Amphastar Pharmaceuticals, Inc.
Form 10-Q
May 10, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2018

or

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 001-36509

AMPHASTAR PHARMACEUTICALS, INC.

(Exact name of Registrant as specified in its charter)

Delaware	33-0702205
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

11570 6th Street

Rancho Cucamonga, CA 91730

(Address of principal executive offices, including zip code)

(909) 980-9484

(Registrant’s telephone number, including area code)

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

Indicate by check mark whether the Registrant (1) 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 during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes No

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

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

If an emerging growth company, indicate by check mark if the Registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of shares outstanding of the Registrant's only class of common stock as of May 3, 2018 was 46,614,060.

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FORM 10-Q FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2018

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SPECIAL NOTE ABOUT FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, or Quarterly Report, contains "forward-looking statements" that involve substantial risks and uncertainties. In some cases, you can identify forward-looking statements by the following words: "may," "might," "will," "could," "would," "should," "expect," "intend," "plan," "anticipate," "believe," "estimate," "pr "potential," "continue," "ongoing" or the negative of these terms or other comparable terminology, although not all forward-looking statements contain these identifying words. Forward-looking statements relate to future events or future financial performance or condition and involve known and unknown risks, uncertainties and other factors that could cause actual results, levels of activity, performance or achievement to differ materially from those expressed or implied by the forward-looking statements. These forward-looking statements include, but are not limited to, statements about:

- our expectations regarding the sales and marketing of our products;
- our expectations regarding our manufacturing and production and the integrity of our supply chain for our products, including the risks associated with our single source suppliers;
- the timing and likelihood of FDA approvals and regulatory actions on our product candidates, manufacturing activities and product marketing activities;
- our ability to advance product candidates in our platforms into successful and completed clinical trials and our subsequent ability to successfully commercialize our product candidates;
- our ability to compete in the development and marketing of our products and product candidates;
- the potential for adverse application of environmental, health and safety and other laws and regulations on our operations;
- our expectations for market acceptance of our new products and proprietary drug delivery technologies, as well as those of our API customers;
- the potential for our marketed products to be withdrawn due to patient adverse events or deaths, or if we fail to secure FDA approval for products subject to the Prescription Drug Wrap-Up program;
- our expectations in obtaining insurance coverage and adequate reimbursement for our products from third-party payers;

- the amount of price concessions or exclusion of suppliers adversely affecting our business;

- our ability to establish and maintain intellectual property protection for our products and our ability to successfully defend our intellectual property in cases of alleged infringement;

- the implementation of our business strategies, product development strategies and technology utilization;

- the potential for exposure to product liability claims;

- future acquisitions, divestitures or investments, including the anticipated benefits of such acquisitions, divestitures or investments;

- our ability to expand internationally;

- economic and industry trends and trend analysis;

- our ability to remain in compliance with laws and regulations that currently apply or become applicable to our business both in the United States and internationally the impact of global and domestic tax reform, including the Tax Cuts and Jobs Act of 2017;

- the timing for completion of construction and validation at our IMS facility; and

- our financial performance expectations, including our expectations regarding our backlog, revenue, cost of revenue, gross profit or gross margin, operating expenses, including changes in research and development, sales and marketing and general and administrative expenses, and our ability to achieve and maintain future profitability.

You should read this Quarterly Report and the documents that we reference elsewhere in this Quarterly Report completely and with the understanding that our actual results may differ materially from what we expect as expressed or implied by our forward-looking statements. In light of the significant risks and uncertainties to which our forward-looking statements are subject, you should not place undue reliance on or regard these statements as a representation or warranty by us or any other person that we will achieve our objectives and plans in any specified timeframe, or at all. We discuss many of these risks and uncertainties in greater detail in this Quarterly Report and in our Annual Report on Form 10-K for the year ended December 31, 2017, particularly in Item 1A. “Risk Factors.” These forward-looking statements represent our estimates and assumptions only as of the date of this Quarterly Report regardless of the time of delivery of this Quarterly Report, and such information may be limited or incomplete, and our statements should not be read to indicate that we have conducted an exhaustive inquiry into, or review of, all potentially available relevant information. Except as required by law, we undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise after the date of this Quarterly Report.

Unless expressly indicated or the context requires otherwise, references in this Quarterly Report to “Amphastar,” “the Company,” “we,” “our,” and “us” refer to Amphastar Pharmaceuticals, Inc. and our subsidiaries.

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

AMPHASTAR PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	March 31, 2018 (unaudited)	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 54,547	$ 65,594
Short-term investments	2,826	2,635
Restricted cash and short-term investments	4,155	4,155
Accounts receivable, net	31,883	35,996
Inventories	62,780	63,609
Income tax refunds and deposits	12,194	6,036
Prepaid expenses and other assets	5,661	9,753
Total current assets	174,046	187,778
Property, plant, and equipment, net	191,915	185,339
Goodwill and intangible assets, net	44,850	45,140
Other assets	10,714	8,663
Deferred tax assets	28,257	27,745
Total assets	$ 449,782	$ 454,665
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 58,498	$ 57,555
Income taxes payable	7,983	3,325
Current portion of long-term debt and capital leases	6,061	6,312
Total current liabilities	72,542	67,192
Long-term reserve for income tax liabilities	879	879
Long-term debt and capital leases, net of current portion	39,706	40,844
Deferred tax liabilities	1,425	1,361
Other long-term liabilities	8,126	7,060
Total liabilities	122,678	117,336

