

Disclosed SEC Investigation Confirmed as On-Going

Akorn: An Acquired Problem, Criminal Exposure, and Shoddy Disclosures

If we alert you to the existence of an undisclosed SEC probe, that means we filed a Freedom of Information Act (FOIA) request with the SEC on the company in question and have a response, in black-and-white, on government letterhead that supports our statement. Other interpretative guidance and disclosures appear below.

Analyst Summary: Even though it's disclosed, we explain why we think it is highly unlikely Akorn's joint SEC/US Attorney (read: criminal) probes are discounted into the shares. With cut-and-paste substituting for meaningful updates regarding these investigations, investors are left with a material exposure that otherwise cannot be analyzed. Further, Hi-Tech Pharmaco, acquired in Apr-2014, had a confirmed, undisclosed SEC probe at the time it was acquired. Accounting problems at Hi-Tech were cited as a contributor to the non-reliance on financial warning Akorn issued in Mar-2015. We were early in warning of potential for problems with a report we wrote in Nov-2014, [What Kind of SEC Problem Did Akorn Inherit With its Acquisition of Hi-Tech Pharmaco?](#) This unsettling combination leaves you open to unexpected surprises.

Facts of Interest or Concern: On 17-Mar-2015, Akorn filed an 8-K in which the company stated, and explained why previously issued financial statements could no longer be relied upon. We got our first sign the SEC was investigating Akorn on 15-Oct-2015. Akorn did not make its first disclosure of an SEC probe until 04-Nov-2015. This was nearly eight months after a non-reliance on financials warning issued in Mar-2015. A US Attorney investigation was also disclosed at that time. In a letter dated 08-Jun-2016, the SEC confirmed Akorn, Inc.'s involvement in on-going enforcement proceedings, again, that were first disclosed in Nov-2015

Undisclosed SEC probe at Hi-Tech Pharmaco

Akorn, Inc. acquired Hi-Tech Pharmaco Co. (HITK) in Apr-2014 for \$640 million. However, Hi-Tech Pharmaco had an undisclosed SEC investigation at the time the deal closed. It's never been disclosed, yet accounting

problems at Hi-Tech were cited as a contributor to the non-reliance warning Akorn issued in Mar-2015. Our earlier research into Hi-Tech points to potential SEC issues as far back as Aug-2013. Even six months after the deal closed, in a letter dated 29-Oct-2014, the SEC confirmed that Hi-Tech Pharmaco Co was involved in an ongoing investigation that was undisclosed at the time.

Our Take: We criticize management for delayed disclosure of the SEC and US Attorney probes as well as not disclosing Hi-Tech's SEC woes. We think the SEC started investigating Akorn separately shortly after the non-reliance notice announced in Mar-2015. The SEC does not ignore those things and almost certainly started a probe shortly thereafter. Yet it was not disclosed until Nov-2015. This means management felt the investigation was not sufficiently material to warrant disclosure until then. One must ask, what changed to prompt disclosure of something management previously convinced themselves did not need to be disclosed?

It is not common to see the US Attorney run an investigation alongside an SEC probe. There is only one reason for doing this: SEC probes are civil and someone in the government has reason to believe a criminal probe is warranted. Someone could go to jail. Those with an interest will surely want to ask the company about this.

We further criticize the company for using cut-and-paste in the place of substantive updates and details on these exposures. We think this has created a dangerous complacency among investors.

Keep in mind that a disclosed is not the same as a risk that is discounted if you don't have the details needed to conduct the requisite analysis. This is where negative

surprises come from. We say you should at least allow for one here.

Relevant Recent Disclosures:

From the Akorn 10-Q filed on 4-Aug-2016 –

The Chicago Regional Office of the SEC is conducting an investigation regarding the previously disclosed financial statement restatement, internal control weaknesses and other related matters. Additionally, the United States Attorney's Office for the Southern District of New York ("USAO") has requested information regarding these matters. Akorn has been furnishing requested information and is fully cooperating with the SEC and USAO.

From the Akorn 10-Q filed on 2-Jun-2016 –

The Chicago Regional Office of the Securities and Exchange Commission (SEC) is conducting an investigation regarding the previously disclosed restatement, internal controls and other related matters. Additionally, the United States Attorney's Office for the Southern District of New York (USAO) has requested information regarding these matters. Akorn has been furnishing requested information and is fully cooperating with the SEC and USAO.

