Lau Richard KC
Form 5
February 11, 2013

FORM 5

OMB APPROVAL

OMB Number:	3235-0362
Expires:	January 31, 2005
Estimated average burden hours per response...	1.0

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).
Form 3 Holdings Reported
Form 4 Transactions Reported

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

ANNUAL STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

1. Name and Address of Reporting Person *
Lau Richard KC

(Last) (First) (Middle)

1132 BISHOP STREET, SUITE 2200

(Street)

HONOLULU,Â HIÂ 96813

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
Territorial Bancorp Inc. [TBNK]

3. Statement for Issuer's Fiscal Year Ended (Month/Day/Year)
12/31/2012

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
SVP

6. Individual or Joint/Group Reporting

(check applicable line)

_X_ Form Filed by One Reporting Person
___ Form Filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)	4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned at end of Issuer's Fiscal Year (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
				Amount	(A) or (D)	Price			
Common Stock	08/19/2012	Â	F4	650	D	$ 23.62	33,240	D	Â
Common Stock	09/13/2012	Â	S4	4 (3)	D	$ 23.73	33,236	D	Â
Common Stock	09/13/2012	Â	S4	1 (3)	D	$ 23.7225	33,235	D	Â
Common Stock	09/13/2012	Â	S4	1 (3)	D	$ 23.71	33,234	D	Â

Common Stock	09/13/2012	Â	S4	89 (3)	D	$ 23.7	33,145	D	Â
Common Stock	09/13/2012	Â	S4	47 (3)	D	$ 23.69	33,098	D	Â
Common Stock	09/13/2012	Â	S4	51 (3)	D	$ 23.68	33,047	D	Â
Common Stock	Â	Â	Â	Â	Â	Â	10,420 (2)	I	By 401(k)
Common Stock	Â	Â	Â	Â	Â	Â	1,500	I	By corporation
Common Stock	Â	Â	Â	Â	Â	Â	2,028 (2)	I	By ESOP

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

Persons who respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

SEC 2270 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)	5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. D S (I
					(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares	
Stock Options	$ 17.36	Â	Â	Â	Â	Â	08/19/2011	08/19/2020	Common Stock	19,524 (1)	

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
Lau Richard KC 1132 BISHOP STREET, SUITE 2200 HONOLULU,Â HIÂ 96813	Â	Â	Â SVP	Â

Signatures

/s/ Edward A. Quint, pursuant to power of attorney	02/11/2013
**Signature of Reporting Person	Date

Explanation of Responses:

- * If the form is filed by more than one reporting person, see Instruction 4(b)(v).
- ** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).
- **(1)** Stock options vest at a rate of 20% per year commencing on August 19, 2011.
- **(2)** Reflects transactions not required to be reported pursuant to Section 16 of the Securities Exchange Act of 1934, as amended.
- **(3)** Represents shares sold in connection with the payment of taxes due on vesting of restricted shares.

Note: File three copies of this Form, one of which must be manually signed. If space provided is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. 1986, as amended, U.S. Treasury regulations promulgated thereunder, rulings and pronouncements of the Internal Revenue Service, or IRS, and judicial decisions, all as in effect on the date of this prospectus and all of which are subject to change (possibly on a retroactive basis) or to differing interpretations. We have not sought, and will not seek, any ruling from the IRS with respect to the tax consequences discussed in this prospectus, and there can be no assurance that the IRS will not take a position contrary to the tax discussion below or that any such position would not be sustained.

This summary is limited to non-U.S. holders that purchase our common stock issued pursuant to this offering and that hold our common stock as a capital asset, which generally is property held for investment. This summary also does not address the tax considerations arising under the laws of any foreign, state or local jurisdiction, or under U.S. federal estate or gift tax laws except as specifically described below. In addition, this summary does not address tax considerations that may be applicable to a non-U.S. holder in light of its particular circumstances or to non-U.S. holders that may be subject to special tax rules, including, without limitation:

- Ø banks, insurance companies or other financial institutions;
- Ø partnerships or other pass through entities;
- Ø U.S. expatriates;
- Ø tax-exempt organizations;
- Ø tax-qualified retirement plans;
- Ø dealers in securities or currencies;
- Ø traders in securities that elect to use a mark-to-market method of accounting for their securities holdings; or
- Ø persons that will hold common stock as a position in a hedging transaction, straddle or conversion transaction for tax purposes.

