

PERNIX THERAPEUTICS HOLDINGS, INC.

Form 10-Q

November 14, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(Mark
One)

☒ Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended: September 30, 2012

☐ Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from: _____ to _____

001-14494
Commission File Number

PERNIX THERAPEUTICS HOLDINGS, INC.
(Exact name of Registrant as specified in its charter)

Maryland
(State or other jurisdiction
of incorporation or organization)

33-0724736
(I.R.S. Employer
Identification Number)

10003 Woodloch Forest Drive, The
Woodlands, TX
(Address of principal executive offices)

77380
(Zip Code)

(832) 934-1825
(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 report(s)) and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐.

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 ☒ No ☐.

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 definitions of "large accelerated filer," "accelerated filer," and "smaller reporting

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company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	<input type="radio"/>	Accelerated filer	<input type="radio"/>
Non-accelerated filer	<input type="radio"/>	Smaller reporting company	<input checked="" type="radio"/>

(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 ☐ No ☒

On November 12, 2012, there were 29,113,443 shares outstanding of the Registrant’s common stock, par value \$0.01 per share.

PERNIX THERAPEUTICS HOLDINGS, INC.

Quarterly Report on Form 10-Q
For the Three and Nine Months Ended September 30, 2012

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Cautionary Statement Regarding Forward-Looking Statements

The Private Securities Litigation Reform Act of 1995 provides a “safe harbor” for forward-looking statements to encourage companies to provide prospective information, so long as those statements are identified as forward-looking and are accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those discussed in the statement. We desire to take advantage of these “safe harbor” provisions with regard to the forward-looking statements in this Form 10-Q and in the documents that are incorporated herein by reference. These forward-looking statements reflect our current views with respect to future events and financial performance. Specifically, forward-looking statements may include:

projections of revenues, expenses, income, income per share and other performance measures;

statements regarding expansion of operations, including entrance into new markets and development of products; and

statements preceded by, followed by or that include the words “estimate,” “plan,” “project,” “forecast,” “intend,” “expect,” “anticipate,” “believe,” “seek,” “target” or similar expressions.

These forward-looking statements express our best judgment based on currently available information and we believe that the expectations reflected in our forward-looking statements are reasonable.

By their nature, however, forward-looking statements often involve assumptions about the future. Such assumptions are subject to risks and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements. As such, we cannot guarantee you that the expectations reflected in our forward-looking statements will actually be achieved. Actual results may differ materially from those in the forward-looking statements due to, among other things, the following factors:

changes in general business, economic and market conditions;

volatility in the securities markets generally or in the market price of our stock specifically; and

the risks outlined in the section entitled “Risk Factors” contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011.

We caution you not to place undue reliance on any forward-looking statements, which speak only as of the date of this Form 10-Q. Except as required by law, we do not undertake any obligation to publicly update or release any revisions to these forward-looking statements to reflect any events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PERNIX THERAPEUTICS HOLDINGS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2012 (unaudited)	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	\$37,037,057	\$ 34,551,180
Accounts receivable, net	20,786,923	20,601,360
Inventory, net	6,981,146	6,261,162
Prepaid expenses and other current assets	2,319,860	2,144,203
Prepaid income taxes	1,713,675	
Deferred income taxes	5,168,000	4,552,000
Total current assets	74,006,661	68,109,905
Property and equipment, net	6,961,435	911,948
Other assets:		
Investments	6,355,262	4,451,831
Intangible assets, net	24,602,367	8,876,504
Other long-term assets	193,783	213,783
Total assets	\$112,119,508	\$ 82,563,971
LIABILITIES		
Current liabilities:		
Accounts payable	\$5,915,601	\$ 2,987,913
Accrued personnel expenses	1,691,677	2,044,121
Accrued allowances	14,887,900	17,006,409
Income taxes payable		585,931
Other accrued expenses	3,107,302	1,565,918
Contracts payable	1,750,000	1,290,000
Debt – short term	248,946	
Line of credit		6,000,000
Total current liabilities	27,601,426	31,480,292
Long-term liabilities		
Contracts payable		600,000
Debt – long term	1,439,845	
Deferred income taxes	4,465,000	860,000
Total liabilities	33,506,271	32,940,292

Commitments and contingencies

STOCKHOLDERS' EQUITY

Common stock, \$.01 par value, 90,000,000 shares authorized, 31,143,639 and 27,820,004 issued, and 29,070,829 and 25,749,137 outstanding at September 30, 2012 and December 31, 2011, respectively	290,708	257,491
Treasury stock, at cost (2,072,810 and 2,070,867 shares held at September 30, 2012 and December 31, 2011, respectively)	(3,772,410)	(3,751,890)
Additional paid-in capital	56,886,190	30,185,292

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Retained earnings	21,832,507	21,843,418
Accumulated other comprehensive income	3,376,242	1,089,368
Total equity	78,613,237	49,623,679
Total liabilities and stockholders' equity	\$112,119,508	\$ 82,563,971

See accompanying notes to condensed consolidated financial statements.

PERNIX THERAPEUTICS HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net revenues	\$ 18,134,158	\$ 17,064,196	\$ 43,115,517	\$ 39,203,944
Costs and expenses:				
Cost of product sales	7,759,761	7,684,233	15,861,461	13,069,161
Selling, general and administrative expenses	9,837,217	5,542,274	24,302,513	15,555,478
Research and development expense	332,971	147,138	511,694	717,802
Loss from the operations of the joint venture with SEEK		100,614	240,195	691,865
Royalties expense, net		32,461		377,273
Depreciation and amortization expense	885,982	603,528	2,320,589	1,690,827
Total costs and expenses	18,815,931	14,110,248	43,236,452	32,102,406
Income (loss) from operations	(681,773)	2,953,948	(120,935)	7,101,538
Other income (expense):				
Interest income (expense), net	7,431	(37,300)	(59,976)	(129,964)
Income (loss) before income taxes	(674,342)	2,916,648	(180,911)	6,971,574
Income tax provision (benefit)	(404,000)	922,000	(170,000)	2,500,000
Net income (loss)	\$ (270,342)	\$ 1,994,648	\$ (10,911)	\$ 4,471,574
Unrealized gain on securities, net of income tax	808,374		2,286,874	
Comprehensive income	\$ 538,032	\$ 1,994,648	\$ 2,275,963	\$ 4,471,574
Net income (loss) per share, basic	\$ (0.01)	\$ 0.08	\$ 0.00	\$ 0.19
Net income (loss) per share, diluted	\$ (0.01)	\$ 0.08	\$ 0.00	\$ 0.19
Weighted-average common shares, basic	29,069,119	24,841,554	27,765,275	23,401,910
Weighted-average common shares, diluted	29,069,119	25,147,191	27,765,275	23,737,231

See accompanying notes to condensed consolidated financial statements.

PERNIX THERAPEUTICS HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited)

	Common Stock	Additional Paid-In Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive income	Total
Balance at December 31, 2011	\$ 257,491	\$ 30,185,292	\$ (3,751,890)	\$ 21,843,418	\$ 1,089,368	\$ 49,623,679
Stock-based compensation	2,881	1,898,687				1,901,568
Issuance of stock options for services from non-employees		540,252				540,252
Issuance of common stock, net of stock withheld for income tax liability	669	392,594	(20,520)			372,743
Income tax benefit on stock based awards		148,000				148,000
Issuance of common stock upon additional public offering, net of issuance costs of \$846,202	29,667	23,721,365				23,751,032
Net loss				(10,911)		(10,911)
Unrealized gain on securities, net					2,286,874	2,286,874
Balance at September 30, 2012	\$ 290,708	\$ 56,886,190	\$ (3,772,410)	\$ 21,832,507	\$ 3,376,242	\$ 78,613,237

See accompanying notes to condensed consolidated financial statements.

PERNIX THERAPEUTICS HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine months ended September 30,	
	2012	2011
Cash flows from operating activities:		
Net income (loss)	\$(10,911)	\$4,471,574
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	162,814	67,898
Amortization	2,157,775	1,622,929
Deferred income tax benefit	(517,388)	(2,414,000)
Loss on disposal of assets	19,845	
Stock compensation expense	1,901,568	872,269
Expense from stock options issued in exchange for services	540,252	137,066
Loss from the operations of the joint venture with SEEK	240,195	691,865
Changes in operating assets and liabilities: (net of effects of acquisition of GSL)		
Accounts receivable	855,760	(8,894,041)
Inventory	190,352	(3,372,902)
Prepaid expenses and other assets	(147,639)	167,863
Accounts payable	83,337	2,519,564
Income taxes	(2,299,606)	(870,851)
Accrued expenses	(2,502,663)	6,264,128
Net cash from operating activities	673,691	1,263,362
Cash flows from investing activities:		
Investment in joint venture with SEEK		(1,000,000)
Acquisition of gastroenterology product license	(2,400,000)	
Acquisition of Great Southern Laboratories ("GSL")	(4,666,964)	
Acquisition of license for non-codeine antitussive drug in development	(5,000,000)	
Other intangibles	(850,000)	
Proceeds from sale of equipment	7,550	
Purchase of software and equipment	(279,673)	(133,281)
Net cash from investing activities	(13,189,087)	(1,133,281)
Cash flows from financing activities:		
Proceeds from line of credit		1,000,000
Payments on line of credit	(6,000,000)	
Payment on contracts payable	(2,990,000)	(1,930,000)
Proceeds from issuance of stock in additional offering, net of issuance costs of \$846,202 and		
\$255,254 for the nine months ended 2012 and 2011, respectively	23,751,032	19,259,746
Transfer to/from restricted cash		500,000
Payments on GSL mortgages and capital leases	(80,732)	
Payment received on notes receivable		113,333
Tax benefit on stock-based awards	148,000	123,000
Proceeds from issuance of stock	172,973	106,905
Net cash from financing activities	15,001,273	19,172,984
Net increase in cash and cash equivalents	2,485,877	19,303,065

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Cash and cash equivalents, beginning of period	34,551,180	8,260,059
Cash and cash equivalents, end of period	\$37,037,057	\$27,563,124

Supplemental disclosure:

Cash paid for income taxes	\$2,446,643	\$5,646,690
Interest paid during the period	\$116,105	\$150,771

Non-cash transaction

Acquisition of Omeclamox® license - contract payable	\$2,000,000	\$120,000
Acquisition of product license - contract payable	\$850,000	\$
Assumption of mortgage in acquisition of GSL	\$1,641,668	\$
Assumption of capital leases in acquisition of GSL	\$106,869	\$
Accrued 2011 bonus paid in unrestricted common stock	\$199,770	\$
Non-cash intangible value of deferred tax liability related to intellectual property license acquired	\$2,687,368	\$

See accompanying notes to condensed consolidated financial statements.

