with a product may result in restrictions on the product or even complete withdrawal of the product from the market. Further, the failure to maintain compliance with regulatory requirements may result in administrative or judicial actions, such as product recalls, complete withdrawal of the product from the market or restrictions on the marketing or manufacturing of the product; warning letters, fines or holds on post-approval clinical trials; suspension or revocation of product approvals, or refusal of the FDA to approve pending applications or supplements to approved applications; refusal to permit the import, or export of products or product seizure or detention; or civil or criminal penalties or injunctions.

The Prescription Drug Marketing Act, or PDMA, regulates the distribution of drugs and drug samples at the federal level and sets minimum standards for the licensing and regulation of drug distributors by the states. The distribution of prescription drug products is also regulated by the PDMA. Both the PDMA and state laws limit the distribution of

prescription pharmaceutical samples and enforce requirements to ensure accountability in distribution.

In November 2013, the Drug Quality and Security Act became law, and establishes requirements to facilitate the tracing of prescription drug products through the pharmaceutical supply distribution chain. Specifically, the law requires FDA to establish standards for the exchange of transaction documentation and to establish processes to provide waivers and exceptions to requirements. By January 1, 2015, manufacturers, wholesalers, dispensers, and repackagers must ensure that all prior transaction information is provided at each transfer of ownership. Additionally, in the event of a recall or for the purpose of investigating a suspect product or an illegitimate product, manufacturers, wholesalers, dispensers, and repackagers must provide within a reasonable time the applicable transaction documentation upon request to FDA or other appropriate federal or state officials. This law includes a number of new requirements that will be implemented over time and will require us to devote additional resources to satisfy these requirements.

From time to time, legislation is drafted, introduced and enacted by Congress that could significantly change the statutory provisions governing the approval, manufacturing and marketing of products regulated by the FDA. In addition to new legislation, FDA regulations and policies are often revised or reinterpreted by the agency or the courts in ways that may considerably affect our business and our products. It is impossible to predict whether further legislative or FDA regulation or policy changes will be enacted or implemented and what the impact of such changes, if any, may be.

Prescription Drug Wrap-Up

The FDCA, enacted in 1938, was the first statute requiring premarket approval of drugs by the FDA. These approvals, however, focused exclusively on safety data. In 1962, Congress amended the FDCA to require that sponsors demonstrate that new drugs are effective, as well as safe, in order to receive FDA approval. These amendments also required the FDA to conduct a retrospective evaluation of the effectiveness of the drug products that the FDA approved between 1938 and 1962 on the basis of safety alone. The agency contracted with the National Academy of Science/National Research Council, or the NAS/NRC, to make an initial evaluation of the effectiveness of many drug products. The FDA's administrative implementation of the NAS/NRC reports was the Drug Efficacy Study Implementation, or DESI.

Drugs that were not subject to applications approved between 1938 and 1962 were not subject to DESI review. For a period of time, the FDA permitted these drugs to remain on the market without approval. In 1984, however, spurred by serious adverse reactions to one of these products, Congress urged the FDA to expand the new drug requirements to include all marketed unapproved prescription drugs. The FDA created a program, known as the Prescription Drug Wrap-Up, to address these remaining unapproved drugs. Many of these drugs claimed to have been on the market prior to 1938 or to be identical, related, or similar to such a drug. A drug subject to the Prescription Drug Wrap-Up is marketed illegally, unless the manufacturer can establish that the drug is grandfathered or otherwise not a "new drug." Under the 1938 grandfather clause, a drug product that was on the market prior to the passage of the 1938 Act and which contained in its labeling the same representations concerning the conditions of use as it did prior to passage of that Act was not considered a "new drug" and was therefore exempt from the requirement of having an approved NDA. Under the 1962 grandfather clause, a drug is exempt from the effectiveness requirements if its composition and labeling have not changed since 1962 and if, on the day before the 1962 Amendments became effective, it was (a) used or sold commercially in the U.S., (b) not a new drug as defined by the FDCA at the time, and (c) not covered by an effective application. The two grandfather clauses have been construed very narrowly by the courts and the FDA believes that there are very few drugs on the market that are actually entitled to grandfather status because the drugs currently on the market likely differ from the previous versions. If a firm claims that its product is grandfathered, it is the firm's burden to prove that assertion. Pernix believes that several of its marketed pharmaceutical products are identical, related or similar to products that have existed on the market without an NDA or ANDA. Beginning in 2008, we began converting these cough and cold products to OTC monograph from DESI drugs. For additional information, see "Risks Related to Regulatory Matters- Some of our specialty pharmaceutical products are now being

marketed without FDA approvals."

Over The Counter Drugs

As for over the counter, or OTC, drugs, in 1972, the FDA implemented a process of reviewing OTC drugs through rulemaking by therapeutic classes (e.g., antacids, antiperspirants, cold remedies). Advisory panels are convened for each therapeutic class and their reports are published in the Federal Register. After FDA review, tentative final monographs for the classes of drugs are published. The final step is the publication of a final monograph for each class, which sets forth the allowable claims, labeling, and active ingredients for the OTC drugs in each class. Monographs are a kind of "Recipe Book" for acceptable ingredients, doses, formulations and labeling. Drugs must meet all of the general conditions for OTC drugs and all of the conditions contained in an applicable final monograph to be considered generally recognized as safe and effective (GRAS/GRAE) and to be marketed without FDA approval of a marketing application. The general conditions include, among other things, compliance with cGMP, establishment registration and labeling requirements. Any product that fails to conform to each of the general conditions and a monograph is subject to regulatory action. We believe our promoted branded cough and cold OTC products conform to an FDA OTC monograph.

Pursuant to the Dietary Supplement and Nonprescription Drug Consumer Protection Act, enacted in 2006, manufacturers, packers, or distributors of OTC drugs marketed in the United States without an approved application must also submit to the FDA reports of serious adverse events associated with such drugs when used in the United States, accompanied by a copy of the label on or within the retail package of such drug. In addition, the manufacturer, packer, or distributor must submit follow-up reports received within one year of the initial report.

The Hatch-Waxman Act

Abbreviated New Drug Applications. Through the NDA approval process, applicants are obligated to list with the FDA each patent with claims that cover the applicant's product or an approved use of the product. When the drug has been approved, each of the patents listed in the application for the drug is then published in the FDA's Approved Drug Products with Therapeutic Equivalence Evaluations, commonly known as the Orange Book. Drugs listed in the Orange Book can, in turn, be cited by potential competitors in pursuit of approval of an Abbreviated New Drug Application, or ANDA. An ANDA provides for marketing of a drug product that has the same active pharmaceutical ingredients in the same strengths, route of administration, conditions of use and dosage form as the listed drug and has been shown through bioequivalence testing to be therapeutically equivalent to the listed drug. Using bioequivalence as the basis for approving generic copies of drug products was established by the Drug Price Competition and Patent Term Restoration Act of 1984, also known as the Hatch-Waxman Act. ANDA applicants are not required to conduct or submit results of pre-clinical or clinical tests to prove the safety or efficacy of their drug product, other than the requirement for bioequivalence testing. ANDA approved drugs are commonly referred to as "generic equivalents" to the listed drug, and can be replaced by pharmacists under prescriptions written for the original listed drug.

The ANDA applicant is required to certify to the FDA concerning each patent listed for the approved product in the FDA's Orange Book. Specifically, the applicant must certify that:

the required patent information has not been filed;

the listed patent has expired;

the listed patent will expire on a particular date, but has not expired and approval is sought after patent expiration; or

the listed patent is unenforceable, invalid or will not be infringed by the manufacture, sale or use of the new product, also known as a Paragraph IV certification.

A Paragraph IV certification demonstrates that the new product will not infringe the already approved product's listed patents or that such patents are invalid or unenforceable. Provided the applicant does not challenge the listed patents, the ANDA application will not be approved until all the listed patents claiming the referenced product have expired. ANDA approval will not be delayed if there are no listed patents or all patents have expired.

If a Paragraph IV certification has been provided to the FDA by the ANDA applicant, the NDA and patent holders must also receive notice from the applicant of the Paragraph IV certification. The applicant must also send notice of the Paragraph IV certification to the NDA and patent holders with a comprehensive account of the factual and legal basis for the applicant's belief that the patents are invalid, unenforceable or not infringed once the ANDA has been accepted for filing by the FDA. The NDA and patent holders may then initiate a patent infringement lawsuit in response to the notice of the Paragraph IV certification. The filing of a patent infringement lawsuit within 45 days of the receipt of a Paragraph IV notice automatically prevents the FDA from approving the ANDA until the earlier of 30 months from the receipt of notice by the patent holder, or until a court deems the patent unenforceable, invalid or not infringed. Hatch-Waxman provides for a 180 day period of generic product exclusivity for the first generic applicant

to challenge a listed patent for an NDA-approved drug. Thus, many if not most successful new drug products are subject to generic applications and patent challenges prior to the expiration of all listed patents.

Section 505(b)(2) New Drug Applications. As an alternate path to FDA approval, particularly for modifications to drug products previously approved by the FDA, an applicant may submit an NDA under Section 505(b)(2) of the FDCA. Section 505(b)(2) was enacted as part of the Hatch-Waxman Act, and permits the submission of an NDA where at least some of the information required for approval comes from clinical trials not conducted by or for the applicant and for which the applicant has not obtained a right of reference. The FDA interprets Section 505(b)(2) of the FDCA to permit the applicant to rely upon the FDA's previous findings of safety and effectiveness for an approved product. The FDA requires submission of information needed to support any changes to a previously approved drug, such as published data or new studies conducted by the applicant, including bioavailability or bioequivalence studies, or clinical trials demonstrating safety and effectiveness. The FDA may then approve the new product candidate for some or all of the label indications for which the referenced product has been approved, as well as for any new indication sought by the Section 505(b)(2) applicant.

To the extent that the Section 505(b)(2) applicant is relying on studies conducted for an already approved product, the applicant is subject to existing exclusivity for the reference product and is required to certify to the FDA concerning any patents listed for the approved product in the Orange Book to the same extent that an ANDA applicant would. Therefore, authorization of a Section 505(b)(2) NDA can be delayed until all the listed patents claiming the referenced product have expired, until any non-patent exclusivity, such as exclusivity for obtaining approval of a new chemical entity, listed in the Orange Book for the referenced product has expired, and, in the case of a Paragraph IV certification and subsequent patent infringement suit, until the earlier of 30 months from when the patent holder receives notice or a decision or settlement in the infringement case finding the patents to be unenforceable, invalid or not infringed.

Some pharmaceutical companies and others have opposed the FDA's interpretation of Section 505(b)(2), despite the approval of numerous products by the FDA pursuant to Section 505(b)(2) over the last several years. A change in interpretation by the FDA of Section 505(b)(2) could prevent or delay the approval of any Section 505(b)(2) NDAs that we submit.

Marketing Exclusivity and Patent Term Restoration. Newly-approved drugs and indications may benefit from a statutory period of non-patent marketing exclusivity under the Hatch-Waxman Act. The Hatch-Waxman Act grants five-year marketing exclusivity to the first applicant to achieve approval of an NDA for a new chemical entity, or NCE, meaning that the FDA has not previously approved any other drug containing the same active pharmaceutical ingredient. The Hatch-Waxman Act prohibits the submission of a Section 505(b)(2) NDA or an ANDA for another version of such drug during the exclusivity period. But, submission of a Section 505(b)(2) NDA or an ANDA containing a Paragraph IV certification is allowed after four years, which may activate a 30-month stay of approval of the Section 505(b)(2) NDA or ANDA if the patent holder sues. The Hatch-Waxman Act also provides three years of marketing exclusivity for the approval of new and supplemental NDAs, including Section 505(b)(2) NDAs, if new clinical investigations, other than bioavailability studies, that were conducted or sponsored by the applicant are deemed by the FDA to be essential to the approval of the application. Such clinical trials may, for example, support new indications, dosages or strengths of an existing drug. This three-year exclusivity covers only the conditions of use associated with the new clinical investigations and does not prohibit the FDA from approving ANDAs for drugs containing the original active agent. Five year and three-year exclusivity will not block the submission or approval of another "full" NDA. The applicant submitting a full NDA would be required to conduct its own preclinical studies and clinical trials or obtain a right of reference to such studies or trials.

Pediatric Exclusivity. Pediatric exclusivity is another type of non-patent marketing exclusivity in the U.S. If granted, it provides an additional six months of marketing security to the term of any existing regulatory exclusivity or listed patent term. This six-month exclusivity may be granted based on the voluntary completion of a pediatric study in accordance with an FDA-issued "Written Request" for such a study. We plan to work with the FDA to establish the need for pediatric studies for our product candidates, and may consider attempting to obtain pediatric exclusivity for some of our product candidates.

Medical Devices

Medical devices are also subject to extensive regulation by the FDA under the FDCA. FDA regulations govern, among other things, product development, testing, clinical trials, manufacture, packaging, labeling, storage, marketing clearance or approval, advertising and promotion, sales and distribution, and import and export.

Typically medical devices must receive either premarket notification (510(k)) clearance, unless they are exempt, or premarket application approval, or PMA approval, from the FDA prior to commercial distribution. The appropriate type of marketing application is determined by the device classification. Generally, lower risk devices are placed in either class I or II. Most class II devices require 510(k) clearance while most class I devices are exempt from

premarket notification and may be commercially distributed without 510(k) clearance. Devices deemed by the FDA to pose the greatest risk, such as life-sustaining, life-supporting or implantable devices, or devices deemed not substantially equivalent to a legally marketed device, or preamendment class III devices, i.e., devices in commercial distribution before May 28, 1976, for which a regulation requiring a PMA application has been promulgated, are required to have approved PMAs before marketing. The 510(k) clearance and PMA approval processes can be expensive, uncertain and lengthy and a device may never be cleared or approved for marketing.

After a device is approved or cleared and placed into commercial distribution, numerous regulatory requirements apply. The FDA reviews design and manufacturing practices, labeling and record keeping, and manufacturers' required reports of adverse experiences and other information to identify potential problems with marketed medical devices. Device manufacturers are subject to periodic and unannounced inspection by the FDA for compliance with the Quality System Regulation, cGMP requirements that govern the methods used in, and the facilities and controls used for, the design, manufacture, packaging, servicing, labeling, storage, installation and distribution of all finished medical devices intended for human use.

If the FDA finds that a manufacturer has failed to comply or that a medical device is ineffective or poses an unreasonable health risk, it can institute or seek a wide variety of enforcement actions and remedies, ranging from a public warning letter to more severe actions such as: (i) fines, injunctions, and civil penalties; (ii) recall or seizure of products; (iii) operating restrictions, partial suspension or total shutdown of production; (iv) refusing requests for 510(k) clearance or approval of new products; (v) imposing a clinical hold on or terminating a study; (vi) withdrawing 510(k) clearance or approvals already granted; and (vii) criminal prosecution. The FDA also has the authority to require repair, replacement or refund of the cost of any medical device.

The FDA also administers certain controls over the export of medical devices from the United States, as international sales of medical devices that have not received FDA approval are subject to FDA export requirements. Additionally, exported medical devices must also comply with applicable regulatory requirements in the importing countries. In the European Union, a single regulatory approval process has been created, and approval is represented by the CE Mark.

Medical Foods

The term “medical foods” does not pertain to all foods fed to sick patients. Medical foods are prescription foods specially formulated and intended for the dietary management of a disease that has distinctive nutritional needs that cannot be met by normal diet alone. They were defined in the FDA’s 1988 Orphan Drug Act Amendments and are subject to the general food safety and labeling requirements of the FDCA but are exempt from the labeling requirements for health claims and nutrient content claims under the Nutrition Labeling and Education Act of 1990. Medical foods are distinct from the broader category of foods for special dietary use and from traditional foods that bear a health claim. In order to be considered a medical food the product must, at a minimum:

be a specially formulated and processed product (as opposed to a naturally occurring food in its natural state) for oral ingestion or tube feeding (nasogastric tube);

be labeled for the dietary management of a specific medical disorder, disease or condition for which there are distinctive nutritional requirements; and

be intended to be used under medical supervision.

In addition, medical foods must comply with all applicable requirements for the manufacture of foods, including food cGMPs, registration of food facility requirements and, if applicable, FDA regulations for low acid canned food and emergency permit controls. The FDA advises that it considers the statutory definition of medical foods to narrowly constrain the types of products that fit within this category of food. The FDA inspects medical food manufacturers annually to assure the safety and integrity of the products. Failure of our contract manufacturers to comply with applicable requirements could lead to sanctions that could adversely affect our business.

Regulation of Controlled Substances

We, our third party manufacturers and certain of our products including ZUTRIPO, REZIRA, VITUZ, REPREXAIN (a product we promote for Amneal Pharmaceuticals for short term management of acute pain), their generic equivalents, and certain other generic products are subject to the Controlled Substances Act, which institutes registration, recordkeeping, reporting, labeling, packaging, storage, distribution and other requirements administered by the DEA. The DEA is concerned with the control of handlers of controlled substances, and with the equipment and raw materials used in their manufacture and packaging, in order to prevent loss and diversion into illicit channels of commerce. Accordingly, we must adhere to a number of requirements with respect to our controlled substance products including registration, recordkeeping and reporting requirements; labeling and packaging requirements; security controls, procurement and manufacturing quotas; and certain restrictions on refills.

The DEA regulates controlled substances as Schedule I, II, III, IV or V substances. Schedule I substances by definition have no established medicinal use in treatment in the U.S. A pharmaceutical product may be listed as Schedule II, III, IV or V, with Schedule II substances considered to present the highest relative risk of abuse and Schedule V substances the lowest relative risk of abuse. In January 2013, an FDA advisory panel voted to impose tighter restrictions on all products containing hydrocodone that, if approved by the FDA, would result in ZUTRIPRO, REZIRA, VITUZ and REPREXAIN being classified as Schedule II substances.

Any facility that manufactures, distributes, dispenses, imports or exports any controlled substance is required to register annually with the DEA. The registration is specific to the particular location, activity and controlled substance schedule. A separate registration is needed for import and manufacturing, and each registration will indicate which schedules of controlled substances are authorized.

Prior to issuing a registration, the DEA may inspect a facility to evaluate whether an applicant meets registration requirements, including applicable security measures. Security requirements vary by controlled substance schedule, with the most stringent requirements applying to Schedule I and Schedule II substances. To evaluate security measures the DEA takes into consideration, among other things, the type of building construction, the type of vault, safe, and secure enclosures or storage systems, the adequacy of key control systems and electronic detection and alarm systems. The DEA also requires employers to conduct comprehensive employee screening programs. Records must be maintained for the handling of all controlled substances and periodic reports issued to the DEA, including distribution reports for Schedule I and II controlled substances, Schedule III substances that are narcotics and other designated substances. Reports must also be made for thefts or losses of any controlled substance and any person registered by the DEA who desires to dispose of a controlled substance may request authority to dispose of the controlled substance from the Office of Controlled Substances. Additionally, particular authorization and notification requirements apply to imports and exports.

Registered establishments that handle controlled substances must go through periodic inspections by the DEA. Failure to comply with applicable requirements, particularly as manifested in loss or diversion, can result in enforcement action that could have a significant negative effect on our business, results of operations and financial performance. Depending on the violation, the DEA may suspend or revoke registrations, pursue civil penalties, or pursue criminal penalties.

Individual states also regulate controlled substances, and we and our contract manufacturers will be subject to state regulation concerning the manufacture and distribution of these products.

Foreign Regulation

In addition to regulations in the United States, we will be subject to a variety of foreign regulations governing clinical trials and commercial sales and distribution of our products and product candidates to the extent we choose to clinically evaluate or sell any products outside of the United States. Whether or not we obtain FDA approval for a product, we must obtain permission to commence clinical trials and approval by the comparable regulatory authorities of foreign countries before we can commence marketing of the product in those countries. The approval procedure differs among countries and can involve requirements for additional testing. The time necessary for approval may vary from that required for the FDA. Thus, there can be significant delays in obtaining mandatory approvals from foreign regulatory authorities after the appropriate applications are filed. The requirements governing the conduct of clinical trials, product licensing, pricing and reimbursement vary greatly from country to country. As in the United States, post-approval regulatory requirements, such as those regarding product manufacture, marketing, or distribution would apply to any product that is approved outside the United States.

In the European Union, medicinal products must be authorized either through the decentralized procedure by the competent authorities of the EU Member States, or through the centralized procedure by the European Commission following an opinion by the EMA. The centralized procedure provides for the grant of a single marketing authorization that is valid for all European Union member states. The centralized procedure is compulsory for medicines produced by certain biotechnological processes, products with a new active substance indicated for the treatment of certain diseases such as neurodegenerative disorder or diabetes and products designated as orphan medicinal products, and optional for those products which are highly innovative or for which a centralized process is in the interest of patients. The decentralized approval procedure provides for approval by one or more “concerned”

member states based on an assessment of an application performed by one member state, known as the reference member state. Under the decentralized approval procedure, an applicant submits an application, or dossier, and related materials (draft summary of product characteristics, draft labeling and package leaflet) to the reference member state and concerned member states. The reference member state prepares a draft assessment and drafts of the related materials within 120 days after receipt of a valid application. Within 90 days of receiving the reference member state's assessment report, each concerned member state must decide whether to approve the assessment report and related materials. If a member state objects to approval of the assessment report and related materials on the grounds of potential serious risk to public health, the disputed points may eventually be referred to the European Commission, whose decision is binding on all member states. In many EU countries, pricing and reimbursement negotiations must also take place before the product is sold in their national market between the company marketing the product and the competent national authorities.

Hazardous Materials

As a by-product of its daily operations as a manufacturer of pharmaceutical finished products, Pernix Manufacturing consistently generates small quantities of hazardous waste, both as a result of its manufacturing processes and its analytical testing processes. Pernix Manufacturing contracts with certified third-party service providers to legally dispose of its hazardous waste in a manner required by local, state, and federal laws. The expense of responsibly disposing of its hazardous waste is factored into the cost of goods and is not expected to be of significance.

We also depend on third parties to support us in manufacturing and developing certain products and do not directly handle, store or transport hazardous materials or waste products. We depend on these parties to abide by all applicable federal, state and local laws and regulations governing the use, manufacture, storage, handling and disposal of hazardous materials and waste products. We do not anticipate the cost of complying with the laws and regulations to be material.

Pharmaceutical Pricing and Reimbursement

Our ability to commercialize our products effectively depends substantially on the availability of sufficient coverage and reimbursement from third-party payors, including governmental bodies such as the Medicare and Medicaid programs, managed care organizations and private insurers. Each payor has its own process and standards for determining whether it will cover and reimburse a procedure or particular product. Private payors often rely on the lead of governmental payors in rendering coverage and reimbursement determinations. Third-party payors are more frequently contesting the prices charged for treatments and examining their cost effectiveness, in addition to their efficacy and safety. We may need to conduct expensive pharmacoeconomic studies in order to illustrate the cost effectiveness of our products, in addition to the costs required to obtain FDA approvals. Even with these studies, our products may be considered less effective, less safe or less cost-effective than existing products, and third-party payors may decide not to provide coverage and reimbursement for our products, in whole or in part. The resulting payment rates may not be sufficient for us to sell our products at a profit even if third-party payors approve coverage and reimbursement.

The cost of pharmaceuticals continues to generate substantial governmental and third-party interest. We expect that the pharmaceutical industry will experience pricing pressures due to the trend toward managed healthcare, the increasing influence of managed care organizations and additional legislative proposals. Current and future healthcare reforms could substantially affect our business.

We expect that federal and state governments and the private sector will continue to evaluate and may adopt health care policies intended to limit rising health care costs. These cost containment measures could include:

regulations on government backed reimbursement for drugs;

regulations on payments to health care providers that affect demand for drug products;

objections to the pricing of drugs or limits or prohibitions on reimbursement for specific products through other means;

waning of restrictions on imports of drugs; and

increase of managed care systems in which health care providers commit to provide comprehensive health care for a fixed cost per person.

Within the Medicare Part D prescription drug benefit, which took effect in January 2006, Medicare participants can obtain prescription drug coverage from private plans that are allowed to limit the number of prescription drugs that are covered on their formularies. In this program, certain of our products may be disqualified from formularies and may be subject to substantial price pressures that reduce the prices we are able to charge.

Outpatient pharmaceuticals sold to state managed Medicaid programs are subject to the national Medicaid Drug Rebate Program. To have their drugs included under state Medicaid programs, pharmaceutical companies must enter into an agreement with the Secretary of Health and Human Services in which they agree to pay a rebate to the state and federal governments that is decided on the basis of a calculation specified by the Centers for Medicare & Medicaid Services (CMS). Pharmaceutical companies are also required to take part in a similar agreement with the U.S. Department of Veterans Affairs, which requires additional discounts. We participate in these types of pricing agreements with respect to certain of our currently marketed products.

In general, the amount of the Medicaid prescription drug rebate is calculated based in part on the average manufacturer's price (AMP) for the drug. There has been historical and current legislation surrounding this calculation. The Health Care Reform legislation, discussed in more detail below, changed the definition of AMP to the average price paid to the manufacturer for the drug in the United States by wholesalers for drugs distributed to retail community pharmacies and by retail community pharmacies that purchase drugs directly from the manufacturer. The term expressly excludes certain payments and discounts, including customary prompt payment discounts to wholesalers; service fees paid by manufacturers to wholesalers or retailers; and payments from managed care organizations, mail order pharmacies, long-term care providers, and any other entity that does not conduct business as a wholesaler or retail community pharmacy. On February 2, 2012, CMS published in the Federal Register a proposed rule providing details regarding the calculation and reporting requirements for such rebates. We cannot predict whether and in what form the regulations will be made final and what effect these regulations may have on our pricing and reimbursement.

Foreign countries that have price controls in place on pharmaceutical products may generate lower-priced product competition. Proposed federal legislation may increase consumers' ability to import lower-priced versions of competing products from Canada and elsewhere. If such proposals become law, our products may be susceptible to an increase in price competition from lower priced imported drugs. Additionally, several local and state governments have launched importation schemes for their citizens, and, absent any federal action to restrict such activities, we anticipate other states and local governments will launch importation programs. The importation of foreign products that compete with ours could adversely impact our business.

Effects of Legislation on the Pharmaceutical Industry

On March 23, 2010, President Obama signed into law H.R. 3590, the Patient Protection and Affordable Care Act, or Affordable Care Act. On March 30, 2010, the President signed H.R. 4872, the Healthcare and Education Reconciliation Act of 2010, or Reconciliation Act, which included a package of corrective changes to the Affordable Care Act as well as additional elements to reform healthcare in the United States. We refer to the Affordable Care Act and the Reconciliation Act as Health Care Reform.

The passage of Health Care Reform is expected to result in a transformation of the delivery and payment for healthcare services in the U.S. The combination of these measures will expand health insurance coverage to an estimated 32 million Americans by 2019. In addition, there are significant health insurance reforms that will improve patients' ability to obtain and maintain health insurance. Such measures include, for example, the elimination of lifetime caps, no rescission of policies, no denial of coverage due to preexisting conditions, a prohibition on varying premiums by more than 3:1 for age and 1.5:1 for tobacco use, a prohibition on imposing excessive waiting periods for coverage, and enhanced support for the Children's Health Insurance Program. The legislation provides for implementation of this expansion in a variety of ways, including the creation of exchanges for finding health insurance policies, tax penalties on individuals without health insurance and on certain employers who do not provide it, and tax credits to make health insurance more affordable. The expansion of healthcare insurance and these additional market reforms should result in greater access to our products.

However, a number of provisions contained in Health Care Reform may adversely affect reimbursement for and access to our products. The Health Care Reform requires states to expand Medicaid coverage to all non-elderly individuals whose income is less than 133% of the federal poverty line by 2014. The legislation also extends Medicaid prescription drug rebates to drugs dispensed to enrollees of certain Medicaid managed care organizations. Additionally, the new laws increase the minimum basic Medicaid rebate for brand name and generic prescription drugs, create an alternate Medicaid rebate calculation for "line extensions" of oral solid dosage forms of innovator products and expand the entities eligible for 340B pricing to include children's hospitals. As discussed above under "Pricing and Reimbursement," Health Care Reform changed the calculation and reporting requirements for the Medicaid prescription drug rebate calculation. Finally, the new laws also limit distributions from flexible spending accounts for medicines to prescribed drugs and insulin only.

Beginning in 2011, Health Care Reform also requires drug manufacturers to provide a 50% discount on brand-name prescriptions filled in the Medicare Part D coverage gap, also known as the "donut hole." The legislation then expands on the manufacturers' 50% discount on brand-name prescriptions and gradually closes the coverage gap, with 75% discounts on brand-name and generic drugs by 2020. The elimination of the coverage gap may result in greater access to our products for Part D beneficiaries. Moreover, Health Care Reform makes a number of other revisions to the Medicare Part D program, including, for example, a reduction in Part D premium subsidies for higher-income beneficiaries, improvement in determining the Medicare Part D low-income benchmark, improved information for subsidy-eligible individuals under prescription drug plans, and funding outreach and assistance for low-income programs.

Finally, Health Care Reform created an Independent Payment Advisory Board (IPAB), which is tasked with reducing the per capita growth rate in Medicare spending in the event that that growth rate exceeds a certain target. The IPAB is prohibited by statute from making payment reductions to certain sectors, such as hospitals and health agencies. This limitation increases the risk that the IPAB would propose to limit access to certain pharmaceutical products and/or to mandate price controls for pharmaceuticals.

On June 28, 2012, the United States Supreme Court upheld certain provisions of the Affordable Care Act, including the constitutionality of its individual mandate that requires most Americans to buy health insurance starting in 2014. However, certain members of Congress have proposed a number of legislative initiatives, including repeal of all or part of all of the Affordable Care Act.

The Budget Control Act, passed in 2011, created measures for spending reductions by Congress. A Joint Select Committee on Deficit Reduction was unable to reach required goals, triggering, among other things, automatic reductions to the budgets of federal health agencies and an automatic two-percent reduction to Medicare payments to healthcare providers. These spending reductions went into effect on April 1, 2013. The Bipartisan Budget Act of 2013 extended the two-percent reduction to Medicare payments to healthcare providers for two years through fiscal year 2023.

We are unable to predict the future course of federal or state healthcare legislation and regulations, including rules and regulations that will be issued to implement provisions of Health Care Reform. Health Care Reform and further changes in the law or regulatory framework that reduce our revenues or increase our costs could also have a material adverse effect on our business, financial condition and results of operations and cash flows.

Other Regulations

A number of federal and state laws and regulations, including those loosely referred to as fraud and abuse laws, contain certain requirements and penalties, and are used to prosecute health care providers, suppliers, physicians and others related to health care products or services in connection with government programs, such as Medicare and Medicaid. These laws are extremely complicated, apply broadly and may constrain our business and the financial arrangements through which we market, sell and distribute our products. Examples of these laws and regulations include:

Anti-kickback Statute. The federal anti-kickback statute is a criminal statute that, among other things, makes it a felony for individuals or entities to knowingly and willfully offer, pay, solicit or receive, any remuneration (directly or indirectly, overtly or covertly, in cash or in kind) to induce or in return for (i) the referral of an individual to a person for arranging for or furnishing any item or service for which payment may be made in whole or in part under a federal health care program, or (ii) the purchase, lease, or order of, or arranging for or recommending the purchase, lease or order of any good, facility, service or item for which payment may be made in whole or in part under a federal health care program. The term “remuneration” has been interpreted broadly and includes both direct and indirect compensation and other items and services of value. Both the party offering or paying remuneration and the recipient may be found to have violated the statute. Some courts, as well as certain governmental guidance, have interpreted the scope of the anti-kickback statute to cover any situation where one purpose of the remuneration is to obtain money for the referral of services or to induce future referrals, even if there are other legitimate reasons for the remuneration. There are narrow exemptions and regulatory safe harbors, but to qualify for a safe harbor an arrangement must precisely meet each of the requirements. Further, many legitimate arrangements fall outside of the scope of any exemption or safe harbor, although that does not necessarily mean such arrangements will be subject to penalties under the anti-kickback statute.

The Health Care Reform added a new section to the anti-kickback statute, which provides that neither actual knowledge of the anti-kickback statute nor specific intent is required to show a violation of the anti-kickback statute. Violations of the anti-kickback statute may now also be treated as a false or fraudulent claim for purposes of the False Claim Act or constitute a federal health care offense.

Federal False Claims Act. The Federal False Claims Act imposes civil liability on any person who, among other things, knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval; knowingly

makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim; or knowingly makes, uses, or causes to be made or used, a false record or statement material to an obligation to pay or transmit money or property to the government, or knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the government. Penalties include three times the government's damages plus civil penalties of $5,500 to $11,000 per false claim. In addition, the Federal False Claims Act permits a person who meets certain requirements, referred to as a qui tam plaintiff or "whistleblower," to file a lawsuit on behalf of the government against the person or entity that allegedly violated the law. If the government determines to intervene in the lawsuit and the government prevails, the qui tam plaintiff is rewarded with a percentage of the recovery.

Health Care Reform as well as other legislation, such as Fraud Enforcement and Recovery Act of 2009, makes it easier for the government and qui tam realtor to bring a Federal False Claims Act case.

Federal Health Insurance Portability and Accountability Act of 1996. The HIPAA statute imposes criminal liability in connection with the delivery of or payment for health care benefits, items or services, for, among other things, knowingly and willfully (i) executing a scheme or artifice to defraud any health care benefit program or to obtain, by means of false or fraudulent pretenses, representations or promises, any of the money of the health care benefit program, or (ii) falsifying, concealing or covering up by any trick, scheme or device, a material fact, or making any materially false, fictitious or fraudulent statements or representations, or making or using any materially false writing or document knowing it contains any materially false, fictitious or fraudulent statement or entry. Further, the HIPAA statute and implementing regulations established certain standards and requirements for the privacy and security of individuals' health information, which standards and requirements were expanded by the Health Information Technology for Economic and Clinical Health Act.

Other Federal Criminal and Civil Health Care Laws. The Social Security Act contains numerous penalties for fraud and abuse in the health care industry, such as imposition of a civil monetary penalty, a monetary assessment, exclusion from participation in federal health care programs or a combination of these penalties. Additionally, Health Care Reform provided that a violation of certain provisions of the FDCA constitutes a federal health care offense.

In addition, there is a trend of increased federal and state regulation of payments made to physicians, including the tracking and reporting of gifts, compensation and other remuneration to physicians. Health Care Reform includes examples of this trend. Applicable manufacturers, including drug and biological manufacturers, must report information to the U.S. Department of Health and Human Services related to payments and other transfers of value to physicians during the preceding calendar year, which information will later be made publicly available. Failure to submit required information may result in civil monetary penalties of up to an aggregate of $150,000 per year (and up to an aggregate of $1 million per year for "knowing failures") for all payments, transfers of value or ownership or investment interests not appropriately reported.

Various states have disclosure laws as well.

There are certain federal and state laws that require compliance programs for certain sectors of the health care industry. For instance, one state requires that pharmaceutical companies must adopt a comprehensive compliance program that among other items, is in accordance with both the April 2003 Office of Inspector General Compliance Program Guidance for Pharmaceutical Manufacturers, and certain policies for compliance with the Pharmaceutical Research and Manufacturers of America Code on Interactions with Healthcare Professionals, or PhRMA Code.

The PhRMA Code seeks to promote transparency in relationships between health care professionals and the pharmaceutical industry and to ensure that pharmaceutical marketing activities comport with the highest ethical standards. The PhRMA Code contains strict limitations on certain interactions between health care professionals and the pharmaceutical industry relating to gifts, meals and entertainment, among other things. In addition, the International Federation of Pharmaceutical Manufacturers and Associations (IFPMA) recently issued a Code of Practice relating to interactions with the heath care community, which replaces and expands upon its 2006 Code of Pharmaceutical Marketing Practices. Further, certain states have also imposed restrictions on relationships between health care professionals and the pharmaceutical industry.

Various states have enacted laws and regulations comparable to the federal laws and regulations, including those related to fraud and abuse. These state laws and regulations may apply to items or services reimbursed by any third-party payor, including private, commercial insurers and other payors. Moreover, these laws and regulations vary significantly from state to state and, in some cases, are broader than the federal laws and regulations. These

differences increase the costs of compliance and the risk that the same arrangements may be subject to different compliance standards in different states.

The medical device and pharmaceutical industries are experiencing greater scrutiny and regulation by government authorities and have been the subject of numerous investigations, often involving marketing and other business practices. More particularly, these investigations relate primarily to financial arrangements with health care providers, regulatory compliance, and product promotional practices.

Employees

As of December 31, 2013, we had 191 full-time employees, consisting of 63 employed by Pernix Manufacturing; 91 sales representatives; 4 engaged in research, development and regulatory affairs; and 33 engaged in management, finance, administration and warehouse operations. None of our employees are subject to a collective bargaining agreement. We consider our employee relations to be satisfactory.

Available Information

We make available free of charge on or through our internet website our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission. Our internet address is www.pernixtx.com. Information is also available through the Securities and Exchange Commission's website at www.sec.gov or is available at the Securities and Exchange Commission's Public Reference Room located at 100 F Street, NE, Washington DC, 20549. Information on the operation of the Public Reference Room is available by calling the Securities and Exchange Commission at 800-SEC-0330.

ITEM 1A. RISK FACTORS

If any of the following risks actually occur, our business, financial condition, results of operations and cash flows could be materially adversely affected and the value of our shares could be negatively impacted. Although we believe that we have identified and discussed below the key risk factors affecting our business, there may be additional risks and uncertainties that are not presently known that may materially adversely affect our business.

Risks Related to our Acquisition Strategy and Managing Growth

We may not be able to continue to grow through acquisitions.

We have sought growth largely through acquisitions, including the acquisitions of Macoven in 2010, GSL and Cypress in 2012 and Pernix Sleep (f/k/a Somaxon) in 2013. As part of our ongoing expansion strategy, we plan to make additional strategic acquisitions of products and companies. However, our Amended Credit Agreement with MidCap and the Indenture governing the Notes include restrictive covenants, which include, among other things, restrictions on the incurrence of indebtedness, as well as certain consolidations, acquisitions, mergers, purchases or sales of assets and capital expenditures, subject to certain exceptions and permissions limited in scope and dollar value. In addition to these restrictive covenants our Amended Credit Agreement with MidCap contains certain financial covenants. For additional information, see Note 15, Debt and Lines of Credit, to our consolidated financial statements included in this Annual Report on Form 10-K. In the future, we may pursue growth opportunities through acquisitions that are not directly similar to those currently operated by us. We cannot assure you that acquisitions will be available on terms attractive to us. Moreover, we cannot assure you that such acquisitions will be permissible under our existing Amended Credit Agreement with MidCap or the Indenture governing the Notes or that we will be able to arrange financing on terms acceptable to us or to obtain timely federal and state governmental approvals on terms acceptable to us, or at all.

We may be unable to successfully integrate newly acquired businesses and realize the anticipated benefits of these acquisitions.

Management has in the past, and will in the future, devote significant attention and resources to integrating the business practices and operations of any newly acquired business. Potential difficulties we have or may in the future encounter in the integration process include the following:

the inability to successfully combine our businesses with any newly acquired business and meet the capital requirements of the combined business, in a manner that permits us to achieve the cost savings or revenue enhancements anticipated to result from these acquisitions, which would result in the anticipated benefits of the acquisitions not being realized in the time frame currently anticipated or at all;

lost sales and customers as a result of certain customers of Pernix or the newly acquired business deciding not to do business with the combined company;

the additional complexities of integrating companies with different core products and markets;

potential unknown liabilities and unforeseen increased expenses associated with an acquisition; and

performance shortfalls as a result of the diversion of management's attention caused by integrating the operations of a newly acquired business with those of Pernix.

For all these reasons, you should be aware that it is possible that integrating a newly acquired business could result in the distraction of our management, the disruption of our ongoing business or inconsistencies in our products, standards, controls, procedures and policies, any of which could adversely affect our ability to maintain relationships with customers, vendors and employees or to achieve the anticipated benefits of the acquisitions, or could otherwise adversely affect our business and financial results.

Our future results will suffer if we do not effectively manage our expanded operations.

Our acquisitions of GSL, Cypress and Somaxon significantly changed the composition of our operations, markets and product mix. Our future success depends, in part, on our ability to address these changes, and, where necessary, to attract and retain new personnel that possess the requisite skills called for by these changes.

We may continue to expand our operations through additional acquisitions, license arrangements, other strategic transactions and new product offerings. Our future success depends, in part, upon our ability to manage our expansion opportunities. Integrating new operations into our existing business in an efficient and timely manner, successfully monitoring our operations, costs, regulatory compliance and customer relationships, and maintaining other necessary internal controls pose substantial challenges for us. As a result, we cannot assure you that our expansion or acquisition opportunities will be successful, or that we will realize our expected operating efficiencies, cost savings, revenue enhancements, synergies or other benefits.

Our business operations and financial position could be adversely affected as a result of our substantial indebtedness.

As of December 31, 2013, after giving effect to the issuance of Notes under the Indenture and our Amended Credit Agreement with MidCap in February 2014, we would have had $81.9 million of debt outstanding and the ability to borrow approximately $23.1 million under our Amended Credit Agreement with MidCap subject to borrowing base capacity. This significant indebtedness could have important consequences. For example, it may:

- make it difficult for us to satisfy our obligations under the Notes, the Amended Credit Agreement with MidCap and our other indebtedness and contractual and commercial commitments;
- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- require us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures and other general corporate purposes;
- restrict us from making strategic acquisitions, entering new markets or exploiting business opportunities;
- place us at a competitive disadvantage compared to our competitors that have proportionally less debt;
- limit our ability to borrow additional funds and/or leverage our cost of borrowing; and
- decrease our ability to compete effectively or operate successfully under adverse economic and industry conditions.

As of March 12, 2014, we believe that our existing cash and cash from operations will be sufficient to continue to fund our existing level of operating expense, certain planned development activities and general capital expenditure requirements through 2014. Further, we continue to have additional opportunities to recognize synergistic savings from our acquisitions as certain contractual commitments expire, to pace our research and development spend as

available capital permits and to potentially sell non-core assets. In the event our capital resources are otherwise insufficient to meet future capital requirements and operating expenses, we may seek to finance our cash needs through public or private equity or debt financings, strategic relationships, including the divestiture of non-core assets, assigning receivables, milestone payments or royalty rights, or other arrangements. Securing additional financing will require a substantial amount of time and attention from our management and may divert a disproportionate amount of its attention away from our day-to-day activities, which may adversely affect our management's ability to conduct our day-to-day operations. In addition, we cannot guarantee that future financing will be available in sufficient amounts or on terms acceptable to us, if at all. If we are unable to raise additional capital when required or on acceptable terms, we may be required to:

Significantly delay, scale back or discontinue the development or commercialization of our products and product candidates;

Seek collaborators for one or more of our current or future products or product candidates at an earlier stage than otherwise would be desirable or on terms that are less favorable than might otherwise be available; or

Relinquish or license on unfavorable terms, our rights to technologies or product candidates that we otherwise would seek to develop or commercialize ourselves.