From the Akorn 8-K filed on 14-Jan-2016 –

In addition, as previously disclosed, the Chicago Regional Office of the SEC is conducting an investigation regarding the restatement, internal controls and other related matters. Additionally, the United States Attorney's Office for the Southern District of New York ("USAO") has requested information regarding these matters. Akorn has been furnishing requested information and fully cooperating with the SEC and USAO. We could become subject to one or more government enforcement actions arising out of these inquiries.

First disclosure of an SEC and US Attorney investigation, from the Akorn 8-K filed on 4-Nov-2015 –

The Chicago Regional Office of the Securities and Exchange Commission (SEC) is conducting an investigation regarding the previously disclosed restatement, internal controls and other related matters. Additionally, the United States Attorney's Office for the Southern District of New York (USAO)

has requested information regarding these matters. Akorn has been furnishing requested information and is fully cooperating with the SEC and USAO.

From the Akorn 8-K filed on 17-Mar-2015 –

Item 4.02 Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review

On March 17, 2015, the Company issued a press release announcing that the Audit Committee, upon the recommendation of the Company's management, concluded that the previously issued financial statements contained in the Company's Quarterly Reports on Form 10-Q for the quarters ended June 30, 2014 and September 30, 2014 should not be relied upon because of an error in the financial statements as of and for the three and six month periods ended June 30, 2014, which then impacted the financial statements as of and for the nine month period ended September 30, 2014, and that those financial statements would be restated to make the necessary accounting adjustments.

On April 17, 2014, the Company completed its acquisition of Hi-Tech Pharmacal Co., Inc. ("Hi-Tech") for a total purchase price of approximately \$650.0 million. During the 2014 year-end audit process, an error was identified in the fair value allocation of assets acquired and liabilities assumed in connection with the acquisition of Hi-Tech, which resulted in an overstated chargeback reserve as of April 17, 2014. The error, which was identified on March 11, 2015, resulted from an overstatement of Hi-Tech's chargeback reserve in connection with applying the acquisition method of accounting at the closing of the Hi-Tech acquisition.

The overstatement in the chargeback reserve was caused by a manual error made in preparing the data whereby there was a duplication of inventory units held by one customer utilized in the calculation of the reserve amount for Hi-Tech products at the acquisition date. The duplication resulted in an overstatement of chargeback reserves by approximately \$8.9 million for the opening balance sheet of Hi-Tech as of April 17, 2014. The chargeback reserve at the end of the quarter ended June 30, 2014 was then calculated correctly, resulting in the earlier overstated reserve amount being included in revenue during the quarter ended June 30, 2014.

The correction of the error in the quarter ended June 30, 2014 resulted in a reduction of previously reported revenue by \$8.9 million, a reduction of previously reported pre-tax income by \$8.9 million and a reduction of previously reported net income, goodwill and retained earnings by \$5.6 million, for the Company's three and six month periods ended June 30, 2014.

The error was limited to the Company's financial results for the three and six month periods ended June 30, 2014, but the error did impact the Company's previously filed results for the nine months ended September 30, 2014 (which were filed in connection with the Company's Form 10-Q for the quarter ended September 30, 2014) and the Company's previously furnished preliminary results for the full year ended December 31, 2014 (which were furnished as part of the Company's Form 8-K on February 26, 2015 in connection with the Company's earnings announcement for the fourth quarter of 2014) because the second quarter results were included within those periods. The estimated impact of this error for the restated three and six month periods ended June 30, 2014 is to reduce basic and diluted net income per share by approximately \$0.05 per share. The estimated impact of this error for the restated nine month period ended September 30, 2014, and the year ended December 31, 2014, is to reduce both basic and diluted net income per share by approximately \$0.06 and \$0.05 per share, respectively.

The error and subsequent restatement is non-cash in nature and does not have an impact on the Company's cash and cash equivalents balances for any of the affected periods or the Company's liquidity or capital position

Important: The SEC reminds us that its assertion of the law enforcement exemption should not be construed as an indication by the Commission or its staff that any violations of law have occurred with respect to any person, entity, or security.

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Notes: *The SEC did not disclose the details on investigations referenced herein. All we know is that they somehow pertain to the conduct, transactions, and/or disclosures of the companies referenced. The SEC reminds us that its assertion of the law enforcement exemption should not be construed as an indication by the Commission or its staff that any violations of law have occurred with respect to any person, entity, or security. New SEC investigative activity could theoretically begin or end after the date covered by this latest information which would not be reflected here.*

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