Commitments and contingencies:		
Stockholders' equity:		
Preferred stock: par value $0.0001; 20,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock: par value $0.0001; 300,000,000 shares authorized; 50,471,687 and 46,656,793 shares issued and outstanding as of March 31, 2018 and 50,039,212 and 46,623,581 shares issued and outstanding as of December 31, 2017, respectively	5	5
Additional paid-in capital	316,665	313,891
Retained earnings	69,570	76,235
Accumulated other comprehensive loss	(910)	(2,100)
Treasury stock	(58,226)	(50,702)
Total stockholders' equity	327,104	337,329
Total liabilities and stockholders' equity	$ 449,782	$ 454,665

See Accompanying Notes to Condensed Consolidated Financial Statements.

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AMPHASTAR PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited; in thousands, except per share data)

	Three Months Ended March 31,	
	2018	2017
Net revenues	$ 58,393	$56,670
Cost of revenues	41,332	33,842
Gross profit	17,061	22,828
Operating (income) expenses:		
Selling, distribution, and marketing	1,721	1,479
General and administrative	10,998	11,338
Research and development	14,260	11,250
Gain on sale of intangible assets	—	(2,643)
Total operating expenses	26,979	21,424
Income (loss) from operations	(9,918)	1,404
Non-operating income (expenses):		
Interest income	124	91
Interest expense	(18)	(191)
Other income, net	782	200
Total non-operating income, net	888	100
Income (loss) before income taxes	(9,030)	1,504
Income tax expense (benefit)	(1,784)	611
Net income (loss)	$ (7,246)	$893
Net income (loss) per share:		
Basic	$ (0.16)	$0.02
Diluted	$ (0.16)	$0.02
Weighted-average shares used to compute net income (loss) per share:		
Basic	46,514	46,069
Diluted	46,514	48,057

See Accompanying Notes to Condensed Consolidated Financial Statements.

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AMPHASTAR PHARMACEUTICALS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited; in thousands)

	Three Months Ended March 31,	
	2018	2017
Net income (loss)	$ (7,246)	$ 893
Other comprehensive income, net of income taxes		
Foreign currency translation adjustment	1,190	466
Total other comprehensive income	1,190	466
Total comprehensive income (loss)	$ (6,056)	$ 1,359

See Accompanying Notes to Condensed Consolidated Financial Statements.

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AMPHASTAR PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited; in thousands)

	Three Months Ended March 31,	
	2018	2017
Cash Flows From Operating Activities:		
Net income (loss)	$ (7,246)	$ 893
Reconciliation to net cash provided by operating activities:		
Loss (gain) on disposal and impairment of long-lived assets	598	(2,643)
Depreciation of property, plant, and equipment	3,201	3,100
Amortization of product rights, trademarks, and patents	729	721
Share-based compensation expense	4,666	4,451
Changes in operating assets and liabilities:		
Accounts receivable, net	4,635	920
Inventories	1,441	1,891
Prepaid expenses and other assets	(761)	344
Income tax refund, deposits, and payable	(1,761)	394
Accounts payable and accrued liabilities	2,858	12,327
Net cash provided by operating activities	8,360	22,398
Cash Flows From Investing Activities:		
Purchases and construction of property, plant, and equipment	(12,340)	(7,267)
Sale of intangible assets	4,400	1,000
Purchase of short-term investments	(201)	(1,564)
Maturity of short-term investments	—	1,345
Payment of deposits and other assets	(597)	521
Net cash used in investing activities	(8,738)	(5,965)
Cash Flows From Financing Activities:		
Proceeds from equity plans, net of withholding tax payments	(1,793)	(2,173)
Purchase of treasury stock	(7,624)	(8,203)
Principal payments on long-term debt	(1,411)	(1,342)
Net cash used in financing activities	(10,828)	(11,718)
Effect of exchange rate changes on cash	159	(174)
Net increase (decrease) in cash, cash equivalents, and restricted cash	(11,047)	4,541
Cash, cash equivalents, and restricted cash at beginning of period	67,459	72,354
Cash, cash equivalents, and restricted cash at end of period	$ 56,412	$ 76,895

Supplemental Disclosures of Cash Flow Information:		
Interest paid, net of capitalized interest	$ 532	$ 390
Income taxes paid	$ 8	$ 440

See Accompanying Notes to Condensed Consolidated Financial Statements.

AMPHASTAR PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. General

Amphastar Pharmaceuticals, Inc., a California corporation, was incorporated on February 29, 1996 and merged with and into Amphastar Pharmaceuticals, Inc., a Delaware corporation, in July 2004 (together with its subsidiaries, hereinafter referred to as "the Company"). The Company is a specialty pharmaceutical company that primarily develops, manufactures, markets, and sells generic and proprietary injectable, inhalation, and intranasal products, including products with high technical barriers to market entry. Additionally, the Company sells insulin active pharmaceutical ingredient, or API, products. Most of the Company's products are used in hospital or urgent care clinical settings and are primarily contracted and distributed through group purchasing organizations and drug wholesalers. The Company's insulin API products are sold to other pharmaceutical companies for use in their own products and are being used by the Company in the development of injectable finished pharmaceutical products. The Company's inhalation products will be primarily distributed through drug retailers if they are approved and brought to market.