Additional equity or debt financing, or corporate collaboration and licensing arrangements, may not be permissible under the Indenture or the Amended Credit Agreement with MidCap or otherwise available on acceptable terms, if at all. Additional equity financing will be dilutive to stockholders, and debt financing, if available, may involve additional restrictive covenants. Any exploration of strategic alternatives may not result in an agreement or transaction and, if completed, any agreement or transaction may not be successful or on attractive terms. The inability to enter into a strategic transaction, or a strategic transaction that is not successful or on attractive terms, could accelerate our need for cash and make securing funding on reasonable terms more difficult. In addition, if we raise additional funds through collaborations or other strategic transactions, it may be necessary to relinquish potentially valuable rights to our potential products or proprietary technologies, or grant licenses on terms that are not favorable to us.

Despite our significant level of indebtedness, we and our subsidiaries may still be able to incur substantially more debt, which could exacerbate the risks associated with our substantial leverage.

We may be able to incur substantial additional indebtedness in the future. Although certain of our agreements, including the Amended Credit Agreement with MidCap and the Indenture governing our Notes limit our ability and the ability of our subsidiaries to incur additional indebtedness, these restrictions are subject to a number of qualifications and exceptions and, under certain circumstances, debt incurred in compliance with these restrictions could be substantial. To the extent that we incur additional indebtedness, the risks associated with our substantial leverage described above, including our possible inability to service our debt (including the Notes), would increase.

Our debt service obligations may adversely affect our cash flow.

A higher level of indebtedness increases the risk that we may default on our debt obligations. We may not be able to generate sufficient cash flow to pay the interest on our debt, and future working capital, borrowings or equity financing may not be available to pay or refinance such debt. If we are unable to generate sufficient cash flow to pay the interest on our debt, we may have to delay or curtail our operations.

Our ability to generate cash flows from operations and to make scheduled payments on our indebtedness will depend on our future financial performance. Our future financial performance will be affected by a range of economic, competitive and business factors that we cannot control, such as those risks described in this section. A significant reduction in operating cash flows resulting from changes in economic conditions, increased competition or other events beyond our control could increase the need for additional or alternative sources of liquidity and could have a material adverse effect on our business, financial condition, results of operations, prospects and our ability to service our debt and other obligations. If we are unable to service our indebtedness we will be forced to adopt an alternative strategy that may include actions such as reducing capital expenditures, selling assets, restructuring or refinancing our indebtedness or seeking additional equity capital. These alternative strategies may not be effected on satisfactory terms, if at all, and they may not yield sufficient funds to make required payments on our indebtedness.

If for any reason we are unable to meet our debt service and repayment obligations, we would be in default under the terms of the agreements governing our debt, which may allow our creditors at that time to declare outstanding indebtedness to be due and payable, which would in turn trigger cross-acceleration or cross-default rights between the relevant agreements.

In addition, the borrowings under our Amended Credit Agreement with MidCap bear interest at variable rates and other debt we incur could likewise be variable-rate debt. If interest rates increase, our debt service obligations on the variable rate indebtedness would increase even though the amount borrowed thereunder remains the same, and our net income and cash flows, including cash available for servicing our indebtedness, would correspondingly decrease.

The Indenture governing the Notes and the Amended Credit Agreement with MidCap impose significant operating and/or financial restrictions on us and our subsidiaries that may prevent us from pursuing certain business opportunities and restrict our ability to operate our business.

The Indenture governing the Notes and the Amended Credit Agreement with MidCap contain covenants that restrict our and our subsidiaries' ability to take various actions, such as:

incur additional debt;

pay dividends and make distributions on, or redeem or repurchase, their capital stock;

make certain investments, purchase certain assets or other restricted payments;

sell assets, including in connection with sale-leaseback transactions;

create liens;

enter into transactions with affiliates;

make lease payments in exceeding a specified amount; and

merge, consolidate or transfer all or substantially all of their assets.

In addition, the Indenture provides that we are required to maintain a minimum liquidity of $8.0 million at all times.

Upon the occurrence of a change of control, as described in the Indenture, holders of the Notes may require us to repurchase for cash all or part of their Notes at a repurchase price equal to 100% plus a specified percentage (that is initially 40% and declines over the life of the Notes) of the principal amount of the Notes to be repurchased, plus accrued and unpaid interest. If, upon the occurrence of a change of control, as described in the Indenture, a holder elects to convert its Notes in connection with such change of control, such holder may be entitled to an increase in the conversion rate as described in the Indenture. To the extent such increase in the conversion rate would result in the conversion price of the Notes to be less than $2.3278 per share (subject to adjustment) and equal to or greater than $2.09 per share (subject to adjustment), we will be obligated to deliver cash in lieu of any share that was not delivered on account of such limitation. However, we may not have enough available cash or be able to obtain financing at the time we are required to make repurchases of Notes surrendered therefor or payments of cash on Notes converted in connection with certain change of control transactions. In addition, our ability to repurchase the Notes or to pay cash upon conversions of the Notes may be limited by law, by regulatory authority or by agreements governing our indebtedness. Our failure to repurchase Notes at a time when the repurchase is required by the Indenture or to pay any cash payable on future conversions of the Notes in connection with certain change of control transaction as required by the Indenture would constitute a default under the Indenture. A default under the Indenture or the change of control itself could also lead to a default under agreements governing our indebtedness. If the repayment of the related indebtedness were to be accelerated after any applicable notice or grace periods, we may not have sufficient funds to repay the indebtedness and repurchase the Notes or make cash payments upon conversions in connection with certain change of control transactions. These and other provisions could prevent or deter a third party from acquiring us, even where the acquisition could be beneficial to you.

In addition, the Amended Credit Agreement with MidCap requires that we maintain a minimum amount of EBITDA and net invoiced revenues unless we demonstrate minimum liquidity of at least $30 million.

Our ability to comply with these covenants will likely be affected by many factors, including events beyond our control, and we may not satisfy those requirements. Our failure to comply with our debt-related obligations could result in an event of default under the particular debt instrument, which could permit acceleration of the indebtedness under that instrument and, in some cases, the acceleration of our other indebtedness, in whole or in part.

These restrictions will also limit our ability to plan for or react to market conditions, meet capital needs or otherwise restrict our activities or business plans and adversely affect our ability to finance our operations, enter into

acquisitions or to engage in other business activities that would be in our interest.

Our ability to borrow under the Amended Credit Agreement with MidCap is limited by the amount of our borrowing base. Any negative impact on the elements of our borrowing base, such as accounts receivable and inventory could reduce our borrowing capacity under the Amended Credit Agreement with MidCap.

If we fail to attract and retain key personnel, we may be unable to successfully develop or commercialize our products.

Our success depends in part on our continued ability to attract, retain and motivate highly qualified managerial personnel. We are highly dependent upon our executive management team, particularly Douglas Drysdale, our Chairman, President and Chief Executive Officer. The loss of the services of Mr. Drysdale or any one or more other members of our executive management team or other key personnel could delay or prevent the successful completion of some of our development and commercialization objectives.

Recruiting and retaining qualified sales and marketing personnel is critical to our success. We may not be able to attract and retain these personnel on acceptable terms given the competition among numerous pharmaceutical and biotechnology companies for similar personnel. In addition, we rely on consultants and advisors, including scientific and clinical advisors, to assist us in formulating our development and commercialization strategy. Our consultants and advisors may be employed by employers other than us and may have commitments under consulting or advisory contracts with other entities that may limit their availability to us.

Our management devotes substantial time to comply with public company regulations.

As a public company, we incur significant legal, accounting and other expenses. In addition, the Sarbanes-Oxley Act, as well as rules subsequently implemented by the SEC and the NASDAQ Global Market, impose various requirements on public companies, including with respect to corporate governance practices. Moreover, these rules and regulations increase legal and financial compliance costs and make some activities more time-consuming and costly.

In addition, the Sarbanes-Oxley Act requires, among other things, that our management maintain adequate disclosure controls and procedures and internal control over financial reporting. In particular, we must perform system and process evaluation and testing of our internal control over financial reporting to allow management and, as applicable, our independent registered public accounting firm to report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. Our compliance with Section 404 will require us to incur substantial accounting and related expenses and expend significant management efforts. If we are not able to comply with the requirements of Section 404 or if we or our independent registered public accounting firm identifies deficiencies in our internal control over financial reporting that are deemed to be material weaknesses, our financial reporting could be unreliable and misinformation could be disseminated to the public.

Any failure to develop or maintain effective internal control over financial reporting or difficulties encountered in implementing or improving our internal control over financial reporting could harm our operating results and prevent us from meeting our reporting obligations. Ineffective internal controls also could cause our stockholders and potential investors to lose confidence in our reported financial information, which would likely have a negative effect on the trading price of our common stock. In addition, investors relying upon this misinformation could make an uninformed investment decision and we could be subject to sanctions or investigations by the SEC, NASDAQ Global Market or other regulatory authorities, or to stockholder class action securities litigation.

Our strategy of obtaining, through product acquisitions and in-licenses, rights to products and product candidates for our development pipeline and to proprietary drug delivery and formulation technologies for our life cycle management of current products may not be successful.

Part of our business strategy is to acquire rights to pharmaceutical products, pharmaceutical product candidates in the late stages of development and proprietary drug delivery and formulation technologies. Because we do not have discovery and research capabilities, the growth of our business will depend in significant part on our ability to acquire or in-license additional products, product candidates or proprietary drug delivery and formulation technologies that we believe have significant commercial potential and are consistent with our commercial objectives. However, we may be unable to license or acquire suitable products, product candidates or technologies from third parties for a number of reasons.

The licensing and acquisition of pharmaceutical products, product candidates and related technologies is a competitive area. A number of more established companies are also pursuing strategies to license or acquire products, product candidates and drug delivery and formulation technologies, which may mean fewer suitable acquisition opportunities for us as well as higher acquisition prices. Many of our competitors have a competitive advantage over us due to their

size, cash resources and greater clinical development and commercialization capabilities.

Other factors that may prevent us from licensing or otherwise acquiring suitable products, product candidates or technologies include:

We may be unable to license or acquire the relevant products, product candidates or technologies on terms that would allow us to make an appropriate return on investment;

Companies that perceive us as a competitor may be unwilling to license or sell their product rights or technologies to us;

We may be unable to identify suitable products, product candidates or technologies within our areas of expertise; and

We may have inadequate cash resources or may be unable to obtain financing to acquire rights to suitable products, product candidates or technologies from third parties.

If we are unable to successfully identify and acquire rights to products, product candidates and proprietary drug delivery and formulation technologies and successfully integrate them into our operations, we may not be able to increase our revenues in future periods, which could result in significant harm to our financial condition, results of operations and development prospects.

If we fail to successfully manage any acquisitions, our ability to develop our product candidates and expand our product pipeline may be harmed.

Our failure to adequately address the financial, operational or legal risks of any acquisitions or in-license arrangements could harm our business. Financial aspects of these transactions that could alter our financial position, reported operating results or stock price include:

use of cash resources;

higher than anticipated acquisition costs and expenses;

potentially dilutive issuances of equity securities;

the incurrence of debt and contingent liabilities, impairment losses or restructuring charges;

large write-offs and difficulties in assessing the relative percentages of in-process research and development expense that can be immediately written off as compared to the amount that must be amortized over the appropriate life of the asset; and

amortization expenses related to other intangible assets.

Operational risks that could harm our existing operations or prevent realization of anticipated benefits from these transactions include:

challenges associated with managing an increasingly diversified business;

disruption of our ongoing business;

difficulty and expense in assimilating the operations, products, technology, information systems or personnel of the acquired company;

diversion of management’s time and attention from other business concerns;

inability to maintain uniform standards, controls, procedures and policies;

the assumption of known and unknown liabilities of the acquired company, including intellectual property claims; and

subsequent loss of key personnel.

If we are unable to successfully manage our acquisitions, our ability to develop and commercialize new products and continue to expand our product pipeline may be limited.

Risks Related to Commercialization

The commercial success of our currently marketed products and any additional products that we successfully commercialize will depend upon the degree of market acceptance by physicians, patients, healthcare payors and others in the medical community.

Any products that we bring to the market may not gain market acceptance by physicians, patients, healthcare payors and others in the medical community. If our products do not achieve an adequate level of acceptance, we may not generate significant product revenue and may not be profitable. The degree of market acceptance of our products depends on a number of factors, including:

the prevalence and severity of any side effect;

the efficacy and potential advantages over the alternative treatments;

the ability to offer our branded products for sale at competitive prices, including in relation to any generic products;

substitution of our branded products with generic equivalents at the pharmacy level;

relative convenience and ease of administration;

the willingness of the target patient population to try new therapies and of physicians to prescribe these therapies;

the strength of marketing and distribution support; and

sufficient third-party coverage or reimbursement.

We face competition, which may result in others discovering, developing or commercializing products before or more successfully than us.

The development and commercialization of drugs is highly competitive. We face competition with respect to our currently marketed products and any products that we may seek to develop or commercialize in the future. Our competitors include major pharmaceutical companies, specialty pharmaceutical companies and biotechnology companies worldwide. Potential competitors also include academic institutions, government agencies and other private and public research organizations that seek patent protection and establish collaborative arrangements for development, manufacturing and commercialization. We face significant competition for our currently marketed products. Some of our currently marketed branded products, including ZUTRIPRO and, REZIRA, do not have patent protection and in most cases face generic competition. All of our products face significant price competition from a range of branded and generic products for the same therapeutic indications.

Some or all of our product candidates, if approved, may face competition from other branded and generic drugs approved for the same therapeutic indications, approved drugs used off label for such indications and novel drugs in clinical development. For example, our product candidates may not demonstrate sufficient additional clinical benefits to physicians to justify a higher price compared to other lower cost products within the same therapeutic class. Notwithstanding the fact that we may devote substantial amounts of our resources to bringing product candidates to market, our commercial opportunity could be reduced or eliminated if competitors develop and commercialize products that are more effective, safer, have fewer or less severe side effects, are more convenient or are less expensive than any products that we may develop and/or commercialize.

Our patent rights may not protect our patent protected products and product candidates if competitors devise ways of making products that compete with us without legally infringing our patent rights. For example, our patent rights in SILENOR are limited in ways that affect our ability to exclude third parties from competing against us. In particular, we do not hold composition of matter patents covering the active pharmaceutical ingredient, or API, of SILENOR. Composition of matter patents on APIs are a particularly effective form of intellectual property protection for pharmaceutical products, as they apply without regard to any method of use or other type of limitation. As a result, competitors who obtain the requisite regulatory approval can offer products with the same API as SILENOR so long as the competitors do not infringe any method of use or formulations patents that we may hold.

The Federal Food, Drug, and Cosmetic Act (“FDCA”) and FDA regulations and policies provide certain exclusivity incentives to manufacturers to create modified, non-infringing versions of a drug in order to facilitate the approval of abbreviated new drug applications (“ANDAs”) for generic substitutes. These same types of exclusivity incentives encourage manufacturers to submit new drug applications (“NDAs”) that rely, in part, on literature and clinical data not prepared for or by such manufacturers. Manufacturers might only be required to conduct a relatively inexpensive study to show that their product has the same API, dosage form, strength, route of administration and conditions of

use or labeling as our product and that the generic product is absorbed in the body at the same rate and to the same extent as our product, a comparison known as bioequivalence. Such products would be significantly less costly than certain of our products to bring to market and could lead to the existence of multiple lower-priced competitive products, which would substantially limit our ability to obtain a return on the investments we have made in those products. Our competitors also may obtain FDA or other regulatory approval for their product candidates more rapidly than we may obtain approval for our product candidates.

Products in our portfolio that do not have patent protection are potentially at risk for generic competition. We utilize our generic business to attempt to retain market share from other generic competitors for our branded products. For example, we have attempted to maintain market share in the prescription head lice market by offering an authorized generic of NATROBA. Additionally, products we sell through our collaborative or co-promotion arrangements may also face competition in the marketplace.

Some of our competitors have significantly greater financial, technical and human resources than we have and superior expertise in marketing and sales, research and development, manufacturing, preclinical testing, conducting clinical trials, obtaining regulatory approvals and marketing approved products and thus may be better equipped than us to discover, develop, manufacture and commercialize products. These competitors also compete with us in recruiting and retaining qualified management personnel and acquiring technologies. Many of our competitors have collaborative arrangements in our target markets with leading companies and research institutions. In many cases, products that compete with our products have already received regulatory approval or are in late-stage development, have well-known brand names, are distributed by large pharmaceutical companies with substantial resources and have achieved widespread acceptance among physicians and patients. Smaller or early stage companies may also prove to be significant competitors, particularly through collaborative arrangements with large and established companies.

We will face competition based on the safety and effectiveness of our products, the timing and scope of regulatory approvals, the availability and cost of supply, marketing and sales capabilities, reimbursement coverage, price, patent position and other factors. Our competitors may develop or commercialize more effective, safer or more affordable products, or products with more effective patent protection, than our products. Accordingly, our competitors may commercialize products more rapidly or effectively than we are able to, which would adversely affect our competitive position, our revenue and profit from existing products and anticipated revenue and profit from product candidates. If our products or product candidates are rendered noncompetitive, we may not be able to recover the expenses of developing and commercializing those products or product candidates.

If our competitors introduce their own generic equivalents of our products, our net revenues from such products are expected to decline.

Product sales of generic pharmaceutical products often follow a particular pattern over time based on regulatory and competitive factors. The first company to introduce a generic equivalent of a branded product is often able to capture a substantial share of the market. However, as other companies introduce competing generic products, the first entrant’s market share, and the price of its generic product, will typically decline. The extent of the decline generally depends on several factors, including the number of competitors, the price of the branded product and the pricing strategy of the new competitors.

For example, in the generic drug industry, when a company is the first to introduce a generic drug, the pricing of the generic drug is typically set based on a discount from the published price of the equivalent branded product. Other generic manufacturers may enter the market and, as a result, the price of the drug may decline significantly. In such event, we may in our discretion provide our customers a credit with respect to the customers’ remaining inventory for the difference between our new price and the price at which we originally sold the product to our customers. There are circumstances under which we may, as a matter of business strategy, not provide price adjustments to certain customers and, consequently, we may lose future sales to competitors.

Negative publicity regarding any of our products or product candidates could delay or impair our ability to market any such product, delay or prevent approval of any such product candidate and may require us to spend time and money to address these issues.

If any of our products or any similar products distributed by other companies prove to be, or are asserted to be, harmful to consumers and/or subject to FDA enforcement action, our ability to successfully market and sell our products could be impaired. Because of our dependence on patient and physician perceptions, any adverse publicity associated with illness or other adverse effects resulting from the use or misuse of our products or any similar products distributed by other companies could limit the commercial potential of our products and expose us to potential liabilities.

If we are unable to attract, hire and retain qualified sales and management personnel and successfully manage our sales and marketing programs and resources, or if our commercial partners do not adequately perform, the commercial opportunity for our products may be diminished.

As of December 31, 2013, our sales force consisted of approximately 90 full-time sales representatives. In October 2013 we entered into a co-promotion agreement with Cumberland Pharmaceuticals, Inc., or Cumberland, under which Cumberland will promote Omeclamox-Pak to gastroenterologists across the United States through its field sales force.

We, Cumberland and any other commercialization partner we engage may not be able to attract, hire, train and retain qualified sales and sales management personnel in the future. If we or they are not successful in maintaining an effective number of qualified sales personnel, our ability to effectively market and promote our products may be impaired. Even if we are able to effectively maintain such sales personnel, their efforts may not be successful in commercializing our products.

In addition, a significant portion of revenues we receive from sales of products that are the subject to commercial partnerships will largely depend upon the efforts our partners, including Cumberland. The efforts of our partners in many instances are likely to be outside our control. If we are unable to maintain our commercial partnerships or to effectively establish alternative arrangements for our products, our business could be adversely affected. In addition, despite our arrangements with Cumberland and our other partners, we still may not be able to cover all of the prescribing physicians for our products at the same level of reach and frequency as our competitors, and we ultimately may need to further expand our selling efforts in order to effectively compete.

The efforts of our sales force and partners are complemented by on-line and other non-personal promotional initiatives that target both physicians and patients. We are also focused on ensuring broad patient access to our products by negotiating agreements with leading commercial managed care organizations and with government payors. Although our goal is to achieve sales through the efficient execution of our sales and marketing plans and programs, we may not be able to effectively generate prescriptions and achieve broad market acceptance for our products on a timely basis, or at all.

A failure to maintain optimal inventory levels to meet commercial demand for our products could harm our reputation and subject us to financial losses.

Some of our products, including ZUTRIPO, REZIRA, VITUZ, their generic equivalents and certain other generic products contain controlled substances, which are regulated by the DEA under the Controlled Substances Act. DEA quota requirements limit the amount of controlled substance drug products a manufacturer can manufacture and the amount of API it can use to manufacture those products. We may experience difficulties obtaining raw materials needed to manufacture our products as a result of DEA regulations and because of the limited number of suppliers of pseudoephedrine, an active ingredient in several of our products. If we are unsuccessful in obtaining quotas, unable to manufacture and release inventory on a timely and consistent basis, fail to maintain an adequate level of product inventory, or if inventory is destroyed or damaged or reaches its expiration date, patients might not have access to our products, our reputation and our brands could be harmed and physicians may be less likely to prescribe our products in the future, each of which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We may not be able to obtain the regulatory approvals or clearances that are necessary to manufacture pharmaceutical products.

Before approving a new drug or biologic product, the FDA requires that the facilities at which the product will be manufactured be in compliance with current Good Manufacturing Practices, which we refer to herein as cGMP, requirements which include requirements relating to quality control and quality assurance, as well as the maintenance of records and documentation and utilization of qualified raw materials. To be successful, our products must be manufactured for development and, following approval, in commercial quantities, in compliance with regulatory requirements and at acceptable costs.

On July 2, 2012, we completed the acquisition of the business assets of Great Southern Laboratories, or GSL, a pharmaceutical contract manufacturing company through our wholly owned subsidiary, Pernix Manufacturing, LLC, or Pernix Manufacturing. Pernix Manufacturing serves as a contract manufacturer and as a potential manufacturer of our preclinical and clinical material. Pernix Manufacturing must comply with these cGMP requirements. While we believe Pernix Manufacturing currently meets these requirements, we cannot assure that our manufacturing facilities or those of our contract manufacturers will continue to meet cGMP requirements or will be sufficient to manufacture all of our needs and/or the needs of our customers for commercial materials.

We may also encounter problems with the following:

production yields;

possible facility contamination;

quality control and quality assurance programs;

shortages of qualified personnel;

compliance with FDA or other regulatory authorities' regulations, including the demonstration of purity and potency;

changes in FDA or other regulatory authorities' requirements;

production costs; and/or

development of advanced manufacturing techniques and process controls.

In addition, we are required to register our manufacturing facilities with the FDA and other regulatory authorities and to subject them to inspections confirming compliance with cGMP or other regulations. If we fail to maintain regulatory compliance, the FDA can impose regulatory sanctions including, among other things, refusal to permit us to continue manufacturing approved products. As a result, our business, financial condition and results of operations may be materially harmed.

If we or our third party manufacturers fail to comply with regulatory requirements for our controlled substance products, the DEA may take regulatory actions detrimental to our business, resulting in temporary or permanent interruption of distribution, withdrawal of products from the market or other penalties.

We, our third party manufacturers and certain of our products including ZUTRIPO, REZIRA, VITUZ, their generic equivalents, and certain other generic products are subject to the Controlled Substances Act and DEA regulations thereunder. Accordingly, we must adhere to a number of requirements with respect to our controlled substance products including registration, recordkeeping and reporting requirements; labeling and packaging requirements; security controls, procurement and manufacturing quotas; and certain restrictions on refills. Failure to maintain compliance with applicable requirements can result in enforcement action that could have a material adverse effect on our business, financial condition, results of operations and cash flows. The DEA may seek civil penalties, refuse to renew necessary registrations or initiate proceedings to revoke those registrations. In certain circumstances, violations could result in criminal proceedings.

Product liability lawsuits against us could cause us to incur substantial liabilities and limit commercialization of any products that we may develop.

We face an inherent risk of product liability exposure related to the sale of our currently marketed products and any other products that we successfully develop or commercialize. If we cannot successfully defend ourselves against claims that our products or product candidates caused injuries, we will incur substantial liabilities. Regardless of merit or eventual outcome, liability claims may result in:

decreased demand for our products or any products that we may develop;

injury to reputation;

withdrawal of client trial participants;

withdrawal of a product from the market;

costs to defend the related litigation;

substantial monetary awards to trial participants or patients;

diversion of management time and attention;

loss of revenue; and

the inability to commercialize any products that we may develop.

The amount of insurance that we currently hold may not be adequate to cover all liabilities that we may incur. Insurance coverage is increasingly expensive. We may not be able to maintain insurance coverage at a reasonable cost and we may not be able to obtain insurance coverage that will be adequate to satisfy any liability that may arise.

Seasonality may cause fluctuations in our financial results.

We generally experience some effects of seasonality due to increases in demand for cough and cold products during the winter season. Accordingly, sales of cough and cold products and associated revenue have generally increased at a higher rate immediately prior and during the winter season. In the future, this seasonality may cause fluctuations in our financial results. In addition, other seasonality trends may develop and the existing seasonality that we experience may change.

Risks Related to Our Dependence on Third Parties

We intend to rely on third parties to conduct our clinical trials, and those third parties may not perform satisfactorily, including failing to meet established deadlines for the completion of such trials.

We do not intend to independently conduct clinical trials for our product candidates. We will rely on third parties, such as contract research organizations, clinical data management organizations, medical institutions and clinical investigators, to perform this function. Our reliance on these third parties for clinical development activities reduces our control over these activities. We are responsible for ensuring that each of our clinical trials is conducted in accordance with the general investigational plan and protocols for the trial. Moreover, the FDA requires us to comply with standards, commonly referred to as Good Clinical Practices, for conducting, recording, and reporting the results of clinical trials to assure that data and reported results are credible and accurate and that the rights, integrity and confidentiality of trial participants are protected. Our reliance on third parties that we do not control does not relieve us of these responsibilities and requirements. Furthermore, these third parties may also have relationships with other entities, some of which may be our competitors. If these third parties do not successfully carry out their contractual duties, meet expected deadlines or conduct our clinical trials in accordance with regulatory requirements or our stated protocols, we will not be able to obtain, or may be delayed in obtaining, regulatory approvals for our product candidates and will not be able to, or may be delayed in our efforts to, successfully commercialize our product candidates.

The concentration of our product sales to only a few wholesale distributors increases the risk that we will not be able to effectively distribute our products if we need to replace any of these customers, which would cause our sales to decline.

The majority of our sales are to a small number of pharmaceutical wholesale distributors, which in turn sell our products primarily to retail pharmacies, which ultimately dispense our products to the end consumers. In 2013, Cardinal Health accounted for 24% of our total gross sales, McKesson Corporation accounted for 35% of our total gross sales, and AmerisourceBergen Drug Corporation accounted for 20% of our total gross sales.

If any of these customers cease doing business with us or materially reduce the amount of product they purchase from us and we cannot conclude agreements with replacement wholesale distributors on commercially reasonable terms, we might not be able to effectively distribute our products through retail pharmacies. The possibility of this occurring is exacerbated by the recent significant consolidation in the wholesale drug distribution industry, including through mergers and acquisitions among wholesale distributors and the growth of large retail drugstore chains. As a result, a small number of large wholesale distributors control a significant share of the market.

Any collaboration arrangements that we enter into may not be successful, which could adversely affect our ability to develop and commercialize our product candidates.

We enter into collaboration arrangements from time to time on a selective basis. Our collaborations may not be successful. Of our current product portfolio, we market NATROBA (a prescription treatment for head-lice which we co-promote with ParaPRO, LLC), its generic equivalent, REPREXAIN and OMECLAMOX-PAK pursuant to collaboration arrangements. The success of our collaboration arrangements will depend heavily on the efforts and activities of our collaborators. Collaborators generally have significant discretion in determining the efforts and resources that they will apply to these collaborations.

Disagreements between parties to a collaboration arrangement regarding clinical development and commercialization matters can lead to delays in the development process or commercialization of the applicable product candidate and, in some cases, termination of the collaboration arrangement. These disagreements can be difficult to resolve if neither of the parties has final decision making authority.

Our business could suffer as a result of a failure to manage and maintain our distribution network with our wholesale customers.

We depend on the distribution abilities of our wholesale customers to ensure that our products are effectively distributed through the supply chain. If there are any interruptions in our customers' ability to distribute products through their distribution centers, our products may not be effectively distributed, which could cause confusion and frustration among pharmacists and lead to product substitution.

Risks Related to Intellectual Property

If we are unable to obtain and maintain protection for the intellectual property relating to our technology and products, the value of our technology and products will be adversely affected.

Our success will depend in part on our ability to obtain and maintain protection for the intellectual property covering or incorporated into our technology and products. The patent situation in the field of pharmaceuticals is highly uncertain and involves complex legal and scientific questions. We rely upon patents, trade secret laws and confidentiality agreements to protect our technology and products. We may not be able to obtain additional patent rights relating to our technology or products and pending patent applications to which we have rights may not issue as

patents or if issued, may not issue in a form that will be advantageous to us. Even if issued, any patents issued to us or licensed to us may be challenged, narrowed, invalidated, held to be unenforceable or circumvented, which could limit our ability to stop competitors from marketing similar products or limit the length of term of patent protection we may have for our products. For example, the principal patent protection that covers SILENOR consists of method of use patents. This type of patent protects the product only when used or sold for the specified method. However, this type of patent does not limit a competitor from making and marketing a product that is identical or similar to SILENOR for an indication that is outside of the patented method. Moreover, physicians may prescribe such a competitive or similar product for off-label indications that are covered by the applicable patents. Some physicians are prescribing generic 10mg doxepin capsules and generic oral solution doxepin for insomnia on such an off-label basis in lieu of prescribing SILENOR. In addition, some managed healthcare plans are requiring the substitution of these generic doxepin products for SILENOR, and some pharmacies are suggesting such substitution. Although such off-label prescriptions may induce or contribute to the infringement of method of use patents, the practice is common and such infringement is difficult to prevent or prosecute.

Our patent rights also may not afford us protection against competitors with similar technology. Because patent applications in the United States and many other jurisdictions are typically not published until 18 months after filing, or in some cases not at all, and because publications of discoveries in the scientific literature often lag behind actual discoveries, neither we nor our licensors can be certain that we or they were the first to make the inventions claimed in our or their issued patents or pending patent applications, or that we or they were the first to file for protection of the inventions set forth in these patent applications. If a third party has also filed a U.S. patent application covering our product candidates or a similar invention, we may have to participate in an adversarial proceeding, known as an interference, declared by the U.S. Patent and Trademark Office to determine priority of invention in the United States. The costs of these proceedings could be substantial and it is possible that our efforts could be unsuccessful, resulting in a loss of our U.S. patent position. In addition, patents generally expire, regardless of the date of issue, 20 years from the earliest non-provisional effective U.S. filing date.

Our collaborators and licensors may not adequately protect our intellectual property rights. These third parties may have the first right to maintain or defend our intellectual property rights and, although we may have the right to assume the maintenance and defense of our intellectual property rights if these third parties do not, our ability to maintain and defend our intellectual property rights may be compromised by the acts or omissions of these third parties.

In September 2011, the Leahy-Smith America Invents Act, or the Leahy-Smith Act, was signed into law and includes a number of significant changes to U.S. patent law. These include changes in the way patent applications will be prosecuted and may also affect patent litigation. The U.S. Patent and Trademark Office is currently developing regulations and procedures to administer the Leahy-Smith Act, and many of the substantive changes to patent law associated with the Leahy-Smith Act did not become effective until 18 months after its enactment. Accordingly, it is not clear what, if any, impact the Leahy-Smith Act will have on the cost of prosecuting our patent applications, our ability to obtain patents based on our patent applications and our ability to enforce or defend our issued patents. An inability to obtain, enforce and defend patents covering our proprietary technologies would materially and adversely affect our business prospects and financial condition. Further, the laws of some foreign countries do not protect proprietary rights to the same extent as the laws of the United States. As a result, we may encounter significant problems in protecting and defending our intellectual property both in the United States and abroad. If we are unable to prevent material disclosure of the intellectual property related to our technologies to third parties, we will not be able to establish or, if established, maintain a competitive advantage in our market, which could materially adversely affect our business, operating results and financial condition.

Trademark protection of our products may not provide us with a meaningful competitive advantage.

We use trademarks on most of our currently marketed branded products and believe that having distinctive marks is an important factor in marketing those products. Trademarks are also an important factor in marketing products of other parties under license or co-promotion agreements. Distinctive marks may also be important for any additional products that we successfully develop and commercially market. However, we generally do not expect our marks to provide a meaningful competitive advantage over other branded or generic products. We believe that efficacy, safety, convenience, price, the level of generic competition and the availability of reimbursement from government and other third party payors are and are likely to continue to be more important factors in the commercial success of our products. For example, physicians and patients may not readily associate our trademark with the applicable product or active pharmaceutical ingredient. In addition, prescriptions written for a branded product are typically filled with the generic version at the pharmacy, resulting in a significant loss in sales of the branded product, including for indications for which the generic version has not been approved for marketing by the FDA. Competitors also may use marks or names that are similar to our trademarks. If we initiate legal proceedings to seek to protect our trademarks, the costs of these proceedings could be substantial and it is possible that our efforts could be unsuccessful.

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If we fail to comply with our obligations in our intellectual property licenses with third parties, we could lose license rights that are important to our business.

We have acquired rights to products and product candidates under license and co-promotion agreements with third parties and expect to enter into additional licenses and co-promotion agreements in the future. Our existing licenses impose, and we expect that future licenses will impose, various development and commercialization, purchase commitment, royalty, sublicensing, patent protection and maintenance, insurance and other obligations on us.

If we fail to comply with our obligations under a license agreement, the licensor may have the right to terminate the license in whole, terminate the exclusive nature of the license or bring a claim against us for damages. Any such termination or claim could prevent or impede our ability to market any product that is covered by the licensed patents. Even if we contest any such termination or claim and are ultimately successful, our results of operations and stock price could suffer. In addition, upon any termination of a license agreement, we may be required to license to the licensor any related intellectual property that we developed.

For example, we in-licensed rights to SILENOR through an exclusive licensing arrangement, and may enter into similar licenses in the future. Under our license agreement for SILENOR, we are required to use commercially reasonable efforts to commercialize SILENOR. In addition, our licensor has the contractual right to terminate the license agreement upon the breach by us or a specified insolvency event. In the event that our licensor for SILENOR terminates the license agreement, even though we would maintain ownership of our clinical data and the other intellectual property we developed relating to SILENOR, we would be unable to continue our commercialization activities relating to SILENOR and our business and financial condition may be materially harmed.

If we are unable to protect the confidentiality of our proprietary information and know-how, the value of our technology and products could be adversely affected.

In addition to patented technology, we rely upon unpatented proprietary technology, processes and know-how. We seek to protect our unpatented proprietary information in part by confidentiality agreements with our employees, consultants and third parties. We may not be able to prevent the unauthorized disclosure or use of our technical knowledge or other trade secrets by consultants, third parties, vendors or former or current employees, despite the existence generally of confidentiality agreements and other contractual restrictions. Monitoring unauthorized use and disclosure of our intellectual property is difficult, and we do not know whether the steps we have taken to protect our intellectual property will be adequate.

In addition, the laws of many foreign countries may not protect our intellectual property rights to the same extent as the laws of the United States. To the extent that our intellectual property protection is inadequate, we are exposed to a greater risk of direct competition. If our intellectual property is not adequately protected against competitors' products, our competitive position could be adversely affected, as could our business. We also rely upon trade secrets, technical know-how and continuing technological innovation to develop and maintain our competitive position. We require our consultants and third parties, when appropriate, to execute confidentiality and assignment-of-inventions agreements with us. These agreements typically provide that all materials and confidential information developed or made known to the individual during the course of the individual's relationship with us be kept confidential and not disclosed to third parties except in specific circumstances and that all inventions arising out of the individual's relationship with us shall be our exclusive property. These agreements may be breached, and in some instances, we may not have an appropriate remedy available for breach of the agreements. Furthermore, our competitors may independently develop substantially equivalent proprietary information and techniques, reverse engineer our information and techniques, or otherwise gain access to our proprietary technology. If we are unable to protect the confidentiality of our proprietary information and know-how, competitors may be able to use this information to develop products that compete with our products, which could adversely impact our business.

If we infringe or are alleged to infringe intellectual property rights of third parties, it may adversely affect our business.

Our development and commercialization activities, as well as any product candidates or products resulting from these activities, may infringe or be claimed to infringe one or more claims of an issued patent or may fall within the scope of one or more claims in a published patent application that may be subsequently issued and to which we do not hold a license or other rights. Third parties may own or control these patents or patent applications in the United States and/or abroad. Such third parties could bring claims against us or our collaborators that would cause us to incur substantial expenses and, if successful against us, could cause us to pay substantial damages. Further, if a patent infringement suit were brought against us or our collaborators, we or our collaborators could be forced to stop or delay development, manufacturing or sales of the product or product candidate that is the subject of the suit.

If any relevant claims of third-party patents that we are alleged to infringe are upheld as valid and enforceable in any litigation or administrative proceeding, we or our potential future collaborators could be prevented from practicing the subject matter claimed in such patents, or would be required to obtain licenses from the patent owners of each such patent, or to redesign our products, and could be liable for monetary damages. There can be no assurance that such licenses would be available or, if available, would be available on acceptable terms or that we would be successful in any attempt to redesign our products. Even if we or our collaborators were able to obtain a license, the rights may be nonexclusive, which could result in our competitors gaining access to the same intellectual property. Ultimately, we could be prevented from commercializing a product, or be forced to cease some aspect of our business operations, if, as a result of actual or threatened patent infringement claims, we or our collaborators are unable to enter into licenses on acceptable terms. This could harm our business significantly. Accordingly, an adverse determination in a judicial or administrative proceeding or failure to obtain necessary licenses could prevent us or our future collaborators from manufacturing and selling our products, which would have a material adverse effect on our business, financial condition and results of operations.

There has been substantial litigation and other proceedings regarding patent and other intellectual property rights in the pharmaceutical and biotechnology industries. The cost to us of any patent litigation or other proceedings, even if resolved in our favor, could be substantial. Some of our competitors may be able to sustain the costs of such litigation or proceedings more effectively than we can because of their substantially greater financial resources. Uncertainties resulting from the initiation and continuation of patent litigation or other proceedings could have a material adverse effect on our ability to compete in the marketplace. Patent litigation and other proceedings may also absorb significant management time.

Risks Related to Our Financial Position

We may need substantial additional funding and may be unable to raise capital when needed, which would force us to delay, reduce or eliminate our product development programs, commercialization efforts or acquisition strategy.

We make significant investments in our currently-marketed products for sales, marketing, and distribution. We have used, and expect to continue to use, revenue from sales of our marketed products to fund acquisitions, for development costs and to establish and expand our sales and marketing infrastructure. We have incurred losses from operations and negative operating cash flows since our inception, and we expect to continue to incur substantial losses for the foreseeable future.

As of March 12, 2014, we had approximately $64.6 million of cash and cash equivalents and $32.0 million of potential availability under our Amended Credit Agreement with MidCap . We believe that our existing cash and cash from operation and available credit will be sufficient to enable us to fund our existing level of operating expense, certain planned development activities and general capital expenditure requirements through 2014. Further, we continue to have additional opportunities to recognize synergistic savings from our acquisitions as certain contractual commitments expire, to pace our research and development spend as available capital permits and to potentially sell non-core assets. Our future capital requirements will depend on many factors, including:

our ability to successfully integrate the operations of Cypress and Somaxon;

the level of product sales from our currently marketed products and any additional products that we may market in the future;

the extent to which we acquire or invest in products, businesses and technologies;

the scope, progress, results and costs of clinical development activities for our product candidates;

the costs, timing and outcome of regulatory review of our product candidates;

the number of, and development requirements for, additional product candidates that we pursue;

the costs of commercialization activities, including product marketing, sales and distribution;

the extent to which we choose to establish additional collaboration, co-promotion, distribution or other similar arrangements for our products and product candidates; and

the costs of preparing, filing and prosecuting patent applications and maintaining, enforcing and defending intellectual property related claims.

We intend to obtain any additional funding we require through public or private equity or debt financings, strategic relationships, including the divestiture of non-core assets, assigning receivables, milestone payments or royalty rights, or other arrangements and we cannot assure such funding will be available on reasonable terms, or at all. Additional equity financing will be dilutive to stockholders, and debt financing, if available, may involve restrictive covenants. Any exploration of strategic alternatives may not result in an agreement or transaction and, if completed, any agreement or transaction may not be successful or on attractive terms. The inability to enter into a strategic transaction, or a strategic transaction that is not successful or on attractive terms, could accelerate our need for cash and make securing funding on reasonable terms more difficult. In addition, if we raise additional funds through collaborations or other strategic transactions, it may be necessary to relinquish potentially valuable rights to our potential products or proprietary technologies, or grant licenses on terms that are not favorable to us.

If our efforts in raising additional funds when needed are unsuccessful, we may be required to delay, scale-back or eliminate plans or programs relating to our business, relinquish some or all rights to our products or renegotiate less favorable terms with respect to such rights than we would otherwise choose or cease operating as a going concern. In addition, if we do not meet our payment obligations to third parties as they come due, we may be subject to litigation claims. Even if we were successful in defending against these potential claims, litigation could result in substantial costs and be a distraction to management, and may result in unfavorable results that could further adversely impact our financial condition.

If we are unable to continue as a going concern, we may have to liquidate our assets and may receive less than the value at which those assets are carried on our financial statements, and it is likely that investors will lose all or a part of their investments.

If the estimates that we make, or the assumptions upon which we rely, in preparing our financial statements prove inaccurate, our future financial results may vary from expectations.

Our financial statements have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of our financial statements requires us to make estimates and judgments that affect the reported amounts of our assets, liabilities, stockholders' equity, revenues and expenses, the amounts of charges accrued by us and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. For example, at the same time we recognize revenues for product sales, we also record an adjustment, or decrease, to revenue for estimated charge backs, rebates, discounts, vouchers and returns, which management determines on a product-by-product basis as its best estimate at the time of sale based on each product's historical experience adjusted to reflect known changes in the factors that impact such reserves. Actual sales allowances may vary from our estimates for a variety of reasons, including unanticipated competition, regulatory actions or changes in one or more of our contractual relationships. We cannot assure you, therefore, that there may not be material fluctuations between our estimates and the actual results.

If we fail to meet all applicable continued listing requirements of the NASDAQ Global Market and it determines to delist our common stock, the market liquidity and market price of our common stock could decline.