PERNIX THERAPEUTICS HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011
(Unaudited)

Note Company Overview

1.

Pernix Therapeutics Holdings, Inc. (“Pernix”) is a specialty pharmaceutical company focused on the sales, marketing, manufacturing and development of branded, generic and OTC pharmaceutical products for pediatric and adult indications in a variety of therapeutic areas. The Company expects to continue to execute its growth strategy which involves the horizontal integration of our branded prescription, generic and OTC businesses. The Company manages a portfolio of branded and generic prescription products and a non-codeine antitussive drug in development. The Company’s branded products for the pediatrics market include CEDAX®, an antibiotic for middle ear infections, NATROBA™, a topical treatment for head lice marketed under an exclusive co-promotion agreement with ParaPRO, LLC, REZYST IM™, a proprietary probiotic blend to promote dietary management and a family of prescription treatments for cough and cold (BROVEX®, ALDEX® and PEDIATEX®). The Company expanded into the gastroenterology market with the June 2012 launch of Omeclamox-Pak®, a triple combination medication taken orally to treat *Helicobacter pylori* (*H. pylori*) infection and eradicate duodenal ulcer disease in adults. The Company promotes its branded products through an established U.S. sales force. Pernix also markets generic products through its wholly-owned subsidiary, Macoven Pharmaceuticals. Founded in 1996, the Company’s headquarters is in The Woodlands, TX and the Company’s recently acquired manufacturing facility is in Houston, TX.

Controlled Equity Offering. On February 10, 2012, the Company entered into a controlled equity offering sales agreement (the “Sales Agreement”) with Cantor Fitzgerald & Co. (“Cantor”) 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 plans to continue to use the proceeds of this financing to provide funding for future acquisitions and for general corporate purposes.

Note Basis of Presentation and Summary of Significant Accounting Policies

2.

Interim Financial Statements

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements include all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of these financial statements. Operating results for the three and nine-month periods ended September 30, 2012 are not necessarily indicative of the results for future periods or the full year.

Principles of Consolidation

The condensed 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 and Respicopea, Inc. Transactions between and among the Company and its consolidated subsidiaries are eliminated.

Management's Estimates and Assumptions

The preparation of condensed 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 condensed consolidated financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ materially from those estimates. The Company reviews all significant estimates affecting the condensed 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.

Equity Method of Accounting

For the periods presented, the Company's investment in our former joint venture with SEEK is accounted for at cost and adjusted for the Company's prior share (46%) of the joint venture's undistributed earning or losses. On May 14, 2012, the Company acquired the exclusive right from SEEK to commercialize and market products utilizing certain antitussive intellectual property in the areas of cough, cold, sinus and allergy in the United States and Canada in connection with the termination of the joint venture. See Note 4, Investments and Note 6, Intangible Assets, for additional information.

Revenue Recognition

The Company's consolidated net revenues represent the Company's net product sales and collaboration revenues. The following table sets forth the categories of the Company's net revenues (in thousands) for the three and nine months ended September 30, 2012 and 2011.

	Three Months Ended September 30, (in thousands)		Nine Months Ended September 30, (in thousands)	
	2012	2011	2012	2011
Gross product sales	\$ 20,370	\$ 23,034	\$ 57,620	\$ 56,910
Sales allowances	(5,510)	(6,785)	(19,313)	(21,408)
Net product sales	14,860	16,249	38,307	35,502
Manufacturing revenue	2,094		2,094	
Co-promotion and royalty revenues	1,180	815	2,715	3,702
Net revenues	\$ 18,134	\$ 17,064	\$ 43,116	\$ 39,204

The Company records all of its 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. The Company records revenue from product sales when the customer takes ownership and assumes risk of loss (free-on-board destination). Manufacturing revenue is recognized when the finished product is shipped to the customer. Co-promotion revenue is recognized in the period in which the product subject to the arrangement is sold. 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.

The Company relies on certain materials used in its development and manufacturing processes, most of which are procured from a single source. The Company purchases its pharmaceutical ingredients from a limited number of suppliers. The failure of a supplier, including a subcontractor, to deliver on schedule could delay or interrupt the development or commercialization process and thereby adversely affect the Company's operating results. In addition, a disruption in the commercial supply of or a significant increase in the cost of the active pharmaceutical ingredient ("API") from any of these sources could have a material adverse effect on the Company's business, financial position and results of operations.

The Company's customers consist of drug wholesalers, retail drug stores, mass merchandiser and grocery store pharmacies in the United States. The Company primarily sells its products directly to large national drug wholesalers, which in turn resell the products to smaller or regional wholesalers, retail pharmacies, chain drug stores and other third parties. The following tables list the Company's customers that individually comprised greater than 10% of total gross product sales for the three and nine months ended September 30, 2012 and 2011, or 10% of total trade accounts receivable as of September 30, 2012 and December 31, 2011.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Cardinal Health, Inc.	41%	49%	36%	43%
McKesson Corporation	29%	13%	29%	19%
AmerisourceBergen Drug Corporation	7%	7%	11%	11%
Walgreens Corporation	11%	5%	7%	6%
Morris & Dickson Co., LLC	2%	19%	6%	13%
Total	90%	93%	89%	92%

	Accounts Receivable	
	September 30, 2012	December 31, 2011
Cardinal Health, Inc.	37%	30%
McKesson Corporation	28%	32%
Walgreens Corporation	15%	8%
Total	80%	70%

Net Revenues

Product Sales

The Company recognizes revenue from its product sales in accordance with its revenue recognition policy discussed above. The Company sells its products primarily to large national wholesalers, which have the right to return the products they purchase. The Company is required to estimate the amount of future returns at the time of revenue recognition. The Company recognizes product sales net of estimated allowances for product returns, government program rebates, price adjustments, and prompt pay discounts.

Product Returns

Consistent with industry practice, the Company offers contractual return rights that allow its customers to return the majority of its 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 24 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 remaining shelf life of the product, 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 estimated returns at 5% to 14% of sales of branded products during the third quarter of 2012. The Company is accruing 14% on launch sales of Omeclamox-Pak®. The Company estimated returns at 7% on sales of generic products during the second and third quarter of 2012. The returns estimate on generic products was increased approximately 2% effective April 1, 2012 from prior periods due to the potential impact of changes in Medicaid coverage on certain products. Return estimates are based upon historical data and other facts and circumstances that may impact future expected returns to derive an average return percentage of our products. In addition to the accrual on sales during the nine months ended September 30, 2012, the Company recorded an additional returns allowance of \$620,000 (\$120,000 in the third quarter and \$500,000 in the second quarter) as a result of the loss of Medicaid coverage on certain generic products. The returns reserve may be adjusted as we accumulate sales history and returns experience on this portfolio of products. The Company reviews and adjusts these reserves quarterly.

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 Medicaid utilization for each product.

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 in gross 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 wholesale distributors a prompt payment discount if they make payments within these deadlines. This discount is generally 2%, but may be higher in some instances due to product launches and/or industry expectations. Because the Company's wholesale 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.

See Note 9, Other Revenue Sharing Arrangements, for further discussion of co-promotion and other revenue sharing arrangements.

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 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:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Numerator:				
Net income (loss)	\$ (270,342)	\$ 1,994,648	\$ (10,911)	\$ 4,471,574
Denominator:				
Weighted-average common shares, basic	29,069,119	24,841,554	27,765,275	23,401,910
Dilutive effect of stock options		305,637		335,321
Weighted-average common shares, diluted	29,069,119	25,147,191	27,765,275	23,737,231
Net income (loss) per share, basic and diluted	\$ (0.01)	\$ 0.08	\$ 0.00	\$ 0.19

Outstanding options at September 30, 2012 and 2011 of 2,004,666 and 1,382,845, respectively, were not included above as they were considered anti-dilutive as of September 30, 2012 and 2011. See Note 10, Employee Equity Compensation and Benefits, for information regarding the Company's outstanding options.

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 goods had no effect on net income as previously reported.

Recent Accounting Pronouncements

Other than as set forth below, there have been no other recent accounting pronouncements that have not yet been adopted by us that are expected to have a material impact on our condensed consolidated financial statements from the accounting pronouncements previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2011.

The Financial Accounting Standards Board issued Accounting Standards Update (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 2011-08, Intangibles—Goodwill and Other (Topic 350): Testing Goodwill for Impairment. The Company does not expect the adoption of this guidance to have a material impact, if any, on its financial statements.

On January 1, 2012, the Company adopted the new presentation requirements under ASU 2011-05, Comprehensive Income (Topic 220), Presentation of Comprehensive Income in U.S. GAAP (“ASU 2011-05”) and ASU 2011-12 Comprehensive Income (Topic 220), Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in ASU 2011-05 (“ASU 2011-12”). ASU 2011-05 requires that comprehensive income and the related components of net income and of other comprehensive income be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 also requires reclassification adjustments from other comprehensive income to net income be presented on the face of the financial statements. However, in December 2011, the FASB issued ASU 2011-12 to defer the requirement to present reclassification adjustments from other comprehensive income on the face of the financial statements and allow entities to continue to report reclassifications out of accumulated other comprehensive income consistent with the requirements in effect before ASU 2011-05. The Company has no adjustments between net income and comprehensive income. The adoption of this guidance is not material to the Company or its presentation of its consolidated financial statements.