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements of the Company for the year ended December 31, 2017 and the notes thereto as filed with the Securities and Exchange Commission, or SEC, in the Company's Annual Report on Form 10-K for the year ended December 31, 2017. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles, or GAAP, have been condensed or omitted from the accompanying condensed consolidated financial statements. The accompanying year-end condensed consolidated balance sheet was derived from the audited financial statements. The accompanying interim financial statements are unaudited, but reflect all adjustments which are, in the opinion of management, necessary for a fair statement of the Company's consolidated financial position, results of operations, comprehensive income (loss) and cash flows for the periods presented. Unless otherwise noted, all such adjustments are of a normal, recurring nature. The Company's results of operations, comprehensive income (loss) and cash flows for the interim periods are not necessarily indicative of the results of operations and cash flows that it may achieve in future periods.

Note 2. Summary of Significant Accounting Policies

Basis of Presentation

The unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, and are prepared in accordance with the requirements of the SEC for interim reporting. Effective January 1, 2018, the Company retrospectively adopted Accounting Standard Update, or ASU, No. 2016-15 Classification of Certain Cash Receipts and Cash Payments. Certain amounts in the prior quarter's condensed consolidated balance sheet and condensed consolidated statement of cash flows have been reclassified to conform to the current quarter presentation. This reclassification has no impact on net income or cash flows. All significant intercompany activity has been eliminated in the preparation of the condensed consolidated financial statements. In the opinion of management, the accompanying unaudited condensed consolidated financial statements include all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the consolidated financial position, results of operations, and cash flows of the Company.

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

AMPHASTAR PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Use of Estimates

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

Foreign Currency

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

The Company's French subsidiary, AFP, maintains its book of record in Euros. Its other Chinese subsidiaries maintain their books of record in Chinese Yuan. Its U.K. subsidiary IMS UK, maintains its book of record in Great Britain Pounds. These local currencies have been determined to be the subsidiaries' respective functional currencies. These books of record are translated into USD using average exchange rates during the period. Assets and liabilities are translated at the rate of exchange prevailing on the balance sheet date. Equity is translated at the prevailing rate of exchange at the date of the equity transactions. Translation adjustments are reflected in stockholders' equity and are included as a component of other accumulated comprehensive income (loss). The unrealized gains or losses of intercompany foreign currency transactions that are of a long-term investment nature are reported in other accumulated comprehensive income (loss). The unrealized gains of intercompany foreign currency transactions that are of a long-term investment nature for the three months ended March 31, 2018 and 2017 were $0.9 million, and a $0.5 million, respectively.

Additionally, the Company does not undertake hedging transactions to cover its foreign currency exposure.

Comprehensive Income (loss)

For the three months ended March 31, 2018 and 2017, the Company included its foreign currency translation gain or loss as part of its comprehensive income (loss). Income tax expense of $0.3 million was allocated to other comprehensive income (loss) for the three months ended March 31, 2018. There was no material income tax expense (benefit) allocated to other comprehensive income (loss) for the three months ended March 31, 2017.

Restricted Cash and Short-term Investments

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

AMPHASTAR PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Financial Instruments

The carrying amounts of cash and cash equivalents, short-term investments, restricted cash and short-term investments, accounts receivable, accounts payable, accrued expenses, and short-term borrowings approximate fair value due to the short maturity of these items. The majority of the Company's long-term obligations consist of variable rate debt, and their carrying value approximates fair value as the stated borrowing rates are comparable to rates currently offered to the Company for instruments with similar maturities. However, the Company has one fixed-rate, long-term mortgage for which the carrying value differs from the fair value and is not remeasured on a recurring basis (see Note 12). The Company at times enters into fixed interest rate swap contracts to exchange the variable interest rates for fixed interest rates without the exchange of the underlying notional debt amounts. Such interest rate swap contracts are recorded at their fair values.

Deferred Income Taxes

The Company utilizes the liability method of accounting for income taxes, under which deferred taxes are determined based on the temporary differences between the financial statements and the tax basis of assets and liabilities using enacted tax rates. A valuation allowance is recorded when it is more likely than not that the deferred tax assets will not be realized. At March 31, 2018, the Company had not completed its accounting for the tax effects of the enactment of the Tax Cuts and Jobs Act of 2017, or the Tax Act.

Business Combinations

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

of the fair value of the consideration conveyed to the seller over the fair value of the net assets received.

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

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02 Leases, that is aimed at making leasing activities more transparent and comparable, and which requires substantially all leases be recognized by lessees on their balance sheets as a right-of-use asset and corresponding lease liability, including leases currently accounted for as operating leases. This guidance will become effective for the Company’s interim and annual reporting periods during the year ending December 31, 2019, and all annual and interim reporting periods thereafter. Early adoption is permitted. The Company is required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements for the reporting periods in which the guidance is adopted. While the Company continues to evaluate the provisions of ASC 842 to determine how it will be affected, the primary effect of adopting the new standard will be to record assets and obligations for current operating leases on its consolidated financial statements. Footnote 16 provides details on the Company’s current operating lease arrangements. The adoption of ASC 842 is not expected to have a material impact on the Company’s results of operations or cash flows.