On February 26, 2014, we received a letter from The NASDAQ Stock Market stating that, as a result of the resignations of Cooper C. Collins, James E. Smith, Jr. and Anthem Blanchard from our Board of Directors and Audit Committee on February 21, 2014, we no longer complied with either the requirement that our Audit Committee have three independent members or the requirement that a majority of our Board of Directors be independent, as set forth in NASDAQ Listing Rules 5605(c)(2) and 5605(b)(1), respectively. Under applicable NASDAQ Listing Rules, we have 45 calendar days to submit to NASDAQ a plan to regain compliance with NASDAQ Listing Rules 5605(b)(1) and 5605(c)(2). Upon acceptance of our compliance plan, NASDAQ may grant us an extension of up to 180 calendar days from the date of the notification letter to evidence compliance with these rules. We intend to submit our plan to

NASDAQ and take appropriate steps to regain compliance in the time allowed by NASDAQ. On March 13, 2014, we announced the appointment of John Sedor as a member of our Board of Directors. Mr. Sedor qualifies as an independent director within the meaning of the independent director guidelines of NASDAQ and will serve on our Audit Committee, Nominating Committee and as Chairman of the Compensation Committee.

If we fail to meet all applicable listing requirements of the NASDAQ Global Market and it determines to delist our common stock, trading, if any, in our shares may continue to be conducted on the Over-the-Counter Bulletin Board or in a non-NASDAQ over-the-counter market, such as the “pink sheets.” Delisting of our shares would result in limited release of the market price of those shares and limited analyst coverage and could restrict investors’ interest and confidence in our securities. Also, a delisting could have a material adverse effect on the trading market and prices for our shares and our ability to issue additional securities or to secure additional financing. In addition, if our shares were not listed and the trading price of our shares was less than $5.00 per share, our shares could be subject to Rule 15g-9 under the Exchange Act which, among other things, requires that broker/dealers satisfy special sales practice requirements, including making individualized written suitability determinations and receiving a purchaser’s written consent prior to any transaction. In such case, our securities could also be deemed to be a “penny stock” under the Securities Enforcement and Penny Stock Reform Act of 1990, which would require additional disclosure in connection with trades in those shares, including the delivery of a disclosure schedule explaining the nature and risks of the penny stock market. Such requirements could severely limit the liquidity of our securities and our ability to raise additional capital.

If significant business or product announcements by us or our competitors cause fluctuations in our stock price, an investment in our stock may suffer a decline in value.

The market price of our common stock may be subject to substantial volatility as a result of announcements by us or other companies in our industry, including our collaborators. Announcements that may subject the price of our common stock to substantial volatility include announcements regarding:

- our operating results, including the amount and timing of sales of our products and our ability to successfully integrate the operations of newly acquired businesses;
- the availability and timely delivery of a sufficient supply of our products;
- our licensing and collaboration agreements and the products or product candidates that are the subject of those agreements;
- the results of discoveries, preclinical studies and clinical trials by us or our competitors;
- the acquisition of technologies, product candidates or products by us or our competitors;
- the development of new technologies, product candidates or products by us or our competitors;
- regulatory actions with respect to our product candidates or products or those of our competitors; and
- significant acquisitions, strategic partnerships, joint ventures or capital commitments by us or our competitors.

Because we do not anticipate paying any cash dividends on our capital stock in the foreseeable future, capital appreciation, if any, will be your sole source of gain.

We did not make any distributions for the years ended December 31, 2013, 2012 and 2011. We are currently investing in our promoted product lines and product candidates and do not anticipate paying dividends in the foreseeable future. We currently intend to retain all of our future earnings, if any, to finance the growth and development of our business. In addition, the terms of our Amended Credit Agreement with MidCap and the Indenture governing the Notes prohibit us from paying dividends. As a result, capital appreciation, if any, of our common stock will be your sole source of gain for the foreseeable future.

Holders of our outstanding 8.00% Convertible Senior Notes due 2019 have the ability to exercise significant influence over our management and affairs and matters requiring stockholder approval.

Upon conversion of our outstanding Notes, the Note holders will own an aggregate of 18,055,555 shares of our common stock, which represents approximately 32% of our outstanding common stock upon conversion. In addition, two of these holders have each been granted the right to nominate a member of our board of directors. As a result, these Note holders have the ability to exercise significant influence over our management and affairs and matters requiring stockholder approval. The interests of these holders may differ from or conflict with the interests of our other stockholders.

Sales of a substantial number of shares of our common stock or equity-linked securities could cause our stock price to fall.

Sales of a substantial number of shares of our common stock or equity-linked securities, including the Notes, in the public market or the perception that these sales might occur, could depress the market price of our common stock and the Notes and could impair our ability to raise capital through the sale of additional equity or equity-linked securities. We are unable to predict the effect that sales may have on the prevailing market price of our common stock or the Notes. The price of our common stock also could be affected by possible sales of common stock by investors who view the Notes as a more attractive means of equity participation in us and by hedging or arbitrage activity involving our common stock that may develop as a result of the issuance of the Notes. The hedging or arbitrage could, in turn, affect the trading prices of the Notes, or any common stock that holders receive upon conversion of the Notes.

Our operating results are likely to fluctuate from period to period.

We anticipate that there may be fluctuations in our future operating results. Potential causes of future fluctuations in our operating results may include:

period-to-period fluctuations in financial results due to seasonal demands for certain of our products;

unanticipated potential product liability or patent infringement claims;

new or increased competition from generics;

the introduction of technological innovations or new commercial products by competitors;

changes in the availability of reimbursement to the patient from third-party payers for our products;

the entry into, or termination of, key agreements, including key strategic alliance agreements;

the initiation of litigation to enforce or defend any of our intellectual property rights;

the loss of key employees;

the results of pre-clinical testing, IND application, and potential clinical trials of some product candidates;

regulatory changes;

the results and timing of regulatory reviews relating to the approval of product candidates;

the results of clinical trials conducted by others on products that would compete with our products and product candidates;

failure of any of our products or product candidates to achieve commercial success;

general and industry-specific economic conditions that may affect research and development expenditures;

future sales of our common stock; and

changes in the structure of health care payment systems resulting from proposed healthcare legislation or otherwise.

Our stock price is subject to fluctuation, which may cause an investment in our stock or our Notes to suffer a decline in value.

The market price of our common stock may fluctuate significantly in response to factors that are beyond our control. The stock market in general has recently experienced extreme price and volume fluctuations. The market prices of securities of pharmaceutical and biotechnology companies have been extremely volatile and have experienced fluctuations that often have been unrelated or disproportionate to the operating performance of these companies. These broad market fluctuations could result in extreme fluctuations in the price of our common stock, which could cause a decline in the value of our common stock, which would likely significantly affect the market price of the Notes. This may result in significantly greater volatility in the trading value of the Notes than would be expected for nonconvertible debt securities we may issue.

If we become subject to unsolicited public proposals from activist stockholders due to our shifting strategic focus or otherwise, we may experience significant uncertainty that would likely be disruptive to our business and increase volatility in our stock price.

Public companies, particularly those in volatile industries such as the pharmaceutical industry, have been the target of unsolicited public proposals from activist stockholders. The unsolicited and often hostile nature of these public proposals can result in significant uncertainty for current and potential licensors, suppliers, patients, physicians and other constituents, and can cause these parties to change or terminate their business relationships with the targeted company. Companies targeted by these unsolicited proposals from activist stockholders may not be able to attract and retain key personnel as a result of the related uncertainty. In addition, unsolicited proposals can result in stockholder class action lawsuits. The review and consideration of an unsolicited proposal as well as any resulting lawsuits can be a significant distraction for management and employees, and may require the expenditure of significant time, costs and other resources.

If we were to receive unsolicited public proposals from activist stockholders, we may encounter all of these risks and, as a result, may be delayed in executing our core strategy. We could be required to spend substantial resources on the evaluation of the proposal as well as the review of other opportunities that never come to fruition. If we were to receive any of these unsolicited public proposals, the future trading price of our common stock is likely to be even more volatile than in the past, and could be subject to wide price fluctuations based on many factors, including uncertainty associated with the proposals.

We may become involved in securities or other class action litigation that could divert management's attention and harm our business.

The stock market has from time to time experienced significant price and volume fluctuations that have affected the market prices for the common stock of pharmaceutical and biotechnology companies. These broad market fluctuations may cause the market price of our common stock to decline. In the past, following periods of volatility in the market price of a particular company's securities, securities class action litigation has often been brought against that company. Any securities or other class action litigation asserted against us could have a material adverse effect on our business.

Risks Related to Product Development

We may invest a significant portion of our efforts and financial resources in the development of our product candidates and there is no guarantee we will obtain requisite regulatory approvals or otherwise timely bring these product candidates to market.

Our ability to bring any of our product candidates to market depends on a number of factors including:

successful completion of pre-clinical laboratory and animal testing;

an FDA approved investigational new drug application or IND application, becoming effective, which must occur before human clinical trials may commence;

successful completion of clinical trials;

submission of an NDA;

receipt of marketing approvals from the FDA;

establishing commercial manufacturing arrangements with third-party manufacturers;

launching commercial sales of the product;

acceptance of the product by patients, the medical community and third party payors;

competition from other therapies;

achieving and maintaining compliance with all regulatory requirements applicable to the product; and

a continued acceptable safety profile of the product following approval.

There are no guarantees that we will be successful in completing these tasks. If we are not successful in commercializing any of our product candidates, or are significantly delayed in doing so, our business will be harmed, possibly materially.

If our clinical trials do not demonstrate safety and efficacy in humans, we may experience delays, incur additional costs and ultimately be unable to commercialize our product candidates.

Before obtaining regulatory approval for the sale of some of our product candidates, we must conduct, at our own expense, extensive clinical trials to demonstrate the safety and efficacy of our product candidates in humans. In the United States, we must demonstrate with substantial evidence gathered in well-controlled studies, and to the satisfaction of the FDA, that each product candidate is safe and effective for use in the target indication. Clinical testing is expensive, difficult to design and implement, can take many years to complete and is uncertain as to outcome. The outcome of early clinical trials may not be predictive of the success of later clinical trials, and interim results of a clinical trial do not necessarily predict final results. Even if early phase clinical trials are successful, it is necessary to conduct additional clinical trials in larger numbers of patients taking the drug for longer periods before seeking approval from the FDA to market and sell a drug in the United States. Clinical data is often susceptible to varying interpretations, and companies that have believed their products performed satisfactorily in clinical trials have nonetheless failed to obtain FDA approval for their products. Similarly, even if clinical trials of a product candidate are successful in one indication, clinical trials of that product candidate for other indications may be unsuccessful. A failure of one or more of our clinical trials can occur at any stage of testing.

Failures or delays in the commencement or completion of our clinical trials could result in increased costs to us and delay or limit our ability to generate revenues.

We may experience numerous unforeseen events during, or as a result of, the clinical trial process that could delay or prevent our ability to receive regulatory approval or commercialize our product candidates. Commencement or completion of clinical trials can be delayed or prevented for a number of reasons, including:

FDA or institutional review boards may not authorize us to commence a clinical trial or conduct a clinical trial at a prospective trial site;

difficulty complying with conditions imposed by a regulatory authority regarding the scope or term of a clinical trial;

delays in reaching or failure to reach agreement on acceptable terms with prospective clinical research organizations, or CROs, and trial sites, the terms of which can be subject to extensive negotiation and may vary significantly among different CROs and trial sites;

our clinical trials may produce negative or inconclusive results, and we may decide, or the FDA or analogous foreign governmental entities may require us, to conduct additional clinical trials or we may abandon projects that we expect to be promising;

the number of patients required for our clinical trials may be larger than we anticipate, enrollment in our clinical trials may be slower or more difficult than we anticipate, or participants may drop out of our clinical trials at a higher rate than we anticipate;

our third-party contractors may fail to comply with regulatory requirements or meet their contractual obligations to us in a timely manner;

we might have to suspend or terminate our clinical trials if the participants are being exposed to unacceptable health risks;

regulators or institutional review boards may require that we hold, suspend or terminate clinical research for various reasons, including noncompliance with regulatory requirements;

the cost of our clinical trials may be greater than we anticipate;

the supply or quality of our product candidates or other materials necessary to conduct our clinical trials may be insufficient or inadequate; and

the effects of our product candidates may not be the desired effects or may include undesirable side effects or the product candidates may have other unexpected characteristics.

If we are required to conduct additional clinical trials or other testing of our product candidates in addition to those that we currently contemplate, if we are unable to successfully complete our clinical trials or other testing, if the results of these trials or tests are not positive or are only modestly positive or if there are safety concerns, we may:

be delayed in obtaining marketing approval for one or more of our product candidates;

not be able to obtain marketing approval; or

obtain approval for indications that are not as broad as intended.

Our product development costs also will increase if we experience delays in testing or approvals. Significant clinical trial delays also could shorten the patent protection period during which we may have the exclusive right to commercialize our product candidates or allow our competitors to bring products to market before we do and impair our ability to commercialize our products or product candidates. In addition, failure to conduct the clinical trial in

accordance with regulatory requirements or the trial protocols may also result in the ineligibility to use the data to support market approval.

Risks Related to Regulatory Matters

Some of our specialty pharmaceutical products are now being marketed without FDA approvals.

Even though the FDCA requires pre-marketing approval of all new drugs, as a matter of history and regulatory policy, the FDA has historically refrained from taking enforcement action against some marketed, unapproved new drugs. Specifically, some marketed prescription and nonprescription drugs are not the subject of an approved marketing application because they are thought to be identical, related, or similar to historically-marketed products, which were thought not to require pre-market review and approval, or which were approved only on the basis of safety, at the time they entered the marketplace. When enacted in 1938, the FDCA required proof of safety but not efficacy for new drugs. Between 1938 and 1962, if a drug obtained approval, FDA considered drugs that were identical, related, or similar to the approved drug to be covered by that approval, and allowed those drugs to be marketed without independent approval. In 1962, Congress amended the FDCA to require that a new drug be proven effective, as well as safe, to obtain FDA approval. The FDA established the Drug Efficacy Study Implementation, or DESI, program, which was established to determine the effectiveness of drug products approved before 1962. Drugs that were not subject to applications approved between 1938 and 1962 were not subject to DESI review. For a period of time, the FDA permitted these drugs to remain on the market without approval. In 1984, the FDA created a program, known as the Prescription Drug Wrap-Up, also known as DESI II, to address the remaining unapproved drugs. Most of these drugs contain active pharmaceutical ingredients that were first marketed prior to 1938. The FDA asserts that all drugs subject to the Prescription Drug Wrap-Up are on the market illegally and are subject to FDA enforcement discretion because all prescription drugs must be the subject of an approved drug application.

There are a few narrow exceptions. Under the 1938 grandfather clause, a drug product that was on the market prior to the passage of the FDCA in 1938 and which contains in its labeling the same representations concerning the conditions of use as it did prior to passage of the FDCA was not considered a “new drug” and therefore was exempt from the requirement of having an approved NDA. The 1962 grandfather clause exempts a drug from the effectiveness requirements if its composition and labeling has not changed since 1962 and if, on the day before the 1962 Amendments became effective, it was (a) used or sold commercially in the United States, (b) not a new drug as defined by the FDCA at that time, and (c) not covered by an effective application. The FDA and the courts have interpreted these two grandfather clauses very narrowly. The FDA believes that there are very few drugs on the market that are actually entitled to grandfather status because the drugs currently on the market likely differ from the previous versions in some respect, such as formulation, dosage or strength, dosage form, route of administration, indications, or intended patient population. It is a company’s burden to prove that its product is grandfathered.

The FDA has adopted a risk-based enforcement policy concerning these unapproved drugs. While all such drugs are considered to require FDA approval, FDA enforcement against such products as unapproved new drugs prioritizes products that pose potential safety risks, lack evidence of effectiveness, prevent patients from seeking effective therapies or are marketed fraudulently. In addition, the FDA has indicated that approval of an NDA for one drug within a class of drugs marketed without FDA approval may also trigger agency enforcement of the new drug requirements against all other drugs within that class that have not been so approved.

Some of our specialty pharmaceutical products are marketed in the United States without an FDA-approved marketing application because they have been considered by us to be identical, related or similar to products that have existed in the market without an NDA or ANDA. These products are marketed subject to the FDA’s regulatory discretion and enforcement policies, and it is possible that the FDA could disagree with our determination that one or more of these products is identical, related or similar to products that have existed in the marketplace without an NDA or ANDA. On March 3, 2011, the FDA announced its intent to remove certain unapproved prescription cough, cold, and allergy products from the U.S. market and named products from two cough and cold product families that Pernix sold, as well as certain Cypress products. The FDA provided three dates for the cessation of manufacturing, shipping or other introduction or delivery into commerce – March 3, 2011 for drugs not listed with the FDA under Section 510 of the FDCA, June 1, 2011 for cessation of manufacturing of listed drugs and August 31, 2011 for cessation of shipping of listed drugs covered by the notice. Manufacturing or shipping of the drug products covered by the notice beyond the date specified can result in enforcement action, including seizure, injunction, or other judicial or administrative proceedings. The time periods will not be extended for those who have submitted but not yet received approval of an NDA or ANDA application for a drug product covered by the notice. The Company completed the conversion of the ALDEX and BROVEX product families, two of our legacy cough and cold product families, to OTC monograph from DESI drugs in 2011. The Company believes it has appropriately marketed these lines as OTC monograph products. If the FDA were to disagree with our determination, it could require the removal of our unapproved products from the market, which would significantly reduce our gross sales. We voluntarily discontinued these products in 2013.

The Company’s authorized generic products that are OTC monograph products have not been affected by the FDA announcement. Certain Macoven generic products that were not marketed as OTC monograph were converted, and we did not experience any suspension, delay or interruption in our sales of these products. Our remaining generic DESI cough and cold products that were not being converted to OTC monograph were phased out by 2011 and did not have a material impact on the results of operations or financial condition of the Company. If the FDA were to disagree with our determination, it could ask or require the removal of our unapproved products from the market, which would significantly reduce our gross sales.

In addition, if the FDA issues an approved NDA for one of the drug products within the class of drugs that includes one or more of our unapproved products or completes the efficacy review for that drug product, it may require us to

also file an NDA or ANDA application for its unapproved products in that class of drugs in order to continue marketing them in the United States. While the FDA generally provides sponsors with a one-year grace period during which time they are permitted to continue selling the unapproved drug, it is not statutorily required to do so and could ask or require that the unapproved products be removed from the market immediately. In addition, the time it takes us to complete the necessary clinical trials and submit an NDA or ANDA to the FDA may exceed any applicable grace period, which would result in an interruption of sales of such unapproved products. If the FDA asks or requires that the unapproved products be removed from the market, our financial condition and results of operations would be materially and adversely affected.

If the FDA disagrees with our determination that several of our products meet the over-the-counter requirements, those products may be removed from the market.

Drugs must meet all of the general conditions for OTC drugs and all of the conditions contained in an applicable final monograph to be considered generally recognized as safe and effective (GRAS/GRAE) and to be marketed without FDA approval of a marketing application. The general conditions include, among other things, compliance with cGMP, establishment registration and labeling requirements. Any product which fails to comply with the general conditions and a monograph is liable to regulatory action. We believe our promoted branded products comply with FDA OTC monograph requirements. However, if the FDA determines that our products do not comply with the monograph or if we fail to meet the general conditions, the products may be removed from the market and we may face actions including, but not limited to, restrictions on the marketing or distribution of such products, warning letters, fines, product seizure, or injunctions or the imposition of civil or criminal penalties. Any of these actions would reduce our gross sales.

If we are not able to obtain required regulatory approvals, we will not be able to commercialize our product candidates and our ability to generate increased revenue will be materially impaired.

Our product candidates and the activities associated with their development and commercialization, including their testing, manufacture, safety, efficacy, recordkeeping, labeling, storage, approval, advertising, promotion, sale and distribution, are subject to comprehensive regulation by the FDA, the DEA and other regulatory agencies in the United States. Failure to obtain regulatory approval for a product candidate will prevent us from commercializing the product candidate. Securing FDA approval requires the submission of extensive preclinical and clinical data and supporting information to the FDA for each therapeutic indication to establish the product candidate’s safety and efficacy. Securing FDA approval also requires the submission of information about the product manufacturing process to, and inspection of manufacturing facilities by, the FDA. Our future products may not be effective, may be only moderately effective or may prove to have undesirable or unintended side effects, toxicities or other characteristics that may preclude our obtaining regulatory approval or prevent or limit commercial use.

The process of obtaining regulatory approvals is expensive, often takes many years, if approval is obtained at all, and can vary substantially based upon a variety of factors, including the type, complexity and novelty of the product candidates involved and the nature of the disease or condition to be treated. Changes in regulatory approval policies during the development period, changes in or the enactment of additional statutes or regulations, or changes in regulatory review for each submitted product application, may cause delays in the approval or rejection of an application. The FDA has substantial discretion in the approval process and may refuse to accept any application or may decide that our data is insufficient for approval and require additional preclinical, clinical or other studies. In addition, varying interpretations of the data obtained from preclinical and clinical testing could delay, limit or prevent regulatory approval of a product candidate. Any regulatory approval we ultimately obtain may be limited or subject to restrictions or post-approval commitments that render the approved product not commercially viable.

Any product for which we obtain marketing approval could be subject to restrictions or withdrawal from the market and we may be subject to penalties if we fail to comply with regulatory requirements or if we experience unanticipated problems with our products, when and if any of them are approved.

Any product for which we obtain marketing approval, along with the manufacturing processes, post-approval clinical data, recordkeeping, labeling, advertising and promotional activities for such product, will be subject to continual requirements of and review by the FDA and comparable regulatory authorities. These requirements include submissions of safety and other post-marketing information and reports, registration requirements, cGMP requirements relating to quality control, quality assurance and corresponding maintenance of records and documents, requirements regarding the distribution of samples to physicians and recordkeeping. Even if regulatory approval of a

product is granted, the approval may be subject to limitations on the indicated uses for which the product may be marketed or to the conditions of approval, or contain requirements for costly post-marketing testing and surveillance to monitor the safety or efficacy of the product. Later discovery of previously unknown problems with our products, manufacturers, or manufacturing processes or failure to comply with regulatory requirements may result in actions such as:

withdrawal of the products from the market;

restrictions on the marketing or distribution of such products;

restrictions on the manufacturers or manufacturing processes;

warning letters;

refusal to approve pending applications or supplements to approved applications that we submit;

recalls;

fines;

suspension or withdrawal of regulatory approvals;

refusal to permit the import or export of our products;

product seizure; or

injunctions or the imposition of civil or criminal penalties.

In addition, the FDA strictly regulates labeling, advertising, promotion and other types of information on products that are placed on the market. Drugs may be promoted only for the approved indications and in accordance with the provisions of the approved label, or for the indications specified in an applicable OTC monograph and in accordance with the monograph's labeling requirements. An organization that is found to have improperly promoted off-label uses may be subject to significant liability by the FDA and other agencies that actively enforce laws and regulations prohibiting the promotion of off-label uses. The Federal Trade Commission regulates advertising for OTC drug products and advertising for these products must be truthful, not misleading and adequately substantiated. If we are found to have promoted off-label uses, our OTC products may be deemed out of compliance with the applicable OTC monograph, we may be enjoined from such off-label promotion and become subject to significant liability, which would have an adverse effect on our reputation, business and revenues, if any.

Our sales depend on payment and reimbursement from third-party payors, and a reduction in the payment rate or reimbursement could result in decreased use or sales of our products.

Our sales of currently marketed products are, and any future sales of our product candidates will be, dependent, in part, on the availability of coverage and reimbursement from third-party payors, including government health care programs such as Medicare and Medicaid, and private insurance plans. All of our products are generally covered by managed care and private insurance plans. Generally, the status or tier within managed care formularies, which are lists of approved products developed by MCOs, varies but coverage is similar to other products within the same class of drugs. For example, CEDAX is covered by private insurance plans similar to other marketed, branded cephalosporins. However, the position of any of our branded products that requires a higher patient copayment may make it more difficult to expand the current market share for such product. In some cases, MCOs may require additional evidence that a patient had previously failed another therapy, additional paperwork or prior authorization from the MCO before approving reimbursement for a branded product. Some Medicare Part D plans also cover some or all of our products, but the amount and level of coverage varies from plan to plan. We also participate in the Medicaid Drug Rebate program with the Centers for Medicare & Medicaid Services and submit all of our products for inclusion in this program. Coverage of our products under individual state Medicaid plans varies from state to state. Additionally, some of our products are purchased under the 340B Drug Pricing Program, which is codified as Section 340B of the Public Health Service Act. Section 340B limits the cost of covered outpatient drugs to certain federal

grantees, federally qualified health center lookalikes and qualified disproportionate share hospitals.

There have been, there are and we expect there will continue to be federal and state legislative and administrative proposals that could limit the amount that government health care programs will pay to reimburse the cost of pharmaceutical and biologic products. For example, the Medicare Prescription Drug Improvement and Modernization Act of 2003, or the MMA, created a new Medicare benefit for prescription drugs. More recently, the Deficit Reduction Act of 2005 significantly reduced reimbursement for drugs under the Medicaid program. Legislative or administrative acts that reduce reimbursement for our products could adversely impact our business.

In March 2010, the President signed the PPACA, which makes extensive changes to the delivery of healthcare in the U.S. This act includes numerous provisions that affect pharmaceutical companies, some of which were effective immediately and others of which will be taking effect over the next several years. For example, the act seeks to expand healthcare coverage to the uninsured through private health insurance reforms and an expansion of Medicaid. The act also imposes substantial costs on pharmaceutical manufacturers, such as an increase in liability for rebates paid to Medicaid, new drug discounts that must be offered to certain enrollees in the Medicare prescription drug benefit, an annual fee imposed on all manufacturers of brand prescription drugs in the U.S., increased disclosure obligations and an expansion of an existing program requiring pharmaceutical discounts to certain types of hospitals and federally subsidized clinics. The act also contains cost-containment measures that could reduce reimbursement levels for healthcare items and services generally, including pharmaceuticals. It also will require reporting and public disclosure of payments and other transfers of value provided by pharmaceutical companies to physicians and teaching hospitals. These measures could result in decreased net revenues from our pharmaceutical products and decreased potential returns from our development efforts. Although the PPACA was recently upheld by the U.S. Supreme Court, it is possible that the PPACA may be modified or repealed in the future.

In addition, private insurers, such as MCOs, may adopt their own reimbursement reductions in response to federal or state legislation. Any reduction in reimbursement for our products could materially harm our results of operations. In addition, we believe that the increasing emphasis on managed care in the United States has and will continue to put pressure on the price and usage of our products, which may adversely impact our product sales. Furthermore, when a new product is approved, governmental and private coverage for that product and the amount for which that product will be reimbursed are uncertain. We cannot predict the availability or amount of reimbursement for our product candidates, and current reimbursement policies for marketed products may change at any time.

The MMA established a voluntary prescription drug benefit, called Part D, which became effective in 2006 for all Medicare beneficiaries. We cannot be certain that our currently marketed products will continue to be, or any of our product candidates still in development will be, included in the Medicare prescription drug benefit. Even if our products are included, the private health plans that administer the Medicare drug benefit can limit the number of prescription drugs that are covered on their formularies in each therapeutic category and class. In addition, private managed care plans and other government agencies continue to seek price discounts. Because many of these same private health plans administer the Medicare drug benefit, they have the ability to influence prescription decisions for a larger segment of the population. In addition, certain states have proposed or adopted various programs under their Medicaid programs to control drug prices, including price constraints, restrictions on access to certain products and bulk purchasing of drugs.

If we succeed in bringing additional products to the market, these products may not be considered cost-effective and reimbursement to the patient may not be available or sufficient to allow us to sell our product candidates on a competitive basis to a sufficient patient population. We may need to conduct expensive pharmacoeconomic trials in order to demonstrate the cost-effectiveness of our products and product candidates.

Our relationships with customers and payors are subject to applicable fraud and abuse and other healthcare laws and regulations, which could expose us to criminal sanctions, civil penalties, contractual damages, reputation harm, and diminished profits and future earnings.

Healthcare providers, physicians and others play a primary role in the recommendation and prescription of our products. Our arrangements with third-party payors and customers may expose us to broadly applicable fraud and abuse and other healthcare laws and regulation that may constrain the business or financial arrangements and relationships through which we market, sell and distribute our products. Applicable federal and state healthcare laws and regulations, include but are not limited to, the following:

- the federal healthcare anti-kickback statute prohibits, among other things, persons from knowingly and willfully soliciting, offering, receiving or providing remuneration, directly or indirectly, in cash or in kind, to induce or reward either the referral of an individual for, or the purchase, order or recommendation of, any good or service, for which payment may be made under federal healthcare programs such as Medicare and Medicaid;

- the Ethics in Patient Referrals Act, commonly referred to as the Stark Law, and its corresponding regulations, prohibit physicians from referring patients for designated health services reimbursed under the Medicare and Medicaid programs to entities with which the physicians or their immediate family members have a financial relationship or an ownership interest, subject to narrow regulatory exceptions;

- the federal False Claims Act imposes criminal and civil penalties, including civil whistleblower or qui tam actions, against individuals or entities for knowingly presenting, or causing to be presented, to the federal government, claims for payment that are false or fraudulent or making a false statement to avoid, decrease, or conceal an obligation to pay money to the federal government;

the federal Health Insurance Portability and Accountability Act of 1996, or HIPAA, imposes criminal and civil liability for executing a scheme to defraud any healthcare benefit program and also imposes obligations, including mandatory contractual terms, with respect to safeguarding the privacy, security and transmission of individually identifiable health information;

the federal false statements statute prohibits knowingly and willfully falsifying, concealing or covering up a material fact or making any materially false statement in connection with the delivery of or payment for healthcare benefits, items or services; and

analogous state laws and regulations, such as state anti-kickback and false claims laws, may apply to sales or marketing arrangements and claims involving healthcare items or services reimbursed by non-governmental third party payors, including private insurers, and some state laws require pharmaceutical companies to comply with the pharmaceutical industry's voluntary compliance guidelines and the relevant compliance guidance promulgated by the federal government.

In March 2010, the President signed the Patient Protection and Affordable Care Act, or PPACA, which makes extensive changes to the delivery of healthcare in the U.S. This act includes numerous provisions that affect pharmaceutical companies, some of which were effective immediately and others of which will be taking effect over the next several years. For example, the act seeks to expand healthcare coverage to the uninsured through private health insurance reforms and an expansion of Medicaid. The act also imposes substantial costs on pharmaceutical manufacturers, such as an increase in liability for rebates paid to Medicaid, new drug discounts that must be offered to certain enrollees in the Medicare prescription drug benefit, an annual fee imposed on all manufacturers of brand prescription drugs in the U.S., increased disclosure obligations and an expansion of an existing program requiring pharmaceutical discounts to certain types of hospitals and federally subsidized clinics. The act also contains cost-containment measures that could reduce reimbursement levels for healthcare items and services generally, including pharmaceuticals. It also will require reporting and public disclosure of payments and other transfers of value provided by pharmaceutical companies to physicians and teaching hospitals. These measures could result in decreased net revenues from our pharmaceutical products and decreased potential returns from our development efforts. Although the PPACA was recently upheld by the U.S. Supreme Court, it is possible that the PPACA may be modified or repealed in the future.

In addition, there have been a number of other legislative and regulatory proposals aimed at changing the pharmaceutical industry. These include proposals to permit reimportation of pharmaceutical products from other countries and proposals concerning safety matters. For example, in an attempt to protect against counterfeiting and diversion of drugs, a bill was introduced in a previous Congress that would establish an electronic drug pedigree and track-and-trace system capable of electronically recording and authenticating every sale of a drug unit throughout the distribution chain. This bill or a similar bill may be introduced in Congress in the future. California has already enacted legislation that requires development of an electronic pedigree to track and trace each prescription drug at the saleable unit level through the distribution system. California's electronic pedigree requirement is scheduled to take effect beginning in January 2015. Compliance with California and any future federal or state electronic pedigree requirements will likely require an increase in our operational expenses and will likely be administratively burdensome. As a result of these and other new proposals, we may determine to change our current manner of operation, provide additional benefits or change our contract arrangements, any of which could have a material adverse effect on our business, financial condition and results of operations.

We, as well as many other pharmaceutical companies, sponsor prescription drug coupons and other cost-savings programs to help reduce the burden of co-payments and co-insurance. During 2012, lawsuits have been filed against several pharmaceutical companies alleging, among other things, that the drug-makers violated anti-trust laws and the Racketeer Influenced and Corrupt Organizations Act, or RICO, when they provided coupon programs to privately-insured consumers that subsidize all or part of the cost-sharing obligation (co-pay or co-insurance) for a branded prescription drug or drugs. We cannot be certain as to whether we will be named in any future similar lawsuit or concerning the potential outcome of the ongoing litigation.

Efforts to ensure that our business arrangements with third parties comply with applicable healthcare laws and regulations could be costly. It is possible that governmental authorities will conclude that our business practices may not comply with current or future statutes, regulations or case law involving applicable fraud and abuse or other healthcare laws and regulations. If our past or present operations, including activities conducted by our sales team or agents, are found to be in violation of any of these laws or any other governmental regulations that may apply to us, we may be subject to significant civil, criminal and administrative penalties, damages, fines, exclusion from third-party payor programs, such as Medicare and Medicaid, and the curtailment or restructuring of our operations. If any of the physicians or other providers or entities with whom we do business are found to be not in compliance with applicable laws, they may be subject to criminal, civil or administrative sanctions, including exclusions from government funded healthcare programs.

Many aspects of these laws have not been definitively interpreted by the regulatory authorities or the courts, and their provisions are open to a variety of subjective interpretations, which increases the risk of potential violations. In addition, these laws and their interpretations are subject to change. Any action against us for violation of these laws, even if we successfully defend against it, could cause us to incur significant legal expenses, divert our management's attention from the operation of our business and damage our reputation.

The Food and Drug Administration Amendments Act of 2007 may make it more difficult and costly for us to obtain regulatory approval of our product candidates and to produce, market and distribute our existing products.

The Food and Drug Administration Amendments Act of 2007, or the FDAAA, grants a variety of new powers to the FDA, many of which are aimed at improving drug safety and assuring the safety of drug products after approval. Under the FDAAA, companies that violate the new law are subject to substantial civil monetary penalties. The new requirements and other changes that the FDAAA imposes may make it more difficult, and likely more costly, to obtain approval of new pharmaceutical products and to produce, market and distribute existing products.

We may be subject to investigations or other inquiries concerning our compliance with reporting obligations under federal healthcare program pharmaceutical pricing requirements.

Under federal healthcare programs, some state governments and private payors investigate and have filed civil actions against numerous pharmaceutical companies alleging that the reporting of prices for pharmaceutical products has resulted in false and overstated average wholesale price, which in turn may be alleged to have improperly inflated the reimbursements paid by Medicare, private insurers, state Medicaid programs, medical plans and others to healthcare providers who prescribed and administered those products or pharmacies that dispensed those products. These same payors may allege that companies do not properly report their “best prices” to the state under the Medicaid program. Suppliers of outpatient pharmaceuticals to the Medicaid program are also subject to price rebate agreements. Failure to comply with these price rebate agreements may lead to federal or state investigations, criminal or civil liability, exclusion from federal healthcare programs, contractual damages, and otherwise harm our reputation, business and prospects.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

We own the real property, subject to a mortgage, in which we currently operate our corporate headquarters and manufacturing facility. It is located in Houston, Texas and comprises two non-adjacent properties with a total of 63,215 square feet of manufacturing, storage and office space.

We lease 3,184 square feet in Mount Pleasant, South Carolina, which serves as our accounting office. The term of this lease expires on June 30, 2015, and our lease payment is approximately $4,100 per month, which is subject to certain annual escalators. We also lease a 5,000 square-foot office facility and a 7,200 square-foot warehouse facility in Magnolia, Texas. The facilities are leased from a limited liability company wholly-owned by one of our current officers and one of our former directors. The term of each lease is month to month and may be terminated by either party without penalty. As of December 31, 2013, Pernix pays rent of approximately $5,300 for this facility.

We lease the property in which we operate our Cypress and Hawthorn operations in Madison, Mississippi. It is comprised of 7,840 square feet of office space and 51,830 square feet of warehouse space and the lease expires June 30, 2014. The lease payment is approximately $29,800 per month. We do not plan to renew this lease and will be transitioning the inventory storage and distribution functions currently operated at this facility to Cardinal’s 3PL facility in La Vergne, Tennessee.

Additionally, we lease the property on which we operate our Pernix Sleep operations in San Diego, California. It is comprised of 4,595 square feet and the lease expires September 30, 2014. The lease payment is approximately

$14,000 per month.

Pernix owns approximately 118 acres of undeveloped land in Charleston County, South Carolina which we acquired in our merger with Golf Trust of America, Inc. in March 2010.

ITEM 3. LEGAL PROCEEDINGS

In re Somaxon Pharmaceuticals, Inc. Shareholder Litigation (Lead Case No. 37-201200087821-CU-SLCTL)

A purported class action lawsuit was filed in the Superior Court of California County of San Diego by Daniele Riganello, who, prior to the consummation of the merger between Pernix and Somaxon on March 6, 2013 (the "Merger"), was an alleged stockholder of Somaxon (Riganello v. Somaxon, et al., No. 37-201200087821-CU-SLCTL). A second purported class action was also filed in the court by another alleged stockholder (Wasserstrom vs. Somaxon, et al., No. 37-2012-00029214-CU-SL-CTL). Both plaintiffs filed amended complaints on January 18, 2013. The lawsuits were consolidated into a single action captioned In re Somaxon Pharmaceuticals, Inc. Shareholder Litigation (Lead Case No. 37-201200087821-CU-SLCTL). The operative complaint named as defendants Somaxon, Pernix, Pernix Acquisition Corp. I, as well as each of the former members of Somaxon's board of directors (the "Individual Defendants"). It alleged, among other things, that (i) the Individual Defendants breached fiduciary duties they assertedly owed to Somaxon's former stockholders in connection with the Merger (ii) Somaxon and Pernix aided and abetted the purported breaches of fiduciary duty; (iii) the merger consideration was unfair and inadequate; and (iv) the disclosures regarding the Merger in the Registration Statement on Form S-4, initially filed with the Securities and Exchange Commission on January 7, 2013 (as amended, the "Proxy Statement/Prospectus"), were inadequate.

On January 24, 2013, solely to avoid the costs, risks and uncertainties inherent in litigation, and without admitting any liability or wrongdoing, Pernix and the other named defendants in such litigation signed a memorandum of understanding (the "MOU") to settle such litigation. The MOU resolves the claims brought in the such litigation and provides a release and settlement by the purported class of Somaxon's former stockholders of all claims against the defendants and their affiliates and agents in connection with the Merger. The parties executed a stipulation of settlement setting forth a plaintiff's fee of $185,000 on July 3, 2013. The court entered a preliminary approval of the settlement on January 17, 2014. We sent notices to the class on January 31, 2014, and the final settlement approval hearing is scheduled for April 25, 2014, at which time we will be required to pay the plaintiff's fee and attorney's fees of $15,000, and the case will be dismissed.

Texas Attorney General Medicaid Investigation RE Cypress Pharmaceuticals

On May 9, 2013, our subsidiary, Cypress Pharmaceuticals, Inc., received notice from the Office of the Attorney General of the State of Texas that it had completed its initial analysis of transaction data provided by Cypress during 2012 to the Attorney General's office and offering to settle all claims that the Attorney General alleged arose from Cypress's prior actions under the Texas Medicaid Fraud Prevention Act. Cypress and the Texas Attorney General entered into a Settlement Agreement effective February 6, 2014 finally settling all claims against Cypress through the effective date for an aggregate payment of $12 million, with $2 million paid up front, and $2 million due on the first five anniversaries of the effective date.

Stanton Keith Pritchard, as Sellers' Agent v. Pernix Therapeutics Holdings, Inc. (U.S.D.C., So. Dist. Of TX)

On December 18, 2013, the selling shareholders of Cypress Pharmaceuticals, Inc. filed suit against Pernix to require Pernix to pay into the existing unfunded escrow account the $5.5 million holdback payment and the $4.5 million escrow payment that allegedly became due on December 16, 2013 under the Securities Purchase Agreement between the selling shareholders and Pernix dated November 12, 2012, as amended. The parties entered into a settlement agreement dated January 27, 2014 pursuant to which each party waived and released all claims against the other party pursuant to the Securities Purchase Agreement (including Pernix' put obligation pursuant to the agreement) in exchange for a one-time payment of $1.33 million to the Cypress shareholders by Pernix. The payment was made, and the case was dismissed effective January 29, 2014.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

On January 16, 2013, Pernix received approval from the NASDAQ Stock Market to transfer its common stock listing from the NYSE MKT LLC to the NASDAQ Global Market effective January 28, 2013. Pernix's common stock is listed on the NASDAQ Global Market under the symbol "PTX." On March 12, 2014, the most recent practicable date prior to the filing of this Annual Report on Form 10-K, the closing price of Pernix's common stock as reported on the NASDAQ Global Market was $3.74per share. The following table sets forth, for the fiscal quarters indicated, the high and low sales prices per share of Pernix's common stock as quoted on the NYSE MKT LLC through January 27, 2013 and as quoted on the NASDAQ Global Market commencing January 28, 2013.

	Price range of common stock	
	High	Low
Year Ended December 31, 2012:		
First Quarter	10.75	8.39
Second Quarter	9.51	5.90
Third Quarter	9.20	6.20
Fourth Quarter	8.70	6.70
Year Ended December 31, 2013:		
First Quarter	8.34	4.57
Second Quarter	5.18	2.93
Third Quarter	4.30	2.64
Fourth Quarter	3.59	1.68

Stockholder Information

On March 12, 2014, Pernix had 37,354,335 shares of common stock outstanding. As of March 12, 2014, those shares were held of record by approximately 107 registered holders.

Dividends

Pernix did not make any distributions for the years ended December 31, 2013, 2012 and 2011, and does not anticipate paying dividends in the foreseeable future. Additionally, our Amended Credit Agreement with MidCap and the Indenture governing the Notes include restrictions on our ability to make dividends and distributions. For additional information, see Note 15, Debt and Lines of Credit, to our consolidated financial statements included in this Annual Report on Form 10-K.

Stock Performance Graph

The following stock performance graph illustrates a comparison of the annual percentage change in the cumulative total stockholder return on our common stock. The graph assumes an initial investment of $100 on December 31, 2008.

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Issuer Purchases of Equity Securities

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly-announced plans or programs(1)	Maximum approximate dollar value of shares that may yet be purchased under the plans or programs
October 1, 2013 through October 31, 2013	—	$—	—	$ 1,150,130
November 1, 2013 through November 30, 2013	—	$—	—	$ 1,150,130
December 1, 2013 through December 31, 2013	—	$—	—	$ 1,150,130
Total	—	$—	—	$ 1,150,130

(1) On May 12, 2010, our Board of Directors authorized the repurchase of up to $5,000,000 in shares of our common stock. As of December 31, 2013, approximately $1,150,130 remained available under the repurchase plan. The repurchase plan does not have a termination date and may be eliminated by our Board at any time.