Note Accounts Receivable
3.

Accounts receivable consist of the following:

	September 30, 2012	December 31, 2011
Trade accounts receivable	\$ 18,894,144	\$ 18,844,320
Less allowance for prompt pay discounts	(369,830)	(393,174)
Total trade receivables	18,524,314	18,451,146
Receivables from third parties – collaboration and royalty arrangements	1,482,985	2,146,214
Other miscellaneous receivables (including \$750,000 receivable from former GSL owners related to acquisition)	779,624	4,000
Total accounts receivable	\$ 20,786,923	\$ 20,601,360

As of September 30, 2012 and December 31, 2011, no receivables were outstanding for longer than the agreed upon payment terms. The net amount of accounts receivable was considered collectible and no allowance for doubtful

accounts was recorded in either period.

Note Inventories

4.

Inventories consisted of the following items as of September 30, 2012 and December 31, 2011:

	September 30, 2012	December 31, 2011
Raw materials	\$ 1,013,149	\$ 412,867
Packaging materials	920,051	
Work-in-process	61,407	
Samples	1,534,723	627,474
Finished goods	5,634,250	5,848,295
	9,163,580	6,888,636
Allowance for samples inventory	(1,534,723)	(627,474)
Reserve for obsolescence	(647,711)	
Inventory, net	\$ 6,981,146	\$ 6,261,162

Note Investments

5.

Investments in Marketable Securities and Other Comprehensive Income

The Company holds investment 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 are recorded in the consolidated statements of income and comprehensive income, net of the related income tax effect.

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. The Company has applied a 30% discount to the quoted market value of its TherapeuticsMD stock, which represents the Company's estimate of the discount for lack of marketability for its non-controlling interest. 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. Cooper Collins, the Company's Chief Executive Officer, was appointed to the board of TherapeuticsMD following the Company's acquisition of its interest in TherapeuticsMD.

	As of September 30, 2012			
TherapeuticsMD Common Stock	Cost	Appreciation	Discount	Fair Value
2,631,579 shares	\$ 1,000,000	\$ 8,078,947	\$ (2,723,685)	\$ 6,355,262

Investment in and Termination of Joint Venture

On December 17, 2010, the Company entered into a Joint Venture Agreement (the "JV Agreement") with SEEK 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 products utilizing the JV's intellectual property. 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.

Below is the condensed balance sheet of the JV at the time of Pernix's exit from the JV (as described below):

Condensed Balance Sheet as of: (unaudited) (in thousands)	May 14, 2012	December 31, 2011
Cash and other current assets	\$ 947	\$ 1,512
Intellectual property and other rights (including capitalized development costs)	1,719	1,719
Total assets	\$ 2,666	\$ 3,231
Equity	\$ 2,666	\$ 3,231

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Loss from operations of the joint venture with SEEK	\$ -	\$ 100,614	\$ 240,195	\$ 691,865

Development costs of the JV for products utilizing the JV intellectual property were approximately \$522,000 for the period ended May 14, 2012. The Company recorded approximately 46% of these development costs, or \$240,000 for the nine months ended September 30, 2012, in loss from operations of our JV.

See Note 7, Intangible Assets, for further discussion.

Note Business Combination

6.

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. Recognized goodwill pertains to the value of the expected synergies to be derived from combining the operations of the businesses we acquire including the value of the acquired workforce.

On July 2, 2012, the Company acquired the business assets of Great Southern Laboratories ("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 is deemed receivable as of September 30, 2012), and assumed certain liabilities totaling approximately \$5.8 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 is expected to provide the Company with additional income and potential cost savings. The Company acquired the GSL assets through a wholly-owned subsidiary, Pernix Manufacturing, LLC, and continues to operate the business under the name Great Southern Laboratories. The results of operations of GSL for the three months ended September 30, 2012 have been included in the Company's condensed consolidated financial statements as of and since the acquisition date. Pro forma results of operations have not been presented for this acquisition because the effects of this business combination were not material to the Company's consolidated results of operations.

The purchase price allocation is preliminary and is based on initial estimates of fair values at the date of the acquisition. The Company is currently evaluating the preliminary purchase price allocation, which will be adjusted as additional information relative to the fair value of assets and liabilities becomes available. This allocation may change

in subsequent financial statements pending the final estimates of fair value.

The preliminary purchase price allocation as of September 30, 2012 is as follows:

Consideration	
Cash	\$ 4,666,694
Acquisition-related costs (included in SG&A expenses)	86,668
Recognized amounts of identifiable assets acquired and liabilities assumed:	
Accounts receivable and prepaid assets	619,341
Inventory	872,056
Buildings and equipment	5,960,000
Intangibles – customer relationships	1,848,000
Goodwill	651,000
Deferred tax asset	486,000
Accounts payable	(2,864,351)
Accrued liabilities, net of receivable from sellers of approximately \$450,000	(1,175,559)
Mortgage payable	(1,622,654)
Capital lease obligations	(106,869)

Note Intangible Assets

7.

Acquisition of License. As described in Note 5 above, on May 14, 2012, 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 there was approximately \$2,687,000 arising from a deferred tax liability. The value of the license recorded was approximately \$9,133,000 and is included in the product licenses in the table below. Under the terms of the agreement, Pernix will pay royalties to SEEK on sales of products utilizing the joint venture IP in the United States and Canada. Pernix will also receive royalties from SEEK product sales outside of the United States and Canada. As a result, the Company no longer shares in the development costs outside the United States and Canada.

License of Gastroenterology Product. In January 2012, the Company entered into a license and supply agreement with a private company for a new FDA-approved prescription product to treat gastroenterology disease. Under the terms of the agreement, the Company obtained exclusive U.S. marketing rights to Omeclamox-Pak®, a triple combination medication taken orally to treat *Helicobacter pylori* (H. pylori) infection and eradicate duodenal ulcer disease in adults. The Company paid an up-front license fee of \$2.0 million and paid an additional fee of \$2.0 million forty-five days from the commercial launch of the product which occurred in late June 2012. In addition to these license fees, the agreement calls for the Company to pay royalties and milestone payments based on sales of the product. Pernix has 52 sales representatives promoting Omeclamox-Pak®, 26 of whom are dedicated exclusively to gastroenterology and 26 that cover both gastroenterology and pediatrics.

Acquisition of New Product. In August 2012, the Company completed the purchase of a pediatric prescription product, including certain intellectual property rights, for a total purchase price of \$1.35 million plus the assumption of certain liabilities. The Company paid \$500,000 at the closing plus \$250,000 paid on October 1, 2012, \$600,000 to be paid on February 1, 2013, and the assumption of certain liabilities.

Intangible assets consist of the following:

	Life	September 30, 2012	December 31, 2011
	12 - 15 years		
Patents		\$ 1,442,000	\$ 1,442,000
Brand – CEDAX	8 years	3,887,000	3,887,000
Product licenses	1 – 13 years	15,105,051	120,000
Customer Relationships – GSL	8 years	1,848,000	
Non-compete and supplier contract – Macoven	2 - 7 years	5,194,571	5,194,571
Trademark rights	Indefinite	638,563	238,758
Goodwill	Indefinite	2,057,591	1,406,591
		30,172,581	12,288,920
Accumulated amortization		(5,570,214)	(3,412,416)
		\$ 24,602,367	\$ 8,876,504

Estimated amortization expense related to intangible assets with definite lives for each of the five succeeding years and thereafter is as follows:

	Amount
2012 (October – December 2012)	\$ 595,000
2013	2,380,000
2014	2,380,000
2015	2,380,000
2016	2,380,000
Thereafter	12,224,000
	\$ 22,339,000

Amortization expense is approximately \$775,000 and \$2,158,000 for the three and nine months ended September 30, 2012, respectively, and \$578,000 and \$1,623,000 for the three and nine months ended September 30, 2011, respectively.

Note Accrued Allowances 8.

Accrued allowances consist of the following:

	September 30, 2012	December 31, 2011
Accrued returns allowance	\$ 4,643,200	\$ 5,712,500
Accrued price adjustments	5,519,200	5,450,619
Accrued government program rebates	4,725,500	5,843,290
Total	\$ 14,887,900	\$ 17,006,409

Note Lines of Credit

9.

On September 8, 2010, the Company entered into a Loan Agreement (the “Loan Agreement”) with Regions Bank (“Regions”). The Loan Agreement provides for a \$5 million secured revolving line of credit (the “RLOC”) and a \$5 million secured guidance line of credit (the “GLOC” and together with the RLOC, the “Loans”). The RLOC may be used to fund working capital needs and the GLOC may be used for acquisitions approved by Regions. The Loans were scheduled to mature on September 8, 2012 but were extended under the same terms until December 31, 2012. The loans bear interest at LIBOR plus 2.5%.

The Loan Agreement contains customary restrictive covenants and events of default, including breaches of representations and warranties and breaches of covenants.

In consideration for Regions entering into the Loan Agreement, the Company granted Regions a first priority security interest in substantially all of its assets except for all patents owned by Pernix as well as certain trademarks. Regions is also entitled to a first priority security interest on any intellectual property assets acquired with proceeds from the GLOC.

On September 30, 2012, the Company had no outstanding amounts under the GLOC or the RLOC.

Note Other Revenue Sharing Arrangements

10.

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 goods sold.