AMPHASTAR PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

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

In August 2017, the FASB issued ASU No. 2017-12 Targeted Improvements to Accounting for Hedging Activities, which amends the hedge accounting model in ASC 815 to enable entities to better portray the economics of their risk management activities in the financial statements and enhance the transparency and understandability of hedge results. The amendments also simplify the application of hedge accounting in certain situations. The new guidance is effective for the Company's interim and annual reporting periods during the year ending December 31, 2019. Early adoption is permitted. The Company does not believe that the adoption of this accounting guidance will have a material impact on its consolidated financial statements and related disclosures.

In February 2018, the FASB issued ASU No. 2018-02 Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which allows entities to reclassify from accumulated other comprehensive income to retained earnings stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017. The guidance is effective for the Company's interim and annual reporting periods during the year ending December 31, 2019. Early adoption is permitted. The Company does not believe that the adoption of this accounting guidance will have a material impact on its consolidated financial statements and related disclosures.

Note 3. Revenue Recognition

During the quarter ended March 31, 2018, the Company adopted ASC 606, Revenue from Contracts with Customers, or ASC 606, using the modified retrospective transition method. The adoption of ASC 606 did not have a material impact on the Company's revenue recognition or on the condensed consolidated financial statements and related disclosures.

Subsequent to the adoption of ASC 606, revenue is recognized at the time that the Company's customers obtain control of the promised goods. Revenues derived from contract manufacturing services are recognized when third-party products are shipped to customers, after the customer has accepted test samples of the products to be shipped. The results for the reporting period beginning after January 1, 2018, are presented in accordance with the new standard, although comparative information continues to be reported under the accounting standards and policies in effect for those periods.

AMPHASTAR PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

For the accounting policy related to revenue recognition for the years ended prior to and on December 31, 2017, see Note 4, Revenue Recognition, to the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2017.

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

Provision for Chargebacks and Rebates

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

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

	Three Months Ended March 31,	
	2018	2017
	(in thousands)	
Beginning balance	$ 18,470	$ 39,709
Provision for chargebacks and rebates	25,334	58,606

Credits and payments issued to third parties	(28,774)	(76,242)
Ending balance	$ 15,030	$ 22,073

Changes in the chargeback provision from period to period are primarily dependent on the Company's sales to its wholesalers, the level of inventory held by wholesalers, and the wholesaler's customer mix. Changes in the rebate provision from period to period are primarily dependent on retailer's and other indirect customers' purchases. The approach that the Company uses to estimate chargebacks has been consistently applied for all periods presented. Variations in estimates have been historically small. The Company continually monitors the provision for chargebacks and rebates and makes adjustments when it believes that the actual chargebacks and rebates may differ from the estimates. The settlement of chargebacks and rebates generally occurs within 30 days to 60 dates after the sale to wholesalers. Accounts receivable and/or accounts payable and accrued liabilities are reduced and/or increased by the chargebacks and rebate amounts depending on whether the Company has the right to offset with the customer. Of the provision for chargebacks and rebates as of March 31, 2018 and December 31, 2017, $5.3 million and $6.8 million were included in accounts receivable, net, on the condensed consolidated balance sheets, respectively. The remaining provision of $9.7 million and $11.7 million were included in accounts payable and accrued liabilities, respectively.

Accrual for Product Returns

The Company offers most customers the right to return qualified excess or expired inventory for partial credit; however, API product sales are generally non-returnable. The Company's product returns primarily consist of the returns of expired products from sales made in prior periods. Returned products cannot be resold. At the time product revenue is

AMPHASTAR PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

recognized, the Company records an accrual for product returns estimated using the expected value method. The accrual is based, in part, upon the historical relationship of product returns to sales and customer contract terms. The Company also assesses other factors that could affect product returns including market conditions, product obsolescence, and the introduction of new competition. Although these factors do not normally give the Company's customers the right to return products outside of the regular return policy, the Company realizes that such factors could ultimately lead to increased returns. The Company analyzes these situations on a case-by-case basis and makes adjustments to the product return reserve as appropriate. As of March 31, 2018 and December 31, 2017, cumulative sales of approximately $1.0 million and $1.2 million, respectively, for one of the Company's products were not recognized in revenues, due to insufficient information available to determine that a significant reversal of such amount will not occur when the uncertainty associated with the return refund is subsequently resolved.

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

	Three Months Ended March 31,	
	2018	2017
	(in thousands)	
Beginning balance	$ 6,522	$ 3,143
Provision for product returns	747	1,062
Credits issued to third parties	(498)	(462)
Ending balance	$ 6,771	$ 3,743

Of the provision of product returns as of March 31, 2018 and December 31, 2017, $4.6 million and $4.1 million were included in accounts payable and accrued liabilities on the condensed consolidated balance sheets, respectively. The remaining provision of $2.2 million and $2.4 million were included in other long-term liabilities, respectively. For the three months ended March 31, 2018 and 2017, the Company's aggregate product return rate was 1.3% and 1.1% of qualified sales, respectively.

Note 4. Income (loss) per Share

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

As the Company reported a net loss for the three months ended March 31, 2018, the diluted net loss per share, as reported, equals the basic net loss per share since the effect of the assumed exercise of stock options, vesting of nonvested RSUs, and issuance of common shares under the Company's ESPP are anti-dilutive. Total stock options, nonvested RSUs, and shares issuable under the Company's ESPP excluded from the three months ended March 31, 2018 net loss per share were 11,610,229 stock options; 1,259,273 nonvested RSUs, and 56,128 shares issuable under the ESPP.