Equity Compensation Plan Information

The following table sets forth information with respect to our common stock that has been authorized for issuance under all of Pernix's equity compensation plans as of December 31, 2013. Pernix does not have any equity compensation plans which were not approved by its stockholders.

Equity Compensation Plan Information

Plan Category	Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights (a)(1)	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (b)	Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (c)(2)
Equity Compensation Plans Approved by Security Holders	1,144,500	4.77	3,846,566
Equity Compensation Plans Not Approved by Security Holders			
Total	1,144,500	4.77	3,846,566

(1) Includes 30,000 options, in the aggregate, issued under GTA's 2007 Stock Incentive Plan which were assumed by Pernix in the reverse merger transaction on March 9, 2010. The weighted-average exercise price of all of the outstanding options under these plans is $3.53. Excludes 460,000 options, in the aggregate, granted to ParaPRO, LLC on August 3, 2011, that vest over seven years pursuant to the commercial terms of the co-promotion agreement between the Company and ParaPRO for the marketing and sale of NATROBA. These options have an exercise price of $3.65. All other outstanding options were issued from our Amended and Restated 2009 Stock Incentive Plan (the "Plan").

(2) Includes 2,972,493 shares remaining available for issuance under our 2009 Plan, which may be issued as options, stock appreciation rights, restricted stock, restricted stock units or performance awards, and 873,973 shares remaining to be granted under our 2010 Employee Stock Purchase Plan.

Recent Sales of Unregistered Securities

None.

ITEM 6. SELECTED FINANCIAL DATA

The selected financial data set forth below for the years ended December 31, 2013, 2012, and 2011 and at December 31, 2013 and 2012 are derived from and should be read in conjunction with our audited financial statements, including the notes thereto, included elsewhere in this Annual Report on Form 10-K. The selected financial data for the years ended December 31, 2010 and 2009 and as of December 31, 2011, 2010, and 2009 are derived from our audited financial statements not included in this Annual Report on Form 10-K.

	Year Ended December 31,				
	2013(1,2,3,4,5,6,7)	2012(3,4,5,6,7)	2011(6,7)	2010(7)	2009(7)
	(In thousands, except per share data)				
Statement of Operations Data:					
Net revenues	$ 84,872	$ 61,313	$ 60,606	$ 33,227	$ 27,930
Expenses:					
Cost of sales	43,870	23,377	20,921	6,182	5,409
Selling, general and administrative expenses	62,551	35,452	22,158	15,188	12,382
Research and development	4,798	732	922	998	712
Loss from operations of the joint venture	–	240	814	–	–
Loss on plant, property and equipment, impairment of intangibles	19,638		380		
Depreciation and amortization expense	8,676	3,201	2,303	1,239	211
Total costs and expenses	139,533	63,002	47,498	23,607	18,714
Income (loss) from operations	(54,661)	(1,689)	(13,108)	9,620	9,216
Other income (expense)	8,270	(95)	(171)	1,175	22
Income (loss) before income taxes	(46,391)	(1,784)	12,937	10,795	9,238
Income tax expense (benefit)	(20,756)	(374)	4,589	1,486	39
Net income (loss) before non-controlling interest	$ (25,635)	$ (1,410)	$ 8,348	$ 9,309	$ 9,199
Net loss attributable to non-controlling interest	–	–	–	–	(41)
Net income (loss) attributable to controlling interest	–	–	–	–	9,240
Net income (loss) per share attributable to controlling interest - basic	$ (0.70)	$ (0.05)	$ 0.35	$ 0.40	$ 0.44
Net income (loss) per share attributable to controlling interest - diluted	$ (0.70)	$ (0.05)	$ 0.34	$ 0.40	$ 0.44

	2013(1,2,3,4,5,6)	2012(3,4,5,6)	2011(6)	2010	2009

Balance Sheet Data:					
Cash and cash equivalents	$ 15,647	$ 23,023	$ 34,551	$ 8,260	$ 4,578
Total assets	211,386	251,447	82,564	46,034	13,412
Debt (current and non-current)	18,310	43,636	6,000	–	–
Contractual obligations (current and non-current)	19,791	15,896	1,890	4,000	–
Stockholders' equity	$ 110,722	$ 78,539	$ 49,624	$ 18,905	$ 5,376

(1) On March 6, 2013, we acquired all of the outstanding common stock of Pernix Sleep, Inc. (f/k/a Somaxon Pharmaceuticals, Inc.). The Somaxon acquisition broadened our product portfolio to include Silenor, a non-controlled substance approved for the treatment of insomnia characterized by difficulty with sleep maintenance. The results of operations have been included in our consolidated financial statements since the acquisition date.

(2) On September 11, 2013, we completed the sale of certain of our generic assets held by Cypress.

(3) On December 31, 2012, we completed the acquisition of Cypress Pharmaceuticals, Inc., a privately-owned generic pharmaceutical company and its subsidiary, Hawthorn Pharmaceuticals, Inc., a privately owned, branded pharmaceutical company. The assets and liabilities assumed from this acquisition are included in our consolidated balance sheet as of December 31, 2012. The results of operations have been included in our consolidated financial statements since January 1, 2013.

(4) On July 2, 2012, we acquired the business assets of Great Southern Laboratories, or GSL, a pharmaceutical contract manufacturing company located in Houston, Texas. The results of operations have been included in our consolidated financial statements since the acquisition date.

(5) On February 10, 2012, we entered into a controlled equity offering sales agreement. We sold 2,966,739 shares of common stock under this controlled equity program for total net proceeds of approximately $23.8 million and closed the controlled equity offering on May 1, 2012.

(6) On July 27, 2011, we completed an underwritten registered direct offering of 4,000,000 shares of common stock (3,000,000 shares of which were sold by Pernix and 1,000,000 shares of which were sold by certain selling shareholders). Net proceeds from the transaction were approximately $19.3 million.

(7) Certain reclassifications have been made to prior period amounts in our consolidated statements of income to conform to the current period presentation. These reclassifications related to the classification of cost of samples as a selling expense instead of including in cost of product sales and the classification of coupon processing and program administrative fees as selling expense instead of being included in net sales. In addition, royalty expense was reclassified from a separate line item to cost of product sales. These reclassifications had no effect on net income as previously reported.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis of Pernix's consolidated financial condition and results of operations together with the consolidated financial statements and accompanying notes included in this Annual Report on Form 10-K. In addition to historical information, the following discussion contains forward-looking statements that involve risks, uncertainties and assumptions. Pernix's actual results may differ materially from those anticipated in these forward-looking statements as a result of many important factors, including, but not limited to, those set forth in "Item 1A – Risk Factors" of Part I of this Annual Report Form 10-K.

Overview

We are a specialty pharmaceutical company that sells, markets, manufactures and develops a number of branded and generic pharmaceutical products primarily indicated for sleep, bacterial infections and cough and cold conditions. We intend to see continued growth through the promotion of our products to physicians, healthcare practitioners and consumers, as appropriate. Since inception, we have engaged in a number of acquisitions and licensing arrangements to expand our product offerings. As part of our ongoing expansion strategy, we plan to make strategic acquisitions of products and companies, as well as develop and in-license additional products, with the aim of adding chronic, non-seasonal, specialty products to our revenue base.

Our branded products include CEDAX®, an antibiotic for middle ear infections, and a family of prescription treatments for cough and cold (ZUTRIPRO®, REZIRA®, and VITUZ®). We also market SILENOR® (doxepin), which is approved for the treatment of insomnia characterized by difficulty with sleep maintenance and is not a controlled substance. We promote our branded products through our sales and marketing organization.

We also currently promote Omeclamox-Pak® through a License and Supply Agreement with GastroEntero-Logic, LLC. We recently entered into a promotion agreement with Cumberland Pharmaceuticals pursuant to which Cumberland began promoting Omeclamox-Pak to gastroenterologists as discussed further below.

We recently entered into an Exclusive License Agreement with Osmotica Pharmaceutical Corp. to promote its desvenlafaxine product, Khedezla™ Extended-Release Tablets, 50 and 100 mg as discussed further below.

We sell our generic products in the areas of cough and cold, pain, vitamins, dermatology, antibiotics and gastroenterology through our wholly-owned subsidiaries, Macoven Pharmaceuticals, LLC, or Macoven, and Cypress Pharmaceuticals, Inc., or Cypress.

Our wholly-owned subsidiary, Pernix Manufacturing, LLC, or Pernix Manufacturing, manufactures and packages products for the pharmaceutical industry in a range of dosage forms.

Exclusive License Agreement. On February 27, 2014, we entered into an exclusive license agreement with Osmotica Pharmaceutical Corporation to promote KHEDEZLA (desvenlafaxine) Extended-Release (ER) Tablets, 50 mg and 100 mg. The sales and marketing of KHEDEZLA will be supported by our team of approximately 90 sales professionals, promoting the product to high desvenlafaxine prescribing physicians. The New Drug Application (NDA) for KHEDEZLA Tablets was approved by the U.S. Food and Drug Administration pursuant to section 505(b)(2) of the Federal Food, Drug, and Cosmetic Act in July 2013. KHEDEZLA is indicated for the treatment of major depressive disorder (MDD). Pursuant to the agreement, we agreed to make an upfront payment for the license and Osmotica's existing inventory of Khedezla, certain milestone payments payable upon the achievement of certain cumulative sales milestones and royalty payments for sales achieved for promoting the product. Subject to certain earlier termination rights, the initial term of the agreement expires in February 2024, with two year automatic

renewals.

Note Offering. On February 21, 2014, we issued $65 million aggregate principal amount of the Company's 8.00% Convertible Senior Notes due 2019 in accordance with each of the Securities Purchase Agreements dated February 4, 2014 by and between the Company and the investors party thereto and the related Indenture dated February 21, 2014, by and between the Company and the trustee named therein. See further discussion herein under the heading "Liquidity and Capital Resources."

MidCap Revolver Amendment. On February 21, 2014, we, together with our subsidiaries, entered into Amendment No. 1 to the Amended and Restated Credit Agreement with MidCap Funding IV, LLC, as Agent and as a lender, and the other lenders from time to time parties thereto. This Amendment No. 1 amends the Amended and Restated Credit Agreement that the Company and its subsidiaries entered into, effective May 8, 2013, with MidCap Financial, LLC, as Administrative Agent and as a lender, and the additional lenders from time to time parties thereto. See further discussion herein under the heading "Liquidity and Capital Resources."

Resignation of Directors. At the request of the Company, on February 21, 2014, each of Cooper C. Collins, James E. Smith, Jr. and Anthem Blanchard resigned as members of the Board of Directors of the Company. In addition, Mr. Collins also resigned as Chief Strategy Officer of the Company effective as of April 15, 2014. These resignations did not relate to any disagreements with the Board of Directors (the "Board") or management of the Company or disagreements with respect to matters related to the operations, policies or practices of the Company.

As a result of the Board resignations, the size of the Board was decreased to five directors, leaving two vacancies to be filled by the existing directors prior to the Company's 2014 annual meeting of shareholders. Funds managed by each of Athyrium Capital Management and Cetus Capital were given certain Board nomination rights.

As a result of the resignations of Messrs. Collins, Smith and Blanchard, the Company notified the Nasdaq Stock Market ("NASDAQ") on February 21, 2014, that it was not in compliance with the majority independent director and audit committee requirements under NASDAQ Listing Rule 5605. NASDAQ Listing Rule 5605(b)(1) requires that a majority of the board of directors be comprised of independent directors as defined in Rule 5605(a)(2). NASDAQ Listing Rule 5605(c)(2)(A) requires that a corporation's Audit Committee be comprised of at least three members, each of whom are independent directors. Currently, the Company's Board consists of one independent director and two non-independent directors and the Audit Committee is comprised of one member who is the current independent director. The Company is actively pursuing independent director candidates and expects to fill the vacancies created by these resignation as soon as practicable. The Company intends that these new independent directors will serve as members of the Audit Committee and the other applicable committees of the Board.

In accordance with NASDAQ Listing Rules 5605(b)(1)(A) and 5605(c)(4), the Company has a cure period during which it may regain compliance with the Listing Rules. In this case, the Company's cure period will expire upon its 2014 annual shareholders' meeting. The Company expects to regain compliance on a timely basis prior to its 2014 annual meeting of shareholders.

Settlement with Former Shareholders of Cypress. A Stipulation of Dismissal was filed with the United States District Court for the Southern District of Texas (Houston Division) on January 29, 2014 in connection with the settlement of all claims brought against the Company by the former shareholders (the "Plaintiff Shareholders") of Cypress and all claims brought against the Plaintiff Shareholders by Cypress in connection with the purchase of Cypress by the Company pursuant to the Securities Purchase Agreement by and among the Company, Cypress and the Plaintiff Shareholders (the "Purchase Agreement"). See further discussion herein under the heading "Liquidity and Capital Resources."

Texas Attorney General Medicaid Investigation. The Company reached an agreement with the Attorney General of the State of Texas to settle all claims arising from certain actions by Cypress under the Texas Medicaid Fraud

Prevention Act prior to its acquisition by the Company in connection with a Civil Investigative Demand made on Cypress. See further discussion herein under the heading “Liquidity and Capital Resources.”

Promotion Agreement for Gastroenterology Product. In January 2012, we entered into a license and supply agreement with a private company for OMECLAMOX-PAK, an FDA-approved prescription product to treat gastroenterology disease. Under the terms of the agreement, we obtained exclusive marketing rights to this product in the United States. We paid an up-front license fee of $2.0 million and an additional fee of $2.0 million upon commercial launch of the product in July 2012. In addition to these license fees, the agreement calls for us to pay royalties and milestone payments based on the sales of the product. On October 28, 2013, we entered into a promotion agreement with Cumberland Pharmaceuticals Inc. to promote Omeclamox-Pak. Pursuant to the agreement, Cumberland will promote Omeclamox-Pak to gastroenterologists in the United States, and we will continue to promote the product to certain primary care physicians. Cumberland paid an upfront payment of $4.0 million to us on October 29, 2013. There are also additional milestones at the first and second anniversary dates of the execution of the agreement totaling $4.0 million in the aggregate. Royalty payments ranging from 15% to 20% based on tiered levels of gross profits will be paid by Cumberland to the Company monthly.

Asset Dispositions. On September 11, 2013, the Company completed the sale of certain of its generic assets held by Cypress to Breckenridge. The acquisition was consummated pursuant to the terms of the Purchase Agreement, as amended. Breckenridge paid the Company $2,000,000 in cash upon execution of the Purchase Agreement, and $17,850,000, before customary closing costs of approximately $173,000, in cash at Closing, and issued two promissory notes, each in an amount of $4,850,000, with one due on the first anniversary after Closing and the other due on the second anniversary after Closing, for an aggregate purchase price of up to $29,550,000. See Note 5, Disposition of Certain Cypress Assets, to our consolidated financial statements included in this Annual Report on Form 10-K for further discussion.

Renegotiation of Natroba Co-Promotion Agreement. In September 2013, the Company amended the terms of our co-promotion agreement with ParaPRO. ParaPRO assumed responsibility for distribution of NATROBA and related activities, and the Company and its subsidiaries no longer purchase quantities of NATROBA at a discount for sale to customers. The Company continues to provide promotion services for NATROBA in its assigned territories for co-promotion fees based on prescriptions generated by its sales force. With respect to generic products covered by the agreement, the Company continues to provide distribution and co-promotion services for fees based on units distributed and prescriptions dispensed in defined territories. See Note 19, Other Revenue Sharing Arrangements, to our consolidated financial statements included in this Annual Report on Form 10-K for further discussion

U.S. License of Cough, Cold, Sinus & Allergy Intellectual Property. Effective August 30, 2013, the Company re-licensed all of our rights to these assets in the United States and licensed the Dr. Cocoa trademark and logo to infirst+ in exchange for a royalty of 5% of net sales in the United States through 2019 and 2.5% of net sales in the United States and Canada from 2020 through 2029. Our subsidiary, Pernix Manufacturing, entered into a supply agreement with infirst+ to supply certain of infirst+'s manufactured products in the United States. As a result of this transaction, the Company no longer has any rights to a royalty for products utilizing the intellectual property described above outside of the United States and Canada. See Note 11, Investment in Joint Venture, to our consolidated financial statements included in this Annual Report on Form 10-K for further discussion.

Merger with Somaxon. On March 6, 2013, the Company acquired all of the outstanding common stock of Somaxon Pharmaceuticals, Inc. pursuant to an agreement and plan of merger dated December 10, 2012. As a result of the merger, each outstanding share of Somaxon common stock was converted into the right to receive approximately 0.478 shares of the Company's common stock, with cash paid in lieu of fractional shares. As a result of the merger, the Company issued an aggregate of approximately 3,665,689 shares of its common stock to the former stockholders of Somaxon. See Note 4, Business Combinations and Other Acquisitions, to our consolidated financial statements included in this Annual Report on Form 10-K for further discussion.

Acquisition of Cypress. On December 31, 2012, we completed the acquisition of a privately-owned, generic pharmaceutical company, Cypress Pharmaceuticals, Inc. and its branded pharmaceutical subsidiary Hawthorn Pharmaceuticals, Inc., which we refer to collectively herein as Cypress. Cypress offers a wide array of generic pharmaceutical products in the areas of cough and cold, nutritional supplements, analgesics, urinary tract, women's health, pre-natal vitamins and dental health, as well as allergy, respiratory, iron deficiency, nephrology and pain management. Hawthorn offers a broad portfolio of branded products including allergy, respiratory, iron deficiency, nephrology and pain management. See Note 4, Business Combinations and Other Acquisitions, and Note 23, Subsequent Events, to our consolidated financial statements included in this Annual Report on Form 10-K for further discussion.

As part of the funding for this acquisition, we entered into a $42 million credit facility on December 31, 2012 with Midcap Funding V, LLC, as administrative agent, as a lender and as co-bookrunner and sole lead arranger, Business Development Corporation of America, as co-bookrunner, and additional lenders from time to time party thereto. See Note 15, Debt, and Note 23, Subsequent Events, to our consolidated financial statements included in this Annual

Report on Form 10-K for further discussion.

Acquisition of GSL. On July 2, 2012, we completed our acquisition of the business assets of Great Southern Laboratories, or GSL, a pharmaceutical contract manufacturing company located in Houston, Texas. We closed on the related real estate on August 30, 2012. Upon the final closing, we paid an aggregate of approximately $4.6 million, net of the $300,000 escrow that was refunded to us subsequent to close, and assumed certain liabilities totaling approximately $5.9 million, for substantially all of GSL's assets, including the land and buildings in which GSL operates. GSL has an established manufacturing facility with an existing base of customers in the pharmaceutical industry, which provides us with additional income and potential cost savings. We acquired the GSL assets through our wholly owned subsidiary, Pernix Manufacturing, LLC, or PML. See Note 4, Business Combinations and Other Acquisitions, to our consolidated financial statements included in this Annual Report on Form 10-K for further discussion.

Financial Operations Overview

The discussion in this section describes our consolidated income statement categories. For a discussion of our consolidated results of operations, see “Results of Operations” below.

For the years ended December 31, 2013, 2012 and 2011, our net sales were approximately $84,872,000, $61,313,000 and $60,607,000, respectively, and our net (loss) income before income taxes was approximately ($46,391,000), ($1,784,000) and $12,937,000, respectively.

Our net cash (used in) provided by operating activities for the years ended December 31, 2013, 2012 and 2011 was approximately ($6,532,000), ($1,926,000) and $9,397,000, respectively.

Net Revenues

Pernix’s net revenues consist of net product sales, manufacturing revenue and revenue from co-promotion and other revenue sharing agreements. Pernix recognizes product sales net of estimated allowances for product returns, price adjustments (including customer rebates, service fees, chargebacks and other discounts), government program rebates (Medicaid, Medicare and other government sponsored programs) and prompt pay discounts. The primary factors that determine Pernix’s net product sales are the level of demand for Pernix’s products, unit sales prices, the applicable federal and supplemental government program rebates, contracted rebates, chargebacks and service fees and other discounts that Pernix may offer. In addition to our own product portfolio, from time to time we may enter into co-promotion or other revenue sharing arrangements pursuant to which we receive a percentage of revenue on sales of our products that they generate. Revenue from agreements pursuant to which contracted third parties market products to which we have rights and submit a specified profit share to us and other revenue such as sales of API (active pharmaceutical ingredients) was approximately $4,329,000, $4,514,000 and $5,543,000 for the years ended December 31, 2013, 2012 and 2011, respectively. Manufacturing revenue from Pernix Manufacturing, acquired in July 2012 as discussed previously, was approximately $3,011,000 and $5,424,000 for the years ended December 31, 2013 and 2012, respectively. The following table sets forth a summary of Pernix’s net sales revenue for the years ended December 31, 2013, 2012 and 2011.

	Year Ended December 31,		
	2013	2012	2011
	(in thousands)		
Upper respiratory, allergy and antibiotic products	$54,583	$39,094	$61,454
Gastroenterology	9,641	8,830	122
Dietary supplements and medical food products	29,112	11,964	4,509
Analgesics	21,946	14,007	7,889
Sleep maintenance	12,956	—	—
Dermatology products	5,417	7,211	11,865
Other products	11,400	958	—
Gross Product Sales	145,055	82,064	85,839
Sales Allowances	(67,523)	(30,689)	(30,775)
Net Product Sales	77,522	51,375	55,064
Manufacturing revenue	3,011	5,424	—
Co-promotion and other revenue	4,329	4,514	5,543
Net Sales Revenues	$84,872	$61,313	$60,607

Allowances for Prompt Pay Discounts, Product Returns, Price Adjustments, and Medicaid Rebates

The following table sets forth a summary of our allowances for product returns, government program rebates and price adjustments as of December 31, 2013:

	Product Returns	Government Program Rebates	Price Adjustments
		(in thousands)	
Balance at December 31, 2010	$4,313	$4,432	$ 1,744
Current provision:			
Adjustments to provision for prior year sales	498	1,137	300
Provision – current year sales	4,784	9,969	12,311
Payments and credits	(3,883)	(9,695)	8,904
Balance at December 31, 2011	5,712	5,843	5,451
Allowances assumed in acquisition of Cypress	5,901	1,175	4,586
Current provision:			
Adjustments to provision for prior year sales	1,840	(1,075)	(272)
Provision – current year sales	5,426	7,689	15,368
Payments and credits	(6,822)	(6,595)	(14,173)
Balance at December 31, 2012	12,057	7,037	10,960
Allowances assumed in acquisition of Somaxon	776	479	1,113
Post-closing opening balance sheet adjustments	1,374	391	416
Allowances for certain co-promotion agreements (1)	58	110	483
Reclass from contingent consideration	3,934	—	—
Current provision:			
Adjustments to provision for prior year sales	1,611	(921)	(300)
Provision – current year sales	9,394	6,335	48,567
Payments and credits	(17,155)	(9,495)	(42,938)
Balance at December 31, 2013	$12,049	3,936	18,301

(1) Allowances for certain co-promotion agreements represent allowances for which the expense is the responsibility of the other party to the co-promotion agreement. However, since we are responsible for the remittance of the payment of these deduction items to the billing third party, these items are included in accrued allowances on our balance sheet.

Product Returns. Consistent with industry practice, we offer contractual return rights that allow our customers to return short-dated or expiring products within an 18-month period, commencing from six months prior to and up to twelve months subsequent to the product expiration date. Our products have a 15 to 36-month expiration period from the date of manufacture. We adjust our estimate of product returns if we become aware of other factors that we believe could significantly impact our expected returns. These factors include our estimate of inventory levels of our products in the distribution channel, the shelf life of the product shipped, review of consumer consumption data as reported by external information management companies, actual and historical return rates for expired lots, the forecast of future sales of the product, competitive issues such as new product entrants and other known changes in sales trends. We estimate returns at percentages up to 10% of sales of branded products (may be higher for product launches or on sales of short dated product). Returns estimates are based upon historical data and other facts and circumstances that may impact future expected returns to derive an average return percentage for our products. In addition to the accrual on sales during the year ended December 31, 2013, we recorded an additional returns allowance for the returns of certain recalled products of approximately $390,000 and reclassified approximately $300,000 in unrealized price adjustments

and approximately $921,000 in unrealized Medicaid rebates on these recalled products due to the fact that they will now be returned instead of prescribed under Medicaid. We also reclassed approximately $3,943,000 from the contingent consideration liability to the returns allowance for the year ended December 31, 2013 as the result of the settlement of the litigation and related indemnification claims with the former Cypress shareholders. The returns reserve may be adjusted as we accumulate sales history and returns experience on our portfolio of products. We review and adjust these reserves quarterly. If estimates regarding product demand are inaccurate, if changes in the competitive environment effect demand for certain products, or if other unforeseen circumstances effect a product's salability, actual returns could differ and such differences could be material. For example, a 1% difference in our provision assumptions for the year ended December 31, 2013 would have affected pre-tax earnings by approximately $1,459,000.

Government Program Rebates. The liability for government program rebates is estimated based on historical and current rebate redemption and utilization rates contractually submitted by each state's program administrator and assumptions regarding future government program utilization for each product sold. As we become aware of changing circumstances regarding the Medicaid and Medicare coverage of our products, we will continue to incorporate such changing circumstances into the estimates and assumptions that we use to calculate government program rebates. If our estimates and assumptions prove inaccurate, we may be subject to higher or lower government program rebates. For example, with respect to the provision for the year ended December 31, 2013, a 1% difference in the provision assumptions based on utilization would have effected pre-tax earnings by approximately $572,000 and a 1% difference in the provisions based on reimbursement rates would have affected pre-tax earnings by approximately $135,000.

Price Adjustments. Our estimates of price adjustments which include customer rebates, service fees, chargebacks and other discounts are based on our estimated mix of sales to various third-party payors who are entitled either contractually or statutorily to discounts from the listed prices of our products and contracted service fees with our wholesalers. In the event that the sales mix to third-party payors or the contract fees paid to the wholesalers are different from our estimates, we may be required to pay higher or lower total price adjustments than originally estimated. For example, for the year ended December 31, 2013, a 1% difference in the assumptions based on the applicable sales would have affected pre-tax earnings by approximately $2,073,000.

We, from time to time, offer certain promotional product-related incentives to our customers. These programs include sample cards to retail consumers, certain product incentives to pharmacy customers and other sales stocking allowances. For example, we have initiated coupon programs for certain of our promoted products whereby we offer a point-of-sale subsidy to retail consumers. We estimate our liabilities for these coupon programs based on redemption information provided by a third party claims processing organization. We account for the costs of these special promotional programs as a reduction of gross revenue when applicable products are sold to the wholesalers or other retailers. Any price adjustments that are not contractual but that are offered at the time of sale are recorded as a reduction of revenue when the sales order is recorded. These adjustments are not accrued as they are offered on a non-recurring basis at the time of sale and are recorded as an expense at the time of the sale. These allowances may be offered at varying times throughout the year or may be associated with specific events such as a new product launch or to reintroduce a product. Approximately 8% of the provision relates to point-of-sale discounts to the wholesaler.

Prompt Payment Discounts. We typically require our customers to remit payments within the first 30 days for branded products (60 to 120 days for generics, depending on the customer and the products purchased). We offer wholesale distributors a prompt payment discount if they make payments within these deadlines. This discount is generally 2% to 3%, but may be higher in some instances due to product launches and/or industry expectations. Because our wholesale distributors typically take advantage of the prompt pay discount, we accrue 100% of the prompt pay discounts, based on the gross amount of each invoice, at the time of our original sale, and apply earned discounts at the time of payment. This allowance is recorded as a reduction of accounts receivable and revenue. We adjust the accrual periodically to reflect actual experience. Historically, these adjustments have not been material. We do not anticipate that future changes to our estimates of prompt payment discounts will have a material impact on our net revenue. Prompt pay discounts were approximately $3,053,000, $1,713,000 and $1,775,000 for the years ended December 31, 2013, 2012 and 2011, respectively.

Cost of Product Sales

Our cost of product sales is primarily comprised of the costs of manufacturing and distributing our pharmaceutical products and profit sharing and royalty expenses related to co-promotion and license agreements with third parties. In particular, cost of product sales includes manufacturing, packaging and distribution costs, the cost of active pharmaceutical ingredients and the write-off of obsolete inventory. We partner with third parties to manufacture

certain of our products and product candidates while some of our products are manufactured by Pernix Manufacturing, the manufacturing plant that we acquired in July 2012.

Most of our manufacturing arrangements with third party manufacturers are not subject to long-term agreements and generally may be terminated by either party without penalty at any time. Changes in the price of raw materials and manufacturing costs could adversely affect our gross margins on the sale of our products. Changes in our mix of products sold also affect our cost of product sales.

From time to time in the ordinary course of business, the Company enters into agreements regarding royalty payments or other profit sharing payments. Royalty expenses include the contractual amounts Pernix is required to pay licensors from which it has acquired the rights to certain of its marketed products. Royalty and profit sharing expenses will vary based on changes in product sales and/or product mix.

For further discussion of our agreements that are subject to a profit split arrangement or royalty, see Note 4, Business Combinations and Other Acquisitions, and Note 19, Other Revenue Sharing Arrangements, to our consolidated financial statements included in this Annual Report on Form 10-K.

The cost of NATROBA is included in our cost of product sales from August 2011 (the month of launch) to September 30, 2013. We pay wholesale average cost less a nominal discount when we purchase NATROBA inventory. Under the original agreement with ParaPRO, we received a contracted cost of goods rebate per unit when the product was shipped to retailers in our specified territories. Under the renegotiated terms effective August 12, 2012, we receive a flat co-promotion fee on NATROBA per unit based on prescriptions in our specified territories. Because of the structure of the NATROBA agreement, we recognize significantly lower margins on sales of NATROBA as compared to the other products we market. Subsequent to September 30, 2013, we no longer distribute the product but still market the product pursuant to the co-promotion agreement and receive a set fee per prescription in specified territories.

Selling Expenses

Our selling expenses consist of the cost of product samples, program management fees, sales data fees, salaries, commission and incentive expenses for our sales force; all overhead costs of our sales force; and out-going freight, marketing collateral and promotion costs. The most significant component of our sales and marketing expenses is salaries, commissions and incentive expenses for our sales force. Sales commissions are based on when our products are dispensed by retail customers, not when we sell Pernix products to our wholesale customers. Therefore, there may be a lag between the time of Pernix’s sale to its customer and when the commission is ultimately earned and paid on that sale.

General and Administrative Expenses

General and administrative expenses primarily include salaries, benefits and overhead of management and administrative personnel; legal and professional fees; consulting fees; deal expenses, pharmaceutical excise taxes, and all lines of insurance. Pernix’s general and administrative expenses have increased significantly from the year ended December 31, 2012 due to the acquisition of Pernix Manufacturing and growth in our operating infrastructure resulting in personnel additions and their related overhead costs, costs related to the expansion of our product portfolio and expenses in support of growing a public company.

Research and Development Expenses

Research and development expenses consist of costs incurred in identifying, developing and testing products and product candidates. Pernix either expenses research and development costs as incurred or, if Pernix pays manufacturers a prepaid research and development fee, Pernix will expense such fee ratably over the term of the development. Pernix believes that significant investment in research and development is important to its competitive position and may, in the future, increase its expenditures for research and development to realize the potential of the product candidates that it is developing or may develop, including the in-process research and development projects of Cypress.

Other Income and Expenses

Depreciation Expense. Depreciation expense is recognized for our property and equipment, which depreciates over the estimated useful lives of the assets using the straight-line method.

Amortization Expense. Amortization expense is recognized for certain of our intangible assets, consisting primarily of licensing and acquisition agreements, including but not limited to, the customer relationships acquired in the acquisition of GSL in July 2012, the license related to the non-codeine antitussive drug in development (BC 1036) acquired in May 2012, the OMECLAMOX-PAK license acquired in February 2012, CEDAX in March 2010 and Macoven in September 2010, which are amortized over their estimated useful lives using the straight-line method. See Note 12, Intangible Assets, to our consolidated financial statements included in this Annual Report on Form 10-K for further discussion.

Income Taxes. Deferred taxes are recognized for the tax consequences of “temporary differences” by applying enacted statutory rates applicable to future years to the difference between the financial statement carrying amounts and the tax bases of existing assets and liabilities. The effect on deferred taxes for a change in tax rates is recognized in income in the period that includes the enactment date. Pernix will recognize future tax benefits to the extent that realization of such benefits is more likely than not.

Critical Accounting Estimates

Management's discussion and analysis of Pernix's financial condition and results of operations are based on Pernix's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of Pernix's consolidated financial statements requires Pernix's management to make estimates and assumptions that affect Pernix's reported assets and liabilities, revenues and expenses and other financial information. Reported results could differ significantly under different estimates and assumptions. In addition, Pernix's reported financial condition and results of operations could vary due to a change in the application of a particular accounting standard.

Pernix regards an accounting estimate or assumption underlying its financial statements as a "critical accounting estimate" where:

the nature of the estimate or assumption is material due to the level of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and

the impact of the estimates and assumptions on its financial condition or operating performance is material.

Our significant accounting policies are described in the notes to our consolidated financial statements in Part II, Item 8, of this Annual Report on Form 10-K. Not all of these significant accounting policies, however, fit the definition of "critical accounting estimates." Pernix believes that its estimates relating to revenue recognition, sales allowances such as returns on product sales, government program rebates, customer coupon redemptions, wholesaler/pharmacy discounts, product service fees, rebates and chargebacks, sales commissions, amortization, depreciation, stock-based compensation, the determination of fair values of assets and liabilities in connection with business combinations and deferred income taxes fit the definition of "critical accounting estimates."

Revenue Recognition

We record revenue from product sales and co-promotion agreements when realized or realizable and earned. Revenue is realized or realizable and earned 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. At the time of a product sale, estimates for a variety of sales deductions, such as returns on product sales, government program rebates, price adjustments and prompt pay discounts are recorded. Refer to the discussion of sales deductions above under "Allowances for Product Returns, Medicaid Rebates, Price Adjustments (chargebacks, rebates, vendor fees, coupons and point-of-sale discounts), and Prompt Pay Discounts" herein.

We record all of our revenue from product sales, manufacturing sales and co-promotion agreements when realized or realizable and earned. Revenue is realized or realizable and earned when all of the following criteria are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services have been performed and are billable; (3) the seller's price to the buyer is fixed or determinable; and (4) collectability is reasonably assured. We record revenue from product sales when the customer takes ownership and assumes risk of loss (free-on-board destination).

For arrangements that involve the delivery of more than one element, each product, service and/or right to use assets is evaluated to determine whether it qualifies as a separate unit of accounting. This determination is based on whether the deliverable has "stand-alone value" to the customer. The consideration that is fixed or determinable is then allocated to each separate unit of accounting based on the relative selling price of each deliverable. The estimated selling price of each deliverable is determined using the following hierarchy of values: (i) vendor-specific objective evidence of

fair value, (ii) third-party evidence of selling price (TPE) and (iii) best estimate of selling price (BESP). The BESP reflects the best estimate of what the selling price would be if the deliverable was regularly sold by us on a stand-alone basis. In most cases we expect to use TPE or BESP for allocating consideration to each deliverable. The consideration allocated to each unit of accounting is recognized as the related goods or services are delivered, limited to the consideration that is not contingent upon future deliverables. Analyzing the arrangement to identify deliverables requires the use of judgment, and each deliverable may be an obligation to deliver services, a right or license to use an asset, or another performance obligation.

The Company recognizes revenue from milestone payments when earned, provided that (i) the milestone event is substantive in that it can only be achieved based in whole or in part on either the entity's performance or on the occurrence of a specific outcome resulting from the entity's performance and its achievability was not reasonably assured at the inception of the collaboration arrangement and (ii) the Company does not have ongoing performance obligations related to the achievement of the milestone earned and (iii) it would result in additional payments being due to the Company. Milestone payments are considered substantive if all of the following conditions are met: the milestone payment is non-refundable; achievement of the milestone was not reasonably assured at the inception of the arrangement; substantive effort is involved to achieve the milestone; and the amount of the milestone appears reasonable in relation to the effort expended, the other milestones in the arrangement and the related risk associated with the achievement of the milestone. Any amounts received under the promotion arrangement in advance of performance, if deemed substantive, are recorded as deferred revenue and recognized as revenue as the Company completes its performance obligations. See Note 19, Other Revenue Sharing Arrangements, to our consolidated financial statements included in this Annual Report on Form 10-K for analysis of milestone events deemed to be substantive or non-substantive.

Manufacturing revenue is recognized when the finished product is shipped to the customer.

Stock Based Compensation

Compensation expense is determined by reference to the fair value of an award on the date of grant and is amortized on a straight-line basis over the vesting period. Pernix accounts for its stock based compensation pursuant to ASC 718, Accounting for Stock Options and Other Stock Based Compensation. ASC 718 also establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. See Note 20, Employee Compensation and Benefits, and Note 24, Subsequent Events, to our consolidated financial statements included in this Annual Report on Form 10-K, regarding the calculation of the value of options issued and other details regarding all stock based compensation awarded in the years then ended.

Inventory

Inventory primarily consists of finished goods which include pharmaceutical products ready for commercial sale or distribution as samples as well as Pernix Manufacturing's inventory of raw materials and packaging supplies for the manufacture of products. Inventory is stated at the actual cost per bottle determined under the specific identification method. Pernix's estimate of the net realizable value of its inventories is subject to judgment and estimation. The actual net realizable value of its inventories could vary significantly from its estimates and could have a material effect on its financial condition and results of operations in any reporting period. An allowance for slow-moving or obsolete inventory or declines in the value of inventory is determined based on management's assessments. The raw materials the Company has in inventory are provided to certain of our manufacturers to utilize in the manufacture of our products and, from time to time, are sold to other companies to utilize in their own products. As of December 31, 2013 and 2012, we had approximately $13,810,000 and $22,014,000 in inventory, respectively, which is net of a reserve of approximately $2,634,000 and $1,057,000 as of December 31, 2013 and 2012, respectively. Inventory at December 31, 2013 includes an increase in the basis of acquired inventory from the Cypress and Somaxon acquisitions of approximately $2,714,000. Inventory at December 31, 2012 includes approximately $5,577,000 in inventory acquired in the acquisition of Cypress plus an increase in the basis of this inventory of $8,600,000.

Results of Operations

Comparison of the Year Ended December 31, 2013 and 2012

Net Revenues. Net revenues were approximately $84,872,000 and $61,313,000 for the years ended December 31, 2013 and 2012, respectively, an increase of approximately $23,559,000, or 38.4%. The Cypress and Hawthorn product portfolio, acquired on December 31, 2012, contributed approximately $34,503,000 in net revenues and the Somaxon product, acquired on March 6, 2013, contributed approximately $6,681,000 in net revenues. These increases were offset by a decrease in the net revenues of our legacy portfolio (pre-acquisition portfolio) of products of approximately $15,213,000 and a decrease in the manufacturing revenue of approximately $2,412,000. This decrease was due in part to (i) the discontinuation of the sale of certain generic products due to patent litigation settlement, (ii) the discontinuation of certain cough and cold products, and (iii) the change in the terms of the co-promotion agreement for NATROBA with ParaPRO pursuant to which we no longer recognize the gross sales of NATROBA. Gross to net deductions as a percent of gross product sales have increased by approximately 10% primarily due to rebates under managed care contracts as well as coupon programs initiated on more of our products and increased utilization under our coupon programs. Total net revenues during the year ended December 31, 2013 consisted of 54% from brand product sales and 46% from generic product sales compared to 61% brand and 39% generic during the year ended December 31, 2012.

Allowances for Product Returns, Medicaid Rebates, Price Adjustments (chargebacks, rebates, vendor fees, coupons and point-of-sale discounts), and Prompt Pay Discounts. Product returns allowances are based on the products' expiration dates, which are generally 15 to 36-months from the date the product was originally sold. For the years ended December 31, 2013 and 2012, product returns allowances were approximately $10,699,000, or 7.4% of gross product sales, and $7,266,000, or 8.8% of gross product sales, respectively. The decrease in the product returns allowances as a percentage of gross product sales was primarily due to the addition of the Cypress generic portfolio which has lower returns as a percentage of gross product sales than our brand portfolio and our legacy generic products.

Government program rebates were approximately $5,423,000, or 3.8% of gross product sales, and $6,614,000 or 7.9% of gross product sales, respectively, for the years ended December 31, 2013 and 2012. The liability for government program rebates is estimated based on historical and current rebate redemption and utilization rates contractually submitted by each state's program administrator and assumptions regarding future government program utilization. The decrease in rebates as a percentage of gross product sales was primarily due to changes in Medicaid coverage in 2013 and a shift in marketing focus that reduced Medicaid prescriptions of our products.

Price adjustments were approximately $51,400,000, or 35.5% of gross product sales and $16,809,000, or 20.2% of gross product sales, respectively, for the years ended December 31, 2013 and 2012. The increase in price adjustments as a percentage of gross product sales was due primarily to rebates under managed care contracts as well as coupon programs initiated on more of our products and increased utilization under our coupon programs. In addition, several of our customers increased their distribution service fee rates in 2013 which is charged on all products these customers purchase. Rebates and chargebacks are not typically a component of customer contracts for brand products so price adjustments are primarily impacted by generic sales. Contributing to the increase was price protection adjustments of approximately $1,381,000 resulting from a generic product price increase during the year.

Prompt pay discounts taken were approximately $3,053,000, or 2.1% of gross product sales and $1,713,000, or 2.1% of gross product sales, for the years ended December 31, 2013 and 2012, respectively. Approximately $532,000 and $728,000 in accrued allowances for prompt pay discounts was netted against accounts receivable at December 31, 2013 and 2012, respectively.

Cost of Sales. Cost of sales was approximately $43,870,000, or 29.7% of gross product sales, and $23,377,000, or 26.3% of gross product sales, for the years ended December 31, 2013 and 2012, respectively, an increase of approximately $20,493,000, or 2.3% of gross product sales. Approximately $6,359,000 of this amount is from the increased basis of the inventory acquired in connection with the Cypress and Somaxon acquisitions that was recognized for products sold during the year ended December 31, 2013. The remaining increase in basis of the inventory acquired in connection with the Cypress and Somaxon acquisitions is approximately $2,714,000, and will be amortized on a pro-rata basis as the acquired inventory is sold and included in cost of sales in future periods. The allowance for obsolete and slow moving inventory, included in cost of sales, was approximately $3,037,000 in the year ended December 31, 2013 compared to approximately $822,000 in the year ended December 31, 2012. Cost of sales, excluding the cost associated with the increase in inventory basis and the allowance for obsolete and slow moving inventory, was approximately $34,474,000, or 23.4% of gross product sales, similar to the prior year period which was approximately $22,555,000, or 25.4%.