Restructure of Natroba Agreement

In July 2012, the Company and ParaPRO replaced their then-existing co-promotion and supply agreements relating to Natroba™ with a new agreement to restructure the terms for marketing and distributing Natroba. Under the terms of the new agreement, the Company will no longer have the minimum purchase order commitments related to the marketing and promotion of Natroba that were required under the previous agreements. If the Company fails to meet certain

dispensed volumes, the Company or ParaPRO would have the option to either modify or terminate the new agreement. The previous options granted to ParaPRO under its services agreement with the Company were not impacted by this new agreement. The Company and ParaPRO will continue to work together to co-promote and market Natroba, which may include an authorized generic equivalent, and the Company will continue to distribute Natroba. The Company will be paid a co-promotion fee per unit prescribed which will be recorded as co-promotion revenue. This replaces the unit purchase price rebate per unit that was previously recorded as a rebate to cost of goods sold. The cost that the Company pays for NATROBA is significantly higher than the direct manufacturing cost that the Company pays on the other products in our portfolio which impacts our gross profit margin. NATROBA was launched in August 2011.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Pernix Consolidated Gross Margin - including Natroba	59%	57%	65%	68%
Pernix Consolidated Gross Margin - excluding Natroba	74%	79%	73%	78%

1 Excludes approximately \$492,000 and \$1,311,000 in write offs of obsolete, expired and/or donated product inventory for the three and nine months ended September 30, 2011, respectively.

2 Excludes approximately \$293,000 and \$390,000 in write offs of obsolete, expired and/or donated product inventory for the three and nine months ended September 30, 2012, respectively.

Note 11. Employee Equity Compensation and Benefits

Stock Options

The Company's 2009 Stock Incentive Plan (the "2009 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 September 30, 2012, approximately 208,333 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 five months.

The Company currently uses the Black-Scholes-Merton 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:

	Nine Months Ended September 30, 2012
Weighted average expected stock price volatility	64.7%
Estimated dividend yield	0.0%
Risk-free interest rate	1.1%
Expected life of option (in years)	6.0
Weighted average fair value per share	\$ 5.33

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.

The following table shows the option activity, described above, during the nine months ended September 30, 2012:

Option Shares	Shares	Average Exercise Price
Outstanding at December 31, 2011 (1)	1,848,491	\$ 4.55
Granted	215,000	9.07
Exercised	(28,492)	2.39
Cancelled	(30,333)	4.49
Expired		
Outstanding at September 30, 2012	2,004,666	\$ 5.07
Vested and exercisable, end of period	783,666	\$ 4.17

(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 10, Other Revenue Sharing Arrangements.

The following table shows the details by range of exercise price for the total options outstanding at September 30, 2012:

Range of Exercise Price (\$)	Options Outstanding		Options Exercisable	
	Shares	Remaining Contractual Life (years)	Shares	Weighted Average Exercise Price
1.94 - 2.20	25,833	.4	25,833	\$ 2.00
3.31 – 4.20(1)	1,346,500	7.0	664,170	3.83
6.10	187,333	8.8	60,331	6.10
7.90 – 9.02	345,000	9.2	13,333	7.90
10.13 – 10.35	100,000	9.0	19,999	10.14
	2,004,666	7.6	783,666	\$ 4.17

(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 10, Other Revenue Sharing Arrangements.

As of September 30, 2012, the aggregate intrinsic value of 783,666 options outstanding and exercisable was approximately \$2,628,000.

As of September 30, 2012, there was approximately \$2,364,000 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 1.9 years and approximately \$1,988,000 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 4.3 years.

Restricted Stock

Amendment to Employment Agreement. On March 23, 2012, the Company, Macoven and John McMahon, Macoven's Vice President of Product Sales, entered into an amendment to Mr. McMahon's amended and restated employment agreement pursuant to which all provisions relating to quarterly bonuses and a bonus pool were removed. The amendment also provided for the issuance of 165,000 shares of restricted stock, valued at approximately \$1,411,000, pursuant to the Company's 2009 Amended and Restated Stock Incentive Plan with certain volume limitations on the sale of such shares after vesting.

Also on March 23, 2012, in connection with the amendment to Mr. McMahon's agreement, the Company granted Michael Venters, Macoven's Executive Vice President of Corporate Development, 85,000 shares of restricted stock, valued at approximately \$727,000, pursuant to the Company's 2009 Amended and Restated Stock Incentive Plan with the same volume limitations as Mr. McMahon. Both grants vest in equal installments on each of the first three anniversaries of the date of grant.

Director Compensation. On March 22, 2012, each non-executive director received a grant of options to purchase 10,000 shares of our common stock and a grant of 10,000 shares of restricted stock. The options and restricted stock each vest one-third per year on the first three anniversaries of the grant date. The options were granted at the market price of \$9.02, the closing market price on March 21, 2012. In addition, our Board approved a \$5,000 increase in the annual cash compensation of the non-executive Chairman.

The following table shows the restricted stock, described above, during the nine months ended September 30, 2012:

Restricted Stock Shares	Shares	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2011	120,002	\$ 6.56
Granted	290,000	8.61
Vested	(61,669)	6.15
Forfeited		
Nonvested at September 30, 2012	348,333	\$ 8.34

During the nine months ended September 30, 2012, 290,000 restricted common shares were issued as described above. Approximately \$2,318,000 of total unrecognized compensation cost related to unvested restricted stock is expected to be recognized over a weighted-average period of 2.3 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 1st and November 1st), 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. Compensation expense related to the Employee Stock Purchase Plan and included in the table below for the three and nine months ended September 30, 2012 was approximately \$16,000 and \$56,000, respectively.

Stock-Based Compensation Expense

The following table shows the approximate amount of total stock-based compensation expense recognized for employees and non-employees:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Employees	\$ 546,000	\$ 238,000	\$ 1,412,000	\$ 577,000
Non-employees/Directors	132,000	119,000	489,000	295,000
Total	\$ 678,000	\$ 357,000	\$ 1,901,000	\$ 872,000

Note Income Taxes
12.

The income tax provision consisted of the income tax expense (benefit) for the three and nine months ended September 30, 2012 and 2011, as presented in the table below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Current:				
Federal	\$ 403,000	\$ 1,543,000	\$ 721,000	\$ 4,313,000
State	(394,000)	145,000	(345,000)	601,000
	9,000	1,688,000	376,000	4,914,000
Deferred:				
Federal	(463,000)	(689,000)	(544,000)	(2,091,000)
State	50,000	(77,000)	(2,000)	(323,000)
	(413,000)	(766,000)	(546,000)	(2,414,000)
	\$ (404,000)	\$ 922,000	\$ (170,000)	\$ 2,500,000

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:

	September 30, 2012	December 31, 2011
Deferred Tax Assets:		
Accounts receivable	\$ 136,000	\$ 149,000
Inventory	239,000	
Fixed assets	88,000	66,000
Accrued expenses and allowances	3,395,000	3,831,000
Stock awards	1,299,000	515,000
Investment in joint venture with SEEK		312,000
NOL and capital loss carryforwards	1,376,000	493,000
Gross deferred tax assets	\$ 6,533,000	\$ 5,366,000
Deferred Tax Liabilities:		
Investments	\$ (1,979,000)	\$ (674,000)
Other	(132,000)	(99,000)
Intangibles	(3,719,000)	(901,000)
Gross deferred tax liability	\$ (5,830,000)	\$ (1,674,000)
Net deferred tax asset	\$ 703,000	\$ 3,692,000
Included in consolidated balance sheet:		
Deferred income tax assets/deferred income tax liabilities – current	5,168,000	4,552,000
Deferred income tax assets/deferred income tax liabilities - long term	(4,465,000)	(860,000)
Net deferred tax asset	\$ 703,000	\$ 3,692,000

In assessing the realization 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 are considered realizable based on the reversal of deferred tax liabilities and the Company's projected levels of taxable income.

Note. 13 Commitments and Contingencies

Legal Matters

United States District Court for the Eastern District of Texas, Civil Action No. 6:12-cv-00027-LED. On January 19, 2012, plaintiffs, Merck & Cie, South Alabama Medical Science Foundation, and PamLab, L.L.C., filed suit seeking unspecified damages and injunctive relief against our wholly-owned subsidiary, Macoven Pharmaceuticals, for

infringement of U.S. Patent Nos. 5,997,915, 6,254,904, 6,673,381, 7,172,778, 7,674,490, and 6,011,040 based on Macoven's commercialization of the following products: Vitacirc-B; ALZ-NAC; L-methylfolate PNV; L-methylfolate calcium 7.5 mg; and L-methylfolate calcium 15 mg. Macoven filed responsive pleadings denying liability for infringement and filing counterclaims for non-infringement and patent invalidity. On September 19, 2012, pursuant to Defendants' unopposed motion to stay the action, the Court stayed the lawsuit pending final determination in ITC Investigation No. 337-TA-2912 (see description of ITC case below).

ITC Investigation No. 337-TA-2912, In the Matter of Reduced Folate Nutraceutical Products and L-methylfolate Raw Ingredients Used Therein. On September 10, 2012, plaintiffs, Merck & Cie, South Alabama Medical Science Foundation, and PamLab L.L.C. (collectively "Plaintiffs") filed a Complaint in the U.S. International Trade Commission (ITC) under Section 337 of the Tariff Act of 1930, as Investigation No. 337-TA-2912. The Complaint names Macoven Pharmaceuticals, L.L.C., Gnosis S.p.A., Gnosis Bioresearch S.A., and Gnosis U.S.A. Inc. as respondents (collectively "Respondents"), and asserts that the Respondent Macoven infringes U.S. Patent Nos. 5,997,915, 6,673,381, 7,172,778, and 6,011,040 based on Macoven's commercialization of the following products: Vitaciric-B; ALZ-NAC; L-methylfolate calcium. The ITC initiated the investigation on October 10, 2012. Macoven's responsive pleadings are to be filed with the ITC on October 30, 2012. Macoven intends to deny liability for infringement and assert patent invalidity as a defense.

Pernix is subject to various other 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.

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, which are approximately \$2.8 million.

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 granted to ParaPRO. The options have an exercise price of \$3.65 which is 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 and are 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 September 30, 2012, there was approximately \$1,988,000 of total unrecognized stock compensation cost related to unvested stock options issued to ParaPRO which is expected to be recognized ratably over a weighted-average period of 4.3 years.