For purposes of this summary, the term non-U.S. holder means a beneficial owner of our common stock that is not, for U.S. federal income tax purposes:

- Ø an individual citizen or resident of the U.S.;

- a corporation, or other entity treated as a corporation for U.S. federal income tax purposes, that is created or organized under the laws of the United States or any political subdivision of the United States;
- an estate whose income, regardless of its source, is includible in gross income for U.S. federal income tax purposes;
- a trust (1) if a U.S. court is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions regarding the trust, or (2) that has in effect a valid election to be treated as a U.S. person; or
- a partnership, or other entity treated as a partnership for U.S. federal income tax purposes.

Material U.S. federal income and estate tax consequences to non-U.S. holders

If a partnership or other entity classified as such for U.S. federal income tax purposes holds shares of our common stock, the tax treatment of a partner or owner will generally depend on the status of the partner or owner and the activities of the partnership or other entity. It is advised that partnerships (and other entities classified as such for U.S. federal income tax purposes) owning shares of our common stock, and holders of interests in such entities, consult their tax advisors.

Any non-U.S. holder of our common stock should consult their tax advisor regarding the tax consequences of purchasing, holding, and disposing of these shares of stock.

DIVIDENDS

As previously discussed, we do not anticipate paying dividends on our common stock in the foreseeable future. If we pay dividends on our common stock, however, those payments will constitute dividends for U.S. federal income tax purposes to the extent paid from our current or accumulated earnings and profits, as determined under U.S. federal income tax principles. To the extent those payments exceed our current and accumulated earnings and profits, the payments will constitute a return of capital and first reduce the non-U.S. holder s adjusted tax basis, but not below zero, and then will be treated as gain from the sale of stock, as described below under the heading Gain on Disposition of Common Stock. Any amount treated as a dividend paid to a non-U.S. holder will ordinarily be subject to a 30% U.S. federal withholding tax, or a lower rate if an applicable income tax treaty so provides. A non-U.S. holder will be required to satisfy certain certification and disclosure requirements in order to claim a reduced rate of withholding pursuant to an applicable income tax treaty.

Dividends that are effectively connected with a non-U.S. holder s conduct of trade or business within the United States (and, where an applicable tax treaty so requires, are attributable to a permanent establishment or fixed base in the U.S.) will not be subject to U.S. federal withholding tax, provided certain certification and disclosure requirements are met, but instead generally will be taxed in the same manner as if the non-U.S. holder were a U.S. person. Additionally, non-U.S. holders that are corporations receiving such dividends may be subject to an additional branch profits tax at a rate of 30%, or at a lower rate if provided by an applicable income tax treaty.

Non-U.S. holders are encouraged to consult their tax advisors regarding any claim to benefits under an applicable income tax treaty and the method of claiming the benefits of the treaty. A refund or credit for any non-U.S. holder that is subject to a reduced U.S. federal withholding income tax rate may be obtained by timely filing a claim for a refund with the IRS.

GAIN ON DISPOSITION OF COMMON STOCK

A non-U.S. holder of our common stock generally will not be taxed on gain recognized upon disposition unless:

- Ø the non-U.S. holder is present in the U.S. for 183 days or more during the taxable year of the disposition and has met certain other requirements.

- Ø the income or gain is effectively connected with the non-U.S. holder s conduct of trade or business within the U.S. and, if an applicable income tax treaty so requires, is attributable to a permanent establishment or fixed base of the non-U.S. holder in the U.S.; or

- Ø we are or have been a United States real property holding corporation for U.S. federal income tax purposes at any time within the shorter of the five-year period preceding such disposition or your holding period for our common stock, and certain other requirements are met. We believe that we are not, and that we will not become, a United States real property holding corporation.

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Material U.S. federal income and estate tax consequences to non-U.S. holders

If you are an individual described in the first bullet point immediately above you will be subject to a flat 30% tax on the amount by which gain resulting from the disposition of our common stock and any other U.S.-source capital gains realized in the same taxable year exceed the U.S.-source capital losses recognized in that taxable year, unless an applicable income tax treaty provides for an exemption or lower rate. If you are an individual described in the second bullet point immediately above you will be subject to tax on the net gain derived from the sale under regular graduated U.S. federal income tax rates. If you are a corporation described in the second bullet point immediately above, you will be subject to tax on the net gain generally in the same manner as if you were a U.S. corporation for U.S. federal income tax purposes, and may also be subject to the branch profits tax equal to 30%, or such lower rate as may be specified by an applicable income tax treaty, on your effectively connected earnings and profits.

U.S. FEDERAL ESTATE TAX

Common stock owned or treated as owned by a non-U.S. holder who is an individual will be included in that non-U.S. holder s gross estate for U.S. federal estate tax purposes unless an applicable estate tax or other treaty provides otherwise and such non-U.S. holder therefore may be subject to U.S. federal estate tax.