Gross Margin. Gross profit margin on the net sales of our products was 55.8% (excluding the increase in the cost of sales attributed to sales of the acquired inventory which has a significantly higher basis than the inventory purchased post-closing) and 61.9% for the years ended December 31, 2013 and 2012, respectively, a decrease of approximately 6.1%. This decrease in gross margin is due to an increase in obsolete and slow moving inventory as well as an increase in the number of products subject to profit sharing arrangements.

Selling, General and Administrative Expenses (SG&A). SG&A expenses were approximately $62,551,000 and $35,452,000 for the years ended December 31, 2013 and 2012, respectively, an increase of approximately $27,099,000, or 76.4%.

Overall compensation expense represented approximately $26,142,000, or 41.7%, and $17,267,000, or 48.7%, of total selling, general and administrative expenses for the years ended December 31, 2013 and 2012, respectively. The increase of approximately $8,876,000 in overall compensation expense is primarily due to the addition of Cypress employees effective January 1, 2013, and the addition of Pernix Manufacturing employees in July 2012 offset by decreases resulting from the reorganization of the consolidated company and the elimination and consolidation of

certain management level and staff positions.

Other selling, general and administrative expenses were approximately $36,409,000 and $18,185,000 for the years ended December 31, 2013 and 2012, respectively, an increase of approximately $18,224,000. This increase was primarily due to the incremental increase of the SG&A expenses from the acquisitions of Cypress, Somaxon and the manufacturing facility. In addition, during the year ended December 31, 2013, Pernix recorded the fair value of the settlement of the Texas Medicaid litigation of approximately $9,780,000.

Research and Development Expenses (R&D). R&D expenses were approximately $4,798,000 and $732,000 for the years ended December 31, 2013 and 2012, respectively. The increase of $4,066,000 was primarily due to expenses incurred related to the in-process research and development, including the compensation of the individuals in the R&D department, acquired in connection with the acquisition of Cypress and furthering the development of a late-stage pediatric product.

Loss from the Operations of the Joint Venture. The loss from the operations of our former joint venture with SEEK was approximately $0 and $240,000 for the years ended December 31, 2013 and 2012. The joint venture was terminated in May 2012. For further discussion, see Note 11, Investment in Joint Venture, to our consolidated financial statements included in this Annual Report on Form 10-K.

Depreciation and Amortization Expense. Depreciation expense was approximately $672,000 and $324,000 for the years ended December 31, 2013 and 2012, respectively. Amortization expense was approximately $8,004,000 and $2,878,000 for the years ended December 31, 2013 and 2012, respectively. The increase in amortization expense of approximately $5,126,000 is primarily due to the addition of intangible assets in the acquisitions of Cypress and Somaxon. For further discussion, see Note 12, Intangible Assets and Goodwill, to our consolidated financial statements included in this Annual Report on Form 10-K.

Change in the Fair Value of the Put Right. During the year ended December 31, 2013, we recorded increases in the value of the put right of approximately $8,361,000. The put right was waived pursuant to a settlement with the former shareholders of Cypress and the related gain of approximately $11,726,000 was included in Gain on Contingent Consideration and Put Right on the income statement to our consolidated financial statements included in this Annual Report on Form 10-K.

Change in the Fair Value of the Contingent Consideration. During the year ended December 31, 2013, we recorded decreases in the value of the contingent consideration of approximately $805,000. Approximately $3,934,000 of the contingent consideration was reclassed to the returns allowance and approximately $1,050,000 was reclassed to goodwill in connection with the resolution of certain indemnification claims included in the settlement with the former shareholders of Cypress. Approximately $4,542,000 in contingent consideration was included in Gain on Contingent Consideration and Put Right on the income statement to our consolidated financial statements included in this Annual Report on Form 10-K as we do not expect the trigger any of the future milestones that would require payment of this contingent consideration.

Gain on Sale of Investment. On June 14, 2013, the Company sold all its shares of TherapeuticsMD for approximately $4,605,000 in cash proceeds, recognizing a gain on the investment of approximately $3,605,000.

Interest Expense, net. Interest expense was approximately $4,182,000 and $169,000 for the years ended December 31, 2013 and 2012, respectively. The increase in interest expense of approximately $4,013,000 was primarily due to the interest and related financing costs from the Amended and Restated Credit Agreement. Interest income was approximately $134,000 and $74,000 for the years ended December 31, 2013 and 2012, respectively. For further discussion, see Note 15, Debt and Lines of Credit, to our consolidated financial statements included in this Annual Report on Form 10-K.

Comparison of the Year Ended December 31, 2012 and 2011

Net Revenues. Net revenues were approximately $61,313,000 and $60,607,000 for the years ended December 31, 2012 and 2011, respectively, an increase of approximately $706,000, or 1.2%. The increase in net revenues during the year ended December 31, 2012 was primarily due to a decrease in deductions from revenue of approximately $86,000 and the addition of the manufacturing revenue from Pernix Manufacturing of approximately $5,424,000, partially

offset by a decrease in gross product sales of approximately $3,792,000 and a decrease in co-promotion and other revenue of approximately $1,012,000. The decrease in gross product sales was primarily due to the phasing out of our legacy cough and cold products. The decrease in the deductions from revenue was primarily due to the decrease in the allowance from Medicaid rebates as a result of changes in Medicaid coverage on certain of our products and decreases in customer chargebacks and administrative fees due primarily to more direct sales to retailers, partially offset by increases in point of sales discounts, the allowances for coupon redemption and the allowance for product returns.

Allowances for Product Returns, Medicaid Rebates, Price Adjustments (chargebacks, rebates, vendor fees, coupons and point-of-sale discounts), and Prompt Pay Discounts. Product returns allowances are based on the products' expiration dates, which are generally 15 to 36-months from the date the product was originally sold. For the years ended December 31, 2012 and 2011, product returns allowances were approximately $7,266,000, or 8.8%, of gross product sales, and $5,283,000, or 6.1%, of gross product sales, respectively. The increase in the product returns allowances as a percentage of gross product sales was primarily due to changes in Medicaid coverage in 2012 that reduced Medicaid prescriptions of our products resulting in overstocked units that were returned as well as higher returns on a product with a 15-month shelf life that was launched in June 2011.

Government program rebates were approximately $6,614,000, or 8.0% of gross product sales, and $11,106,000 or 12.8% of gross product sales, respectively, for the years ended December 31, 2012 and 2011. The liability for government program rebates is estimated based on historical and current rebate redemption and utilization rates contractually submitted by each state's program administrator and assumptions regarding future government program utilization. The decrease in rebates as a percentage of gross product sales was primarily due to changes in Medicaid coverage on certain of our products in 2012.

Price adjustments were approximately $15,096,000, or 18.4% of gross product sales and $12,611,000, or 14.5% of gross product sales, respectively, for the years ended December 31, 2012 and 2011. The increase in price adjustments as a percentage of gross product sales was due primarily to an increase in coupon utilization on our products. Rebates and chargebacks are not typically a component of customer contracts for brand products so price adjustments are primarily impacted by generic sales.

Prompt pay discounts taken were approximately $1,713,000, or 2.0% of gross product sales and $1,775,000, or 2.0% of gross product sales, for the years ended December 31, 2012 and 2011, respectively. Approximately $728,000 and $393,000 in accrued allowances for prompt pay discounts was netted against accounts receivable at December 31, 2012 and 2011, respectively.

Cost of Sales. Cost of sales was approximately $23,377,000, or 28.5% of gross product sales, and $20,921,000, or 24.1% of gross product sales, for the years ended December 31, 2012 and 2011, respectively, an increase of approximately $2,456,000, or 11.7%. The increase in cost of sales was primarily due to approximately $2,508,000 in product manufacturing costs incurred by Pernix Manufacturing on sales to external customers, approximately $1,730,000 in increased expense from co-promotion and other profit sharing arrangements on OMECLAMOX-PAK® (launched in June 2012) and certain generic products (launched during the fourth quarter of 2011), and a decrease of approximately $1,580,000 in cost of goods rebates as a result of the restructure of the NATROBA agreement. This increase was partially offset by a decrease of approximately $1,928,000 in the costs of product sales resulting from the decrease in gross product sales and a decrease of approximately $1,283,000 in inventory write-offs.

Gross Margin. Gross profit margin on the sale of our products was 65% and 69% for the years ended December 31, 2012 and 2011, respectively. The decrease in gross profit margin is primarily due to the sale of lower margin products and profit sharing arrangements with various parties. For additional information on our gross profit margin, see Note 16, Concentrations, to our consolidated financial statements included in this Annual Report on Form 10-K.

Selling, General and Administrative Expenses (SG&A). SG&A expenses were approximately $35,452,000 and $22,538,000 for the years ended December 31, 2012 and 2011, respectively, an increase of approximately $12,914,000, or 57.3%. Pernix Manufacturing SG&A expense contributed approximately $3,503,000, costs related to the acquisitions of Cypress, Somaxon and GSL contributed approximately $1,001,000 and our OTC division, which was created in July 2012, contributed approximately $312,000 to this increase. In addition, litigation expense increased approximately $1,241,000 for the year ended December 31, 2012, consulting and professional fees increased approximately $1,137,000, advertising and marketing costs increased approximately $1,013,000 and sample costs increased approximately $687,000 (due in part to the launch of OMECLAMOX-PAK® in June 2012). The remaining increase in SG&A expenses of approximately $4,020,000 was due to increases in employee carrying costs (such as travel, vehicle, technology, etc. for the addition of certain key positions in December 2011 and the hiring of additional gastroenterology sales representatives to market OMECLAMOX-PAK® in May 2012), coupon program fees, marketing research, regulatory and license fees, insurance, leases, sales reporting expenses, information technology and software implementation expenses, stock compensation expense, certain public company costs, investor relations expenses and other expenses.

Overall compensation expense represented approximately $14,884,000, or 42.0%, and $13,054,000, or 57.9%, of total SG&A for the years ended December 31, 2012 and 2011, respectively. The increase in overall compensation expense is primarily due to an increase in stock compensation expense, the addition of Pernix Manufacturing employees in July 2012, the addition of certain positions in December 2011 and the hiring of additional sale representatives to market OMECLAMOX-PAK® in May 2012, partially offset by a decrease in bonus and incentive compensation.

Research and Development Expenses (R&D). R&D expenses were approximately $732,000 and $922,000 for the years ended December 31, 2012 and 2011, respectively. R&D expenses during the year ended December 31, 2012 were primarily related to development of the prescription product for the pediatrics market pursuant to a product development agreement. R&D expenses for the year ended December 31, 2011 were primarily due to the launch of a new generic product in 2011. Other research and development costs during the periods relate to the testing of product durability.

Loss from the Operations of the Joint Venture. The loss from the operations of our former joint venture with SEEK was approximately $240,000 and $814,000 for the years ended December 31, 2012 and 2011, respectively, which represents primarily research and development costs related to the development of a non-codeine antitussive drug designed to address the serious need for a safer and more effective, non-opiod treatment for persistent cough. The joint venture was terminated in May 2012. For further discussion, see Note 11, Investment in Joint Venture, to our consolidated financial statements included in this Annual Report on Form 10-K.

Depreciation and Amortization Expense. Depreciation expense was approximately $324,000 and $97,000 for the years ended December 31, 2012 and 2011, respectively. Amortization expense was approximately $2,878,000 and $2,205,000 for the years ended December 31, 2012 and 2011, respectively. The increase in amortization expense of approximately $673,000, or 30.5%, is due to the addition of intangible assets in the acquisition of GSL and other licenses acquired in 2012 (including the license for OMECLAMOX-PAK®). For further discussion, see Note 12, Intangible Assets and Goodwill, to our consolidated financial statements included in this Annual Report on Form 10-K.

Interest Expense, net. Interest expense was approximately $169,000 and $212,000 for the years ended December 31, 2012 and 2011, respectively, related to our line of credit and insurance financing arrangements. Interest income was approximately $74,000 and $41,000 for the years ended December 31, 2012 and 2011, respectively.

Liquidity and Capital Resources

Sources of Liquidity

Pernix’s net (loss) income was approximately ($25,635,000), $(1,410,000) and $8,348,000 for the years ended December 31, 2013, 2012 and 2011, respectively.

Pernix requires cash to meet its operating expenses and for research and development, capital expenditures, acquisitions, and in-licenses of rights to products. To date, Pernix has funded its operations primarily from product sales, co-promotion agreement revenues, proceeds from equity offerings and debt facilities.

As further described below, recent events significantly impacting our liquidity and capital resources include:

- the settlement of all claims brought against us by the former shareholders (the “Plaintiff Shareholders”) of Cypress and all claims brought against the Plaintiff Shareholders by Cypress in connection with the purchase of Cypress;
- the settlement with the Attorney General of the State of Texas of all claims arising from certain actions by Cypress under the Texas Medicaid Fraud Prevention Act prior to its acquisition by the Company;
- the issuance of $65 million aggregate principal amount of Convertible Senior Notes due 2019; and
- the Amended Credit Agreement with Midcap which provides for the addition of a $20 million uncommitted accordion feature to the lenders’ existing $20 million revolving loan commitment.

Settlement with Former Shareholders of Cypress. A Stipulation of Dismissal was filed with the United States District Court for the Southern District of Texas (Houston Division) on January 29, 2014 in connection with the settlement of all claims brought against us by the former shareholders (the "Plaintiff Shareholders") of Cypress and all claims brought against the Plaintiff Shareholders by Cypress in connection with the purchase of Cypress by us pursuant to the Securities Purchase Agreement by and among the Company, Cypress and the Plaintiff Shareholders (the "Purchase Agreement"). As part of the settlement, Pernix has agreed to pay $1,330,000 to the Plaintiff Shareholders on or before February 7, 2014, which amount was accrued at the time of the Cypress acquisition as a contingent consideration in our financial statements. This payment was made according to these terms. In exchange for this payment, both parties released all claims against the other parties, which includes the Plaintiff Shareholders waiving any rights to the put obligation of the Company included in the Purchase Agreement. Additionally, this payment repays in full all currently existing obligations by us to fund the escrow account or to pay the holdback amount under the Purchase Agreement. The settlement also modified the language relating to the milestone payment payable to the Plaintiff Shareholders pursuant to the Purchase Agreement but still reflects a one-time payment of $5,000,000, payable in cash or stock, upon the achievement of one of such milestones.

Texas Attorney General Medicaid Investigation. We reached an agreement with the Attorney General of the State of Texas to settle all claims arising from certain actions by Cypress under the Texas Medicaid Fraud Prevention Act prior to its acquisition by us in connection with a Civil Investigative Demand made on Cypress. As part of the settlement, we have agreed to pay $12,000,000 to the State of Texas, which amount was accrued, net of a discount to fair value of approximately $2,220,000, in our financial statements at December 31, 2013 and recorded as an expense during the quarter ended December 31, 2013. An initial payment of $2,000,000 was due and payable within ten business days of the effective date of the final settlement agreement (the "Effective Date") and was paid accordingly. Thereafter, we will make subsequent payments of $2,000,000 on each of the first five anniversaries of the Effective Date.

Note Offering. On February 21, 2014, we issued $65 million aggregate principal amount of our 8.00% Convertible Senior Notes due 2019 (the "Notes") in accordance with each of the Securities Purchase Agreements (the "Securities Purchase Agreements"), dated February 4, 2014 by and between the Company and the investors party thereto (the "Investors"). We anticipate using the net proceeds from the issuance of Notes for the acquisition of accretive specialty products, as well as for working capital and general corporate purposes. The Notes are governed by the terms of an indenture (the "Indenture"), dated as of February 21, 2014, between the Company and Wilmington Trust, National Association, as trustee (the "Trustee"). The Notes are the senior unsecured obligations of the Company and bear interest at a rate of 8.00% per annum, payable quarterly in arrears on March 15, June 15, September 15 and December 15, beginning on June 15, 2014. The Notes will mature on February 15, 2019, unless earlier converted or repurchased. The Notes will be convertible into shares of our common stock, par value $0.01 per share (the "Common Stock"), at an initial conversion rate of 277.7778 shares of Common Stock per $1,000 principal amount of the Notes, which corresponds to an initial conversion price of approximately $3.60 per share of Common Stock and represents a conversion premium of approximately 72% based on the last reported sale price of the Common Stock of $2.09 on February 4, 2014, the date upon which the Securities Purchase Agreements were entered. The conversion rate is subject to adjustment from time to time upon the occurrence of certain events, including, but not limited to, the issuance of stock dividends, payment of cash dividends and the below-market-price issuance of Common Stock. If, upon the occurrence of a change of control, as described in the Indenture, a holder elects to convert its Notes in connection with such change of control, such holder may be entitled to an increase in the conversion rate as described in the Indenture. To the extent such increase in the conversion rate would result in the conversion price of the Notes to be less than $2.3278 per share (subject to adjustment) and equal to or greater than $2.09 per share (subject to adjustment), we will be obligated to deliver cash in lieu of any share that was not delivered on account of such limitation. We may not redeem the Notes prior to the maturity date and no "sinking fund" is provided for the Notes, which means that we are not required to periodically redeem or retire the Notes. Upon the occurrence of a change of control, as described in the Indenture, holders of the Notes may require us to repurchase for cash all or part of their Notes at a repurchase price equal to 100% plus a specified percentage (that is initially 40% and declines over the life of the notes) of the principal amount of the Notes to be repurchased, plus accrued and unpaid interest.

In connection with the issuance of Notes, on February 21, 2014, we and funds managed by each of Athyrium Capital Management and Cetus Capital entered into Representation Agreements (the "Representation Agreements"), pursuant to which we agreed to amend the Indenture to increase the interest rate on the Notes to 11.00%, if (i) prior to the 2014 annual shareholders' meeting (a) any of Doug Drysdale, Steven Elms or Michael Pearce ceases to be a member of our board of directors without each of such Investors' prior written consent, except in the event of death or disability or (b) one of such Investors has designated one other director and such person has not been appointed to our board of directors within five business days of such notice or (ii) on any date prior to the earlier of the date of our third annual shareholders' meeting that occurs after the date of Representation Agreements and the date upon which the Notes held by each such Investor are convertible into less than 5% of our Common Stock, (a) the number of members on our board of directors exceeds five, unless such increase was approved by each such Investor's designee, (b) with respect to any election of directors by the our shareholders, we fail to nominate, our board of directors fails to recommend, or our shareholders fail to elect, one director designated by each such Investor, as notified by each such Investor to the

Company at least ten business days prior to the filing of any proxy statement relating to the election of directors, provided that such Investor designee satisfies certain nominating criteria described in the Representation Agreements or (c) any such designee of such Investor dies, becomes disabled, retires, resigns, is removed or otherwise ceases to be a director, and such Investor designates a replacement therefor by written notice to us and the other Board members fail to appoint such replacement designee within ten business days provided that such Investor designee satisfies certain nominating criteria described in the Representation Agreements; provided that following any subsequent appointment of such Investor's designee to our board of directors, we shall be permitted to reduce the interest rate for the Notes to 8.00% upon delivery of an officer's certificate to the trustee for the Notes stating that the condition for such reduction has been satisfied.

Also in connection with the issuance of the Notes, on February 21, 2014, we and the Investors entered into Registration Rights Agreements (the "Registration Rights Agreements"), pursuant to which we agreed to file a resale registration statement for the resale of the Common Stock underlying the Notes no later than December 31, 2018. The Investors were also given certain demand registration rights and "piggyback" registration rights as more fully described in the Registration Rights Agreements.

MidCap Revolver Amendments. On February 21, 2014, in connection with the Notes offering, we entered into Amendment No. 1 to the Amended and Restated Credit Agreement (the "Amendment" and together with the Amended and Restated Credit Agreement, as amended by the Amendment, the "Amended Credit Agreement") with MidCap Funding IV, LLC, as Agent and as a lender ("MidCap"), and the other lenders from time to time parties thereto. In addition to allowing for the Note issuance, the Amendment provides for the addition of a $20 million uncommitted accordion feature to the lenders' existing $20 million revolving loan commitment. Pursuant to the Amendment, MidCap and the other lenders released their liens on certain of our assets. The obligations under the Amended Credit Agreement are secured by a first priority security interest in our accounts, inventory, deposit accounts, securities accounts, securities entitlements, permits and cash.

The covenants contained in the Amended Credit Agreement require us to maintain a minimum amount of EBITDA and net invoiced revenues unless we demonstrate minimum liquidity of at least $30 million. The Amended Credit Agreement continues to include customary covenants for a secured credit facility, which include, among other things, (a) restrictions on (i) the incurrence of indebtedness, (ii) the creation of or existence of liens, (iii) the incurrence or existence of contingent obligations, (iv) making certain dividends or other distributions, (v) certain consolidations, mergers or sales of assets and (vi) purchases of assets, investments and acquisitions; and (b) requirements to deliver financial statements, reports and notices to the Agent and the other lenders, provided that, the restrictions described in (a)(i)-(vi) above are subject to certain exceptions and permissions limited in scope and dollar value. The Amended Credit Agreement also contains customary representations and warranties and event of default provisions for a secured credit facility.

In connection with the Amendment, we entered into an Amended and Restated Security and Pledge Agreement (the "Amended and Restated Security Agreement") with MidCap as Agent. The Amended and Restated Security Agreement amends and restates the Security and Pledge Agreement, dated as of December 31, 2012, that we entered into with MidCap Funding V, LLC (the "Original Security Agreement"). The Amended and Restated Security Agreement creates a security interest in favor of MidCap, for the benefit of the lenders from time to time parties to the Amended and Restated Security Agreement, in our accounts, inventory, deposit accounts, securities accounts, securities entitlements, permits and cash as security for our repayment of our obligations under the Amended Credit Agreement.

Under the Amended and Restated Credit Agreement effective May 7, 2013, our borrowing base on the revolving loan commitment is equal to (A) 85% of eligible accounts, plus (B) 50% of eligible inventory, minus (C) certain reserves and/or adjustments, subject to certain conditions and limitations. Notwithstanding the foregoing, the Amended and Restated Credit Agreement provided for an advance of up to $3 million in excess of our borrowing base until June 8, 2013, at which time all excess amounts were repaid. Pursuant to the terms of the Amended and Restated Credit Agreement, the closing of the sale of the Cypress assets triggered a requirement by us to repay the term loan included in the Amended and Restated Credit Agreement. At the closing of the sale of these assets as further described below, we paid approximately $7.7 million from the sale proceeds to MidCap in fulfillment of this requirement, and as a result, the term loan has been repaid in full. As of March 12, 2014, the outstanding balance under the revolver was $8.0 million.

The loans under this facility bear interest at a rate equal to the sum of the LIBOR rate (with a floor of 1.5%) plus an applicable margin of 7.50% per annum. Pursuant to the Amended and Restated Credit Agreement, the Company paid certain customary fees to the administrative agent and lenders.

Under the Amended and Restated Credit Agreement, the revolving loan will be paid based on our cash receipts. In addition, we are able to voluntarily prepay outstanding amounts under the revolving loan commitment at any time, subject to certain prepayment penalties.

Disposition of Certain Cypress Assets. As described in Note 1, Company Overview, and Note 5, Disposition of Certain Cypress Assets, to our consolidated financial statements included in this Annual Report on Form 10-K, on September 11, 2013, we closed on the sale of certain generic assets and ANDAs owned by our subsidiary, Cypress, to Breckenridge Pharmaceutical, Inc. for $30 million. Under the terms of the agreement, Breckenridge paid us $20 million in an upfront payment and $9.7 million of which is to be paid in two equal payments over the next two years. The assets include seven previously marketed products, eight Abbreviated New Drug Applications (ANDAs) filed at the FDA, and certain other ANDAs in various stages of development and the transfer of $1.0 million in inventory.

Pernix has an effective shelf registration statement on Form S-3 filed with the SEC under which we may offer from time to time any combination of debt securities, common and preferred stock and warrants for aggregate proceeds of up to $75,000,000, of which $29,000,000 remains available for issuance.

Cash Flows

The following table provides information regarding Pernix's cash flows for the years ended December 31, 2013, 2012 and 2011 (in thousands).

	Year Ended December 31, (in thousands)		
Cash (used in) provided by	2013	2012	2011
Operating activities	$(6,532)	$(1,926)	$9,397
Investing activities	23,387	(64,897)	(2,175)
Financing activities	(24,231)	55,295	19,069
Net increase (decrease) in cash and cash equivalents	(7,376)	$(11,528)	$26,291

Net Cash (Used In) Provided By Operating Activities

Net cash used in operating activities for the years ended December 31, 2013 and 2012 was approximately $(6,532,000) and $(1,926,000), respectively. Net cash used in operating activities for the year ended December 31, 2013 primarily reflected Pernix's net loss of approximately $25,635,000, adjusted by non-cash expenses totaling approximately $19,773,000, offset by a non-cash deferred income tax benefit of approximately $22,516,000 and approximately $21,846,000 in net changes in accounts receivable, inventories, accrued expenses, and other operating assets and liabilities. Non-cash expenses for the year ended December 31, 2013 included depreciation of approximately $672,000, amortization of intangibles and interest accretion on contingent consideration of approximately $8,004,000, amortization of deferred financing costs of approximately $1,295,000, stock compensation expense of approximately $2,048,000, stock option expense for options issued to ParaPRO of approximately $548,000, the change in the fair value of contingent consideration, including the put right, of approximately $7,556,000, the impairment charge on certain intangible assets of approximately $19,429,000, the loss on disposal of software and equipment of approximately $208,000, offset by accretion of interest on notes receivable of approximately $114,000, gain on the sale of certain stock held as an investment of approximately $3,605,000 and the gain on the contingent consideration, including the put right, resulting primarily from the settlement with the former shareholders of Cypress of approximately $16,269,000.

The cash flow used in operating activities was offset by cash inflows from our receivables for which the balance decreased by approximately $12,163,000 from the year ended December 31, 2012 to the year ended December 31, 2013 primarily attributable to the divesture of certain Cypress generic products, the discontinuation of certain legacy cough and cold products and certain products being on backorder at December 31, 2013. Inventories decreased approximately $7,406,000 from December 31, 2012 to December 31, 2013 attributable to the same reasons as the accounts receivable decrease. Prepaid expenses and other assets increased by approximately $2,180,000 from December 31, 2012 to December 31, 2013 due to coupon program funding and product related government fees.

Accounts payable decreased by approximately $3,545,000 from the year ended December 31, 2012 to the year ended December 31, 2013 due primarily to the decrease in inventory purchases as well as timing of payments. Accrued liabilities and allowances increased by approximately $7,360,000 from the year ended December 31, 2012 to the year ended December 31, 2013 primarily due to the settlement related to the Texas Attorney General Medicaid investigation offset by cash used in the payment of personnel costs and other accrued expenses.

Net cash (used in) provided by operating activities for the years ended December 31, 2012 and 2011 was approximately $(1,926,000) and $9,397,000, respectively. Net cash used in operating activities for the year ended December 31, 2012 primarily reflected Pernix's net loss of approximately $1,410,000, adjusted by non-cash expenses totaling approximately $6,807,000, partially offset by a non-cash deferred income tax benefit of approximately $1,837,000 and approximately $5,486,000 in net changes in accounts receivable, inventories, accrued expenses, and other operating assets and liabilities. Non-cash expenses for the year ended December 31, 2012 included depreciation of approximately $324,000, amortization of approximately $2,878,000, loss on disposal of assets of approximately $26,000, stock compensation expense of approximately $2,654,000, stock option expense for options issued to ParaPRO of approximately $685,000 and expenses from our former joint venture with SEEK of approximately $240,000.

Net cash provided by operating activities for the year ended December 31, 2011 primarily reflected Pernix's net income of approximately $8,347,000, adjusted by non-cash expenses totaling approximately $5,093,000, partially offset by a non-cash deferred income tax benefit of approximately $2,273,000 and approximately $1,770,000 in net changes in accounts receivable, inventories, accrued expenses and other operating assets and liabilities. Non-cash expenses included amortization of approximately $2,205,000, depreciation of approximately $97,000, an impairment charge of $380,000, stock compensation expense of approximately $1,284,000, stock option expense for options issued to ParaPRO of approximately $313,000 and expenses from our former joint venture with SEEK of approximately $814,000.

Accounts receivable increased by approximately $3,886,000 from the year ended December 31, 2011 to the year ended December 31, 2012 primarily attributable to higher generic product sales, which have longer payment terms than brand sales. Inventories decreased approximately $650,000 from December 31, 2011 to December 31, 2012 primarily as a result of lower inventory purchases in the fourth quarter of 2012. Prepaid expenses and other assets increased by approximately $180,000 from December 31, 2011 to December 31, 2012 due to prepaid product related government fees and coupon program funding.

Accounts payable increased by approximately $1,842,000 from the year ended December 31, 2011 to the year ended December 31, 2012 due primarily to the addition of GSL's accounts payable. Accrued liabilities and allowances increased approximately $2,406,000 from December 31, 2011 to December 31, 2012 primarily due to an increase in accrued allowances for sales deductions and an increase in commissions payable.

Net Cash (Used In) Provided By Investing Activities

Net cash provided by (used in) investing activities for the years ended December 31, 2013 and 2012 was approximately $23,387,000 and $(64,897,000), respectively. The cash provided by investing activities for the year ended December 31, 2013 consisted of approximately $4,605,000 in proceeds from the sale of TherapeuticsMD stock, approximately $19,588,000 in proceeds from the sale of certain Cypress assets, approximately $31,000 in proceeds from the sale of certain equipment, offset by approximately $310,000 paid to former owners of Cypress under a reimbursement obligation related to Cypress cash balances at closing and approximately $527,000 in office furniture and equipment purchases.

The cash flow used in investing activities for the year ended December 31, 2012 consisted of $2,400,000 to acquire the license for OMECLAMOX®, $5,000,000 to acquire the license from SEEK for the non-codeine antitussive drug in development, approximately $4,667,000 to acquire GSL, approximately $51,662,000 to acquire Cypress, and approximately $850,000 for the acquisition of other product licenses and purchases of software, furniture and equipment of approximately $326,000. The cash flow from investing activities for the year ended December 31, 2012 of approximately $2,176,000 consisted of a $1,000,000 additional investment in our joint venture with SEEK, a $1,000,000 investment in TherapeuticsMD for which we received 2,631,579 shares of its common stock, and approximately $176,000 in purchases of equipment and furniture.

The cash flow from investing activities for the year ended December 31, 2011 of approximately $2,176,000 consisted of a $1,000,000 additional investment in our joint venture with SEEK, a $1,000,000 investment in TherapeuticsMD for which we received 2,631,579 shares of its common stock, and approximately $176,000 in purchases of equipment and furniture.

Net Cash (Used In) Provided By Financing Activities

Net cash used in financing activities for the year ended December 31, 2013 was approximately $(24,231,000) compared to net cash provided by financing activities for the year ended December 31, 2012 of approximately

$55,294,000. The cash used in financing activities for the year ended December 31, 2013 consisted of approximately (i) $12,497,000 in prepayments of the term loan that had previously been outstanding under our original credit agreement with MidCap, (ii) $10,000,000 in principal payments on the new term loan, (iii) $2,656,000 in payments net of borrowings on the Amended and Restated Credit Agreement, (iv) $1,700,000 in payments on contracts payable, (v) $144,000 in payments under our mortgage and certain capital leases, (vi) $147,000 of tax benefits on stock-based awards and (v) $229,000 in payments of an employees' income tax liability from the vesting of restricted stock, offset by approximately $2,881,000 in cash on-hand at Somaxon on the day of closing, and $261,000 in net proceeds from the issuance of stock to employees.

Net cash provided by financing activities for the year ended December 31, 2012 was approximately $55,294,000, which represented approximately (i) $23,751,000 in net proceeds from our controlled equity offering, (ii) $315,000 tax benefit on stock-based awards, and (iii) $835,000 in net proceeds from the issuance of stock to employees and board members, partially offset by approximately (1) $6,000,000 in payments on our line of credit, (2) $40,055,000, net of capitalized loan costs of approximately $1,945,000, in proceeds from our original credit agreement with MidCap, (3) $3,540,000 in payments on contracts and (4) $121,000 in payments on the Pernix Manufacturing mortgage and capital lease obligations.

Net cash provided by financing activities for the year ended December 31, 2011 was approximately $19,069,000, which represented approximately (i) $1,000,000 in proceeds from our revolving line of credit, (ii) $19,260,000 in net proceeds from the registered equity offering completed on July 27, 2011, (iii) $500,000 in cash released from a letter of credit and transferred from restricted to unrestricted cash, (iv) $113,000 in payment received on notes receivable, (v) $137,000 tax benefit on stock-based awards, and (vi) $289,000 in proceeds from the issuance of stock under our employee stock purchase and incentive stock plans, partially offset by (1) approximately $1,200,000 in installment payments on the repurchase of stock from a related party, (2) $1,000,000 for the last scheduled installment on the acquisition of Gaine, and (3) $30,000 in payments under other installment contracts payable.

As of March 12, 2014, Pernix has approximately $64.6 million in cash and approximately $32.0 million of potential borrowings under our revolving line of credit subject to our borrowing base capacity. Pernix's future capital requirements will depend on many factors, including:

- the level of product sales of its currently marketed products and any additional products that Pernix may market in the future;
- the extent to which Pernix acquires or invests in products, businesses and technologies;
- the level of inventory purchase commitments under supply, manufacturing, license and/or co-promotion agreements;
- the scope, progress, results and costs of development activities for Pernix's current product candidates;
- the costs, timing and outcome of regulatory review of Pernix's product candidates;
- the number of, and development requirements for, additional product candidates that Pernix pursues;
- the costs of commercialization activities, including manufacturing, product marketing, sales and distribution;
- the costs and timing of establishing manufacturing and supply arrangements for clinical and commercial supplies of Pernix's product candidates and products;
- the working capital funding required by the manufacturing plant that Pernix acquired on July 2, 2012;
- the extent to which Pernix chooses to establish collaboration, co-promotion, distribution or other similar arrangements for its marketed products and product candidates; and
- the costs of preparing, filing and prosecuting patent applications and maintaining, enforcing and defending claims related to intellectual property owned by or licensed to Pernix.

A significant portion of the Company's planned expenditures for 2014 are expenses in connection with our development programs, notably our planned OTC launch for a pediatric product which is expected to end phase II development in 2015 and our planned Rx to OTC switch for Silenor. As of March 12, 2014, Pernix believes that its existing cash and cash from operations will be sufficient to continue to fund its existing level of operating expenses, current development activities and general capital expenditure requirements through 2014.

Off-Balance Sheet Arrangements

Since its inception, Pernix has not engaged in any off-balance sheet arrangements, including structured finance, special purpose entities or variable interest entities.

Effects of Inflation

Pernix does not believe that inflation has had a significant impact on its revenues or results of operations since inception.

Contractual Obligations

Contractual obligations represent future cash commitments and liabilities under agreements with third parties and exclude contingent contractual liabilities for which we cannot reasonably predict future payment, including contingencies related to potential future development, financing, royalty payments and/or scientific, regulatory, or commercial milestone payments under development agreements. Further, obligations under employment agreements contingent upon continued employment are not included in the table below. The following table summarizes our contractual obligations as of December 31, 2013 (in thousands):

		Payments Due by Period			
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Operating leases(1)	$513	$470	$43	$—	—
Professional services agreements(2)	1,099	1,047	52	—	—
Supply agreements and purchase obligations(3)	577	577	—	—	—
Long-term debt obligations(4)	1,862	228	456	456	722
Settlement obligations(5)	15,500	2,750	5,500	5,000	2,250
Total contractual obligations	$19,551	$5,072	$6,051	$5,456	$2,972

(1) Operating leases include minimum payments under leases for our facilities and certain equipment.

(2) Professional service agreements include agreements with a specific term for consulting, information technology, telecom and software support, data and sales reporting tools and services.

(3) Supply agreements and purchase obligations include fixed or minimum payments under manufacturing and supply agreements with third-party manufacturers and other providers of goods and services. The contractual obligations table set forth above does not reflect certain minimum sales requirements related to our co-promotion agreements. Our failure to satisfy minimum sales requirements under our co-promotion agreements generally allows the counterparty to terminate the agreement and/or results in a loss of our exclusivity rights. In addition to minimum sales requirements under our co-promotion agreements, the table above does not include commitments under open purchase orders for inventory that can be cancelled without penalty, which are approximately $6.0 million.

(4) The long-term debt obligations represent the mortgage on certain real estate assumed in the acquisition of Pernix Manufacturing.

(5) Settlement obligations represent remaining payments due under settlement agreements.

See Notes 15, Debt and Lines of Credit, 17, Stockholder’s Equity, and 22, Commitments and Contingencies, to our consolidated financial statements included in this Annual Report on Form 10-K for additional information.

In addition to the material contractual cash obligations included the chart above, we have committed to make potential future milestone payments to third parties as part of licensing, distribution, acquisition and development agreements. Payments under these agreements generally become due and payable only upon achievement of certain development,

regulatory and/or commercial milestones. Because the achievement of milestones is neither probable nor reasonably estimable, such contingent payments have not been recorded on our consolidated balance sheets and have not been included in the table above. See Notes 4, Business Combinations and Other Acquisitions, and 10, Intangible Assets and Goodwill, to our consolidated financial statements included in this Annual Report on Form 10-K for additional information.

Recent Accounting Pronouncements

See Note 2, Summary of Significant Accounting Policies, to our consolidated financial statements included in this Annual Report on Form 10-K.

Seasonality

Historically, the months of September through March account for a greater portion of our sales than the other months of the fiscal year. This sales pattern is likely to continue if we sell primarily cough and cold products, which are subject to seasonal fluctuations. The following table shows gross product sales by quarter for the years ended December 31, 2013, 2012 and 2011.

	Gross Product Sales (in thousands)		
	2013	2012	2011
Three months ending March 31	$22,078	$20,268	$18,252
Three months ending June 30	20,573	16,982	15,626
Three months ending September 30	18,295	20,370	23,034
Three months ending December 31	23,926	24,444	29,836
Total gross product sales	$84,872	$82,064	$86,748

ITEM 7A. QUANTITAIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The information required by this Item is contained in the financial statements set forth in Item 15 (a) under the caption “Consolidated Financial Statements and Supplementary Data” as a part of this Annual Report on Form 10-K.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

The term “disclosure controls and procedures” is defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (the “Exchange Act”). The rules refer to the controls and other procedures designed to ensure that information required to be disclosed in reports that we file or submit under the Exchange Act is (1) recorded, processed, summarized and reported within the time periods specified in the Commission’s rules and forms and (2) accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure. As of December 31, 2013, management, including the CEO and our principal financial officer, performed an evaluation of the effectiveness of our disclosure controls and procedures. Based on that evaluation, management, including the CEO and our principal financial officer, concluded that as of December 31, 2013, our disclosure controls and procedures were effective.

Management’s Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control system was designed by, or under the supervision of our CEO and principal financial officer, and were effected by our Board of Directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements.

Our management with the participation of our CEO and principal financial officer, evaluated the effectiveness of our internal control over financial reporting as of December 31, 2013. In making this evaluation, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on this assessment, management has concluded that, as of December 31, 2013, our internal control over financial reporting was effective.

Based on the most recent evaluation, our management has concluded that no change in its internal control over financial reporting occurred during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, its internal control over financial reporting.

The effectiveness of our internal controls over financial reporting as of December 31, 2013 have been audited by Cherry Bekaert, LLP an independent registered public accounting firm, as stated in their report which appears herein.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Information required by this item will be contained in our definitive proxy statement, or the Definitive Proxy Statement, to be filed with the Securities and Exchange Commission in connection with our 2014 Annual Meeting of Stockholders, which is expected to be filed not later than 120 days after the end of our fiscal year ended December 31, 2013, under the headings “Election of Directors,” “Corporate Governance,” “Executive Officers,” and “Section 16(a) Beneficial Ownership Reporting Compliance,” and is incorporated herein by reference.

We have a written Code of Conduct and Ethics that applies to our principal executive officer, principal financial officer and our principal accounting officer and every other director, officer and employee of Pernix. The Code of Conduct and Ethics is available on our Internet website at www.pernixtx.com. A copy of the Code of Conduct and Ethics will be provided free of charge by making a written request and mailing it to our corporate headquarters offices to the attention of the Investor Relations Department. If any amendment to, or a waiver from, a provision of the Code of Conduct and Ethics that applies to the principal executive officer, principal financial officer and principal accounting officer is made, such information will be posted on our Internet website within four business days at www.pernixtx.com.

ITEM 11. EXECUTIVE COMPENSATION

Information required by this item may be found in our Definitive Proxy Statement under the heading “Executive Compensation” and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

Information required by this item may be found in our Definitive Proxy Statement under the headings “Security Ownership of Certain Beneficial Owners” and “Security Ownership of Directors and Executive Officers” and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Information required by this item may be found in our Definitive Proxy Statement under the headings “The Board of Directors and Board Committees” and “Certain Relationships and Related-Party Transactions” and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

Information required by this item may be found in our Definitive Proxy Statement under the heading “Proposal to Ratify the Appointment of Independent Registered Public Accounting Firm” and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

The following documents are filed as part of this Annual Report on Form 10-K:

1. Consolidated Financial Statements and Supplementary Data

2. Financial Statement Schedules.

Schedule II –Valuation and Qualifying Accounts

All other financial statement schedules have been omitted because the required information is included in the consolidated financial statements or notes thereto or because they are not applicable or not required.

3. Exhibits.

The exhibits listed in the accompanying Index to Exhibits are filed or incorporated by reference as part of this Annual Report on Form 10-K.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Annual Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized.

PERNIX THERAPEUTICS HOLDINGS, INC.

Date: March 17, 2014

By: /s/ Douglas Drysdale
Douglas Drysdale
President & Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report on Form 10-K has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Douglas Drysdale Douglas Drysdale	President, Chief Executive Officer and Chairman (Principal Executive Officer)	March 17, 2014
/s/ Tracy S. Clifford Tracy S. Clifford	Vice President of Accounting and Corporate Controller (Principal Financial and Accounting Officer)	March 17, 2014
/s/ Michael C. Pearce Michael C. Pearce	Director	March 17, 2014
/s/ Steven A. Elms Steven A. Elms	Director	March 17, 2014
/s/ John A. Sedor John A. Sedor	Director	March 17, 2014

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Stockholders and Board of Directors
Pernix Therapeutics Holdings, Inc.
Houston, Texas

We have audited Pernix Therapeutics Holdings, Inc.'s and subsidiaries internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control—Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Pernix Therapeutics Holdings, Inc.'s ans subsidiaries management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States of America). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Pernix Therapeutics Holdings, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control—Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States of America), the consolidated balance sheets of Pernix Therapeutics Holdings, Inc. and subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of income (loss), stockholders' equity, and cash flows for each of the three-years in the period ended December 31, 2013, and the related consolidated financial statement schedule as of December 31, 2013, 2012, and 2011, and our report dated March 17, 2014 expressed an unqualified opinion.