Lease Commitments

The Company leases its office facilities in The Woodlands, Texas under a lease with an unrelated third party. The term of the current lease expires on May 8, 2015. Pursuant to this lease, the Company pays rent of approximately \$15,000 per month with stated annual escalators and shares in 2.49% of the excess operating expenses of the building.

The Company leases its office and warehouse facility in Magnolia, Texas under a triple net lease with an entity owned by several of the Company's employees and directors including our Chief Executive Officer. The term of this lease is month to month and may be terminated by either party without penalty. Pursuant to this lease, the Company pays rent of approximately \$5,100 per month, with an annual CPI escalator.

The Company leases its office facilities in South Carolina under a lease with an unrelated third party. The term of the current lease expires April 1, 2013. Pursuant to this lease, the Company pays rent of approximately \$2,300 per month with annual escalators of 10%.

Capital leases on certain pharmaceutical manufacturing equipment assumed in the acquisition of GSL have terms to November 2013. There were multiple assets under various individual capital leases as of September 30, 2012. The Company leases certain equipment under operating leases pursuant to which future expected payments are approximately \$14,000 in 2012, \$25,000 in 2013, \$34,000 in 2014 and \$4,000 thereafter.

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 Condensed Consolidated Balance Sheets as of September 30, 2012 and December 31, 2011.

Acquisitions, License and Co-promotion Agreements

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 three and nine months ended September 30, 2012 and 2011, we recognized approximately \$1,058,000 and \$742,000 and \$2,973,000 and \$1,296,000, respectively, in expense included in cost of goods sold from payments pursuant to co-promotion and other revenue sharing arrangements.

Other Contingencies

Development of Late-stage 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 Pernix will pay the costs related to the development of the product. Pernix expects to invest approximately \$6 million over an estimated 36-month period for development and regulatory expenses related to this product candidate, and Pernix's development partner will manage the development program. Pernix and its development partner expect to commence pivotal phase III studies in the next 12 months.

The Company is exposed to various risks of loss 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 a 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 insurance.

Note 14. Subsequent Events

On November 13, 2012, the Company entered into a definitive agreement to acquire Cypress Pharmaceuticals, Inc. ("Cypress"), a privately-owned generic pharmaceutical company, and Hawthorne Pharmaceuticals, Inc. ("Hawthorne"), a privately-owned branded pharmaceutical company. Under the agreement, Pernix could pay up to \$101 million, which includes up-front payments of \$68.5 million in cash and \$12.5 million in equity, \$10 million payable in cash in December 2013, and an additional \$10 million in milestone payments payable in cash and equity. The Company has received a commitment for a \$60 million credit facility, subject to certain conditions. MidCap Financial will serve as Sole Bookrunner, Administrative Agent and Joint Lead Arranger for the credit facility. Cypress and Hawthorne, founded in 1993, are headquartered in Madison, MS and have 170 employees, including 115 sales reps. Hawthorne offers a wide array of branded pharmaceutical products, including allergy, respiratory, iron deficiency, nephrology, and pain management. Cypress offers a broad range 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.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion is designed to provide a better understanding of our unaudited consolidated financial statements, including a brief discussion of our business and products, key factors that impact our performance and a summary of our operating results. You should read the following Management's Discussion and Analysis of Financial Condition and Results of Operations together with our unaudited condensed consolidated financial statements and the related notes included in "Part I—Item 1. Financial Statements" of this Quarterly Report on Form 10-Q and the consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2011. In addition to historical information, the following discussion contains forward-looking statements that involve risks, uncertainties and assumptions. Our actual results could differ materially from those anticipated by the forward-looking statements due to important factors including, but not limited to, those set forth under "Part I—Item 1A. Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2011.

Executive Overview

Strategy

Pernix Therapeutics Holdings, Inc. ("Pernix" or the "Company") is a specialty pharmaceutical company focused on the sales, marketing, manufacturing and development of branded, generic and over-the-counter ("OTC") pharmaceutical products for pediatric and adult indications in a variety of therapeutic areas. We expect to continue to execute our growth strategy which includes the horizontal integration of our branded prescription, generic and OTC businesses. We manage a portfolio of branded and generic products, as well as a non-codeine antitussive drug in development. Our branded products for the pediatrics market include CEDAX®, an antibiotic for middle ear infections, NATROBA™, a topical treatment for head lice marketed under an exclusive co-promotion agreement with ParaPRO, LLC, and a family of prescription treatments for cough and cold (BROVEX®, ALDEX® and PEDIATEX®). Our branded products for gastroenterology include OMECLAMOX-PAK®, a 10-day treatment for H. pylori infection and duodenal ulcer disease, and REZYST™, a probiotic blend to promote dietary management. We promote our branded pediatric and gastroenterology products through our sales force. We market our generic products through our wholly-owned subsidiary, Macoven Pharmaceuticals.

On November 13, 2012, the Company entered into a definitive agreement to acquire Cypress Pharmaceuticals, Inc. ("Cypress"), a privately-owned generic pharmaceutical company, and Hawthorne Pharmaceuticals, Inc. ("Hawthorne"), a privately-owned branded pharmaceutical company. Under the agreement, Pernix could pay up to \$101 million, which includes up-front payments of \$68.5 million in cash and \$12.5 million in equity, \$10 million payable in cash in December 2013, and an additional \$10 million in milestone payments payable in cash and equity. The Company has received a commitment for a \$60 million credit facility, subject to certain conditions. MidCap Financial will serve as Sole Bookrunner, Administrative Agent and Joint Lead Arranger for the credit facility. Cypress and Hawthorne, founded in 1993, are headquartered in Madison, MS and have 170 employees, including 115 sales reps. Hawthorne offers a wide array of branded pharmaceutical products, including allergy, respiratory, iron deficiency, nephrology, and pain management. Cypress offers a broad range 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.

On July 2, 2012, we completed our acquisition of the business assets of Great Southern Laboratories ("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, and assumed certain liabilities totaling approximately \$5.5 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 is expected to provide us with additional income and potential cost savings. We acquired the GSL assets through a wholly-owned subsidiary, Pernix Manufacturing, LLC, and continues to operate the business under the name Great Southern Laboratories.

Pernix is the surviving corporation of a 2010 merger between Pernix Therapeutics, Inc., or PTI, and Golf Trust of America, Inc., or GTA. The words “we,” “us” or “our” refers to Pernix and its consolidated subsidiaries, except where the context otherwise requires.

Pernix was incorporated in November 1996 and is headquartered in The Woodlands, Texas and employs approximately 166 people full-time, 58 of which are employed at Great Southern Laboratories which Pernix acquired on July 2, 2012.

Our business strategy is to:

- promote products through our sales and marketing organization of approximately 74 sales representatives, primarily in highly populated states, targeting pediatric and high-prescribing physicians;

- develop and launch generic and authorized generic products through Macoven, our wholly-owned subsidiary;

- launch new line extensions and new formulations of our currently marketed products;

maximize the value of our non-codeine antitussive drug in development;

continue to diversify and expand our product portfolio through acquisitions, co-promotions and in-licensing agreements;

leverage our business model by expanding into additional therapeutic areas. For example, in May 2012, we established a sales force of approximately 30 representatives, consisting of new and existing representatives, dedicated to gastroenterology following our entry into the license agreement described below;

integrate and maximize the value of our recently acquired manufacturing assets and facility, Great Southern Laboratories; and

adapt quickly to a rapidly changing pharmaceutical environment, and operate as a quick, nimble, and agile company.

We believe that if we continue to implement this strategy successfully, we can deliver consistent long-term revenue and earnings growth.

Acquisitions and License Agreements, Co-Promotions and Collaborations

We have and continue 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.

Restructure of Natroba Agreement

See Note 10 to our Condensed Consolidated Financial Statements for the three and nine months ended September 30, 2012 and 2011 contained in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Acquisition of Pharmaceutical Manufacturing Company

See Note 6 to our Condensed Consolidated Financial Statements for the three and nine months ended September 30, 2012 and 2011 contained in Part I, Item 1 of this Quarterly Report on Form 10-Q. As noted above, we expect to utilize the manufacturing plant that we recently acquired to manufacture several of our products moving forward which we expect to result in a reduction in the cost of certain of our products.

Acquisition of New Product

See Note 7 to our Condensed Consolidated Financial Statements for the three and six months ended June 30, 2012 and 2011 contained in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Termination of Joint Venture

See Notes 5 and 7 to our Condensed Consolidated Financial Statements for the three and nine months ended September 30, 2012 and 2011 contained in Part I, Item 1 of this Quarterly Report on Form 10-Q.

License of Gastroenterology Product.

For discussion regarding the license we acquired related to Omeclamox-Pak®, see Note 7 to our Condensed Consolidated Financial Statements for the three and nine months ended September 30, 2012 and 2011 contained in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Collaborations

Development of Late-stage Pediatric Product. For discussion regarding a development agreement that we entered into with a private company for a prescription product for the pediatrics market, see Note 13 to our Condensed Consolidated Financial Statements for the three and nine months ended September 30, 2012 and 2011 contained in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Third Quarter 2012 Highlights

The following summarizes certain key financial measures as of, and for, the three months ended September 30, 2012:

Cash and cash equivalents equaled \$37.0 million as of September 30, 2012.

Net revenues were approximately \$18.1 million.

Net loss before taxes was approximately \$0.7 million.

Opportunities and Trends

There continue to be unmet patient needs in the pediatric area as well as other therapeutic areas. We believe that we can systematically focus our efforts on developing and acquiring products or acquiring the assets of other companies whose products or assets can meet these needs. We also believe that future growth will be realized in the execution of branded and generic development opportunities outside the pediatric area. We believe the combination of product development and acquisitions will enhance our growth opportunities. Additionally, we will continue to leverage our industry relationships to identify and take advantage of new product opportunities.

We are operating in challenging economic and industry environments. The challenges we face are compounded by the continued uncertainty around the impact of the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010, which we refer to collectively herein as Health Care Reform. Given this business climate, we will continue to focus on managing and deploying our available cash efficiently and strengthening our industry relationships in order to be well-positioned to identify and capitalize upon potential growth opportunities.