For the three months ended March 31, 2017, options to purchase 2,376,234 shares of stock with a weighted-average exercise price of $22.44 per share, were excluded in the computation of diluted net income per share because the effect from the assumed exercise of these options would be anti-dilutive.

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The following table provides the calculation of basic and diluted net income (loss) per share for each of the periods presented:

	Three Months Ended March 31,	
	2018	2017
	(in thousands, except per share data)	
Basic and dilutive numerator:		
Net income (loss)	$ (7,246)	$ 893
Denominator:		
Weighted-average shares outstanding — basic	46,514	46,069
Net effect of dilutive securities:		
Incremental shares from equity awards	—	1,988
Weighted-average shares outstanding — diluted	46,514	48,057
Net income (loss) per share — basic	$ (0.16)	$ 0.02
Net income (loss) per share — diluted	$ (0.16)	$ 0.02

Note 5. Segment Reporting

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

- Finished pharmaceutical products
- Active pharmaceutical ingredients, or API

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

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Selected financial information by reporting segment is presented below:

	Three Months Ended March 31,	
	2018	2017
	(in thousands)	
Net revenues:		
Finished pharmaceutical products	$ 53,117	$ 55,934
API	5,276	736
Total net revenues	58,393	56,670
Gross profit:		
Finished pharmaceutical products	19,725	24,310
API	(2,664)	(1,482)
Total gross profit	17,061	22,828
Operating expenses	26,979	21,424
Income (loss) from operations	(9,918)	1,404
Non-operating income	888	100
Income (loss) before income taxes	$ (9,030)	$ 1,504

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

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

	Three Months Ended March 31,	
	2018	2017

	(in thousands)	
Finished pharmaceutical products net revenues:		
Lidocaine	$ 9,782	$ 8,289
Phytonadione	9,181	7,886
Naloxone	8,927	10,939
Enoxaparin	7,007	10,410
Epinephrine	3,223	9,574
Medroxyprogesterone	2,706	—
Other finished pharmaceutical products	12,291	8,836
Total finished pharmaceutical products net revenues	$ 53,117	$ 55,934

Discontinuation of epinephrine injection, USP vial product

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

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

	Net Revenue Three Months Ended March 31,		Long-Lived Assets	
	2018	2017	March 31, 2018	December 31, 2017
	(in thousands)			
United States	$ 53,104	$ 55,930	$ 110,461	$ 110,235
China	—	—	43,323	41,078
France	5,289	740	38,131	34,026
United Kingdom	—	—	—	—
Total	$ 58,393	$ 56,670	$ 191,915	$ 185,339

Note 6. Customer and Supplier Concentration

Customer Concentrations

Three large wholesale drug distributors, AmerisourceBergen Corporation, or AmerisourceBergen, Cardinal Health, Inc., or Cardinal, and McKesson Corporation, or McKesson, are all distributors of the Company’s products, as well as suppliers of a broad range of health care products. The Company considers these three customers to be its major customers, as each individually, and these customers collectively, represented a significant percentage of the Company’s net revenue for the three months ended March 31, 2018 and 2017 and accounts receivable as of March 31, 2018 and December 31, 2017. The following table provides accounts receivable and net revenue information for these major customers:

	% of Total Accounts Receivable	% of Net Revenue

	March 31, 2018		December 31, 2017		Three Months Ended March 31, 2018		2017	
McKesson	22	%	22	%	28	%	26	%
AmerisourceBergen	24	%	33	%	26	%	30	%
Cardinal Health	20	%	12	%	23	%	24	%

Supplier Concentrations

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

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Note 7. Fair Value Measurements

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

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

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

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

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

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

Nonfinancial assets and liabilities are not measured at fair value on a recurring basis but are subject to fair value adjustments in certain circumstances. These items primarily include long-lived assets, goodwill, and intangible assets for which the fair value of assets is determined as part of the related impairment test. As of March 31, 2018 and

December 31, 2017, there were no significant adjustments to fair value for nonfinancial assets or liabilities.

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Note 8. Goodwill and Intangible Assets

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

	Weighted-Average Life (Years)	Original Cost (in thousands)	Accumulated Amortization	Net Book Value
Definite-lived intangible assets				
Cortrosyn® product rights	12	$ 27,134	$ 26,688	$ 446
IMS (UK) international product rights	10	9,802	1,634	8,168
Patents	12	486	181	305
Land-use rights	39	2,540	436	2,104
Other intangible assets	4	69	50	19
Subtotal	12	40,031	28,989	11,042
Indefinite-lived intangible assets				
Trademark	*	29,225	—	29,225
Goodwill - Finished pharmaceutical products	*	4,583	—	4,583
Subtotal	*	33,808	—	33,808
As of March 31, 2018	*	$ 73,839	$ 28,989	$ 44,850

	Weighted-Average Life (Years)	Original Cost (in thousands)	Accumulated Amortization	Net Book Value
Definite-lived intangible assets				
Cortrosyn® product rights	12	$ 27,134	$ 26,243	$ 891
IMS (UK) international product rights	10	9,440	1,337	8,103
Patents	12	486	170	316
Land-use rights	39	2,540	419	2,121
Other intangible assets	4	69	46	23
Subtotal	12	39,669	28,215	11,454
Indefinite-lived intangible assets				