/s/ Cherry Bekaert LLP

Atlanta, Georgia

March 17, 2014

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Stockholders and Board of Directors
Pernix Therapeutics Holdings, Inc.
Houston, Texas

We have audited the accompanying consolidated balance sheets of Pernix Therapeutics Holdings, Inc. and subsidiaries (collectively, the "Company") as of December 31, 2013 and 2012, and the related consolidated statements of income (loss) and comprehensive income (loss), stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2013. We have also audited the accompanying consolidated financial statement schedule for each of the three years in the period ended December 31, 2013 listed in the index at Item 15. These consolidated financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and schedule based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pernix Therapeutics Holdings, Inc. and subsidiaries at December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2013 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related consolidated financial statement schedule for each of the three years in the period ended December 31, 2103, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control – Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 17, 2014 expressed an unqualified opinion thereon.

/s/ Cherry Bekaert LLP

Atlanta, Georgia
March 17, 2014

PERNIX THERAPEUTICS HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	December 31, 2013	2012
ASSETS		
Current assets:		
Cash and cash equivalents	$15,646,963	$23,022,821
Accounts receivable, net	25,681,371	36,647,087
Inventory, net	13,809,929	22,014,405
Prepaid expenses and other current assets	5,878,292	3,888,117
Note receivable, net of unamortized discount of $100,582	4,749,418	—
Prepaid income taxes	1,318,446	2,024,411
Deferred income tax assets – current	9,301,000	8,118,500
Total current assets	76,385,419	95,715,341
Property and equipment, net	6,872,042	6,946,944
Other assets:		
Investments	—	5,710,526
Goodwill	42,496,592	37,160,911
Intangible assets, net	80,022,283	104,054,431
Note receivable, net of unamortized discount of $318,696	4,531,304	—
Other long-term assets	1,078,655	1,858,534
Total assets	$211,386,295	$251,446,687
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$3,443,629	$5,045,488
Accrued personnel expense	3,803,274	2,881,967
Accrued allowances	34,285,578	30,054,551
Other accrued expenses	5,532,549	5,548,084
Put option and contingent consideration - Cypress acquisition	1,330,000	6,562,169
Other liabilities	4,072,933	1,568,495
Debt – short term	16,999,687	2,286,513
Total current liabilities	69,467,650	53,947,267
Long-term liabilities		
Put option and contingent consideration – Cypress acquisition	—	7,765,511
Other liabilities	14,387,766	——
Debt – long term	1,309,767	41,349,563
Deferred income taxes	15,499,000	35,535,500
Total liabilities	100,664,183	138,597,841
Commitments and contingencies (Note 22)		
Temporary Equity		
Common stock subject to repurchase (4,427,084 shares as of December 31, 2012)	—	34,309,901
STOCKHOLDERS' EQUITY		
	371,893	288,749

Common stock $.01 par value, 90,000,000 shares authorized, 39,318,301 and 35,374,828 issued, and 37,189,351 and 33,302,018 outstanding at December 31, 2013 and 2012, respectively		
Treasury stock, at cost (2,128,950 and 2,072,810 shares held at December 31, 2013 and 2012, respectively)	(4,001,475)	(3,772,410)
Additional paid-in capital	119,553,760	58,614,226
Retained earnings (deficit)	(5,202,066)	20,433,262
Other comprehensive income	—	2,975,118
Total stockholders' equity	110,722,112	78,538,945
Total liabilities and stockholders' equity	$211,386,295	$251,446,687

See accompanying notes to consolidated financial statements

PERNIX THERAPEUTICS HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF (LOSS) INCOME AND COMPREHENSIVE (LOSS) INCOME

	Years Ended December 31,		
	2013	2012	2011
Net revenues	$84,872,087	$61,312,559	$60,606,855
Cost and expenses:			
Cost of sales	43,870,350	23,376,895	20,921,233
Selling, general and administrative expenses	62,550,591	35,451,653	22,157,966
Research and development expense	4,797,927	731,665	922,432
Loss from operations of the joint venture	—	240,195	814,351
Loss on disposal of assets, impairments of intangibles	19,637,525	—	380,000
Depreciation and amortization expense	8,676,285	3,201,483	2,302,894
Total costs and expenses	139,532,678	63,001,891	47,498,876
(Loss) Income from operations	(54,660,591)	(1,689,332)	13,107,979
Other income (expense):			
Change in fair value of put right	(8,360,889)	—	—
Change in fair value of contingent consideration	805,000	—	—
Gain on contingent consideration and put right	16,268,600	—	—
Interest expense, net	(4,048,711)	(94,823)	(171,378)
Gain on sale of investment	3,605,263	—	—
Total other (loss) income, net	8,269,263	(94,823)	(171,378)
(Loss) income before income taxes	(46,391,328)	(1,784,155)	12,936,601
Income tax (benefit) provision	(20,756,000)	(373,999)	4,589,000
Net (loss) income	(25,635,328)	(1,410,156)	8,347,601
Other comprehensive (loss) income			
Unrealized gains during period, net of tax of $(411,000), $1,061,000 and $674,000, respectively	(702,000)	1,885,750	1,089,368
Reclassification adjustment for net gains included in net loss, net of tax of $(1,332,000)	(2,273,118)	—	—
Comprehensive (loss) income	$(28,610,446)	$475,594	$9,436,969
Net (loss) income per share, basic	$(0.70)	$(0.05)	$0.35
Net (loss) income per share, diluted	$(0.70)	$(0.05)	$0.34
Weighted-average common shares, basic	36,444,161	28,146,207	23,990,734
Weighted-average common shares, diluted	36,444,161	28,146,207	24,460,291

See accompanying notes to consolidated financial statements

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PERNIX THERAPEUTICS HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Common Stock						
	Shares	Amount	Additional Paid-In Capital	Treasury Stock	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income	Total
Balance at December 31, 2010	22,627,727	$226,277	$8,934,735	$(3,751,890)	$13,495,817	$—	$18,904,939
Stock-based compensation							
Restricted stock	60,000	600	320,192	—	—	—	320,792
Stock options	—	—	861,507	—	—	—	861,507
Employee stock purchase plan	—	—	100,968	—	—	—	100,968
Issuance of stock options for services from non-employees	—	—	312,563	—	—	—	312,563
Issuance of common stock upon the exercise of stock options	27,842	279	78,122	—	—	—	78,401
Issuance of common stock in connection with employee stock purchase plan	33,568	335	210,460	—	—	—	210,795
Income tax benefit on stock based awards	—	—	137,000	—	—	—	137,000
Issuance of common stock upon registered direct offering, net of issuance costs of $255,254	3,000,000	30,000	19,229,745	—	—	—	19,259,745
Net income	—	—	—	—	8,347,601	—	8,347,601
Unrealized gain on securities, net	—	—	—	—	—	1,089,368	1,089,368
Balance at December 31, 2011	25,749,137	$257,491	$30,185,292	$(3,751,890)	$21,843,418	$1,089,368	$49,623,679
Stock-based compensation							
Restricted stock	668,057	6,681	1,037,370	—	—	—	1,044,051
Cancelled/reclass par value of	(728,333)	(7,284)	7,284				—

unvested restricted stock							
Stock options	—	—	1,546,885	—	—	—	1,546,885
Employee stock purchase plan	—	—	63,250	—	—	—	63,250
Issuance of stock options for services from non-employees	—	—	685,094	—	—	—	685,094
Issuance of common stock in lieu of cash bonus	21,252	213	199,558	—	—	—	199,771
Issuance of common stock upon the exercise of stock options	171,491	1,715	664,626	—	—	—	666,341
Forfeit of restricted common stock in payment of income tax liability	—	—	—	(20,520)	—	—	(20,520
Issuance of common stock in connection with employee stock purchase plan	26,591	266	188,502	—	—	—	188,768
Income tax benefit on stock based awards	—	—	315,000	—	—	—	315,000
Issuance of common stock upon additional public offering, net of issuance costs of $846,202	2,966,739	29,667	23,721,365	—	—	—	23,751,032
Net loss	—	—	—	—	(1,410,156)		(1,410,156)
Unrealized gain on securities, net	—	—	—	—	—	1,185,750	1,185,750
Balance at December 31, 2012	28,874,934	$288,749	$58,614,226	$(3,772,410)	$20,433,262	$2,975,118	$78,538,945
Stock-based compensation							
Restricted stock	284,875	2,848	1,533,394	—	—	—	1,536,242
Cancelled/reclass par value of unvested restricted stock	(219,322)	(2,193)	2,193	—	—	—	—
Stock options	—	—	441,134	—	—	—	441,134
Employee stock purchase plan	—	—	71,100	—	—	—	71,100
	—	—	547,807	—	—	—	547,807

Issuance of stock options for services from non-employees							
Issuance of common stock upon the exercise of stock options	40,000	400	111,200	—	—	—	111,600
Forfeit of restricted common stock in payment of income tax liability	(39,349)	(393)		(229,065)	—	—	(229,458)
Issuance of common stock in connection with employee stock purchase plan	65,868	659	149,183	—	—	—	149,842
Issuance of restricted stock in lieu of cash payment	97,654	977	161,048	—	—	—	162,025
Issuance of common stock in connection with the Somaxon acquisition	3,657,607	36,576	23,803,848	—	—	—	23,840,424
Reclass of shares (previously subject to the put right of the former Cypress shareholders in connection with the Cypress acquisition) from temporary equity	4,427,084	44,270	34,265,627	—	—	—	34,309,897
Income tax benefit on stock based awards	—	—	(147,000)	—	—	—	(147,000)
Net loss	—	—	—	—	(25,635,328)	—	(25,635,328)
Unrealized gain on securities, net	—	—	—	—	—	(2,975,118)	(2,975,118)
Balance at December 31, 2013	37,189,351	$371,893	$119,553,760	$(4,001,475)	$(5,202,066)	$—	$110,722,112

See accompanying notes to consolidated financial statements

PERNIX THERAPEUTICS HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2013	2012	2011
Cash flows from operating activities:			
Net (loss) income	$(25,635,328)	$(1,410,156)	$8,347,601
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation	671,889	323,644	97,498
Amortization of intangibles and interest accretion of contingent consideration	8,004,396	2,877,839	2,205,396
Amortization of deferred financing costs	1,294,859	—	—
Interest accretion on notes receivable	(113,723)	—	—
Impairment charge to fair value of land	—	—	380,000
Deferred income tax benefit	(22,516,000)	(1,836,329)	(2,273,000)
Gain on sale of investment	(3,605,263)	—	—
Stock compensation expense	2,048,476	2,654,186	1,283,267
Expense for stock options issued in exchange for services	547,807	685,094	312,563
Change in fair value of contingent consideration and put right	7,555,889	—	—
Gain on contingent consideration and put right	(16,268,600)	—	—
Loss on impairment of certain intangible assets	19,429,496	—	—
Loss on disposal of software and equipment	208,029	25,802	—
Loss from the operations of the joint venture	—	240,195	814,351
Changes in operating assets and liabilities, net of effects of acquisitions			
Accounts receivable	12,162,596	(3,885,502)	(5,843,120)
Income taxes	641,720	(1,335,077)	(2,237,121)
Inventory	7,406,073	(650,147)	(2,115,428)
Prepaid expenses and other assets	(2,179,790)	(179,854)	(274,384)
Accounts payable	(3,544,997)	(1,841,801)	739,570
Accrued allowances	(3,074,944)	1,543,533	6,517,735
Accrued expenses and personnel expenses	245,709	862,962	1,442,514
Other Liabilities	10,189,299	—	—
Net cash (used in) provided by operating activities	(6,532,407)	(1,925,611)	9,397,442
Cash flows from investing activities:			
Proceeds from sale of investment	4,605,263	—	—
Acquisitions of licenses	—	(7,400,000)	—
Acquisition of Cypress Pharmaceuticals (“Cypress”)	(309,589)	(51,661,505)	—
Acquisition of Great Southern Laboratories (“GSL”)	—	(4,666,964)	—
Investment in TherapeuticsMD	—	—	(1,000,000)
Investment in joint venture with SEEK	—	—	(1,000,000)
Proceeds from sale of certain Cypress assets	19,588,137	—	—
Other intangibles	—	(850,000)	—
Proceeds from sale of equipment	31,475	7,550	—
Purchase of software and equipment	(527,515)	(326,291)	(175,596)
Net cash provided by (used in) investing activities	23,387,771	(64,897,210)	(2,175,596)

Cash flows from financing activities:			
Cash acquired in connection with acquisition of Somaxon	2,880,837	—	—
Payments on original Midcap loan	(12,497,196)	—	—
Payments on term loan	(10,000,000)	—	—
Net payments on revolving credit facility	(2,655,876)	—	—
Proceeds from line of credit	—	—	1,000,000
Payments on line of credit	—	(6,000,000)	—
Proceeds from credit facility, net of capitalized loan costs	—	40,054,528	—
Payments on contracts payable	(1,700,000)	(3,540,000)	(1,230,000)
Proceeds from issuance of stock in additional offering, net of issuance costs of $846,202 and $255,254 for the years ended December 31, 2012 and 2011, respectively	—	23,751,032	19,259,746
Transfer to/from restricted cash	—	—	500,000
Payments on mortgages and capital leases	(143,971)	(120,687)	—
Principal payments received on notes receivable	—	—	113,333
Payment on acquisition obligation – Gaine	—	—	(1,000,000)
Proceeds from issuance of stock	261,442	834,589	289,196
Tax benefit on stock-based awards	(147,000)	315,000	137,000
Payment of employee income tax liability with surrender of employee restricted stock	(229,458)	—	—
Net cash (used in) provided by financing activities	(24,231,222)	55,294,462	19,069,275
Net increase (decrease) in cash and cash equivalents	(7,375,858)	(11,528,359)	26,291,121
Cash and cash equivalents, beginning of year	23,022,821	34,551,180	8,260,059
Cash and cash equivalents, end of year	$15,646,963	$23,022,821	$34,551,180
Supplemental Disclosure of Cash Flow Information:			
Cash paid for income taxes	1,265,246	$2,482,407	$8,911,190
Interest paid during the period	2,732,778	200,486	177,816
Non-cash investing and financing activities:			
Acquisition of product licenses – contract payable balance	500,000	630,000	90,000
Accrued bonus paid in unrestricted stock	—	199,770	—
Accrued severance paid in restricted common stock	142,024	—	—
Acquisition of Cypress and Somaxon – Purchase price adjustment (see Note 4)	5,412,562	—	—
Acquisition of Somaxon – Fair value of common stock	24,840,424	—	—

Effective December 31, 2012, Pernix acquired Cypress. Under the terms of the merger agreement, Cypress shareholders received approximately 4.43 million shares of Pernix common stock with a market value of $34.3 million (based on the closing price of our common stock on December 31, 2012) as part of the purchase consideration.

In July and August 2012, Pernix acquired GSL. Under the terms of the merger agreement, Pernix assumed a mortgage liability of $1.6 million and capital leases of $0.1 million as part of the purchase consideration.

See accompanying notes to consolidated financial statements

PERNIX THERAPEUTICS HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Company Overview

The Company is a specialty pharmaceutical company that sells, markets, manufactures and develops a number of branded and generic pharmaceutical products primarily indicated for sleep, bacterial infections and cough and cold conditions. The Company intends to see continued growth through the promotion of its products to physicians, healthcare practitioners and consumers, as appropriate. Since inception, the Company has engaged in a number of acquisitions and licensing arrangements to expand its product offerings. As part of its ongoing expansion strategy, the Company plans to make strategic acquisitions of products and companies, as well as develop and in-license additional products, with the aim of adding chronic, non-seasonal, specialty products to our revenue base.

The Company's branded products include CEDAX®, an antibiotic for middle ear infections, and a family of prescription treatments for cough and cold (ZUTRIPRO®, REZIRA®, and VITUZ®). The Company also markets SILENOR® (doxepin), which is approved for the treatment of insomnia characterized by difficulty with sleep maintenance and is not a controlled substance. The Company promotes its branded products through its sales and marketing organization.

The Company also currently promotes Omeclamox-Pak® through a License and Supply Agreement with GastroEntero-Logic, LLC. The Company recently entered into a promotion agreement with Cumberland Pharmaceuticals pursuant to which Cumberland began promoting Omeclamox-Pak to gastroenterologists.

The Company recently entered into an Exclusive License Agreement with Osmotica Pharmaceutical Corp. to promote its desvenlafaxine product, Khedezla™ Extended-Release Tablets, 50 and 100 mg.

The Company sells its generic products in the areas of cough and cold, pain, vitamins, dermatology, antibiotics and gastroenterology through its wholly-owned subsidiaries, Macoven Pharmaceuticals, LLC, or Macoven, and Cypress Pharmaceuticals, Inc., or Cypress.

Our wholly-owned subsidiary, Pernix Manufacturing, LLC, or Pernix Manufacturing, manufactures and packages products for the pharmaceutical industry in a range of dosage forms.
Business Combinations

On March 6, 2013, the Company acquired all of the outstanding common stock of Somaxon Pharmaceuticals, Inc. pursuant to an agreement and plan of merger dated December 10, 2012. As a result of the merger, each outstanding share of Somaxon common stock was converted into the right to receive 0.477 shares of the Company's common stock, with cash paid in lieu of fractional shares. As a result of the merger, the Company issued an aggregate of approximately 3,665,689 shares of its common stock to the former stockholders of Somaxon. At the time of acquisition, Somaxon was only marketing Silenor. The company's name was changed from Somaxon to Pernix Sleep, Inc.

On December 31, 2012, the Company completed the acquisition of Cypress Pharmaceuticals, Inc., a generic pharmaceutical company, and its subsidiary Hawthorn Pharmaceuticals, Inc., a branded pharmaceutical company, both of which were privately owned companies, collectively referred to herein as Cypress. The Company paid $52 million in cash, issued 4,427,084 shares of our common stock ("the acquisition shares") having an aggregate market value equal to approximately $34.3 million based on the closing price per share of $7.75 as reported on the NYSE MKT LLC on December 31, 2012, and agreed to pay up to $6.5 million in holdback and contingent payments, $4.5 million to be deposited in escrow on December 15, 2013 and $5.0 million in shares of our common stock upon the

occurrence of a milestone event, for an aggregate purchase price of up to $102.3 million. The Company also granted a put right to the sellers pursuant to which the sellers could have put the acquisition shares to the Company at approximately $5.38 per share, exercisable from January 1, 2014 to January 31, 2014 under certain circumstances. See Note 24, Subsequent Events, for further information.

Cypress offers a wide array of branded and generic pharmaceutical products in the areas of cough and cold, nutritional supplements, analgesics, urinary tract, women's health, pre-natal vitamins and dental health, as well as allergy, respiratory, iron deficiency, nephrology and pain management.

See Note 4, Business Combinations and Other Acquisitions, and Note 24, Subsequent Events, for further information.

Asset Dispositions

On September 11, 2013, the Company completed the sale (the "Closing") of certain of its generic assets held by Cypress (the "Assets") to Breckenridge. The sale was consummated pursuant to the terms of the Purchase Agreement, as amended. Breckenridge paid the Company $2,000,000 in cash upon execution of the Purchase Agreement, and $17,850,000, before customary closing costs of approximately $173,000, in cash at Closing, and issued two promissory notes, each in an amount of $4,850,000, with one due on the first anniversary after Closing and the other due on the second anniversary after Closing, for an aggregate purchase price of up to $29,550,000.

Effective September 11, 2013, Pernix and Cypress entered into the Joinder Agreement and First Amendment to Asset Purchase Agreement (the "Purchase Agreement Amendment") with Breckenridge Pharmaceutical, Inc., a Florida corporation ("Breckenridge"), to amend certain of the terms of the Asset Purchase Agreement (the "Purchase Agreement") between the Company and Breckenridge dated August 5, 2013. The Purchase Agreement Amendment amends the Purchase Agreement to, among other things, remove Arbinoxa, a currently marketed product, from the products being acquired by Breckenridge, add an additional product, Folic Acid 2.5 mg, an inactive product owned by Macoven, as a product to be acquired by Breckenridge, and provide for a reduction of the aggregate purchase price to $29,550,000 (which is net of a $150,000 prepayment by the Company of its share of expenses for the transfer of certain of the assets to Breckenridge).

See Note 5, Disposition of Certain Cypress Assets, for further discussion.

Note 2. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of Pernix's wholly-owned subsidiaries Pernix Therapeutics, LLC, GTA GP, Inc., GTA LP, Inc., Gaine, Inc., Macoven Pharmaceuticals LLC, Pernix Manufacturing, LLC. (acquired July 1, 2012), Respicopea, Inc. (acquired May 14, 2012), Cypress (acquired December 31, 2012) and Pernix Sleep, Inc. (acquired March 6, 2013). Respicopea, Pernix Manufacturing, Cypress and Pernix Sleep are included only for the periods subsequent to their acquisition. Transactions between and among the Company and its consolidated subsidiaries are eliminated.

Basis of Accounting

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The Financial Accounting Standards Board ("FASB") has established the FASB Accounting Standards Codification ("ASC") as the single source of authoritative GAAP.

Management's Estimates and Assumptions

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates. The Company reviews all significant estimates affecting the consolidated financial statements on a recurring basis and records the effect of any necessary adjustments prior to their issuance. Significant estimates of the Company include: revenue recognition, sales allowances such as returns on product sales, government program rebates, customer coupon redemptions, wholesaler/pharmacy discounts, product service fees, rebates and chargebacks, sales commissions, amortization, depreciation, stock-based compensation, the determination of fair values of assets and liabilities in connection with business combinations, and

deferred income taxes.

Financial Instruments, Credit Risk Concentrations and Economic Dependency

The financial instruments that potentially subject the Company to concentrations of credit risk are cash, cash equivalents, restricted cash, and accounts receivable.

The Company relies on certain materials used in its development and manufacturing processes, some of which are procured from a single source. Most of Pernix's manufacturing arrangements are not subject to long-term agreements and generally may be terminated by either party without penalty at any time. Changes in the price of raw materials and manufacturing costs could adversely affect Pernix's gross margins on the sale of its products. Changes in Pernix's mix of products sold could also affect its costs of product sales. For the year ended December 31, 2013, approximately 42% of the inventory purchases, excluding NATROBA and its generic which is purchased exclusively from ParaPRO, were from three primary suppliers, allocated 21%, 13% and 8%, respectively, and approximately 16% of the inventory purchases were manufactured by Pernix Manufacturing. For the year ended December 31, 2012, approximately, 35% of the inventory purchases, including Cypress inventory purchases but excluding NATROBA and its generic, which is purchased exclusively from ParaPRO, were from four primary suppliers, allocated 10%, 9%, 8% and 8%, respectively, and approximately 17% of the inventory purchases were manufactured by Pernix Manufacturing. For the year ended December 31, 2011, approximately 65% of our product inventory purchases were from four primary suppliers, allocated 19%, 17%, 16% and 13%, respectively. The Company believes that it has good relationships with its current suppliers, and could secure the services of alternative suppliers if necessary or required.

Trade accounts receivable are unsecured and are due primarily from wholesalers and distributors that sell to individual pharmacies. The Company primarily sold to three major customers in 2013, three in 2012 and four in 2011. See Note 18, Concentrations, for additional information. The Company continually evaluates the collectability of accounts receivable and maintains allowances for potential losses when necessary.

Cash and Cash Equivalents

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. The Company places its cash and cash equivalents on deposit with financial institutions in the United States. Included in cash and cash equivalents is approximately $3,713,000 invested by Regions Morgan Keegan Trust in short-term securities which are secured by government securities at an amount not less than 105% of the amount invested. The Federal Deposit Insurance Corporation (“FDIC”) covers $250,000 for substantially all depository accounts and temporarily provided unlimited coverage through December 31, 2012 for certain qualifying and participating non-interest bearing transaction accounts. This unlimited coverage expired January 1, 2013. The Company from time to time may have amounts on deposit in excess of the insured limits. As of December 31, 2013, the Company had approximately $11,649,000, excluding the Regions Morgan Keegan Trust funds, on deposit in such accounts which exceeded these insured amounts.

Fair Value of Financial Instruments

A financial instrument is defined as cash equivalent, evidence of an ownership interest in an entity, or a contract that creates a contractual obligation or right to deliver or receive cash or another financial instrument from another party. The Company’s financial instruments consist primarily of cash equivalents (including our Regions Trust Account which invests in short-term securities consisting of sweep accounts, money market accounts and money market mutual funds) and an investment in equity securities (TherapeuticsMD) liquidated in June 2013. The carrying values of these assets approximate their fair value.

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. The fair value hierarchy is based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value as follows:

Level 1	Quoted prices in active markets for identical assets or liabilities as of the reporting date.
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 as of the reporting date.
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.

Accounts Receivable

Accounts receivable result primarily from sales of pharmaceutical products and amounts due under revenue sharing arrangements. Credit is extended based on the customer’s financial condition, and generally collateral is not required. The Company ages its accounts receivable using the corresponding sale date of the transaction and considers accounts past due based on terms agreed upon in the transaction, which is generally 30 days for brand sales and 60 to 120 days for generic sales, depending on the customer and the products purchased.

Current earnings are charged with a provision for bad debt expense based on experience and evaluation of the individual accounts. Write-offs of accounts are charged against this allowance once the amount is determined to be uncollectible by management. Recoveries of trade receivables previously written off are recorded when recovered. At December 31, 2013 and 2012, the allowance for doubtful accounts was approximately $84,300 and $297,000, respectively, including the allowance for Cypress and Hawthorn transferred on December 31, 2012.

Inventories

Inventory is valued at the lower of cost or market, with cost determined by using the specific identification method. Allowances for slow-moving, obsolete, and/or declines in the value of inventory are determined based on management’s assessments. Sample inventory utilized for promoting the Company’s products is expensed and included in SG&A expenses when the sample units are distributed to the Company’s sales representatives.

Property, Equipment and Depreciation

Property and equipment are stated at cost. Depreciation is computed over the estimated useful lives of the assets using the straight-line method. Generally, the Company assigns the following estimated useful lives to these categories:

Category	Service Life
Leasehold improvements	Lesser of 15 years or lease term
Equipment	5-7 years
Furniture and fixtures	5-7 years
Computer software and website	3 years

Maintenance and repairs are charged against earnings when incurred. Additions and improvements that extend the economic useful life of the asset are capitalized. The cost and accumulated depreciation of assets sold or retired are removed from the respective accounts, and any resulting gain or loss is reflected in current earnings.

Goodwill

Goodwill represents the excess of cost over the fair value of identifiable net assets acquired and liabilities assumed in business combinations. FASB ASC Topic 350, Intangibles — Goodwill and Other, requires that goodwill and other intangible assets with indefinite useful lives should not be amortized, but shall be tested for impairment annually, or more frequently if circumstances indicate potential impairment. In 2011, the FASB issued Accounting Standards Update No. 2011-08 ("ASU 2011-08"), Testing Goodwill for Impairment. The revised standard allows an entity first to assess qualitatively whether it is more likely than not that a reporting unit's carrying amount exceeds its fair value, referred to in the guidance as "step zero." If an entity concludes that it is more likely than not that a reporting unit's fair value is less than its carrying amount (that is, a likelihood of more than 50 percent), the "step one" quantitative assessment must be performed for that reporting unit. ASU 2011-08 provided examples of events and circumstances

that should be considered in performing the "step zero" qualitative assessment, including macroeconomic conditions, industry and market considerations, cost factors, overall financial performance, events affecting a reporting unit or the entity as a whole and a sustained decrease in share price.

The Company evaluates goodwill for impairment on an annual basis and on an interim basis if events or changes in circumstances between annual impairment tests indicate that the asset might be impaired. There were no impairment charges recorded to goodwill during the periods presented.

Impairment of Long-Lived Assets

The Company reviews long-lived assets, such as property and equipment, and purchased intangible assets subject to amortization for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values and third-party independent appraisals, as considered necessary. If any long-lived assets are considered to be impaired, the impairment to be recognized equals the amount by which the carrying value of the asset exceeds its fair value. For the year ended December 31, 2013, the Company recorded an impairment charge of approximately $19,429,000 to intangible assets. Approximately $18,433,000 of the impairment charge to intangible assets related to in-process research and development on certain products purchased in the acquisition of Cypress. For the year ended December 31, 2012, the Company recorded no charges for impairment. For the year ended December 31, 2011, the Company recorded an impairment charge of approximately $380,000 to the value of the Company’s land based on a current market value appraisal of the property.

Intangible Assets

Intangible assets, such as patents, product licenses and product rights that are considered to have a definite useful life, are amortized on a straight-line basis over the shorter of their economic or legal useful life which ranges from three to fifteen years. Management reviews such assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

The Company has intangible assets that are recorded in connection with acquisitions at their fair value based on the results of valuation analyses. Intangible assets with estimated useful are reviewed for impairment in accordance with FASB ASC Section 360-10-35, Impairment or Disposal of Long-Lived Assets, while other intangible assets determined to have indefinite lives are reviewed for impairment annually in accordance with FASB ASC Topic 350. FASB Accounting Standards Update No. 2012-02 ("ASU 2012-02") modified the former requirement to perform an annual quantitative impairment test for indefinite-lived intangible assets. Similar to the ASU 2011-08 guidance for goodwill, it allows an organization to first perform a qualitative assessment of whether it is more likely than not that an asset has been impaired. For 2013, we began our assessment with the step zero qualitative analysis. Based upon the results of this test, there were indications of impairment. As noted above, the Company recorded an impairment charge on certain intangible assets in 2013.

Equity Method of Accounting

The Company's investment in the joint venture with SEEK was accounted for at cost and adjusted for the Company's share (46%) of the joint venture's undistributed earnings or losses through May 14, 2012. See Note 11, Investment in Joint Venture, for further discussion.

Revenue Recognition

We record revenue from product sales and co-promotion agreements when realized or realizable and earned. Revenue is realized or realizable and earned 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.

We record all of our revenue from product sales, manufacturing sales and co-promotion agreements when realized or realizable and earned. Revenue is realized or realizable and earned when all of the following criteria are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services have been performed and are billable; (3) the seller's price to the buyer is fixed or determinable; and (4) collectability is reasonably assured. We record revenue from product sales when the customer takes ownership and assumes risk of loss (free-on-board destination). At the time of a product sale, estimates for a variety of sales deductions, such as returns on product sales, government program rebates, price adjustments and prompt pay discounts are recorded.

For arrangements that involve the delivery of more than one element, each product, service and/or right to use assets is evaluated to determine whether it qualifies as a separate unit of accounting. This determination is based on whether the deliverable has "stand-alone value" to the customer. The consideration that is fixed or determinable is then allocated to each separate unit of accounting based on the relative selling price of each deliverable. The estimated selling price of each deliverable is determined using the following hierarchy of values: (i) vendor-specific objective evidence of fair value, (ii) third-party evidence of selling price (TPE) and (iii) best estimate of selling price (BESP). The BESP reflects the best estimate of what the selling price would be if the deliverable was regularly sold by us on a stand-alone basis. In most cases we expect to use TPE or BESP for allocating consideration to each deliverable. The consideration allocated to each unit of accounting is recognized as the related goods or services are delivered, limited to the consideration that is not contingent upon future deliverables. Analyzing the arrangement to identify deliverables

requires the use of judgment, and each deliverable may be an obligation to deliver services, a right or license to use an asset, or another performance obligation.

The Company recognizes revenue from milestone payments when earned, provided that (i) the milestone event is substantive in that it can only be achieved based in whole or in part on either the entity's performance or on the occurrence of a specific outcome resulting from the entity's performance and its achievability was not reasonably assured at the inception of the collaboration arrangement and (ii) the Company does not have ongoing performance obligations related to the achievement of the milestone earned and (iii) it would result in additional payments being due to the Company. Milestone payments are considered substantive if all of the following conditions are met: the milestone payment is non-refundable; achievement of the milestone was not reasonably assured at the inception of the arrangement; substantive effort is involved to achieve the milestone; and the amount of the milestone appears reasonable in relation to the effort expended, the other milestones in the arrangement and the related risk associated with the achievement of the milestone. Any amounts received under the promotion arrangement in advance of performance, if deemed substantive, are recorded as deferred revenue and recognized as revenue as the Company completes its performance obligations.

Manufacturing revenue is recognized when the finished product is shipped to the customer.

The following table sets forth a summary of Pernix's consolidated net revenues (in thousands) for the years ended December 31, 2013, 2012 and 2011.

	Year Ended December 31, (in thousands)		
	2013	2012	2011
Gross product sales	$145,055	$82,064	$85,839
Sales allowances	(67,523)	(30,689)	(30,775)
Net product sales	77,532	51,375	55,064
Manufacturing revenue	3,011	5,424	—
Co-promotion, royalty and other revenues	4,329	4,514	5,543
Net revenues	$84,872	$61,313	$60,607

Cost of Product Sales

Cost of product sales is comprised of (1) costs to manufacture or acquire products sold to customers; (2) royalty, co-promotion and other revenue sharing payments under license and other agreements granting the Company rights to sell related products; (3) direct and indirect distribution costs incurred in the sale of products; and (4) the value of any write-offs of obsolete or damaged inventory that cannot be sold. The Company acquired the rights to sell certain of its commercial products through license and assignment agreements with the original developers or other parties with interests in these products. These agreements obligate the Company to make payments under varying payment structures based on our net revenue from related products.

As part of the acquisitions of Cypress and Somaxon, the Company adjusted the predecessor cost basis increasing inventory to fair value as required by ASC No. 820, Fair Value Measurements and Disclosures. As a result, $8,600,000 (Cypress) and $695,000 (Somaxon), respectively, was recorded to adjust inventory to fair value as of December 31, 2013 and 2012, respectively. For the year ended December 31, 2013, approximately $6,359,000 of the increase in the basis of the inventory was included in cost of product sales, as the inventory was subsequently sold.

Product Returns

Consistent with industry practice, the Company offers contractual return rights that allow its customers to return short-dated or expiring products within an 18-month period, commencing from six months prior to and up to twelve months subsequent to the product expiration date. The Company's products have a 15 to 36-month expiration period from the date of manufacture. The Company adjusts its estimate of product returns if it becomes aware of other factors that it believes could significantly impact its expected returns. These factors include its estimate of inventory levels of its products in the distribution channel, the shelf life of the product shipped, review of consumer consumption data as reported by external information management companies, actual and historical return rates for expired lots, the forecast of future sales of the product, competitive issues such as new product entrants and other known changes in sales trends. The Company estimates returns at percentages up to 10% of sales of branded and generic products. Returns estimates are based upon historical data and other facts and circumstances that may impact future expected returns to derive an average return percentage for our products. In addition to the accrual on sales during the year ended December 31, 2013, the Company recorded an additional returns allowance of approximately $1,611,000 as a result of higher than expected returns due to certain recalled and discontinued products and an increase in the opening balance sheet returns allowance for Cypress of approximately $3,934,000 reclassed from contingent consideration pursuant to the settlement of certain indemnification claims among other matters. The returns reserve may be further adjusted as sales history and returns experience is accumulated on our portfolio of products or as our

portfolio of products changes. The Company reviews and adjusts these reserves quarterly. There is a time lag between the date we determine the estimated allowance and when we receive product returns and issue credits to customers. Changes in facts and circumstances arising during this interval may result in adjustments to our estimated allowance being recorded over several periods, which would impact our operating results in those periods.

Government Program Rebates

The liability for Medicaid, Medicare and other government program rebates is estimated based on historical and current rebate redemption and utilization rates contractually submitted by each state's program administrator and assumptions regarding future government program utilization for each product sold.

Price Adjustments

The Company's estimates of price adjustments, which include customer rebates, service fees, chargebacks, shelf stock adjustments, and other fees and discounts, are based on our estimated mix of sales to various third-party payors who are entitled, either contractually or statutorily, to discounts from the listed prices of our products and contracted service fees with our wholesalers. In the event that the sales mix to third-party payors or the contract fees paid to the wholesalers are different from the Company's estimates, the Company may be required to pay higher or lower total price adjustments and/or incur chargebacks that differ from its original estimates and such difference may be significant.

The Company's estimates of discounts are applied pursuant to the contracts negotiated with certain customers and are primarily based on sales volumes. The Company, from time to time, offers certain promotional product-related incentives to its customers. These programs include sample cards to retail consumers, certain product incentives to pharmacy customers and other sales stocking allowances. For example, the Company has initiated coupon programs for certain of its promoted products whereby the Company offers a point-of-sale subsidy to retail consumers. The Company estimates its liabilities for these coupon programs based on redemption information provided by a third party claims processing organization. The Company accounts for the costs of these special promotional programs as price adjustments, resulting in a reduction to revenue.

Any price adjustments that are not contractual or are non-recurring but that are offered at the time of sale or when a specific triggering event occurs, such as sales stocking allowances or price protection adjustments, are recorded as a reduction in revenue when the sales order is recorded or when the triggering event occurs. These allowances may be offered at varying times throughout the year or may be associated with specific events such as a new product launch, the reintroduction of a product or product price changes.

Prompt Payment Discount

The Company typically requires its customers to remit payments within the first 30 days for branded products and within 60 to 120 days for generics, depending on the customer and the products purchased. The Company offers its customers a prompt payment discount if they make payments within these deadlines. This discount is generally 2-3%, but may be higher in some instances due to product launches and/or industry expectations. Because the Company's customers typically take the prompt pay discount, we accrue 100% of prompt pay discounts. These discounts are based on the gross amount of each invoice at the time of our original sale to them. Earned discounts are applied at the time of payment. This allowance is recorded as a reduction of accounts receivable.

Freight

The Company includes freight costs for outgoing shipments in selling expenses except for the outgoing freight costs for Pernix Manufacturing which are included in cost of goods. Outgoing freight costs included in selling expenses were approximately $1,173,000, $376,000 and $384,000 for the years ended December 31, 2013, 2012 and 2011, respectively.

Research and Development Costs

Research and development costs in connection with the Company's internal programs for the development of products are expensed as incurred. Pernix either expenses research and development costs as incurred or will advance third parties a research and development fee which is amortized over the term of the related agreement. Research and development expenses were approximately $4,798,000, $732,000 and $922,000 during the years ended December 31, 2013, 2012 and 2011, respectively.

Segment Information

The Company markets two major product lines: a branded pharmaceuticals product line and a generic pharmaceuticals product line. These product lines qualify for reporting as a single segment in accordance with GAAP because they are similar in the nature of the products and services, production processes, types of customer, distribution methods and regulatory environment. The Company has a manufacturing subsidiary but the majority of its revenue is generated through intercompany sales and is eliminated in consolidation. It is deemed immaterial for segment reporting purposes. The Company initiated an OTC division in 2012 but this division has not marketed any products to date and, therefore, has no revenue and is currently deemed immaterial for segment reporting purposes.

Income Taxes

Deferred taxes are recognized for the tax consequences of "temporary differences" by applying enacted statutory tax rates applicable to future years to the difference between the financial statement carrying amounts and the tax basis of existing assets and liabilities. The effect on deferred taxes for a change in tax rates is recognized in income in the period that includes the enactment date. Pernix will recognize future tax benefits to the extent that realization of such benefits is more likely than not. Management has evaluated the potential impact in accounting for uncertainties in income taxes and has determined that it has no significant uncertain income tax positions as of December 31, 2013. Income tax returns subject to review by taxing authorities include 2009, 2010, 2011 and 2012.

Earnings per Share

Earnings per common share is presented under two formats: basic earnings per common share and diluted earnings per common share. Basic earnings per common share is computed by dividing net income attributable to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period, plus the potentially dilutive impact of restricted stock and common stock equivalents (i.e. stock options). Dilutive common share equivalents consist of the incremental common shares issuable upon exercise of stock options.

The following table sets forth the computation of basic and diluted net income per share:

	Year Ended December 31,		
	2013	2012	2011

Numerator:			
Net income (loss)	$(25,635,328)	$(1,410,156)	$8,347,601
Denominator:			
Weighted-average common shares, basic	36,444,161	28,146,207	23,990,734
Dilutive effect of stock options	—	—	469,557
Weighted-average common shares, diluted	36,444,161	28,146,207	24,460,291
Net (loss) income per share, basic	$(0.70)	$(0.05)	$0.35
Net (loss) income per share, diluted	$(0.70)	$(0.05)	$0.34

As of December 31, 2013 and 2012, total outstanding options are 1,604,500 and 1,711,167. Options not included above are anti-dilutive. Also, the outstanding warrants issued in connection with the acquisition of Somaxon are not included above as they are also anti-dilutive. See Note 20, Employee Compensation and Benefits, for information regarding the Company's outstanding options.

Investments in Marketable Securities and Other Comprehensive Income

The Company held investments in marketable equity securities as available-for-sale and the change in the market value gives rise to other comprehensive income. The components of other comprehensive income (loss) are recorded in the consolidated statements of income (loss) and comprehensive income (loss), net of the related income tax effect. The Company liquidated its investments in marketable equity securities in June 2013 as described below.

On October 5, 2011, the Company acquired 2.6 million shares of TherapeuticsMD for a purchase price of $1.0 million, or $0.38 per share, representing approximately 3.2% of TherapeuticsMD's outstanding common stock at that time. The Company's purchase was contingent upon TherapeuticsMD's acquisition of VitaMedMD, which occurred on October 4, 2011. In connection with the Company's purchase of shares of TherapeuticsMD, the Company also entered into a software license agreement with VitaMedMD pursuant to which VitaMedMD granted the Company an exclusive license to use certain of its physician, patient and product data gathering software in the field of pediatric medicine for a period of five years for a monthly fee of $21,700. As of December 31, 2013, the Company has not activated this software license agreement and has not paid monthly fees pursuant thereto. Cooper Collins, the Company's then Chief Executive Officer, was appointed to the board of Therapeutics MD on February 29, 2012.

On June 14, 2013, the Company sold all its shares of TherapeuticsMD for approximately $4,605,000 in cash proceeds, recognizing a gain on the investment of approximately $3,605,000. Approximately $2,300,000 of the proceeds were utilized to pay down the term loan (see Note 15, Debt).

Reclassifications

Certain reclassifications have been made to prior period amounts in our consolidated statements of income to conform to the current period presentation. These reclassifications related to the classification of cost of samples as a selling expense instead of including in cost of product sales and the classification of coupon processing and program administrative fees as selling expense instead of being included in net sales. These reclassifications had no effect on net income as previously reported.