As we execute our strategy, we will monitor and evaluate success through the following measures:

Net product sales generated from our existing products;

Revenues generated from co-promotion agreements;

Revenues generated from our recently acquired manufacturing facility;

Progress of our development pipeline (as discussed below); and

Acquisition of products and product rights that align with our strategy and that offer potential for sustainable growth.

See Note 1 to our Condensed Consolidated Financial Statements for the three and nine months ended September 30, 2012 and 2011 contained in Part I, Item 1 of this Quarterly Report on Form 10-Q for our discussion of net proceeds received from our controlled equity offering in April 2012 that is expected to fund future acquisitions and for general corporate purposes.

Financial Operations Overview

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

Net Revenues

Pernix’s net revenues consist of net product sales and revenue from co-promotion and other revenue sharing arrangements. Pernix recognizes product sales net of estimated allowances for product returns, price adjustments (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, services fees, chargebacks and other discounts that Pernix may offer. In addition to our own product portfolio, we have entered into co-promotion agreements and other revenue sharing arrangements with various parties in return for a percentage of revenue on sales we generate or on sales they generate.

The following table sets forth a summary of Pernix's net revenues for the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Upper respiratory, allergy and antibiotic products	\$ 6,815	\$ 10,810	\$ 27,056	\$ 40,376
ENT	415		415	
Gastroenterology	1,987		4,279	
Medical food products	287	117	761	625
Dermatology products (including Natroba)	4,076	7,709	5,980	9,962
Other generic products	6,790	4,398	19,129	5,947
Gross product sales	20,370	23,034	57,620	56,910
Sales allowances	(5,510)	(6,785)	(19,313)	(21,408)
Net product sales	14,860	16,249	38,307	35,502
Manufacturing revenue	2,094		2,094	
Collaboration and other revenue	1,180	815	2,715	3,702
Net Revenues	\$ 18,134	\$ 17,064	\$ 43,116	\$ 39,204

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 rebate programs and price adjustments as of September 30, 2012. Prompt pay discounts are recorded as a reduction of accounts receivable and revenue and, therefore, are not included in the table below. The allowance for prompt pay discounts as of September 30, 2012 and December 31, 2011 was approximately \$370,000 and \$393,000, respectively.

	Product Returns (in thousands)	Government Program Rebates (in thousands)	Price Adjustments (in thousands)
Balance at December 31, 2010	\$ 4,313	\$ 4,432	\$ 1,744
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
Assumed liability in product acquisition		187	
Adjustments to provision for prior year sales	620		
Provision – current year sales	3,677	4,101	9,716
Payments and credits	(5,366)	(5,406)	(9,648)
Balance at September 30, 2012	\$ 4,643	\$ 4,725	\$ 5,519

Product Returns. Consistent with industry practice, the Company offers contractual return rights that allow its customers to return the majority of its 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 24 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 remaining shelf life of the product, 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 estimated returns at 5% to 14% of sales of branded products during the third quarter of 2012. The Company is accruing 14% on launch sales of Omeclamox-Pak®. The Company estimated returns at 7% on sales of generic products on sales during the second and third quarters of 2012. The returns estimate on generic products was increased approximately 2% effective April 1, 2012 from prior periods due to the potential impact of changes in Medicaid coverage on certain products. Return estimates are based upon historical data and other facts and circumstances that may impact future expected returns to derive an average return percentage of our products. In connection with our new agreement with ParaPRO, we are working with them to revise the terms for the handling of any returns of Natroba. In the interim, returns will be handled as previously disclosed. The returns reserve may be adjusted as we accumulate sales history and returns experience on this portfolio of products. The Company reviews and adjusts these reserves quarterly. If estimates regarding product demand are inaccurate, if changes in the competitive environment affect 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 nine months ended September 30, 2012 would have affected pre-tax earnings by approximately \$595,000.

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 Medicaid 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 nine months ended September 30, 2012, a 1% difference in the provision assumptions based on utilization would have effected pre-tax earnings by approximately \$127,000 and a 1% difference in the provisions based on reimbursement rates would have affected pre-tax earnings by approximately \$45,000.

Price Adjustments . Our estimates of price adjustments which include customer rebates, service fees, and chargebacks 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 nine months ended September 30, 2012, a 1% difference in the assumptions based on the applicable sales would have affected pre-tax earnings by approximately \$946,000.

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. For the nine months ended September 30, 2012, a 1% difference in the assumption applied to coupon

utilization would have affected pre-tax earnings by approximately \$36,000.

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 15% 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%, 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.

Cost of Product Sales

Our cost of product sales is primarily comprised of the costs of manufacturing and distributing Pernix's pharmaceutical products and samples and collaboration expense related to co-promotional agreements with third parties. In particular, cost of product sales includes third-party manufacturing, packaging and distribution costs and the cost of active pharmaceutical ingredients. Pernix partners with third parties to manufacture the majority of its products and product candidates. We expect to utilize Great Southern Laboratories, the manufacturing plant that we recently acquired, to manufacture several of our products moving forward which we expect to result in a reduction in the cost of certain of our products.

Most of our 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 also affect its cost of product sales.

The cost of NATROBA is included in our cost of product sales from August 2011 (the month of launch). 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 shipped to retailers in our specified territories. Under the renegotiated terms effective August 24, 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.

Selling, General and Administrative Expenses

Our selling, general and administrative expenses consist primarily of salaries, benefits and commissions as well as public company costs, professional and consulting fees, sales data costs, insurance, and company overhead.

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.

Loss from the Operations of the Joint Venture

See Note 5, Investments, to our Condensed Consolidated Financial Statements for the three and nine months ended September 30, 2012 and 2011 contained in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Other Income and Expenses

Depreciation Expense. Depreciation expense is recognized for our property and equipment, which depreciates over the estimated useful life of the asset 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 acquired in May 2012, the gastroenterology 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 7, Intangible Assets, to our Condensed Consolidated Financial Statements for the three and nine months ended September 30, 2012 and 2011 contained in Part I, Item 1 of this Quarterly Report on Form 10-Q.

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 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

For information regarding our critical accounting policies and estimates please refer to “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates” contained in our annual report on Form 10-K for the year ended December 31, 2011 and Note 2 to our condensed consolidated financial statements contained therein. There have been no material changes to the critical accounting policies previously disclosed in that report.

Results of Operations

Comparison of the Three Months Ended September 30, 2012 and 2011

Net Revenues. Net revenues were approximately \$18,134,000 and \$17,064,000 for the three months ended September 30, 2012 and 2011, respectively, an increase of approximately \$1,070,000 or 6.3%. The increase in net revenues during the three months ended September 30, 2012 was primarily due to a decrease in deductions from revenue of approximately \$1,275,000, an increase in co-promotion revenue of approximately \$365,000 and the addition of the manufacturing revenue from GSL of approximately \$2,094,000 offset by a decrease in gross product sales of approximately \$2,664,000. The decrease in the deductions from revenue was primarily due to the decrease in the allowance for Medicaid rebates as a result of changes in Medicaid coverage on certain of our products offset by increases in point of sale discounts, the allowance for coupon redemptions and the allowance for product returns. The decrease in the gross product sales is primarily due to a decrease in sales of our upper respiratory and allergy products which were impacted by the changes in Medicaid coverage off set by increased sales of CEDAX and Omeclamox-Pak®.

Cost of Product Sales. Cost of product sales was approximately \$7,760,000 and \$7,684,000 for the three months ended September 30, 2012 and 2011, respectively, an increase of approximately \$76,000, or 1.0%. The increase in cost of product sales is due to approximately \$931,000 in product manufacturing costs incurred by GSL and approximately \$316,000 in collaboration expense from the co-promotion agreements on Omeclamox-Pak® and certain generic products which were launched after the three months ended September 30, 2011. This increase was offset by a decrease of approximately \$896,000 in the cost of product sales due to the decrease in gross product sales

and a decrease of approximately \$275,000 in product write-offs of expiring and/or donated product inventory.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were approximately \$9,837,000 and \$5,542,000 for the three months ended September 30, 2012 and 2011, respectively, an increase of approximately \$4,295,000, or 77.5%.

Salaries, bonuses, commissions, incentives and stock compensation expense ("overall compensation expense") represented approximately \$4,752,000, or 48.3%, and \$3,162,000, or 57.1%, of total selling, general and administrative expenses for the three months ended September 30, 2012 and 2011, respectively. The increase in overall compensation expense is primarily due to the acquisition of GSL on July 2, 2012, the addition of certain key positions in December 2011 and 26 gastroenterology sales representatives to market Omeclamox-Pak® in May 2012 and an increase of approximately \$321,000 in stock compensation expense. Other selling, general and administrative expenses were approximately \$5,085,000 and \$2,380,000 for the three months ended September 30, 2012 and 2011, respectively, an increase of approximately \$2,705,000, or 113.7%. This increase in other selling, general and administrative expenses was due to approximately \$1,040,000 in expenses from the operations of GSL, an increase in the cost of samples, coupon program fees, marketing research and marketing collateral expenses related to the launch of Omeclamox-Pak®, professional fees (consulting, legal, tax preparation, recruitment, etc.) regulatory and license fees, insurance, leases, sales reporting expenses, freight, information technology and software implementation expenses, certain public company costs and investor relations expenses and increased overhead (such as travel, telephone, and vehicle expenses).

Royalties Expense, net. Royalty expenses, net were approximately \$0 and \$32,000, respectively, during the three months ended September 30, 2012 and 2011, respectively.

Research and Development Expense. Research and development expenses were approximately \$333,000 and \$147,000 for the three months ended September 30, 2012 and 2011, respectively, an increase of approximately \$186,000 or 126.5%. We expect that our research and development expenses will continue to increase as a result of the product development agreement that we entered into in March 2012 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 Pernix will pay the costs related to the development of the product. Pernix expects to invest approximately \$6 million over an estimated 36-month period for development and regulatory expenses related to this product candidate, and Pernix's development partner will manage the development program. Pernix and its development partner expect to commence pivotal phase III studies in the next 12 months.