Trademark	*	29,225	—	29,225
Goodwill - Finished pharmaceutical products	*	4,461	—	4,461
Subtotal	*	33,686	—	33,686
As of December 31, 2017	*	$ 73,355	$ 28,215	$ 45,140

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

Sale of Fourteen Injectable ANDAs

In March 2016, the Company acquired 14 abbreviated new drug applications, or ANDAs, representing 11 different injectable chemical entities from Hikma Pharmaceuticals PLC, or Hikma. In February 2017, the Company sold the 14 ANDAs to an unrelated party. The consideration included a purchase price of $6.4 million of which the amount of $1.0 million was received upon closing, $1.0 million was received in the second quarter of 2017 and the remaining $4.4 million was received in January 2018. In addition to the purchase price, the purchaser agreed to pay the Company a royalty fee equal to 2% of net sales derived from purchaser’s sales of the products for the period from February 2017 through February 2027. The Company has not recognized any royalty fee revenue. The Company is also subject to a certain indemnification liability payable to the purchaser, which is limited up to $0.6 million. The Company recognized a gain of $2.6 million within operating (income) expenses on its condensed consolidated statement of operations for the three months ended March 31, 2017.

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Goodwill

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

	March 31, 2018	December 31, 2017
	(in thousands)	
Beginning balance	$ 4,461	$ 3,976
Currency translation and other adjustments	122	485
Ending balance	$ 4,583	$ 4,461

Primatene® Trademark

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

The trademark was determined to have an indefinite life. In determining its indefinite life, the Company considered the following: the expected use of the intangible; the longevity of the brand; the legal, regulatory and contractual provisions that affect their maximum useful life; the Company’s ability to renew or extend the asset’s legal or contractual life without substantial costs; effects of the regulatory environment; expected changes in distribution channels; maintenance expenditures required to obtain the expected future cash flows from the asset; and considerations for obsolescence, demand, competition and other economic factors.

As a result of environmental concerns about Chlorofluorocarbons, or CFCs, the FDA issued a final ruling on January 16, 2009 that required the CFC formulation of its Primatene® Mist product to be phased out by December 31, 2011. The former formulation of Primatene® Mist contained CFCs as a propellant; however, the Company intends to use the trademark for a future version of Primatene® that utilizes hydrofluoroalkane, or HFA, as a propellant.

In 2013, the Company filed a new drug application, or NDA, for Primatene® Mist and received a Prescription Drug User Fee Act date set for May 2014. In May 2014, the Company received a complete response letter, or CRL, from the FDA, which required additional non-clinical information, label revisions and follow-up studies (label comprehension, behavioral/human factors and actual use) to assess consumers' ability to use the device correctly to support approval of the product in the over-the-counter setting. The Company submitted a responsive NDA amendment in June 2016 and received a second CRL from the FDA in December 2016, which requires additional packaging and label revisions and follow-up studies to assess consumers' ability to use the product correctly to support approval in the over-the-counter setting. After several meetings with the FDA in 2017, the Company further revised its packaging and label and plans to perform another human factors study based on such revisions. In November 2017, the Company submitted its proposed protocol to the FDA. In March 2018, the Company received as Advice Letter from the FDA regarding our proposed protocol. Based on that feedback, the Company has conducted an additional human factors study. The Company believes it has received acceptable results from the study, and the Company has resubmitted the NDA. The Company intends to continue to work with the FDA to address their concerns in the CRL and bring Primatene® Mist back to the over-the-counter market. However, there can be no guarantee that any future amendment to the Company's NDA will result in timely approval of Primatene® Mist or approval at all.

Based on the Company's filed version of Primatene® Mist, the long history of the Primatene® trademark (marketed since 1963), and the Company's perpetual rights to the trademark, the nature of the CRL received in December 2016, the plan that the HFA version will be marketed under the same trademark if approved by the FDA, and other factors previously considered, the trademark continues to have an indefinite useful life, and an impairment charge is not required based on the Company's qualitative assessment as of March 31, 2018.

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Note 9. Inventories

Inventories consist of the following:

	March 31, 2018	December 31, 2017
	(in thousands)	
Raw materials and supplies	$ 22,272	$ 19,973
Work in process	21,796	22,469
Finished goods	18,712	21,167
Total inventories	$ 62,780	$ 63,609

A charge of $1.9 million and $0.4 million was included in the cost of revenues in the Company's consolidated statements of operations for the three months ended March 31, 2018 and 2017, respectively, to adjust the Company's inventory and related firm inventory purchase commitments to their net realizable value.

Note 10. Property, Plant, and Equipment

Property, plant, and equipment consist of the following:

	March 31, 2018	December 31, 2017
	(in thousands)	
Buildings	$ 89,579	$ 89,124
Leasehold improvements	29,938	29,847
Land	7,148	7,110

Machinery and equipment	120,756	118,056
Furniture, fixtures, and automobiles	17,132	16,385
Construction in progress	63,959	58,145
Total property, plant, and equipment	328,512	318,667
Less accumulated depreciation	(136,597)	(133,328)
Total property, plant, and equipment, net	$ 191,915	$ 185,339

As of March 31, 2018 and December 31, 2017, the Company had $2.2 million and $2.3 million, respectively, in capitalized manufacturing equipment that is intended to be used specifically for the manufacture of Primatene® Mist. The Company will continue to monitor developments with the FDA as it relates to its Primatene® indefinite lived intangible assets in determining if there is an impairment of these related fixed assets (see Note 8).