Recent Accounting Pronouncements

The FASB issued ASU 2012-02, Intangibles—Goodwill and Other (Topic 350)—Testing Indefinite-Lived Intangible Assets for Impairment, to establish an optional two-step analysis for impairment testing of indefinite-lived intangibles other than goodwill. The standards update will be effective for financial statements of periods beginning after September 15, 2012, with early adoption permitted. In particular, the two-step analysis establishes an optional qualitative assessment to precede the quantitative assessment, if necessary. In the qualitative assessment, the entity must evaluate the totality of qualitative factors, including any recent fair value measurements, that impact whether an indefinite-lived intangible asset other than goodwill has a carrying amount that more likely than not exceeds its fair value. The entity must proceed to conducting a quantitative analysis, according to which the entity would record an impairment charge for the amount of the asset's fair value exceeding the carrying amount, if (1) the entity determines that such an impairment is more likely than not to exist, or (2) the entity foregoes the qualitative assessment entirely. The standards update finalizes the proposal in Proposed Accounting Standards Update (ASU) No. 2012-100: Intangibles—Goodwill and Other (Topic 350)—Testing Indefinite-Lived Intangible Assets for Impairment, and brings the accounting treatment for determining impairment charges on other intangible assets into conformity with the treatment

of goodwill, as established by Accounting Standards Update No. 2011-08: Intangibles—Goodwill and Other (Topic 350) - Testing Goodwill for Impairment. The adoption of this guidance did not have a material impact on the Company's financial statements.

In February 2013, the FASB issued ASU No. 2013-02, Comprehensive Income (Topic 220)—Reporting Amounts Reclassified Out of Accumulated Other Comprehensive Income (ASU 2013-02). ASU 2013-02 provides guidance about disclosing reclassification adjustments, which was previously deferred for further deliberation by ASU 2011-12. ASU 2013-02 provides financial statement issuers the option to disclose significant amounts reclassified from accumulated other comprehensive income separately by each component in either (1) a single note to the financial statements, or (2) parenthetically on the face of the income statement for each line item(s) affected by the reclassification adjustment. ASU 2013-02 will be effective for all interim and annual financial statement reporting periods beginning after December 15, 2012, with early adoption permitted. The adoption of this guidance did not have a material impact on the Company's financial statements.

In July 2013, the Financial Accounting Standards Board issued a clarification regarding the presentation of an unrecognized tax benefit related to a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. Under this new standard, the liability related to an unrecognized tax benefit, or a portion thereof, should be presented in the financial statements as a reduction to a deferred tax asset if available under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position. Otherwise, the unrecognized tax benefit should be presented in the financial statements as a separate liability. The assessment is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date. The provisions of the new standard are effective on a prospective basis beginning in 2014 for annual and interim reporting periods. Early adoption is permitted. While we are still determining the impact of this standard on the presentation of both our deferred tax assets and income taxes payable, implementation of the standard will have no impact on our consolidated statements of operations.

There were no other recent accounting pronouncements that have not yet been adopted by the Company that are expected to have a material impact on the Company's consolidated financial statements.

Note 3. Fair Value Measurement

The following tables summarize the Company's fair value hierarchy for its financial assets and liabilities measured at fair value on a recurring and nonrecurring basis as of December 31, 2013 and 2012 (in thousands):

	2013			
	Level 1	Level 2	Level 3	Total
Liabilities				
Contingent consideration(1)	—	—	1,330	1,330
Put option(2)	—	—	—	—
Total Liabilities	$—	$—	$1,330	$1,330

	2012			
	Level 1	Level 2	Level 3	Total
Assets				
Investments in TherapeuticsMD	—	—	5,711	5,711
Total Assets	$—	$—	$5,711	$5,711
Liabilities				
Contingent consideration(1)	—	—	10,962	10,962
Put option(2)	—	—	3,365	3,365
Total Liabilities	$—	$—	$14,327	$14,327

(1) Contingent consideration consists of certain holdback payments, contingent cash and equity payments and future cash to be placed in escrow with respect to our acquisition of Cypress. The fair value of the contingent consideration is included in put option and contingent consideration on the accompanying consolidated balance sheets. The fair value of contingent consideration has been estimated using probability weighted discounted cash flow models (DCF). The DCF incorporates Level 3 inputs including estimated discount rates that the Company believes market participants would consider relevant in pricing and the projected timing and amount of cash flows, which are estimated and developed, in part, based on the requirements specific to the Cypress acquisition agreement. The Company analyzes and evaluates these fair value measurements quarterly to determine whether valuation inputs continue to be relevant and appropriate or whether current period developments warrant adjustments to valuation inputs and related measurements. Any increases or decreases in

discount rates would have an inverse impact on the value of related fair value measurements, while increases or decreases in expected cash flows would result in a corresponding increase or decrease in fair value measurements.

(2) The fair value of the put right is included in put option and contingent consideration on the accompanying consolidated balance sheets. The fair value of the put right was calculated using a Black-Scholes valuation model with assumptions for the following variables: term, closing Pernix stock price on the acquisition date, risk-free interest rates and expected volatility, with the volatility factor being the input subject to the most variation. In connection with a settlement between the Company and the former Cypress shareholders, the rights to the put right were waived, and accordingly management adjusted its estimate of the obligation of the put right to zero as of December 31, 2013.

See Note 6, Derivative Instruments, and Note 24, Subsequent Events, for further information.

For the Company's assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3), the following table provides a reconciliation of the beginning and ending balances for each category therein, and gains or losses recognized during the years ended December 31, 2013 and 2012.

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)

Assets:	2013 Investment in Therapeutics MD	2012 Investment in Therapeutics MD
Beginning balance at January 1,	$ 5,710,526	$ 2,763,368
Net realized and unrealized gains (losses)		
Included in earnings (in other income)	3,605,263	
Included in accumulated other comprehensive income (pre-tax) (1)	(4,710,526)	2,947,158
Sale of investment in TherapeuticsMD	(4,605,263)	
Ending balance at December 31,	$	$ 5,710,526

Liabilities:	Contingent Liability Consideration	Contingent Liability Consideration
Beginning balance at January 1,	$ 14,327,680	$
Contingent consideration from Cypress acquisition		10,962,169
Put right from Cypress acquisition		3,365,511
Interest accretion of Cypress contingent consideration	670,000	
Change in fair value of Cypress contingent consideration	(805,000)	
Change in fair value of Cypress put right	8,360,889	
Reclass of contingent consideration against indemnification claims pursuant to settlement with the former Cypress Shareholders	(4,954,969)	
Gain on Cypress contingent consideration	(4,542,200)	
Gain from the waiver of the put right pursuant to settlement with the former Cypress Shareholders	(11,726,400)	
Ending balance at December 31,	$ 1,330,000	$ 14,327,680

(1)Recorded as a component of other comprehensive income and accumulated other comprehensive income, net of tax.

Note 4. Business Combinations and Other Acquisitions

Consideration paid by the Company for the businesses it purchases is allocated to the assets and liabilities acquired based upon their estimated fair values as of the date of the acquisition. The excess of the purchase price over the estimated fair values of the assets acquired and liabilities assumed is recorded as goodwill.

Somaxon Acquisition

On March 6, 2013, Pernix completed an acquisition of Somaxon pursuant to an agreement and plan of merger dated December 10, 2012. As a result of the transaction, each outstanding share of Somaxon common stock was converted into the right to receive 0.477 shares of Pernix common stock. Somaxon stockholders received approximately 3.66 million shares of Pernix common stock which was calculated based on a weighted average price of Pernix stock and a

common stock value consideration of $25 million. Upon completion of the merger all unexercised and unexpired warrants to purchase Somaxon common stock were assumed by Pernix and were estimated to have a fair value of $0.9 million at the closing date.

The Somaxon acquisition broadened the Company's product portfolio and provides the opportunity for OTC development of Silenor, a non-controlled substance approved for the treatment of insomnia characterized by difficulty with sleep maintenance.

The Somaxon acquisition was accounted for as a business combination in accordance with ASC No. 805 "Business Combinations" ("ASC 805") which, among other things, requires assets acquired and liabilities assumed to be measured at their acquisition date fair values. The purchase price allocation is preliminary with respect to taxes and certain accruals and includes the use of estimates based on information currently available and will be finalized during the quarter ending March 31, 2014. The Company believes the estimates used are reasonable and the significant effects of the Somaxon acquisition are properly reflected. However, the estimates are subject to change as additional information becomes available and is assessed by the Company. Since the date of the acquisition, the Company made adjustments to recognize previously unrecorded liabilities of approximately $1.6 million offset by adjustments to increase intangible asset values by $0.3 million and establish deferred tax assets of approximately $10.6 million. Additional changes to the purchase price allocation may result in a corresponding change to the goodwill in the period of change.

The following table summarizes the consideration paid to acquire Somaxon and the estimated values of assets acquired and liabilities assumed in the accompanying unaudited consolidated balance sheet based on their fair values on March 6, 2013 (in thousands, except stock price):

	March 6, 2013 (as initially reported)	Measurement Period Adjustment (i)	March 6, 2013 (As adjusted)
Consideration (ii) :			
Shares of Pernix common stock issued to Somaxon' stockholders	3,665		3,665
Pernix common stock price	$6.26	$	$6.26
Fair value of common stock issued	$22,945	$	$22,945
Fair value of warrants (iii)	895		895
Total consideration	$23,840	$	$23,840
Estimated Fair Value of Liabilities Assumed:			
Current liabilities	$8,764	$ 1,607	$10,371
Long-term liabilities	3,403		3,403
Long-term deferred tax liability (iv)	11,342	(10,569)	773
Amount attributable to liabilities assumed	$23,509	$ (8,962)	$14,547
Total purchase price plus liabilities assumed	$47,349	$ (8,962)	$38,387
Estimated Fair Value of Assets Acquired:			
Current assets, excluding inventory	$4,782	$	$4,782
Inventory (v)	1,090		1,090
Intangible assets (vi)	30,729	300	31,029
Amount attributable to assets acquired	$36,601	$ 300	$36,901
Goodwill (vii)	$10,748	$ (9,262)	$1,486

(i) After the March 31, 2013 condensed consolidated financial statements were filed, the Company updated certain estimates used in the purchase price allocation, primarily with respect to fair value of the consideration, deferred tax amounts and other accruals due to more current information. The adjustments are based on updated assumptions and information related to facts and circumstances that existed as of the acquisition date as well as confirmatory information related to accruals.

(ii) Under the terms of the merger agreement, consideration paid by Pernix consisted of approximately 0.477 shares of Pernix common stock for each share of Somaxon common stock and assumption of Somaxon's warrants. The fair value of the total purchase price was based upon the price of Pernix common stock on the day immediately prior to the closing date of the transaction, March 6, 2013. The Company issued a total of 3.66 million shares of its common stock to former Somaxon stockholders in exchange for their shares of Somaxon common stock and assumed approximately 469,000 outstanding warrants.

(iii) The $0.9 million fair value of the assumed warrants was calculated using a Black-Scholes valuation model with assumptions for the following variables: price of Pernix stock on the closing date of the merger; risk-free interest rates; and expected volatility. The assumed warrants have been classified as equity.

(iv) The Company received carryover tax basis in Somaxon's assets and liabilities because the acquisition was not a taxable transaction under the United States Internal Revenue Code of 1986, as amended. Based upon the preliminary purchase price allocation, an increase in financial reporting carrying value related to the intangible assets and the inventory acquired from Somaxon is expected to result in a deferred tax liability of approximately $11.3 million. Subsequently the net deferred tax liability related to Somaxon was reduced by $10.6 million to $773 thousand due to the re-allocation of the purchase price to recognize the utilizable deferred tax assets associated with the transaction.

(v) As of the effective date of the acquisition, inventories are required to be measured at fair value. The fair value of inventory was estimated based on estimated percentage of completion of work-in-progress inventory and selling costs left to incur.

(vi) As of the effective date of the Somaxon acquisition, identifiable intangible assets are required to be measured at fair value and these acquired assets could include assets that are not intended to be used or sold or that are intended to be used in a manner other than their highest and best use. For purposes of the valuation, it is assumed that all assets will be used and that all assets will be used in a manner that represents the highest and best use of those assets, but it is not assumed that any market participant synergies will be achieved. The consideration of synergies has been excluded because they are not considered to be factually supportable.

The fair value of identifiable intangible assets is determined primarily using the income method, which starts with a forecast of all the expected future net cash flows. Some of the more significant assumptions inherent in the development of intangible asset values, from the perspective of a market participant, include: the amount and timing of projected future cash flows (including revenue, cost of sales, research and development costs, sales and marketing expenses, capital expenditures and working capital requirements) as well as estimated contributory asset charges; the discount rate selected to measure the risks inherent in the future cash flows; and the assessment of the asset's life cycle and the competitive trends impacting the asset, among other factors.

The consolidated financial statements include estimated identifiable intangible assets representing in-process research and development, or IPR&D, intangibles valued at $22.3 million and core technology intangibles valued at $8.0 million. The IPR&D are considered indefinite-lived intangible assets until the completion or abandonment of the associated research and development efforts. Accordingly, during the development period, these assets are not amortized but are subject to impairment review. The core technology intangible assets represent developed technology of products approved for sale in the market, which we refer to as marketed products, and have finite useful lives. They are amortized on a straight line basis over a weighted average period of 4 years.

(vii) Goodwill is calculated as the difference between the acquisition date fair value of the consideration transferred and the values assigned to the assets acquired and liabilities assumed. Goodwill is not amortized but tested for impairment on an annual basis or when indications of impairment exist. Goodwill is not deductible for tax purposes. Goodwill specifically includes the expected synergies and other benefits that the Company believes will result from combining its operations with those of Somaxon and other intangible assets that do not qualify for separate recognition, such as assembled workforce in place at the date of acquisition.

Cypress Acquisition

On December 31, 2012, the Company completed the acquisition of Cypress by purchasing all the outstanding capital stock of Cypress from the former stockholders of Cypress. The Company paid $52.0 million in cash and issued 4,427,084 shares of the Company's common stock with a market value equal to approximately $34.3 million based on the closing price per share of $7.75 as reported on the NYSE MKT LLC on December 31, 2012. In addition, the Company agreed to pay a holdback payment up to $5.5 million on December 15, 2013, a $1.0 million payment contingent on Cypress' 2013 gross sales, $4.5 million to be deposited in escrow on December 15, 2013 and $5.0 million in shares of Company's common stock upon the occurrence of a milestone event, for an aggregate purchase price up to $102.3 million, with a fair value, including the value of the put right (see Note 1, Company Overview), of approximately $100.6 million. As the result of a settlement agreement between the Company and the former Cypress Shareholders, the put right has been waived and the terms of the contingent consideration have been modified. See Note 24, Subsequent Events, for further information.

See Note 5, Disposition of Certain Cypress Assets, for discussion of the sale of certain of the generic assets and ANDAs which were acquired in the Cypress acquisition.

The Cypress acquisition was accounted for as a business combination in accordance with ASC No. 805 "Business Combinations" ("ASC 805") which, among other things, requires assets acquired and liabilities assumed to be measured at their acquisition date fair values.

A preliminary allocation of the purchase price as of December 31, 2012 was prepared in connection with the Company's annual financial statements filed on Form 10-K for the period ended December 31, 2012. Concurrent with the sale of the Cypress assets to Breckenridge (see Note 1, Company Overview) in September 2013, the Company obtained an updated valuation summary of the purchase consideration which was compared to the preliminary fair value estimates that were used to prepare the initial purchase price allocation. With this information, the Company updated the assets acquired, as well as certain other estimates used in the initial purchase price allocation related to deferred tax amounts and other accruals based on the updated valuation. The Company believes the estimates used are reasonable and the significant effects of the acquisition are properly reflected. During the year ended December 31, 2013, the Company made adjustments to reallocate the fair value of the consideration of approximately $1.5 million and to recognize deferred taxes of approximately $2.3 million. The adjustments are based on updated assumptions and information related to facts and circumstances that existed as of the acquisition date as well as confirmatory information related to accruals.

See Note 5, Disposition of Certain Cypress Assets, for more information regarding the sale of certain intangibles assets.

Pro Forma Impact of Acquisitions (Unaudited)

The following unaudited pro forma combined results of operations are provided for years ended December 31, 2013 and 2012 as though the Somaxon and the Cypress acquisitions had been completed as of January 1, 2012. The pro forma combined results of operations for the years ended December 31, 2013 and 2012 have been prepared by adjusting historical results of the Company to include the historical results of Somaxon and the pro forma combined results of operations for the year ended December 31, 2012 have been prepared by adjusting the historical results of the Company to include the historical results of Somaxon and Cypress. These supplemental pro forma results of operations are provided for illustrative purposes only and do not purport to be indicative of the actual results that would have been achieved by the combined company for the periods presented or that may be achieved by the combined company in the future. The pro forma results of operations do not include any cost savings or other synergies that resulted, or may result, from the Somaxon and Cypress acquisitions or any estimated costs that will be

incurred to integrate Somaxon and Cypress. Future results may vary significantly from the results reflected in this pro forma financial information because of future events and transactions, as well as other factors.

	For the year ended December 31, (unaudited, in thousands)	
	2013 (Pro forma)	2012 (Pro forma)
Revenue	$86,601	$117,700
Net loss	$(27,335)	$(21,396)
Pro forma net income (loss) per common share		
Basic	$(0.75)	$(0.59)
Diluted	$(0.75)	$(0.59)

The Company's historical financial information was adjusted to give effect to the pro forma events that were directly attributable to the Somaxon and the Cypress acquisitions and factually supportable. The unaudited pro forma consolidated results include the historical revenues and expenses of assets acquired and liabilities assumed in the acquisitions with the following adjustments:

- Adjustment to recognize incremental amortization expense based on the fair value of intangibles acquired;
- Eliminate historical interest expense for Cypress debt that was extinguished;
- Adjustment to recognize interest expense for debt issued in connection with the Cypress transaction;
- Eliminate transaction costs and non-recurring charges directly related to the Somaxon acquisition that were included in the historical results of operations for Pernix and Somaxon;
- Reflects an adjustment to income tax expense as a result of the adjustments described above;
- Adjustment to recognize the issuance of 4.4 million shares of the Company's common stock as consideration for the Cypress acquisition; and
- Adjustment to recognize the issuance of 3.6 million shares of the Company's common stock as consideration for the Somaxon acquisition.

For the year ended December 31, 2013, the Company recognized net revenue for Somaxon subsequent to the closing on March 6, 2013 in the amount of approximately $6.7 million. Non-recurring transaction costs incurred by Pernix of $0.5 million related to the Somaxon acquisition for the year ended December 31, 2013 are included in the consolidated statement of income (loss) and comprehensive income (loss) in selling, general and administrative expenses. These non-recurring transaction costs have been excluded from the pro forma results in the above table.

Acquisition of GSL

On July 2, 2012, the Company acquired the business assets of Great Southern Laboratories, or GSL, a pharmaceutical contract manufacturing company located in Houston, Texas. The Company closed on the related real estate on August 30, 2012. Upon the final closing, the Company paid an aggregate of approximately $4.9 million (including $300,000 deposited to an escrow that was subsequently refunded to the Company as payment for unrecorded liabilities), and assumed certain liabilities totaling approximately $5.9 million for substantially all of GSL's assets including the land and buildings in which GSL operates. GSL has an established manufacturing facility for the pharmaceutical industry, which was expected to provide the Company with potential cost savings going forward. The Company acquired the GSL assets through a wholly-owned subsidiary, Pernix Manufacturing, LLC. The results of operations of Pernix Manufacturing have been included in the Company's consolidated financial statements since the acquisition date.

The GSL Acquisition was accounted for as a business combination in accordance with ASC No. 805 "Business Combinations" ("ASC 805") which, among other things, requires assets acquired and liabilities assumed to be measured at their acquisition date fair values. The purchase price allocation was preliminary and was based on estimates of fair values at the date of the acquisition. The Company evaluated the preliminary purchase price allocation, which was adjusted as additional information relative to the fair value of assets and liabilities became available.

Pro forma combined results of operations for the years ended December 31, 2012 and 2011, as though the GSL acquisition had been completed as of January 31, 2011, are omitted from this Annual Report on Form 10-K. The Company determined that it is impractical to include such pro forma information given the immateriality of the transaction and the difficulty in obtaining the historical financial information of GSL. Inclusion of such information would require the Company to make estimates and assumptions regarding GSL's historical financial results that we

believe may ultimately prove inaccurate.

Note 5. Disposition of Certain Cypress Assets

As discussed in Note 1, Company Overview, on September 11, 2013, the Company completed the sale of certain of its generic assets held by Cypress to Breckenridge pursuant to the Purchase Agreement, as amended. The assets included seven previously marketed products, eight Abbreviated New Drug Applications (ANDAs) filed at the FDA, and certain other ANDAs in various stages of development and the transfer of $1.0 million in inventory.

Breckenridge paid the Company $2,000,000 in cash upon execution of the Purchase Agreement, $17,850,000, before customary closing costs of approximately $173,000, in cash at Closing, and issued two promissory notes, each in an amount of $4,850,000, net of a present value discount (at an assumed rate of 3.1% on the one-year note and 4.25% on the two-year note) of approximately $505,000 in the aggregate, with one due on the first anniversary after Closing and the other due on the second anniversary after Closing, for an aggregate purchase price of up to $29,550,000.

Pro Forma Impact of Disposition of Cypress Assets (Unaudited)

The following unaudited pro forma combined results of operations are provided for the years ended December 31, 2013 and 2012 as though the disposition had occurred on January 1, 2012.

The unaudited pro forma consolidated statements of income (loss) and comprehensive income (loss) for the years ended December 31, 2013 and 2012 reflect the following pro forma adjustments:

(1) Eliminates the revenues and cost of goods sold as if the transaction occurred on January 1, 2012.

(2) Reflects the reduction in amortization resulting from excluding the assets that were sold from intangible assets, net as if the transaction occurred on January 1, 2012.

(3) Reduces interest expense resulting from applying a portion of the net proceeds as the repayment of the term loan balance outstanding at September 11, 2013 under the Company's Amended and Restated Credit Agreement.

(4) Reflects an adjustment to income tax expense as a result of the adjustments described above.

The unaudited pro forma consolidated financial information is provided for illustrative purposes only and does not purport to represent what the actual results of operations would have been had the transaction occurred on the respective date assumed, nor is it necessarily indicative of the Company's future operating results. However, the pro forma adjustments reflected in the accompanying unaudited pro forma consolidated financial information reflect estimates and assumptions that the Company's management believes to be reasonable.

Pro forma adjustments related to the unaudited pro forma consolidated statements of income (loss) and comprehensive income (loss) for the years ended December 31, 2013 and 2012 were computed assuming the transaction was consummated on January 1, 2012 and include adjustments which give effect to events that are (i) directly attributable to the transaction, (ii) expected to have a continuing impact on the Company, and (iii) factually supportable.

	For the Year Ended December 31, (unaudited, in thousands)	
	2013 (Pro forma)	2012 (Pro forma)
Revenue	$80,186	$110,486
Net loss	$(26,607)	$(23,326)
Pro forma net income (loss) per common share		
Basic	$(0.73)	$(0.64)
Diluted	$(0.73)	$(0.64)

Note 6. Derivative Instruments

In connection with the acquisition of Cypress effective December 31, 2012, the Company issued a put right to Cypress' former shareholders. The put right, which had an expiration date of January 31, 2014, was exercisable during the thirty-day period immediately following the one-year anniversary date of the business acquisition, which if exercised would have enabled them to sell any of the shares they still held at the time of exercise (3,526,844 as of December 31, 2013 from the underlying 4,427,084 shares of the Company's common stock they received as part of the purchase consideration), back to the Company at a price of $5.38 per share, which represents a 30% discount off of the per-share value established on the effective date of the closing of the acquisition. In accordance with the relevant

authoritative accounting literature a portion of the total purchase consideration was allocated to this put liability based on its initial fair value, which was determined to be $3.4 million using a Black-Scholes model. The inputs used in the valuation of the put right include term, stock price volatility, current stock price, exercise price, and the risk free rate of return. The Company has classified the put right, for which the fair value is re-measured on a recurring basis at each reporting date as a Level 3 instrument (i.e. wherein fair value is partially determined and based on unobservable inputs that are supported by little or no market activity), which the Company believes is the most appropriate level within the fair value hierarchy based on the inputs used to determine its fair value at the measurement date. In connection with the settlement between the Company and the former Cypress shareholders, pursuant to which the rights under the put option were waived, the fair value of the put right liability was written off as of December 31, 2013 and recorded as a gain to contingent consideration and is included in other non-operating income in the accompanying Consolidated Statement of Income (Loss) and Comprehensive Income (Loss). See Note 24, Subsequent Events, for further information regarding the settlement.

Note 7. Accounts Receivable

Accounts receivable consist of the following:

	Year Ended December 31,	
	2013	2012
Trade accounts receivable	$25,585,112	$35,723,488
Less allowance for prompt pay discounts	(531,722)	(727,714)
Less allowance for doubtful accounts	(84,328)	(39,231)
Total trade receivables, net	24,969,062	34,956,543
Other miscellaneous receivables	57,475	45,000
Receivables from third parties – revenue sharing arrangements	654,834	1,645,544
Total accounts receivable, net	$25,681,371	$36,647,087

The Company typically requires customers to remit payments within the first 30 days for brand purchases or 60 to 120 days for generic purchases (depending on the customer and the products purchased). The Company offers wholesale distributors a prompt payment discount, which is typically 2-3%, as an incentive to remit payment within this timeframe. Accounts receivable are stated net of the estimated prompt pay discount. The Company's management evaluates accounts receivable to determine if a provision for an allowance for doubtful accounts is appropriate. At December 31, 2013 and 2012, the allowance for doubtful accounts was approximately $84,300 and $39,000

See Note 4, Business Combinations and Other Acquisitions, with respect to accounts receivable acquired in the acquisitions of Cypress and GSL.

Note 8. Inventory

Inventories consist of the following:

	Year Ended December 31,	
	2013	2012
Raw materials	$1,459,742	$1,550,736
Packaging materials	841,492	866,674
Samples	731,677	792,702
Finished goods	13,411,007	19,860,995
	16,443,918	23,071,107
Reserve for obsolescence	(2,633,989)	(1,056,702)
Inventory, net	$13,809,929	$22,014,405

An increase in the basis of inventory related to the acquisitions of Cypress and Somaxon is included in the balances above as of December 31, 2013 and 2012. The increase included in raw materials from the Somaxon acquisition was approximately $220,000 and $0 as of December 31, 2013 and 2012, respectively. The increase included in finished goods from the Cypress and Somaxon acquisitions was approximately $2,714,000, in the aggregate, as of December 31, 2013, and $8,600,000 as of December 31, 2012.

Note 9. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist of the following:

	Year Ended December 31,	
	2013	2012
Prepaid expenses	$4,123,087	$2,837,946
Deposits on inventory and prepaid royalties	235,956	392,922
Prepaid contracts	65,733	108,333
Capitalized financing costs	786,662	492,845
Deposits	227,154	51,102
Deferred expenses	439,700	—
Other current assets	—	4,969
Total	$5,878,292	$3,888,117

See Note 4, Business Combinations and Other Acquisitions, with respect to prepaid expenses and other current assets acquired in the acquisitions of Cypress and GSL.

Note 10. Property, Plant & Equipment

	Year Ended December 31,	
	2013	2012
Land	$1,356,042	$1,356,042
Buildings	3,986,126	3,865,950
Vehicles	15,000	15,000
Equipment	2,343,601	1,777,537
Furniture and fixtures	189,034	167,030
Computer software and website	93,900	246,467
	7,983,703	7,428,026
Less accumulated depreciation	(1,111,661)	(481,082)
	$6,872,042	$6,946,944

During the year ended December 31, 2013, we recognized an impairment charge for capitalized software of approximately $98,000 and equipment of approximately $113,000.

Depreciation expense amounted to approximately $672,000, $324,000 and $97,000 for the years ended December 31, 2013, 2012 and 2011, respectively.

See Note 4, Business Combinations and Other Acquisitions, with respect to property, plant and equipment acquired in the acquisitions of Cypress and GSL.

Note 11. Investment in Joint Venture

On December 17, 2010, the Company entered into a Joint Venture Agreement with SEEK, a United Kingdom drug discovery group, to form a joint venture structured as a private company limited by shares incorporated in the United Kingdom (the “JV”). The purpose of the JV was to develop and obtain regulatory approval in both Europe and the United States for BC 1036, an antitussive cough suppressant pharmaceutical product utilizing theobromine as an active ingredient. Pernix contributed approximately $1.5 million to the JV, in consideration for 50% of the voting interest and approximately 46% of the total economic interest in the JV. On September 26, 2011, the Company funded an additional $1.0 million in cash to the JV for continuing operations.

On May 14, 2012, in connection with its withdrawal from the JV, the Company acquired the exclusive rights from SEEK, its former joint venture partner, to commercialize and market products utilizing the joint venture’s intellectual property (IP) in the areas of cough, cold, sinus and allergy in the United States and Canada for $5 million. The investment in the JV at termination was approximately $1,445,000 and approximately $2,687,000 arising from a deferred tax liability. The total value of the license recorded was approximately $9,133,000. Under the terms of the agreement, Pernix would have paid royalties to SEEK on sales of products utilizing the joint venture IP in the United States and Canada. Pernix would have also received royalties from SEEK for product sales outside of the United States and Canada. As a result, the Company no longer shared in the development costs outside the United States and Canada.

Effective August 30, 2013, the Company re-licensed all of our rights to these assets in the United States and licensed the Dr. Cocoa trademark and logo to infirst+ in exchange for a royalty of 5% of net sales in the United States through 2019 and 2.5% of net sales in the United States and Canada from 2020 through 2029. Our subsidiary, Pernix Manufacturing, entered into a supply agreement with infirst+ to supply certain of infirst+’s manufactured products in the United States. As a result of this transaction, the Company no longer has any rights to a royalty for products utilizing the intellectual property described above outside of the United States and Canada. Because the fair value of

the expected royalty stream supports the carrying value of the related intangibles and the Company had not yet launched the product, there is no financial impact.

Note 12. Intangible Assets and Goodwill

Intangible assets consist of the following:

Cost basis:	Weighted Average Life	December 31, 2013	December 31, 2012
Patents	11 years	$ 500,000	$ 1,442,000
Brand	8 years	3,887,000	3,887,000
Product licenses	11.1 years	15,963,794	15,135,050
Customer relationships	6 years	1,848,000	1,848,000
Non-compete and supplier contract	5.3 years	5,194,571	5,194,571
Trademark rights	Indefinite	399,805	638,563
In-process research and development	Indefinite	25,300,000	45,200,000
Developed technology	12.2 years	40,000,000	37,000,000
		93,093,170	110,345,184
Accumulated amortization		(13,070,887)	(6,290,753)
		$ 80,022,283	$ 104,054,431

Accumulated amortization:	Weighted Average Life	December 31, 2013	December 31, 2012
Patents	11 years	$ (305,625)	$ (591,270)
Brand	8 years	(1,822,038)	(1,336,158)
Product licenses	11.1 years	(2,383,518)	(1,053,055)
Customer relationships	6 years	(462,204)	(154,200)
Non-compete and supplier contract	5.3 years	(3,609,071)	(3,156,070)
Trademark rights	Indefinite	—	—
In-process research and development	Indefinite	—	—
Developed technology	12.2 years	(4,489,431)	—
		$ (13,070,887)	$ (6,290,753)

The weighted average life for our definite-lived intangible assets in total was approximately 9.4 years.

During 2013, the Company recorded impairment charges of approximately $213,000 against product licenses, $545,000 against patents, $239,000 against trademark rights and $18,433,000 against in-process research and development. The impairment charges against in-process research and development consist of $8.9 million related to projects the Company acquired in the acquisition of Cypress that we have elected not to continue to pursue and a write-down of approximately $9.5 million on one project for which the Company is pursuing an alternative strategic path.

In connection with the approval of VITUZ® during the year ended December 31, 2013, $4,000,000 was transferred from in-process research and development to developed technology.

See Note 4, Business Combinations and Other Acquisitions, for further discussion of additions to intangible assets and goodwill.

Estimated amortization expense related to intangible assets with definite lives for each of the five succeeding years and thereafter is as follows:

	Amount

2014	$ 7,695,015
2015	7,691,165
2016	7,691,165
2017	6,175,120
2018	4,681,625
Thereafter	20,388,388
	$ 54,322,478

Amortization expense is approximately $7,334,000, $2,878,000 and $2,205,000 for the years ended December 31, 2013, 2012 and 2011, respectively.

Changes in the carrying amount of goodwill for the year ended December 31, 2013 and 2012 are as follows:

	December 31,	
	2013	2012
Beginning Balance	$37,160,911	$1,406,591
Goodwill acquired – Somaxon	10,748,243	—
Goodwill acquired – Cypress	—	34,838,745
Goodwill acquired – GSL	—	915,575
Adjustments (1)	(5,412,562)	—
Total	$42,496,592	$37,160,911

(1) Primarily reflects the impact of measurement period adjustments related to the Cypress and Somaxon acquisitions composed of a deferred tax asset on the increase in the basis of the acquired inventory, an increase in certain accrued allowances and the impact of the re-evaluation of the opening balance sheet Cypress intangible assets and inventory. See Note 1, Company Overview, Note 4, Business Combinations and Other Acquisitions and Note 5, Disposition of Certain Cypress Assets, for further discussion.

Note 13. Accrued Allowances

Accrued allowances consist of the following:

	December 31,	
	2013	2012
Accrued returns allowance	$12,049,040	$12,057,464
Accrued price adjustments	18,300,788	10,960,042
Accrued government program rebates	3,935,750	7,037,045
Total	$34,285,578	$30,054,551

Note 14. Other Liabilities

Other liabilities consist of the following:

	December 31,	
	2013	2012
Stock repurchase contract with related party (see Note 17)	$—	$600,000
Product license contracts (see Note 12)	—	630,000
Settlement obligations (see Note 22)	14,115,000	—
Deferred revenue	4,279,350	—
Other	66,349	338,495
Total contracts payable and other obligations	$18,460,699	$1,568,495
Other liabilities – short term	$4,072,933	$1,568,495
Other liabilities – long term	$14,387,766	—

Note 15. Debt and Lines of Credit

Debt consists of the following:

	December 31, 2013	December 31, 2012
Amounts outstanding under the Credit Facility – MidCap Funding V, LLC	$ 16,859,891	$ 42,000,000
StanCorp Mortgage	1,449,563	1,580,748
Capital leases (see Note 17)	—	55,328
Total debt	$ 18,309,454	$ 43,636,076
Debt – current	$ 16,999,687	$ 2,286,513
Debt – long term	$ 1,309,767	$ 41,349,563

Credit Facility – MidCap Funding V, LLC

In connection with the purchase of all of the capital stock of Cypress, the Company, together with its subsidiaries, entered into a Credit and Guaranty Agreement, dated December 31, 2012, with MidCap Funding V, LLC, as administrative agent, a lender and as a co-bookrunner, and Business Development Corporation of America, as co-bookrunner, and additional lenders from time to time party thereto (the "Original Credit Agreement"). The Original Credit Agreement provided for a term credit facility of $42 million. Subject to certain permitted liens, the obligations under this facility were secured by a first priority perfected security interest in substantially all of the assets of the Company and its subsidiaries. The proceeds from this facility were used to fund a portion of the cash consideration of the acquisition of Cypress.

The Original Credit Agreement was subject to certain financial and nonfinancial covenants, and also contained customary representations and warranties and event of default provisions for a secured credit facility.

The facility bore interest at a rate equal to the sum of the LIBOR rate plus an applicable margin of 6.50% per annum. The Company was required to make quarterly repayments beginning on March 31, 2013 and ending on December 31, 2017, when all remaining principal was due and payable. In addition, the Company was able to voluntarily repay outstanding amounts under the Original Credit Agreement at any time without premium or penalty.

On May 8, 2013, the Company, together with its subsidiaries, entered into an Amended and Restated Credit Agreement with MidCap Financial, LLC, as Administrative Agent and as a lender, and additional lenders from time to time party thereto (the “Amended and Restated Credit Agreement”). The Amended and Restated Credit Agreement amended and restated in its entirety the Original Credit Agreement. The Amended and Restated Credit Agreement provided for a term loan of $10 million and a revolving loan commitment of $20 million. In connection with the entry into the Restated Credit Agreement, the Company prepaid approximately $12 million of the term loan that had been previously outstanding under the Original Credit Agreement. Under the Amended and Restated Credit Agreement, the Company’s borrowing base on the revolving loan commitment is equal to (A) 85% of eligible accounts, plus (B) 50% of eligible inventory, minus (C) certain reserves and/or adjustments, subject to certain conditions and limitations. Notwithstanding the foregoing, the Amended and Restated Credit Agreement provided for an advance of up to $3 million in excess of the Company’s borrowing base until June 5, 2013, at which time all excess amounts were paid. Unlike the Original Credit Agreement, the Amended and Restated Credit Agreement does not include covenants limiting capital expenditures or requiring the Company to maintain a fixed charge coverage ratio and leverage ratio, but rather contains covenants requiring the Company to maintain a minimum amount of EBITDA and net invoiced revenues. Similar to the Original Credit Agreement, the Amended and Restated Credit Agreement includes customary covenants for a secured credit facility, which include, among other things, (a) restrictions on (i) the incurrence of indebtedness, (ii) the creation of or existence of liens, (iii) the incurrence or existence of contingent obligations, (iv) making certain dividends or other distributions, (v) certain consolidations, mergers or sales of assets and (vi) purchases of assets, investments and acquisitions; and (b) requirements to deliver financial statements, reports and notices to the administrative agent and other lenders. The Amended and Restated Credit Agreement also contains customary representations and warranties and event of default provisions for a secured credit facility.

The loans under this facility bear interest at a rate equal to the sum of the LIBOR rate plus an applicable margin of 7.50% per annum (9% at December 31, 2013). Pursuant to the Restated Credit Agreement, the Company paid certain customary fees to the administrative agent and lenders.

Under the Amended and Restated Credit Agreement, we were required to make monthly repayments of $333,333 on the term loan beginning on November 7, 2013 and ending on May 7, 2016, when all remaining principal is due and payable. Approximately $2,300,000 of the proceeds from the sale of TherapeuticsMD stock were utilized to pay down the term loan in September 2013. The revolving loan will be paid based on our cash receipts through a lockbox

arrangement. In addition, we are able to voluntarily prepay outstanding amounts under the revolving loan commitment at any time, subject to certain prepayment penalties.

Pursuant to the terms of the Amended and Restated Credit Agreement, the closing of the sale of certain Cypress assets (see Note 1) triggered a requirement by the Company to repay the term loan included in the Credit Agreement. At the closing, the Company paid approximately $7.7 million from the sale proceeds to MidCap in fulfillment of this requirement, and as a result, the term loan has been repaid in full. As of December 31, 2013, the outstanding balance under the revolver was approximately $16.9 million. The Company has approximately $3.1 million of remaining available funds subject to borrowing base capacity as of December 31, 2013.

As with the Original Credit Agreement, the obligations under the Amended and Restated Credit Agreement are secured by a first priority perfected security interest in substantially all of the assets of the Company and its subsidiaries, subject to certain permitted liens. The May 2013 amendments described above were treated as a modification of debt under GAAP, and the Company expensed $630,000 of deferred financing fees and recorded approximately $670,000 of new deferred financing fees for the year ended December 31, 2013.

On February 21, 2014, the Company, together with its subsidiaries, amended the credit agreement described above and entered into an Amended Credit Agreement. See Note 24, Subsequent Events, for further discussion.

Mortgage

Certain real estate acquired in the acquisition of GSL is encumbered by a mortgage that the Company assumed. The monthly fixed payment under this mortgage, including principal and interest, is approximately $19,000 until February 1, 2022. This mortgage is included under the caption Debt – short term and Debt – long term on the Consolidated Balance Sheets as of December 31, 2013 and 2012. The outstanding mortgage balance is approximately $1,450,000 and $1,581,000 as of December 31, 2013 and December 31, 2012, respectively.

The future maturity schedule of the mortgage is as follows:

Year Ended December 31, 2013	
2014	$139,796
2015	148,973
2016	158,753
2017	169,174
2018 and thereafter	832,867

Note 16. Temporary Equity

The Company issued 4,427,084 shares of its common stock as consideration to the sellers for the Cypress acquisition. These shares were subject to a put option that would have allowed the sellers of Cypress to sell Pernix the common stock received as consideration to Pernix at a per share price of $5.376, representing 70% of the volume weighted average trading price of Pernix common stock for the 30 trading days prior to November 13, 2012.

The $3.4 million fair value of the put option was calculated using a Black-Scholes valuation model with assumptions for the following variables: the closing Pernix stock price 30 days prior to November 13, 2012, risk-free interest rates, and expected volatility. As the put right provides the sellers of Cypress a cash settlement option, this cash redemption feature is bifurcated from common stock issued as a consideration and classified as current liability. In connection with the Company’s settlement with the former Cypress shareholders, pursuant to which the cash settlement option to the put right was waived, the fair value of the put right was therefore recognized as a gain on contingent commission and the temporary equity was reclassed to shareholders’ equity as of December 31, 2013. See Note 24, Subsequent Events, for further information.

Note 17. Stockholders' Equity

Controlled Equity Offering

On February 10, 2012, the Company entered into a controlled equity offering sales agreement with Cantor Fitzgerald & Co. pursuant to which the Company could issue and sell shares of its common stock having an aggregate offering price of up to $25,000,000 from time to time through Cantor, acting as agent, but in no event more than 5,000,000 shares of common stock. The Company paid Cantor a commission rate of 3.0% of the gross sales price per share of the common stock sold through Cantor as agent under the sales agreement. The Company reimbursed Cantor an amount equal to $50,000, representing certain expenses incurred by Cantor in connection with entering into the sales agreement and provided Cantor with customary indemnification rights. The Company sold 2,966,739 shares of common stock under this controlled equity program for total net proceeds of approximately $23.8 million and closed the controlled equity offering on May 1, 2012. The offering was made pursuant to our effective shelf registration statement filed with the Securities and Exchange Commission on May 31, 2011. The Company used the proceeds of this financing to provide funding for acquisitions and for general corporate purposes in 2012.

Registered Direct Offering

On July 27, 2011, the Company completed an underwritten registered direct offering of 4,000,000 shares of common stock pursuant to the terms of that certain underwriting agreement dated July 21, 2011 by and among the Company, the selling stockholders named therein and the underwriters named therein, for whom Stifel, Nicolaus & Company, Incorporated acted as representative. As provided in the underwriting agreement, (i) the Company sold an aggregate of 3,000,000 shares of its common stock, and (ii) the selling stockholders sold 1,000,000 shares of common stock. The public offering price was $7.00 per share, and the underwriters purchased the shares subject to the offering at a price of $6.58 per share. The offering was led by Aisling Capital and OrbiMed Advisors, LLC. Net proceeds from the sale of the shares of common stock sold by the Company, after underwriting discounts and commissions and offering expenses, were approximately $19.3 million. The offering was made pursuant to an effective shelf registration statement filed with the Securities and Exchange Commission on May 31, 2011.

Stock Repurchase Contract with Related Party

On September 10, 2010, Pernix entered into an agreement, pursuant to a stock repurchase authorization from our board of directors on May 12, 2010, to purchase 2,000,000 shares of its common stock from an employee of Pernix at $1.80 per share. The aggregate purchase price of $3,600,000 is being paid in equal quarterly installments of $300,000 over three years, ending on April 1, 2013.