Loss from the Operations of the Joint Venture. The loss from the operations of our joint venture was approximately \$0 and \$101,000 for the three months ended September 30, 2012 and 2011, respectively, which primarily relates to costs incurred by the joint venture to develop a first-in-class, non-codeine antitussive drug designed to address the serious need for a safer and more effective, non-opioid treatment for persistent cough. For further discussion, see Note 5, Investments, to our Condensed Consolidated Financial Statements for the three and nine months ended September 30, 2012 and 2011 contained in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Other Expenses

Depreciation and Amortization Expense. Depreciation expenses were approximately \$112,000 and \$25,000 for the three months ended September 30, 2012 and 2011, respectively, an increase of approximately \$87,000 or 348.0%.

Amortization expense was approximately \$774,000 and \$578,000 for the three months ended September 30, 2012 and 2011. The increase of approximately \$196,000 is due to the amortization under certain of our acquisition agreements as described in see Notes 6 and 7 to our Condensed Consolidated Financial Statements for the three and nine months ended September 30, 2012 and 2011 contained in Part I, Item I of this Quarterly Report on Form 10-Q.

Interest Expense, net. Interest income was approximately \$20,000 and \$16,000 for the three months ended September 30, 2012 and 2011, respectively. Interest expense was approximately \$12,000 and \$53,000 for the three months ended September 30, 2012 and 2011, respectively. The decrease in interest expense is related to the payoff of the balance previously outstanding under our line of credit.

Summary

The results of operations for the third quarter 2012, as compared to the third quarter 2011, were negatively impacted by certain operating activities initiated in recent months including (i) the net operating loss of approximately \$513,000 from Great Southern Laboratories of which approximately 71% was incurred in the acquisition month of July 2012, (ii) the net loss on the Omeclamox-Pak product of approximately \$400,000, (iii) the expenses incurred in the development of our OTC cough products utilizing the recently licensed cough intellectual property of approximately \$107,000, and (iv) the expenses incurred pursuant to our previously announced pediatric RX development program of approximately \$105,000, along with an increase in our stock compensation expense primarily related to a restricted stock issuance in March 2012 of approximately \$321,000.

Comparison of the Nine Months Ended September 30, 2012 and 2011

Net Revenues. Net revenues were approximately \$43,116,000 and \$39,204,000 for the nine months ended September 30, 2012 and 2011, respectively, an increase of approximately \$3,912,000, or 10.0%. The increase in net revenues during the nine months ended September 30, 2012 was primarily due to an increase in gross product sales of approximately \$710,000, or 1.20%, a decrease in deductions from revenue of approximately \$2,095,000 and the addition of the manufacturing revenue from GSL of approximately \$2,094,000 offset by a decrease in co-promotion and other revenue of approximately \$987,000. The decrease in the deductions from revenue was primarily due to the decrease in the allowance for Medicaid rebates as a result of changes in Medicaid coverage on certain of our products and decreases in customer chargebacks and administrative fees due to more direct sales to retailers offset by increases in point of sale discounts, the allowance for coupon redemptions and the allowance for product returns.

Cost of Product Sales. Cost of product sales was approximately \$15,861,000 and \$13,069,000 for the nine months ended September 30, 2012 and 2011, respectively, an increase of approximately \$2,792,000, or 21.4%. The increase in cost of product sales is due to approximately \$1,181,000 attributed to the increase in gross product sales, approximately \$931,000 in product manufacturing costs incurred by GSL and approximately \$1,678,000 in collaboration expense from the co-promotion agreements on Omeclamox-Pak® and certain generic products which were launched after the three months ended September 30, 2011. This increase was offset by a decrease of approximately \$998,000 in product write-offs of expiring and/or donated product inventory.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were approximately \$24,302,000 and \$15,555,000 for the nine months ended September 30, 2012 and 2011, respectively, an increase of approximately \$8,747,000, or 56.2%. Overall compensation expense represented approximately \$11,423,000, or 47.0%, and \$8,923,000, or 57.4%, of total selling, general and administrative expenses for the nine months ended September 30, 2012 and 2011, respectively. As previously noted the increase in overall compensation expense is primarily due to the acquisition of GSL on July 2, 2012, the addition of certain key positions in December 2011 and 26 gastroenterology sales representatives to market Omeclamox-Pak® in May 2012 and an increase of approximately \$1,029,000 in stock compensation expense. Other selling, general and administrative expenses were approximately \$12,859,000 and \$6,632,000 for the three months ended September 30, 2012 and 2011, respectively, an increase of approximately \$6,227,000, or 93.9%. This increase in other selling, general and administrative expenses was due to approximately \$1,040,000 in expenses from the operations of GSL, an increase in the cost of samples, coupon program fees, marketing research and marketing collateral expenses related to the launch of Omeclamox-Pak®, professional fees (consulting, legal, tax preparation, recruitment, etc.) regulatory and license fees, insurance, leases, sales reporting expenses, freight, information technology and software implementation expenses, certain public company costs and investor relations expenses and increased overhead (such as travel, telephone, and vehicle expenses).

Royalties Expense, net. Royalty expenses, net were approximately \$0 and \$377,000 for the nine months ended September 30, 2012 and 2011, respectively.

Research and Development Expense. Research and development expenses were approximately \$512,000 and \$718,000 for the nine months ended September 30, 2012 and 2011, respectively, a decrease of approximately \$206,000, or 28.7%. The research and development costs during the prior year period are primarily related to the launch of a new generic product. As noted above, we expect that our research and development expenses will increase moving forward as a result of the product development agreement that we entered into in March 2012 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 Pernix will pay the costs related to the development of the product. Pernix expects to invest approximately \$6 million over an estimated 36-month period for development and regulatory expenses related to this product candidate, and Pernix's development partner will manage the development program. Pernix and its development partner expect to commence pivotal phase III studies in the next 12 months.

Loss from the Operations of the Joint Venture. The loss from the operations of our joint venture was approximately \$240,000 and \$692,000 for the nine months ended September 30, 2012 and 2011, respectively, which represents primarily research and development costs related to the development of a first-in-class, non-codeine antitussive drug designed to address the serious need for a safer and more effective, non-opioid treatment for persistent cough. The joint venture was terminated in May 2012. For further discussion, see Note 5, Investments, to our Condensed Consolidated Financial Statements for the three and nine months ended September 30, 2012 and 2011 contained in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Other Expenses

Depreciation and Amortization Expense. Depreciation expenses were approximately \$163,000 and \$68,000 for the nine months ended September 30, 2012 and 2011, respectively. The increase of approximately \$95,000, or 139.7%, is primarily due to assets acquired in the acquisition of GSL.

Amortization expense was approximately \$2,157,000 and \$1,623,000 for the nine months ended September 30, 2012 and 2011, respectively. The increase of approximately \$534,000 is due to the amortization under certain of our commercial agreements that we entered into related to Omeclamox-Pak®, the license for the non-codeine anti-tussive cough suppressant and for and assets acquired in the GSL acquisition. For further discussion, see Notes 6 and 7 to our Condensed Consolidated Financial Statements for the three and nine months ended September 30, 2012 and 2011 contained in Part I, Item I of this Quarterly Report on Form 10-Q.

Interest Expense, net. Interest income was approximately \$56,000 and \$29,000 for the nine months ended September 30, 2012 and 2011, respectively. Interest expense was approximately \$116,000 and \$158,000 for the nine months ended September 30, 2012 and 2011, The decrease in interest expense is related to the payoff of the balance previously outstanding under our line of credit.

Summary

The results of operations for the nine months ended September 30, 2012, as compared to the same period in 2011, was negatively impacted by certain operating activities initiated in recent months including (i) the net operating loss of approximately \$513,000 from Great Southern Laboratories of which approximately 71% was incurred in the acquisition month of July 2012, (ii) the net loss on the Omeclamox-Pak product of approximately \$1,450,000, (iii) the expenses incurred in the development of our OTC cough products utilizing the recently licensed cough intellectual property of approximately \$337,000, and (iv) the expenses incurred pursuant to our previously announced pediatric RX development program of approximately \$137,000, along with an increase in our stock compensation expense primarily related to a restricted stock issuance in March 2012 and stock option issuances after September 30, 2011 of approximately \$1,029,000.

Liquidity and Capital Resources

Sources of Liquidity

Pernix's net (loss) income was approximately \$ (270,000) and \$1,995,000 for the three months ended September 30, 2012 and 2011 and \$ (11,000) and \$4,472,000 for the nine months ended September 30, 2012 and 2011, respectively.

Pernix requires cash to meet its operating expenses and for capital expenditures, acquisitions, and in-licenses of rights to products. To date, Pernix has funded its operations primarily from product sales and co-promotion agreement revenues. As described in Note 1 to our Condensed Consolidated Financial Statements for the three and nine months ended September 30, 2012 and 2011, contained in Part I, Item 1 of this Quarterly Report on Form 10-Q, we received net proceeds of approximately \$23.8 million from our controlled equity offering that commenced in February 2012 and concluded in April 2012. We expect to continue to utilize the proceeds from these equity offerings, together with the proceeds from product sales and possibly available funds under our line of credit to fund future acquisitions and for general corporate purposes. As of November 12, 2012, Pernix had approximately \$36.7 million in cash and cash equivalents.