U.S. INFORMATION REPORTING AND BACKUP WITHHOLDING

We must report to you and to the Internal Revenue Service on an annual basis the amount of dividends paid to you and any related taxes withheld from those dividends. Copies of the information returns reporting dividends and the related tax withheld may also be made available to the tax authorities in the country in which you reside under the provisions of an applicable income tax treaty.

Backup withholding generally will not apply to payments of dividends made by us or our paying agents, in their capacities as such, to a non-U.S. holder of our common stock if the holder has provided the required certification that it is not a U.S. person or certain other requirements are met.

In general, backup withholding and information reporting will not apply to proceeds from the disposition of our common stock paid to a non-U.S. holder if the holder has provided the required certification that it is a non-U.S. holder.

Backup withholding is not an additional tax. Any amounts withheld may be refunded or credited against the holder s U.S. federal income tax liability, if any, provided that the required information is furnished to the IRS in a timely manner.

Non-U.S. holders should consult their tax advisors regarding the application of the information reporting and backup withholding rules to them.

Prospective non-U.S. holders of our common stock should consult their tax advisors with respect to the particular tax consequences to them of owning and disposing of our common stock, including the consequences under the laws of any state, local or foreign jurisdiction or under any applicable tax treaty.

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Underwriting

We are offering the shares of our common stock described in this prospectus through the underwriters named below. UBS Securities LLC, Jefferies & Company, Inc., Wachovia Capital Markets, LLC and Morgan Joseph & Co. Inc. are the representatives of the underwriters. UBS Securities LLC, Jefferies & Company, Inc. and Wachovia Capital Markets, LLC are the joint book-running managers of this offering. We have entered into an underwriting agreement with the representatives. Subject to the terms and conditions of the underwriting agreement, each of the underwriters has severally agreed to purchase the number of shares of common stock listed next to its name in the following table.

Underwriters	**Number of Shares**
UBS Securities LLC	
Jefferies & Company, Inc	
Wachovia Capital Markets, LLC	
Morgan Joseph & Co. Inc.	
Total	6,250,000

The underwriting agreement provides that the underwriters must buy all of the shares if they buy any of them. However, the underwriters are not required to take or pay for the shares covered by the underwriters over-allotment option described below.

Our common stock is offered subject to a number of conditions, including:

Ø receipt and acceptance of our common stock by the underwriters, and

Ø the underwriters right to reject orders in whole or in part.

We have been advised by the representatives that the underwriters intend to make a market in our common stock, but that they are not obligated to do so and may discontinue making a market at any time without notice.

In connection with this offering, certain of the underwriters or securities dealers may distribute prospectuses electronically.

OVER-ALLOTMENT OPTION

We have granted the underwriters an option to buy up to an aggregate of 937,500 additional shares of our common stock. The underwriters may exercise this option solely for the purpose of covering over-allotments, if any, made in connection with this offering. The underwriters have 30 days from the date of this prospectus to exercise this option. If the underwriters exercise this option, they will each purchase additional shares approximately in proportion to the amounts specified in the table above.

COMMISSIONS AND DISCOUNTS

Shares sold by the underwriters to the public will initially be offered at the initial offering price set forth on the cover of this prospectus. Any shares sold by the underwriters to securities dealers may be sold at a discount of up to $ per share from the initial public offering price. Any of these securities dealers may resell any shares purchased from the underwriters to other brokers or dealers at a discount of up to $ per share from the initial public offering price. If all the shares are not sold at the initial public offering price, the representatives may change the offering price and the other selling terms. Upon execution of the underwriting agreement, the underwriters will be obligated to purchase the shares at

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Underwriting

the prices and upon the terms stated therein and, as a result, will thereafter bear any risk associated with changing the offering price to the public or other selling terms. The representatives of the underwriters have informed us that they do not expect to sell more than an aggregate of 312,500 shares of common stock to accounts over which such representatives exercise discretionary authority.

The following table shows the per share and total underwriting discounts and commissions we will pay to the underwriters assuming both no exercise and full exercise of the underwriters option to purchase up to an additional shares.

	No exercise	Full exercise
Per share	$	$
Total	$	$

We estimate that the total expenses of this offering payable by us, not including the underwriting discounts and commissions, will be approximately $3.5 million.