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Note 11. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities consisted of the following:

	March 31, 2018	December 31, 2017
	(in thousands)	
Accrued customer fees and rebates	$ 13,464	$ 15,981
Accrued payroll and related benefits	17,774	15,680
Accrued product returns, current portion	4,586	4,133
Other accrued liabilities	7,043	5,132
Total accrued liabilities	42,867	40,926
Accounts payable	15,631	16,629
Total accounts payable and accrued liabilities	$ 58,498	$ 57,555

Note 12. Debt

Debt consists of the following:

	March 31, 2018	December 31, 2017
	(in thousands)	
Loans with East West Bank		
Line of credit facility due December 2018	$ —	$ —
Equipment loan due January 2019	1,283	1,668
Mortgage payable due February 2021	3,556	3,577
Equipment loan due June 2021	3,980	4,286

Equipment line of credit due December 2022	—	—
Mortgage payable due October 2026	3,509	3,524
Mortgage payable due June 2027	8,903	8,936
Loans with Cathay Bank		
Line of credit facility due May 2018	—	—
Acquisition loan due April 2019	14,562	15,073
Mortgage payable due August 2027	7,752	7,795
Loans with Seine-Normandie Water Agency		
French government loan 1 paid off March 2018	—	17
French government loan 2 due June 2020	88	85
French government loan 3 due July 2021	248	239
Payment Obligation to Merck	599	599
Equipment under Capital Leases	1,287	1,357
Total debt and capital leases	45,767	47,156
Less current portion of long-term debt and capital leases	6,061	6,312
Long-term debt and capital leases, net of current portion	$ 39,706	$ 40,844

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As of March 31, 2018, the fair value of the loans approximates their carrying amount. The interest rate used in the fair value estimation was determined to be a Level 2 input. For certain loans with East West Bank, the Company has entered into fixed interest rate swap contracts to exchange the variable interest rates for fixed interest rates over the life of certain debt instruments without the exchange of the underlying notional debt amount. The interest rate swap contracts do not qualify for hedge accounting and are recorded at fair value based on Level 2 inputs. These swap contacts have an aggregate fair value of $0.4 million and $0.1 million as of March 31, 2018 and December 31, 2017, respectively. The change in fair value is recorded in other income (expense) in the Company's condensed consolidated statement of operations.

Covenants

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

Equipment under Capital Leases

The Company entered into leases for certain equipment under capital leasing arrangements, which will expire at various times through 2022. The cost of equipment under capital leases was $1.6 million and $1.6 million at March 31, 2018 and December 31, 2017, respectively.

Note 13. Income Taxes

The following table sets forth the Company's income tax provision for the periods indicated:

	Three Months Ended March 31,	
	2018	2017
	(in thousands)	
Income (loss) before taxes	$ (9,030)	$ 1,504
Income tax expense (benefit)	(1,784)	611
Net income (loss)	$ (7,246)	$ 893
Income tax provision as a percentage of income before income taxes	19.8 %	40.6 %

The decrease in the Company's effective tax rate for the three months ended March 31, 2018, was primarily due to the Tax Act, which was enacted on December 22, 2017. The Tax Act, among other things, reduces the statutory U.S. federal corporate income tax rate from 35% to 21% and requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred. In March 2018, the FASB issued ASU No. 2018-05 to incorporate Staff Accounting Bulletin, or SAB 118, pursuant to which the Company's final analysis will be completed over a one-year measurement period ending December 22, 2018, and any adjustments during this measurement period will be included in net earnings from continuing operations as an adjustment to income tax expense in the reporting period when such adjustments are determined. During the three month period ended March 31, 2018, the Company has made no changes to the provisional amounts recorded at December 31, 2017. The Company will continue to refine its calculations as additional analysis and changes to certain amounts and estimates are completed and tax returns are filed. The Company's estimates may also be affected as it gains a more thorough understanding of the tax law.

Effective January 1, 2018, the Company adopted ASU No. 2016-16, Intra-Entity Transfers of Assets Other Than Inventory, pursuant to which the income tax consequences of intra-entity transfer of an asset other than inventory is required to be recognized in the period in which the transfer occurs. The Company adopted the standard on a modified

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retrospective basis resulting in an increase of deferred tax assets and the beginning balance of retained earnings by $0.5 million, respectively.

Valuation Allowance

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

The Company has discontinued recognizing AFP income tax benefits by recording a full valuation allowance until it is determined that it is more likely than not that AFP will generate sufficient taxable income to realize its deferred income tax assets.

Note 14. Stockholders' Equity

The changes in stockholders’ equity for the three months ended March 31, 2018, consisted of the following:

	Three Months Ended March 31, 2018 (in thousands)
Stockholders’ equity as of December 31, 2017	$ 337,329
Beginning balance adjustment as a result of the adoption of new accounting standards	582
Net loss	(7,246)

Other comprehensive income	1,190
Net proceeds from equity plans	(1,793)
Share-based compensation expense	4,666
Purchase of treasury stock	(7,624)
Stockholders' equity as of March 31, 2018	$ 327,104

Share Buyback Program

Pursuant to the Company's share buyback program, the Company purchased 407,604 and 532,894 shares of its common stock during the three months ended March 31, 2018 and 2017, totaling $7.6 million and $8.2 million, respectively.