Cash Flows

The following table provides information regarding Pernix's cash flows for the nine months ended September 30, 2012 and 2011:

	Nine Months Ended September 30, (rounded)	
	2012	2011
Cash provided by (used in)		
Operating activities	\$ 674,000	\$ 1,263,000
Investing activities	(13,189,000)	(1,133,000)
Financing activities	15,001,000	19,173,000
Net increase in cash and cash equivalents	\$ 2,486,000	\$ 19,303,000

Net Cash Provided By Operating Activities

Net cash provided by operating activities for the nine months ended September 30, 2012 and 2011 was approximately \$674,000 and \$1,263,000, respectively. Net cash from operating activities for the nine months ended September 30, 2012 reflects Pernix's net loss of approximately \$11,000, adjusted by non-cash expenses totaling approximately \$5,003,000 partially offset by a non-cash deferred income tax benefit of approximately \$517,000 and approximately \$3,820,000 in net changes in accounts receivable, inventories, accrued expenses and other operating assets and liabilities. Non-cash expenses included amortization of approximately \$2,158,000, depreciation of approximately \$163,000, stock compensation expense of approximately \$1,902,000, stock option expense for options issued to ParaPRO of approximately \$540,000 and expenses from our joint venture with SEEK of approximately \$240,000. Net cash provided by operating activities for the nine months ended September 30, 2011 primarily reflected Pernix's net income of approximately \$4,472,000, adjusted by non-cash expenses totaling approximately \$3,392,000 partially offset by a non-cash deferred income tax benefit of approximately \$2,414,000 and approximately \$4,186,000 in net changes in accounts receivable, inventories, accrued expenses and other operating assets and liabilities. Non-cash expenses included amortization of approximately \$1,623,000, depreciation of approximately \$68,000, stock compensation expense of approximately \$872,000, stock option expense for options issued to ParaPRO of approximately \$137,000 and expenses from our Joint Venture with SEEK of approximately \$692,000.

Accounts receivable at September 30, 2012, decreased approximately \$186,000 from December 31, 2011. Inventories increased approximately \$720,000 from December 31, 2011 due primarily to the addition of GSL inventory. Prepaid expenses and other assets increased by approximately \$176,000 primarily due to prepaid product related government fees and coupon program funding.

Accounts payable increased approximately \$2,928,000 due to payables related to the Fall stocking of Natroba and the addition of GSL's accounts payable at September 30, 2012 of approximately \$846,000. Accrued allowances decreased approximately \$2,118,000 primarily due to the decrease in the allowance for Medicaid rebates related to the changes in Medicaid coverage on certain of our products. Accrued expenses increased by approximately \$1,189,000 primarily due to accrued expenses of GSL of approximately \$939,000.

Net Cash from Investing Activities

Net cash used in investing activities for the nine months ended September 30, 2012 and 2011 was approximately \$13,189,000 and \$1,133,000, respectively. The cash used in investing activities for the nine months ended September 30, 2012 consisted of \$2,400,000 to acquire the license for Omeclamox®, approximately \$4,667,000 to acquire GSL, \$5,000,000 to acquire the license from SEEK for the non-codeine antitussive drug in development, , the acquisition of other product licenses for \$850,000 and purchases of software, furniture and equipment of approximately \$280,000 offset by proceeds from the sale of computer equipment of approximately \$8,000. The cash flow from investing activities for the nine months ended September 30, 2011 consisted of a \$1,000,000 additional investment in our joint venture with SEEK and approximately \$133,000 in purchases of equipment and furniture, primarily for the at the time new corporate headquarters.

Net Cash from Financing Activities

Net cash provided by financing activities for the nine months ended September 30, 2012 was approximately \$15,001,000. The cash provided by investing activities for the nine months ended September 30, 2012 consisted of approximately (i) \$23,751,000 in net proceeds from our controlled equity offering, (ii) \$148,000 tax benefit on stock-based awards, (iii) \$173,000 in net proceeds from the issuance of stock to employees and/or board members offset by approximately (iv) \$6,000,000 in payments on our line of credit, (v) \$2,990,000 in payments on contracts and \$81,000 on the GSL mortgage and capital lease obligations.

Net cash provided by financing activities for the nine months ended September 30, 2011 was approximately \$19,173,000 which represents approximately (i) \$1,000,000 in proceeds from our revolving line of credit, (ii) \$19,260,000 in net proceeds from the additional 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) \$123,000 tax benefit on stock-based awards, and (vi) \$107,000 in proceeds from the issuance of stock under our employee stock purchase and incentive stock plans, partially offset by approximately (i) \$900,000 in installment payments on the repurchase of stock from a related party, (ii) \$1,000,000 for the last scheduled installment on the acquisition of Gaine and (iii) \$30,000 in payments under other installment contracts payable.

Funding Requirements

As of November 12, 2012, Pernix has approximately \$39.0 million in cash and a revolving credit line with approximately \$5.0 million available for working capital and \$5.0 million available for acquisitions. Our revolving credit line with Regions Bank currently matures on December 31, 2012. 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.

To the extent that Pernix's capital resources are insufficient to meet its future capital requirements, Pernix will need to finance its cash needs through public or private equity offerings, debt financings, corporate collaboration and licensing arrangements or other financing alternatives. Equity or debt financing, or corporate collaboration and licensing arrangements, may not be available on acceptable terms, if at all.

As of November 12, 2012, Pernix believes that its existing cash, which includes approximately \$23.7 million from the controlled equity offering completed earlier this year, revenues from product sales and the available line of credit proceeds will be sufficient to continue to fund its existing level of operating expenses and general capital expenditure requirements through 2013.

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 September 30, 2012 (in thousands):

	Total	Payments Due by Period			
		Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Operating leases(1)	\$ 729	\$ 287	\$ 311	\$ 132	\$ —
Capital leases(2)	83	79	4		
Professional services agreements(3)	2,072	1,222	841	9	—
Purchase obligations(4)	2,918	2,918	—	—	—
Licenses and other obligations(5)	1,750	1,750	—	—	—
Mortgage obligation (6)	2,129	228	456	228	1,217
Total contractual obligations	\$ 9,681	\$ 6,484	\$ 1,612	\$ 369	\$ 1,217

- (1) Operating leases include minimum payments under leases for our facilities and certain equipment.
- (2) Capital leases include minimum payments under leases for certain manufacturing equipment at GSL.
- (3) Professional services agreements include agreements with a specific term for consulting, information technology, telecom and software support, data and sales reporting tools and other services.
- (4) 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 \$2.8 million.

Based on our recently negotiated term sheet with ParaPRO, we no longer have minimum purchase commitments for NATROBA. For further discussion, see Note 10, Other Revenue Sharing Arrangements, to our Condensed Consolidated Financial Statements for the three and nine months ended September 30, 2012 and 2011 contained in Part I, Item I of this Quarterly Report on Form 10-Q.

- (5) License agreements include payments due under certain product license arrangements for which payments are not contingent on sales or other sales achievements. See Note 7, Intangible Assets, to our Condensed Consolidated Financial Statements for the three and nine months ended September 30, 2012 and 2011 contained in Part I, Item I of this Quarterly Report on Form 10-Q. Other obligations also includes the remaining payments due under a privately negotiated stock repurchase executed in September 2010.
- (6) The mortgage payable is on certain real estate acquired in the acquisition of GSL.

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.

Recent Accounting Pronouncements

Other than those disclosed in Note 2, Basis of Presentation and Summary of Significant Accounting Policies, to our Condensed Consolidated Financial Statements for the three and nine months ended September 30, 2012 and 2011 contained in Part I, Item I of this Quarterly Report on Form 10-Q, there have been no other recent accounting pronouncements that have not yet been adopted by us that are expected to have a material impact on our condensed consolidated financial statements from the accounting pronouncements previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2011.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

3.

Not applicable.

ITEM 4. CONTROLS AND PROCEDURES

4.

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

As of September 30, 2012, our Chief Executive Officer and Chief Financial Officer, with the participation of our management, have evaluated the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)). Based on their evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of September 30, 2012, the design and operation of our disclosure controls and procedures were effective.

There has been no change in our internal control over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM LEGAL PROCEEDINGS

1.

See Legal Matters under Note 13 to our Condensed Consolidated Financial Statements for the three and nine months ended September 30, 2012 and 2011 contained in Part I, Item 1 of this Quarterly Report on Form 10-Q. Also, information regarding reportable legal proceedings is contained in Part I, “Item 3. Legal Proceedings” in our Annual Report on Form 10-K for the year ended December 31, 2011.

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.

ITEM RISK FACTORS

1A.

There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2011 and the additional risk factors previously disclosed in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2012.

ITEM UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

2.

None.

ITEM DEFAULTS UPON SENIOR SECURITIES

3.

None.

ITEM MINE SAFETY DISCLOSURES

4.

None.

ITEM OTHER INFORMATION

5.

None.

ITEM EXHIBITS

6.

EXHIBIT INDEX

Exhibit No. Description

3.1	Articles of Incorporation of Pernix Therapeutics Holdings, Inc. (previously filed as Exhibit 3.1 to our Current Report on Form 8-K filed on March 15, 2010 and incorporated herein by reference).
3.2	Bylaws of Pernix Therapeutics Holdings, Inc. (previously filed as Exhibit 3.2 to our Current Report on Form 8-K filed on March 15, 2010 and incorporated herein by reference).
<u>31.1</u> *	Certification of the Registrant's Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
<u>31.2</u> *	Certification of the Registrant's Principal Accounting Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
<u>32.1</u> *	Certification of the Registrant's Chief Executive Officer and Principal Accounting Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101*	Attached as Exhibit 101 to this report are the following items formatted in XBRL (Extensible Business Reporting Language)
	(i) Condensed Consolidated Balance Sheets as of September 30, 2012 and December 31, 2011
	(ii) Condensed Consolidated Statements of Operations and Comprehensive Income for the Three and Nine Months Ended September 30, 2012 and 2011;
	(iii) Condensed Consolidated Statements of Stockholders' Equity as of September 30, 2012 and December 31, 2011
	(iv) Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2012 and 2011
	(v) Notes to Condensed Consolidated Financial Statements

* Filed herewith.

SIGNATURES

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

PERNIX THERAPEUTICS HOLDINGS, INC.

Date: November 14, 2012

By: /s/ COOPER C. COLLINS
Cooper Collins
Chief Executive Officer and
President

Date: November 14, 2012

By: /s/ DAVID P. BECKER
David P. Becker