Warrants Issued in Acquisition of Somaxon

As discussed in Note 4, Business Combinations and Other Acquisitions, the Company assumed approximately 469,000 outstanding warrants in the acquisition of Somaxon. These warrants have exercise prices ranging from $7.70 to $90.72. The average remaining life of these warrants is approximately 4.3 years.

Note 18. Concentrations

The Company’s customers consist of drug wholesalers, retail drug stores, mass merchandisers and grocery store pharmacies in the United States. The Company primarily sells products directly to drug wholesalers, which in turn, distribute the products to retail drug stores, mass merchandisers and grocery store pharmacies. The following tables list the Company’s customers that individually comprise greater than 10% of total gross product sales (before gross to net deductions) and their aggregate percentage of the Company’s total gross product sales for the years ended December 31, 2013, 2012 and 2011, and the customers that comprise more than 10% of total accounts receivable and such customers’ aggregate percentage of the Company’s total accounts receivable as of the years ended December 31, 2013 and 2012:

	For the years ended December 31,		
Gross Product Sales	2013	2012	2011
Cardinal Health, Inc.	24 %	39 %	37 %
McKesson Corporation	35 %	26 %	23 %
AmerisourceBergen Drug Corporation	20 %	10 %	11 %
Morris & Dickson	3 %	6 %	13 %
Total	82 %	81 %	84 %

	As of December 31,	
Accounts Receivable	2013	2012
Cardinal Health, Inc.	16 %	43 %

Walgreens	8	%	11	%
AmerisourceBergen Drug Corporation	23	%	10	%
McKesson Corporation	35	%	17	%
Total	82	%	81	%

Note 19. Other Revenue Sharing Arrangements

The Company enters into collaborative arrangements to develop and commercialize drug candidates. Collaborative activities might include research and development, marketing and selling (including promotional activities and physician detailing), manufacturing, and distribution. These collaborations often require royalty or profit share payments, contingent upon the occurrence of certain future events linked to the success of the product. Revenues related to products sold by the Company pursuant to these arrangements are included in product sales, while other sources of revenue such as royalties and profit share receipts are included in collaboration, royalty and other revenue as further discussed below. Operating expenses for costs incurred pursuant to these arrangements are reported in their respective expense line item.

Co-promotion Agreements

The Company seeks to enter into co-promotion agreements to enhance the promotional efforts and sales of products. The Company may enter into co-promotion agreements whereby it obtains rights to market other parties' products in return for certain commissions or percentages of revenue on the sales Pernix generates. Alternatively, Pernix may enter into co-promotion agreements with respect to its products whereby it grants another party certain rights to market or otherwise promote one or more of its products. Typically, the Company will enter into this type of co-promotion arrangement when a particular product is not aligned with its product focus or it lacks sufficient sales force representation in a particular geographic area. Co-promotion revenue is included in net revenues. Expense from co-promotion agreements is included in cost of products sold.

In September 2013, the Company amended the terms of our co-promotion agreement with ParaPRO. ParaPRO assumed responsibility for distribution of NATROBA and related activities, and the Company and its subsidiaries no longer purchase quantities of NATROBA at a discount for sale to customers. The Company continues to provide promotion services for NATROBA in its assigned territories for co-promotion fees based on prescriptions generated by its sales force. With respect to generic products covered by the agreement, the Company continues to provide distribution and co-promotion services for fees based on units distributed and prescriptions dispensed in defined territories. As expected, the Company's gross product sales for NATROBA has decreased based on the removal of the distribution-related revenue from the terms of the co-promotion arrangement. However, the corresponding decreases in gross-to-net deductions, costs of goods sold and other distribution costs substantially offset the decrease in gross product sales.

On October 28, 2013, the Company entered into an agreement with Cumberland Pharmaceuticals Inc. to promote Omeclamox-Pak. Pursuant to the agreement, Cumberland will promote Omeclamox-Pak to gastroenterologists in the United States, and the Company will continue to promote the product to certain primary care physicians. This agreement provides for various types of payments, including non-refundable upfront license fees, milestone payments, and future royalties on Cumberland's net product sales of Omeclamox. We received a non-refundable upfront payment of $4.0 million upon execution of the agreement. The terms of the arrangement with Cumberland include continuing performance obligations that were conditions to Cumberland's decision to pursue promotion of this product. Due to these ongoing performance obligations, the Company determined that the promotion rights did not have stand-alone value. The Company also did not have objective and reliable evidence of the fair value of these undelivered obligations. Accordingly, amounts received upfront under the license agreement were recorded as deferred revenue and are being recognized on a straight-line basis over the term of the agreement. Current deferred revenue represents amounts, which are expected to be recognized within one year. There are also additional milestones at the first and second anniversary dates of the execution of the agreement totaling $4.0 million in the aggregate. Royalty payments ranging from 15% to 20% based on tiered levels of gross profits will be paid by Cumberland to the Company monthly. See Note 24, Subsequent Events, for further discussion.

Profit Sharing Agreements Assumed in the Acquisition of Cypress

Hawthorn Pharmaceuticals is a party to a development agreement with Audax, Inc, a developer and inventor of branded and generic pharmaceutical products, entered into on February 10, 2011 (amended May 21, 2012), for the development of three NDA items containing magnesium glycinate, under the trade name Nuvita. Under this agreement, Audax and Hawthorn will jointly own 50% of the products, the NDA for the products, and all related rights, interests, and assets of the products. Hawthorn shall bear all development costs and expenses of the products. Audax is to receive a profit share of 10% of net sales (as defined in the agreement) upon launch of the items. We continue to explore all available development options for this product.

Cypress is a party to a pharmaceutical marketing agreement with Amplogen Pharmaceuticals, LLC, a developer and seller of pharmaceutical products, entered into on January 25, 2012 for the exclusive marketing rights for ANDA 090910, sodium phenyl butyrate tablets 500mg. Amplogen supplies product, at no cost to Cypress, in exchange for a royalty of 60% of contract price obtained on the item. Due to certain delays in the process, the Company now expects the product to launch the summer of 2014. However, there can be no assurance that the product launch will occur by this time.

Hawthorn Pharmaceuticals is a party to a license and promotion agreement with Amneal Pharmaceuticals, a developer and seller of pharmaceutical products, for co-promotional rights to ANDA 076642, hydrocodone/ibuprofen tablets in 10mg/200mg, 5mg/200mg, and 2.5mg/200mg strengths. Under the agreement entered into on August 7, 2012, Amneal has the exclusive right to manufacture, market, sell and promote the product. Hawthorn provides representatives to detail the products in defined fields and territories. Hawthorn receives a royalty fee per prescription on these products.

Hawthorn Pharmaceuticals is a party to a development, license, and supply agreement with Pharmaceutical Associates, Inc., a developer, manufacturer, and distributor of pharmaceutical products, for the exclusive promotion and distribution of (i) hydrocodone bitrate and acetaminophen oral solution 10/325 mg/15mL (promoted under the brand name Zamicet), and (ii) prednisolone sodium phosphate oral solution 20mg/5 mL (promoted under the brand name VERIPRED). Under the terms of the agreement entered into on July 18, 2008, Pharmaceutical Associates is to receive a royalty of 50% of profits obtained on these products. Hawthorn agreed to minimum annual quantities of both products. The term of the agreement is for three years, with an automatic extension of one year (successive), unless Hawthorn is provided 180 days written notice of termination. On February 21, 2013, Hawthorn received a notice effectively terminating its promotion and distribution rights to Zamicet effective August 25, 2013. On June 12, 2013, Hawthorn received a notice effectively terminating its promotion and distribution rights to VERIPRED effective December 12, 2013.

Cypress is a party to a pharmaceutical manufacturing agreement with Stason Pharmaceuticals, a contract manufacturer of branded and generic pharmaceuticals, and developer of ANDA’s, for the exclusive marketing rights to eight generic pharmaceutical products. The terms of the agreement, which was entered into on November 1, 2005, call for Stason to be the exclusive supplier of these products and for Stason to receive a profit share of 50% on all applicable products with the exception of one, in which Stason is to receive 75% of “net sales profit” as defined by the agreement. This agreement was transferred to Breckenridge in the transaction discussed in Note 5, Disposition of Certain Cypress Assets.

Profit Sharing Agreements Assumed in the Acquisition of GSL

In the acquisition of GSL, Pernix Manufacturing assumed two profit sharing agreements relating to the licensing of certain proprietary formulations which require a specified commission per unit for any products manufactured utilizing these proprietary formulations.

Note 20. Employee Compensation and Benefits

The Company participates in a 401(k) plan, which covers substantially all full-time employees. The Plan is funded by employee contributions and discretionary matching contributions determined by management. At the Company’s discretion, it may match up to 100 percent of each employee’s contribution, not to exceed the first six percent of the employee’s individual salary. There is a six-month waiting period from date of hire to participate in the plan. Employees are 100 percent vested in employee and employer contributions. Contribution expense was approximately $450,000, $346,000 and $292,000 for the years ended December 31, 2013, 2012 and 2011, respectively.

Stock Options

The Company's 2009 Stock Incentive Plan was approved concurrent with its merger with Golf Trust of America, Inc. on March 9, 2010. The maximum number of shares that can be offered under this plan is 5,000,000. Incentives may be granted under the 2009 Plan to eligible participants in the form of (a) incentive stock options, (b) non-qualified stock options, (c) restricted stock, (d) restricted stock units, (e) stock appreciation rights and (f) other stock-based awards.

As of December 31, 2013, approximately 30,000 options remain outstanding that were issued to current officers and directors under former incentive plans of GTA. The remaining average contractual life of these options is approximately 1.2 years.

The Company currently uses the Black-Scholes option pricing model to determine the fair value of its stock options. The determination of the fair value of stock-based payment awards on the date of grant using an option pricing model is affected by the Company's stock price, as well as assumptions regarding a number of complex and subjective variables. These variables include the Company's expected stock price volatility over the term of the awards, actual employee exercise behaviors, risk-free interest rate and expected dividends.

The following table shows the weighted average of the assumptions used to value stock options on the date of grant, as follows:

	Year Ended December 31,		
	2013	2012	2011
Weighted average expected stock price volatility	66.8 %	64.7 %	70.0 %
Estimated dividend yield	0.0 %	0.0 %	0.0 %
Risk-free interest rate	1.0 %	1.1 %	1.4 %
Pre-vest forfeiture rate	3.6 %	4.6 %	2.2 %
Expected life of option (in years)	6.00	6.00	6.02
Weighted-average grant-date fair value per share	$4.64	$5.33	$4.68

The Company has not paid and does not anticipate paying cash dividends; therefore, the expected dividend rate is assumed to be 0%. The expected stock price volatility for the stock options is based on historical volatility of a representative peer group of comparable companies selected using publicly available industry and market capitalization data. The risk-free rate was based on the U.S. Treasury yield curve in effect at the time of grant commensurate with the expected life assumption. The expected life of the stock options granted was estimated based on the historical exercise patterns over the option lives.

Option Shares	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value ($000)
Outstanding at December 31, 2011	1,848,491	$4.55		
Granted	215,000	9.07		
Exercised	(171,491)	3.89		
Cancelled	(180,833)	7.57		
Expired	—	—		
Outstanding at December 31, 2012	1,711,167	4.87	7.8	$5,323
Granted	295,000	4.07		
Exercised	(40,000)	2.79		
Cancelled	(361,667)	6.30		
Expired	—	—		
Outstanding at December 31, 2013	1,604,500	4.45		$1,600
Vested and exercisable, end of period	796,161	$4.43	6.2	$1,600

The intrinsic value of options exercised during the years ended December 31, 2013, 2012 and 2011 was approximately $132,000, $672,000 and $1,937,000, respectively.

The following table shows the details by range of exercise price for the total options outstanding at December 31, 2013:

	Options Outstanding		Options Exercisable	
Range of Exercise Price ($)	Shares	Remaining Contractual Life (years)	Shares	Weighted Average Exercise Price

2.20	5,000	1.2	5,000	$2.20
3.31 – 4.20(1)	1,278,000	7.2	638,000	3.71
6.10	136,500	7.6	89,828	6.10
7.75 – 9.02	135,000	8.5	29,999	8.80
10.13 – 10.35	50,000	7.4	33,334	10.14
	1,604,500	7.4	796,161	$4.43

(1) Includes 460,000 options granted to ParaPRO, LLC on August 3, 2011, that vest over seven years, pursuant to the commercial terms of the co-promotion arrangement between the Company and ParaPRO for the marketing and sale of NATROBA. For additional information, see Note 17, Other Revenue Sharing Arrangements.

As of December 31, 2013, there was approximately $450,000 of total unrecognized compensation cost related to unvested stock options issued to employees and directors of the Company, which is expected to be recognized ratably over a weighted-average period of 1.3 years and approximately $1,290,000 of total unrecognized compensation cost related to unvested stock options issued to ParaPRO which is expected to be recognized ratably over a weighted-average period of 3.5 years.

Restricted Stock

The following table shows the restricted stock activity during the year ended December 31, 2013 and 2012:

Restricted Stock Shares	Shares	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2011	120,002	$6.56
Granted	670,000	7.51
Vested	(61,669)	6.15
Forfeited	—	
Nonvested at December 31, 2012	728,333	$7.47
Granted	357,654	3.52
Vested	(172,266)	7.75
Forfeited	(284,867)	6.46
Nonvested at December 31, 2012	628,854	5.60

During the year ended December 31, 2013, 357,654 restricted common shares were issued. Approximately $2,376,000 of total unrecognized compensation cost related to unvested restricted stock is expected to be recognized over a weighted-average period of 1.8 years.

Employee Stock Purchase Plan

Effective July 22, 2010, the Company adopted the 2010 Employee Stock Purchase Plan to provide substantially all employees an opportunity to purchase shares of its common stock through payroll deduction, up to 10% of eligible compensation with a $25,000 maximum deferral. Semi-annually (on May 1 and November 1), participant account balances will be used to purchase shares of stock at the lesser of 85 percent of the fair market value of shares at the beginning or end of such six-month period. The Employee Stock Purchase Plan expires on July 22, 2020. A total of 1,000,000 shares are available for purchase under this plan of which 126,027 have been issued. Compensation expense related to the Employee Stock Purchase Plan and included in the table below for the years ended December 31, 3013, 2012 and 2011 was approximately $71,000, $63,000 and $101,000, respectively.

Stock-Based Compensation Expense

The following table shows the approximate amount of total stock-based compensation expense recognized for employees and directors:

	Years Ended December 31,		
	2013	2012	2011
Employees	$1,656,000	$2,032,000	$834,000
Non-employees/Directors	392,000	622,000	449,000

Total	$2,048,000	$2,654,000	$1,283,000

Note 21. Income Taxes

The income tax provision consisted of the income tax expense (benefits) for the years ended December 31, 2013, 2012 and 2011, as presented in the table below.

The components of the provision (benefit) for income taxes are as follows for the years ending December 31, 2013, 2012 and 2011:

	Year Ended December 31,		
	2013	2012	2011
Current:			
Federal	$1,176,000	$1,718,000	$6,566,000
State	584,000	(255,000)	970,000
Total current provision (benefit)	1,760,000	1,463,000	7,536,000
Deferred Provision			
Federal	(18,985,000)	(1,758,000)	(2,551,000)
State	(3,531,000)	(78,999)	(396,000)
Total deferred provision (benefit)	(22,516,000)	(1,836,999)	(2,947,000)
Total	$(20,756,000)	$(373,999)	$4,589,000

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of the assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The sources of the temporary differences and their effect on deferred taxes are as follows:

	Year Ended December 31,	
	2013	2012
Deferred tax assets:		
Accounts receivable	$230,000	$2,403,000
Differences in carrying value of property and equipment	81,000	—
Accruals	13,082,000	4,477,000
Stock awards	2,272,000	1,623,000
NOL carryovers	7,303,000	1,337,000
Gross deferred tax assets	22,968,000	9,840,000
Deferred tax liabilities:		
Differences in carrying value of property and equipment	$—	$(27,000)
Inventory	(79,000)	(248,000)
Other	(475,000)	(367,000)
Intangibles	(25,106,000)	(34,875,000)
Installment sale	(3,506,000)	—
Investments	—	(1,740,000)
Gross deferred tax liability	(29,166,000)	(37,257,000)
Net deferred tax asset/(liability)	(6,198,000)	(27,417,000)
Included in consolidated balance sheet:		
Deferred income tax assets/(liabilities)–current	9,301,000	8,118,500
Deferred income tax assets/(liabilities)–long-term	(15,499,000)	(35,535,500)
Net deferred tax asset/(liability)	$(6,198,000)	$(27,417,000)

Somaxon has federal net operating loss carryforwards (NOL's) of approximately $246,500,000 at 12/31/13 ranging in expiration from 2023 to 2032. However, based on the change in ownership provision of IRC Section 382, $19,250,000 of those NOL are expected to be available for utilization.

Pernix Therapeutics Holdings, Inc. has federal NOL's of approximately $520,000 at 12/31/13 with an expiration of 2031.

GTA GP, Inc. has federal NOL's of approximately $ 85,300,000 at 12/31/13 ranging in expiration from 2024 to 2033. However, based on the change in ownership provisions of IRC Section 382, $0 of those NOL are expected to be available for utilization.

Somaxon has federal research and development credit carryovers of approximately $ 4,300,000 at 12/31/13. However, based on the change in ownership provision of IRC Section 382, $ 0 of those credits are expected to be available for utilization.

It should be noted that only those amounts that are expected to be utilized are included in the deferred tax assets (Somaxon and Pernix NOL's noted above).

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods that the deferred tax assets are deductible, management believes that it is more likely than not that the Company will realize the benefits of these deductible differences. The amount of the deferred tax assets at the Company level are considered realizable based on the reversal of deferred tax liabilities and the Company's projected levels of taxable income.

The effective income tax rate from continuing operations is different from the federal statutory rate for the years ended December 31, 2013, 2012 and 2011 for the following reasons:

	December 31,		
	2013	2012	2011
Expected taxes at statutory rates	(35.0)%	(35.0)%	35.0 %
State taxes, net of federal tax benefit	(4.1)%	(12.2)%	2.9 %
Cypress put option – change in value	6.3 %	—	—
Cypress put option – contingent gain	(12.3)%	—	—
Non-deductible transaction costs	—	22.3 %	—
Other	0.4 %	3.9 %	(2.4)%
	(44.7)%	(21.0)%	35.5 %

Approximately $12.3 and $31.4 million of the deferred tax liability at December 31, 2013 and 2012, respectively, relates to the difference between the financial statement and tax basis of the intangibles acquired in the Cypress acquisition. The deferred tax liability related to these Cypress intangibles is reduced on an annual basis by the financial statement amortization of such intangibles. In addition, the decrease from the year ended December 31, 2012 to the year ended December 31, 2013 was primarily due to the disposition and the impairment of certain Cypress intangibles assets, as further described in Note 5, Disposition of Cypress Assets, and Note 12, Intangible Assets and Goodwill. The Cypress intangibles are amortized over a period of 11 years.

Note 22. Commitments and Contingencies

Purchase Commitments

Purchase obligations include fixed or minimum payments under manufacturing and supply agreements with third-party manufacturers and other providers of goods and services. Our failure to satisfy minimum sales requirements under our co-promotion agreements generally allows the counterparty to terminate the agreement and/or results in a loss of our exclusivity rights. In addition to minimum sales requirements under our co-promotion agreements, the Company has commitments under open purchase orders for inventory that can be cancelled without penalty of approximately $6.0 million (including Cypress).

Stock Options Issued in Exchange for Services

Pursuant to an agreement for support services entered into between the Company and ParaPRO on August 27, 2010 which commenced upon the launch of NATROBA on August 3, 2011, 460,000 stock options were issued to ParaPRO. The options have an exercise price of $3.65 which was the closing price of the Company's stock as of the date of the support services agreement. The options are exercisable in seven installments in the following amounts: (i) 30,000 on August 1, 2012, (ii) 40,000 on August 1, 2013, (iii) 50,000 on August 1, 2014, (iv) 60,000 on August 1, 2015, (v) 70,000 on August 1, 2016, (vi) 90,000 on August 1, 2017, and (vii) 120,000 on August 1, 2018. The options are exercisable for a period of five years from the date each becomes exercisable and were valued at approximately $2,841,000. These options were granted in a private offering under Rule 4(2) of the Securities Act of 1933. As of December 31, 2013, there was approximately $1,290,000 of total unrecognized compensation cost related to unvested stock options, which is expected to be recognized ratably over a weighted-average period of 3.5 years.

Leases

The Company leases facilities space and equipment under operating lease arrangements that have terms expiring at various dates through 2016. Certain lease arrangements include renewal options and escalation clauses. In addition, various lease agreements to which the Company is a party require that we comply with certain customary covenants throughout the term of the leases. If we are unable to comply with these covenants and cannot reach a satisfactory resolution in the event of noncompliance, these agreements could terminate.

Future minimum lease payments under non-cancelable operating leases do not include the rent payments for the Woodlands, Texas lease that was terminated effective July 31, 2013. The lease had a remaining term through April 2016, representing a future lease commitment of approximately $579,000. The minimum payments as of December 31, 2013 are as follows:

Year Ended December 31,	
2014	$ 470,000
2015	39,000
2016	4,000
2017	—

Total rent expense was approximately $730,000, $375,000 and $249,000 for the years ended December 31, 2013, 2012 and 2011, respectively.

Capital leases on certain pharmaceutical manufacturing equipment assumed in the acquisition of GSL had terms to November 2013.

Milestone Payments

The Company is party to certain license agreements as described in Note 19, Other Revenue Sharing Arrangements, and acquisition agreements as described in Note 4, Business Combinations and Other Acquisitions. Generally, these agreements require that the Company make milestone payments in cash upon the achievement of certain product development and commercialization goals and payments of royalties upon commercial sales. The amount and timing of future milestone payments, as discussed in the Notes referenced herein, may vary depending on when related milestones will be attained, if at all.

Other Revenue Sharing Arrangements

The Company has entered into certain revenue sharing arrangements that require payments based on a specified percentage of net sales or a specified cost per unit sold. For the years ended December 31, 2013, 2012 and 2011, we recognized approximately $6,917,000 $4,245,000 and $2,427,000, respectively, in expense included in cost of goods sold from payments pursuant to co-promotion and other revenue sharing arrangements. See Note 19, Other Revenue Sharing Arrangements, for further discussion.

Somaxon was subject to certain contractual payment obligations pursuant to settlement agreements entered into by it which the Company assumed. As of December 31, 2013, a $379,000 balance remained unpaid under the terms of a settlement agreement relating to the termination of a co-promotion agreement. Pursuant to the terms of this agreement,

six percent of net sales of Silenor are payable to the counterparty until the balance is paid in full. In July 2012 and January 2013, Somaxon settled two patent litigation claims with parties seeking to market generic equivalents of Silenor. Remaining payment obligations owed by Somaxon and assumed by Pernix under these settlement agreements are $1,500,000 and $2,000,000, respectively, payable in equal installments over the next seven and four years, respectively.

Legal Proceedings

Texas Attorney General Medicaid Investigation

The Company reached an agreement with the Attorney General of the State of Texas to settle all claims arising from certain actions by Cypress under the Texas Medicaid Fraud Prevention Act prior to its acquisition by the Company in connection with a Civil Investigative Demand made on Cypress. See Note 24, Subsequent Events, for further information regarding the Company's payment obligations under the settlement.

Somaxon Pharmaceuticals, Inc. Shareholder Litigation (Lead Case No. 37-201200087821-CU-SLCTL)

A purported class action lawsuit was filed in the Superior Court of California County of San Diego by Daniele Riganello, who, prior to the consummation of the merger between Pernix and Somaxon on March 6, 2013 (the "Merger"), was an alleged stockholder of Somaxon (Riganello v. Somaxon, et al., No. 37-201200087821-CU-SLCTL). A second purported class action was also filed in the court by another alleged stockholder (Wasserstrom vs. Somaxon, et al., No. 37-2012-00029214-CU-SL-CTL). The lawsuits were consolidated into a single action captioned In re Somaxon Pharmaceuticals, Inc. Shareholder Litigation (Lead Case No. 37-201200087821-CU-SLCTL). The operative complaint named as defendants Somaxon, Pernix, Pernix Acquisition Corp. I, as well as each of the former members of Somaxon's board of directors (the "Individual Defendants"). It alleged, among other things, that (i) the Individual Defendants breached fiduciary duties they assertedly owed to Somaxon' s former stockholders in connection with the Merger (ii) Somaxon and Pernix aided and abetted the purported breaches of fiduciary duty; (iii) the merger consideration was unfair and inadequate; and (iv) the disclosures regarding the Merger in the Registration Statement on Form S-4, initially filed with the Securities and Exchange Commission on January 7, 2013 (the "Proxy Statement/Prospectus"), were inadequate.

On January 24, 2013, solely to avoid the costs, risks and uncertainties inherent in litigation and without admitting any liability or wrongdoing, Pernix and the other named defendants in such litigation signed a memorandum of understanding (the "MOU") to settle such litigation. In accordance with the MOU, Pernix made certain additional disclosures related to the Merger in the Proxy Statement/Prospectus and agreed to reimburse the plantiffs for certain legal expenses in the amount of $185,000, which is accrued in other liabilities. Subject to confirmatory discovery, which was completed in April 2013, and court approval of a definitive stipulation of settlement, which was filed in July 2013, the MOU resolves the claims brought in such litigation and provides a release and settlement by the purported class of Somaxon's former stockholders of all claims against the defendants and their affiliates and agents in connection with the Merger. The asserted claims will not be released until such stipulation of settlement is approved by the court. There can be no assurance that the court will approve such settlement. Additionally, in connection with the proposed settlement, plaintiffs in such litigation intend to seek an award of attorneys' fees and expenses in an amount to be approved or determined by the court.

In addition to the above proceedings, Pernix is subject to various claims and litigation arising in the ordinary course of business. In the opinion of management, the outcome of such matters will not have a material effect on Pernix's financial position or results of operations.

Uninsured Liabilities

The Company is exposed to various risks of losses related to torts, theft of, damage to, and destruction of assets, errors and omissions, injuries to employees, and natural disasters for which the Company maintains general liability insurance with limits and deductibles that management believes prudent in light of the exposure of the Company to loss and the cost of the insurance.

The Company is subject to various claims and litigation arising in the ordinary course of business. In the opinion of management, the outcome of such matters will not have a material effect on the consolidated financial position or results of operations of the Company.

Note 23. Quarterly Financial Data (Unaudited)

Selected quarterly consolidated financial data are shown below (in thousands, except per share data).

	Three Months Ended			
	March 31, 2013	June 30, 2013	September 30, 2013	December 31, 2013
	(in thousands, except per share data) (unaudited)			
Net revenues	$ 22,078	$ 20,573	$ 18,295	$ 23,926
Operating expenses	30,864	29,088	24,969	54,612
(Loss) Income from operations	(8,786)	(8,515)	(6,674)	(30,686)
Other (expense) income, net	(2,934)	143	(2,406)	13,466
Income tax (benefit) provision	(3,263)	(2,121)	(2,676)	(12,696)
Net (loss) income	$ (8,457)	$ (6,251)	$ (6,404)	$ (4,524)
Net (loss) income per share—basic	$ (0.24)	$ (0.17)	$ (0.17)	$ (0.12)
Net (loss) income per share - diluted	$ (0.24)	$ (0.17)	$ (0.17)	$ (0.12)

	Three Months Ended			
	March 31, 2012	June 30, 2012	September 30, 2012	December 31, 2012
	(in thousands, except per share data) (unaudited)			
Net revenues	$ 14,482	$ 10,499	$ 18,134	$ 18,198
Operating expenses	12,468	11,953	18,816	19,765
(Loss) Income from operations	2,014	(1,454)	(682)	(1,567)
Other (expense) income, net	(40)	(27)	7	(35)
Income tax (benefit) provision	783	(549)	(404)	(304)
Net (loss) income	$ 1,191	$ (932)	$ (271)	$ (1,398)
Net (loss) income per share—basic	$ .05	$ (.03)	$ (.01)	$ (.05)
Net (loss) income per share - diluted	$ .04	$ (.03)	$ (.01)	$ (.05)

In connection with the re-valuation of the Cypress intangible assets, the amortization on these assets has been retrospectively adjusted for the three months periods ending March 31, June 30 and September 30, 2013, in accordance with ASC No. 805, Business Combinations. The retrospective adjustments are included in the quarterly data above.

Note 24. Subsequent Events

Exclusive License Agreement. On February 27, 2014, the Company entered into an exclusive license agreement with Osmotica Pharmaceutical Corporation to promote KHEDEZLA (desvenlafaxine) Extended-Release (ER) Tablets, 50 mg and 100 mg. The sales and marketing of KHEDEZLA will be supported by the Company's team of approximately 90 sales professionals, promoting the product to high desvenlafaxine prescribing physicians. The New Drug Application (NDA) for KHEDEZLA Tablets was approved by the U.S. Food and Drug Administration pursuant to section 505(b)(2) of the Federal Food, Drug, and Cosmetic Act in July 2013. KHEDEZLA is indicated for the treatment of major depressive disorder (MDD). Pursuant to the agreement, the Company agreed to make an upfront payment for the license and Osmotica's existing inventory of Khedezla in the amount of $4,000,000 in the aggregate

with (i) $1,500,000 due upon execution of the agreement, which has been paid, (ii) $1,500,000 to be paid on or before ninety days after the effective date of February 26, 2014, and (iii) $1,000,000 to be paid on or before five months after the effective date. There are also additional milestones based on certain levels of net profits achieved. Royalty payments equivalent to 60% of net profits will be paid by the Company to Osmotica quarterly. The royalty payments reduce to 55% in the second contract year and 50% for each year thereafter.

Note Offering. On February 21, 2014, the Company issued $65 million aggregate principal amount of the Company's 8.00% Convertible Senior Notes due 2019 in accordance with each of the Securities Purchase Agreements dated February 4, 2014 by and between the Company and the investors party thereto.

On February 21, 2014, in connection with the Notes offering, the Company entered into Amendment No. 1 to the Amended and Restated Credit Agreement (the "Amendment" and together with the Amended and Restated Credit Agreement, as amended by the Amendment, the "Amended Credit Agreement") with MidCap Funding IV, LLC, as Agent and as a lender ("MidCap"), and the other lenders from time to time parties thereto. In addition to allowing for the Note issuance, the Amendment provides for the addition of a $20 million uncommitted accordion feature to the lenders' existing $20 million revolving loan commitment. Pursuant to the Amendment, MidCap and the other lenders released their liens on certain of our assets. The obligations under the Amended Credit Agreement are secured by a first priority security interest in the Company's accounts, inventory, deposit accounts, securities accounts, securities entitlements, permits and cash.

The covenants contained in the Amended Credit Agreement require the Company to maintain a minimum amount of EBITDA and net invoiced revenues unless we demonstrate minimum liquidity of at least $30 million. The Amended Credit Agreement continues to include customary covenants for a secured credit facility, which include, among other things, (a) restrictions on (i) the incurrence of indebtedness, (ii) the creation of or existence of liens, (iii) the incurrence or existence of contingent obligations, (iv) making certain dividends or other distributions, (v) certain consolidations, mergers or sales of assets and (vi) purchases of assets, investments and acquisitions; and (b) requirements to deliver financial statements, reports and notices to the Agent and the other lenders, provided that, the restrictions described in (a)(i)-(vi) above are subject to certain exceptions and permissions limited in scope and dollar value. The Amended Credit Agreement also contains customary representations and warranties and event of default provisions for a secured credit facility.

In connection with the Amendment, the Company entered into an Amended and Restated Security and Pledge Agreement (the "Amended and Restated Security Agreement") with MidCap as Agent. The Amended and Restated Security Agreement amends and restates the Security and Pledge Agreement, dated as of December 31, 2012, that we entered into with MidCap Funding V, LLC (the "Original Security Agreement"). The Amended and Restated Security Agreement creates a security interest in favor of MidCap, for the benefit of the lenders from time to time parties to the Amended and Restated Security Agreement, in our accounts, inventory, deposit accounts, securities accounts, securities entitlements, permits and cash as security for our repayment of the Company's obligations under the Amended Credit Agreement.

The loans under this facility bear continue to bear interest at a rate equal to the sum of the LIBOR rate (with a floor of 1.5%) plus an applicable margin of 7.50% per annum. The expiration date of the agreement has been extended to February 21, 2017.

Resignation of Directors

Resignation of Directors. At the request of the Company, on February 21, 2014, each of Cooper C. Collins, James E. Smith, Jr. and Anthem Blanchard resigned as members of the Board of Directors of the Company. In addition, Mr. Collins also resigned as Chief Strategy Officer of the Company effective as of April 15, 2014. These resignations did not relate to any disagreements with the Board of Directors (the "Board") or management of the Company or disagreements with respect to matters related to the operations, policies or practices of the Company.

Recent Appointments

Mr. Doug Drysdale was appointed President and Chief Executive Officer on February 5, 2014 replacing Mr. Michael Pearce. Mr. Drysdale base compensation is $575,000 annually and he is eligible to receive an annual cash bonus equal to 50% of his base salary at the discretion of the Board or the Compensation Committee. Mr. Drysdale also received 1,500,000 in stock options at an exercise price of $2.09 vesting over four years in equal monthly amounts with the first six months accruing but not vesting until the six month anniversary. Mr. Drysdale was also appointed Chairman of the Board. Mr. Pearce transitioned to a consulting role effective March 1, 2014 pursuant to which he will receive a monthly consulting fee of $29,167 until August 31, 2014. Mr. Pearce continues to serve on the Company's board of directors.

On March 9, 2014, the Company appointed Terence Novak to serve as the Company's Chief Operating Officer.

Effective March 13, 2014, the Company's Board of Directors appointed John A. Sedor to serve in one of the vacancies created by the recent resignations of three board members. He was also appointed to serve as Chairman of the Compensation Committee.

Director Compensation

On March 12, 2014, the Board approved an increase in the annual cash compensation paid to the Company's non-executive directors from $30,000 to $40,000. All other cash compensation paid to directors for being a chairman or serving on a committee remains the same.

Settlement with Former Shareholders of Cypress

A Stipulation of Dismissal was filed with the United States District Court for the Southern District of Texas (Houston Division) on January 29, 2014 in connection with the settlement of all claims brought against the Company by the former shareholders (the "Plaintiff Shareholders") of Cypress and all claims brought against the Plaintiff Shareholders by the Company in connection with the purchase of Cypress by us pursuant to the Securities Purchase Agreement by and among the Company, Cypress and the Plaintiff Shareholders (the "Purchase Agreement"). As part of the settlement, the Company agreed to pay $1,330,000 to the Plaintiff Shareholders on or before February 7, 2014, which amount was accrued at the time of the Cypress acquisition as a contingent consideration in our financial statements. This payment was made according to these terms. In exchange for this payment, both parties released all claims against the other parties, which includes the Plaintiff Shareholders waiving any rights to the put obligation of the Company included in the Purchase Agreement. Additionally, this payment repays in full all currently existing obligations by us to fund the escrow account or to pay the holdback amount under the Purchase Agreement. The settlement also modified the language relating to the milestone payment payable to the Plaintiff Shareholders pursuant to the Purchase Agreement but still reflects a one-time payment of $5,000,000, payable in cash or stock, upon the achievement of one of such milestones.

Texas Attorney General Medicaid Investigation

The Company reached an agreement with the Attorney General of the State of Texas to settle all claims arising from certain actions by Cypress under the Texas Medicaid Fraud Prevention Act prior to its acquisition by us in connection with a Civil Investigative Demand made on Cypress. As part of the settlement, the Company has agreed to pay $12,000,000 to the State of Texas. As discussed in Note 5, Disposition of Certain Cypress Assets, the Company recorded the fair value of this settlement in the amount of $9,780,000 in our financial statements at December 31, 2013 and recorded as an expense during the quarter ended December 31, 2013. An initial payment of $2,000,000 was due and payable within ten business days of the effective date of the final settlement agreement (the "Effective Date")

and was paid accordingly. Thereafter, the Company will make subsequent payments of $2,000,000 on each of the first five anniversaries of the Effective Date.

Schedule II
Pernix Therapeutics Holdings, Inc.

Valuation and Qualifying Accounts
Years Ended December 31, 2013, 2012 and 2011
(in thousands)

	Balance at beginning of period	Charged to costs and expenses	Deductions/ Write-offs	Balance at end of period
Allowance for doubtful accounts:				
Year ended December 31, 2013	$ 39	$ 98	$ (53)	$ 84
Year ended December 31, 2012	$ —	$ 43	$ (4)	$ 39
Year ended December 31, 2011	$ —	$ —	$ —	$ —

INDEX TO EXHIBITS

No.	Description	Filed or Furnished with this Form 10-K	Incorporated by Reference	
			Form	Date Filed
2.1	Securities Purchase Agreement, dated as of November 13, 2012, by and among Pernix Therapeutics Holdings, Inc., Cypress Pharmaceuticals, Inc., all of the stockholders of Cypress Pharmaceuticals, Inc. and an individual as agent of all of the stockholders of Cypress Pharmaceuticals, Inc.		8-K	11/15/2012
2.2	First Amendment to Securities Purchase Agreement dated December 28, 2012 among Pernix Therapeutics Holdings, Inc., on the one hand, and Cypress Pharmaceuticals, Inc., a Mississippi corporation, all of the stockholders of Cypress, and for limited purposes set forth therein, an individual as agent of the Sellers, on the other hand.		8-K	01/04/2013
2.3	Agreement and Plan of Merger dated December 10, 2012 by and among Pernix Therapeutics Holdings, Inc., Pernix Acquisition Corp I. and Somaxon Pharmaceuticals, Inc.		8-K	12/12/2012
2.4	Asset Purchase Agreement by and among Breckenridge Pharmaceutical, Inc. (“Breckenridge”), on the one hand, and the Company and Cypress Pharmaceuticals, Inc. (“Cypress”), on the other hand, dated as of August 5, 2013		10-Q	08/09/2013
2.5	Joinder Agreement and First Amendment to Asset Purchase Agreement dated September 11, 2013 among the Company and Cypress, on the one hand, and Breckenridge, on the other hand		8-K	09/17/2013
3.1	Articles of Incorporation of Pernix Therapeutics Holdings, Inc.		8-K	03/15/2010
3.2	Bylaws of Pernix Therapeutics Holdings, Inc.		8-K	03/15/2010
4.1	Form of certificate representing shares of common stock of Pernix Therapeutics Holdings, Inc.		10-K	03/29/2012
4.2			8-K	02/26/2014

	Indenture, dated February 21, 2014, by and between Pernix Therapeutics Holdings, Inc. and Wilmington Trust, National Association		
4.3	Form of 8.00% Convertible Senior Note due 2019 (included in Exhibit 4.2)	8-K	02/26/2014
10.1*	2009 Stock Incentive Plan	8-K	03/15/2010
10.2*	2010 Employee Stock Purchase Plan	8-K	08/16/2010
10.3*	Golf Trust of America, Inc. 2007 Stock Option Plan	S-8	06/04/2010
10.4*	2007 Stock Option Plan	Def14A	11/16/2007
10.5*	Employment and Non-Compete Agreement, dated December 31, 2008, by and between Pernix Therapeutics, Inc. and Michael Venters	8-K	03/15/2010

10.6*	Employment Offer Letter, dated May 10, 2013, by and between Pernix Therapeutics, Inc. and Cooper Collins	10-Q	08/09/2013
10.7*	Amended and Restated Employment and Non-Compete Agreement, dated March 14, 2011, by and among Pernix Therapeutics Holdings, Inc., Macoven Pharmaceuticals, LLC. and John McMahon	10-K	03/30/2011
10.8*	Amendment No. 1 to Amended and Restated Employment and Non-Compete Agreement, dated March 23, 2012, by and among Pernix Therapeutics Holdings, Inc., Macoven Pharmaceuticals, LLC. and John McMahon	10-K	03/29/2012
10.9*	Employment Offer Letter, dated May 10, 2013, by and between Pernix Therapeutics Holdings, Inc., and Michael Pearce	10-Q	08/09/2013
10.10	Form of Amended and Restated Merger Partner Stockholder Agreement	8-K	05/31/2011
10.11	Amended and Restated Credit Agreement dated as of May 8, 2013 by and among Pernix Therapeutics Holdings, Inc., together with its subsidiaries, Midcap Financial, LLC., as Administrative Agent and Lender and the additional lenders from time to time party thereto.	8-K	05/13/2013
10.12*	Severance Letter, dated July 19, 2013, by and between Pernix Therapeutics Holdings, Inc. and Tracy S. Clifford	10-Q	08/09/2013
10.13*	Employment Offer Letter, dated April 19, 2013, by and between Pernix Therapeutics Holdings, Inc. and Brian T. Dorsey	8-K	04/25/2013
10.14	Amended and Restated License Agreement by and between Pernix Sleep, Inc. (formerly Somaxon Pharmaceuticals, Inc.) and ProCom One, Inc. dated September 15, 2010.	10-Q	11/12/2013
10.15	Form of Securities Purchase Agreement, dated February 4, 2014.	8-K	02/07/2014
10.16*	Employment Agreement dated as of February 5, 2014 by and between Pernix Therapeutics Holdings, Inc. and Douglas Drysdale.	8-K	02/07/2014
10.17	Amendment No. 1 to the Amended and Restated Credit Agreement, dated February 21, 2014, between Pernix Therapeutics Holdings, Inc. and MidCap Funding IV, LLC, as Agent and as a lender, and the other lenders from time to	8-K	02/26/2014

	time parties thereto			
10.18	Amended and Restated Security and Pledge Agreement, dated February 21, 2014, by and between Pernix Therapeutics Holdings, Inc. and MidCap Funding IV, LLC, as Agent.		8-K	02/26/2014
10.19	Form of Representation Agreement, dated February 21,2014, by and between Pernix Therapeutics Holdings, Inc. and the Investors party thereto		8-K	02/26/2014
10.20	Form of Registration Rights Agreement, dated February 21,2014, by and between Pernix Therapeutics Holdings, Inc. and the Investors party thereto		8-K	02/26/2014
10.21*	Amendment No. 1 to the Pernix Therapeutics Holdings, Inc. 2009 Stock Incentive Plan	√		
10.22*	Employment Agreement dated as of March 9, 2014 by and between PernixTherapeutics Holdings, Inc. and Terence Novak		8-K	03/11/2014

21.1	Subsidiaries of the Company	√
23.1	Consent of Cherry Bekaert L.L.P.	√
31.1	Certification by Douglas Drysdale pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	√
31.2	Certification by Tracy S. Clifford pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	√
32.1	Certification by Douglas Drysdale and Tracy S. Clifford 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.DEF	XBRL Taxonomy Extension Definition Linkbase Document	
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	

* Indicates a management contact or compensatory plan or arrangement