On May 7, 2018, the Company's Board of Directors authorized an increase of $20.0 million to the Company's share buyback program, which is expected to continue for an indefinite period of time. The primary goal of the programs is to offset dilution created by the Company's equity compensation programs.

Purchases are made through open market and private block transactions pursuant to Rule 10b5-1 plans, privately negotiated transactions or other means as determined by the Company's management and in accordance with the requirements of the SEC. The timing and actual number of shares repurchased will depend on a variety of factors including price, corporate and regulatory requirements, and other conditions. These repurchased shares are accounted for under the cost method and are included as a component of treasury stock in the Company's consolidated balance sheets.

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The 2015 Equity Incentive Plan

As of March 31, 2018, the Company reserved an aggregate of 4,782,238 shares of common stock for future issuance under the 2015 Equity Incentive Plan, or the 2015 Plan. In January 2018, an additional 1,165,590 shares were reserved under the 2015 Plan pursuant to the evergreen provision.

Share-Based Award Activity and Balances

The Company accounts for share based compensation payments in accordance with ASC 718, which requires measurement and recognition of compensation expense at fair value for all share based payment awards made to employees and directors. Under these standards, the fair value of option awards and the option components of the Employee Stock Purchase Plan awards are estimated at the grant date using the Black-Scholes option-pricing model. The fair value of RSUs is estimated at the grant date using the Company's common share price. Non vested stock options held by non-employees are revalued at each balance sheet date. The portion that is ultimately expected to vest is amortized and recognized in compensation expense on a straight-line basis over the requisite service period, generally from the grant date to the vesting date.

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

	Three Months Ended March 31,	
	2018	2017
Average volatility	39.6 %	36.7 %
Risk-free interest rate	2.7 %	2.2 %
Weighted-average expected life in years	5.8	5.7
Dividend yield rate	— %	— %

A summary of option activity under all plans for the three months ended March 31, 2018, is presented below:

	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value(1) (in thousands)
Outstanding as of December 31, 2017	10,898,701	$ 14.65		
Options granted	966,026	20.59		
Options exercised	(147,508)	12.61		
Options cancelled	(106,615)	13.02		
Options expired	(375)	14.66		
Outstanding as of March 31, 2018	11,610,229	$ 15.19	5.02	$ 49,844
Exercisable as of March 31, 2018	8,122,678	$ 15.07	3.79	$ 36,557

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

For the three months ended March 31, 2018 and 2017, the Company recorded of $2.4 million and $2.0 million, respectively, related to stock options granted to employees under all plans, and expenses of $0.1 million and $0.1 million, respectively, related to stock options granted to the Board of Directors under all plans.

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Information relating to option grants and exercises is as follows:

	Three Months Ended March 31,	
	2018	2017
	(in thousands, except per share data)	
Weighted-average grant date fair value per option share	$ 7.94	$ 4.87
Intrinsic value of options exercised	1,061	24
Cash received from options exercised	1,861	96
Total fair value of the options vested during the year	6,407	4,781

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

	Options	Weighted-Average Grant Date Fair Value
Non-vested as of December 31, 2017	4,310,241	$ 4.21
Options granted	966,026	7.94
Options vested	(1,682,101)	3.81
Options forfeited	(106,615)	4.77
Non-vested as of March 31, 2018	3,487,551	5.41

As of March 31, 2018, there was $15.6 million of total unrecognized compensation cost, net of forfeitures, related to nonvested stock option based compensation arrangements granted under all plans. The cost is expected to be recognized over a weighted-average period of 2.7 years and will be adjusted for future changes in estimated forfeitures.

Restricted Stock Units

The Company grants restricted stock units, or RSUs, to certain employees and members of the Board of Directors with a vesting period of up to five years. The grantee receives one share of common stock at a specified future date for each RSU awarded. The RSUs may not be sold or otherwise transferred until certificates of common stock have been issued, recorded, and delivered to the participant. The RSUs do not have any voting or dividend rights prior to the issuance of certificates of the underlying common stock. The share-based expense associated with these grants was based on the Company's common stock fair value at the time of grant and is amortized over the requisite service period, which generally is the vesting period using the straight-line method. During the three months ended March 31, 2018 and 2017, the Company recorded a total expense of $1.7 million and $2.0 million, respectively, related to RSU awards granted to employees under all plans and expenses of $0.1 million and $0.1 million, respectively, related to RSU awards granted to the Board of Directors.

As of March 31, 2018, there was $17.2 million of total unrecognized compensation cost, net of forfeitures, related to nonvested RSU-based compensation arrangements granted under all plans. The cost is expected to be recognized over a weighted-average period of 2.8 years and will be adjusted for future changes in estimated forfeitures.

AMPHASTAR PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Information relating to RSU grants and deliveries is as follows:

	Total RSUs Issued	Total Fair Market Value of RSUs Issued as Compensation(1) (in thousands)
RSUs outstanding at December 31, 2017	1,392,781	