NO SALES OF SIMILAR SECURITIES

We, our executive officers and directors and shareholders owning substantially all of our stock have entered into lock-up agreements with the underwriters. Under these agreements, subject to certain exceptions, we and each of these persons may not, without the prior written approval of UBS Securities LLC, offer, sell, contract to sell or otherwise dispose of, directly or indirectly, or hedge our common stock or securities convertible into or exchangeable or exercisable for our common stock. These restrictions will be in effect for a period of 180 days after the date of this prospectus. At any time and without public notice, UBS Securities LLC may, in its sole discretion, release some or all of the securities from these lock-up agreements.

INDEMNIFICATION

We have agreed to indemnify the underwriters against certain liabilities, including certain liabilities under the Securities Act. If we are unable to provide this indemnification, we have agreed to contribute to payments the underwriters may be required to make in respect of those liabilities.

NASDAQ GLOBAL MARKET QUOTATION

We have applied to have our common stock approved for quotation on The Nasdaq Global Market under the trading symbol CPIX .

PRICE STABILIZATION, SHORT POSITIONS

In connection with this offering, the underwriters may engage in activities that stabilize, maintain or otherwise affect the price of our common stock, including:

- stabilizing transactions;
- short sales;
- purchases to cover positions created by short sales;
- imposition of penalty bids; and
- syndicate covering transactions.

Stabilizing transactions consist of bids or purchases made for the purpose of preventing or retarding a decline in the market price of our common stock while this offering is in progress. These transactions

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Underwriting

may also include making short sales of our common stock, which involve the sale by the underwriters of a greater number of shares of common stock than they are required to purchase in this offering, and purchasing shares of common stock on the open market to cover positions created by short sales. Short sales may be covered short sales, which are short positions in an amount not greater than the underwriters over-allotment option referred to above, or may be naked short sales, which are short positions in excess of that amount.

The underwriters may close out any covered short position by either exercising their over-allotment option, in whole or in part, or by purchasing shares in the open market. In making this determination, the underwriters will consider, among other things, the price of shares available for purchase in the open market as compared to the price at which they may purchase shares through the over-allotment option.

Naked short sales are in excess of the over-allotment option. The underwriters must close out any naked short position by purchasing shares in the open market. A naked short position is more likely to be created if the underwriters are concerned that there may be downward pressure on the price of the common stock in the open market that could adversely affect investors who purchased in this offering.

The underwriters also may impose a penalty bid. This occurs when a particular underwriter repays to the underwriters a portion of the underwriting discount received by it because the representatives have repurchased shares sold by or for the account of that underwriter in stabilizing or short covering transactions.

As a result of these activities, the price of our common stock may be higher that the price that otherwise might exist in the open market. If these activities are commenced, they may be discontinued by the underwriters at any time. The underwriters may carry out these transactions on The Nasdaq Global Market, in the over-the-counter market or otherwise.

DETERMINATION OF OFFERING PRICE

Prior to this offering, there was no public market for our common stock. The initial public offering price will be determined by negotiation by us and the representatives of the underwriters. The principal factors to be considered in determining the initial public offering price include:

- the information set forth in this prospectus and otherwise available to representatives;
- our history and prospects, and the history of and prospects for the industry in which we compete;
- our past and present financial performance and an assessment of our management;
- our prospects for future earnings and the present state of our development;
- the general condition of the securities markets at the time of this offering;
- the recent market prices of, and demand for, publicly traded common stock of generally comparable companies; and
- other factors deemed relevant by the underwriters and us.

AFFILIATIONS

Certain of the underwriters and their affiliates may from time to time provide certain commercial banking, financial advisory, investment banking and other services for us for which they were and will be entitled to receive separate fees. The underwriters and their affiliates may from time to time in the future engage in transactions with us and perform services for us in the ordinary course of their business.

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Notice to investors

EUROPEAN ECONOMIC AREA

In relation to each Member State of the European Economic Area, or EEA, which has implemented the Prospectus Directive (each, a Relevant Member State), with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State, or the Relevant Implementation Date, our common stock will not be offered to the public in that Relevant Member State prior to the publication of a prospectus in relation to our common stock that has been approved by the competent authority in that Relevant Member State or, where appropriate, approved in another Relevant Member State and notified to the competent authority in that Relevant Member State, all in accordance with the Prospectus Directive, except that, with effect from and including the Relevant Implementation Date, our common stock may be offered to the public in that Relevant Member State at any time:

Ø to legal entities which are authorized or regulated to operate in the financial markets or, if not so authorized or regulated, whose corporate purpose is solely to invest in securities;

Ø to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than 43,000,000 and (3) an annual net turnover of more than 50,000,000, as shown in its last annual or consolidated accounts; or

Ø in any other circumstances which do not require the publication by us of a prospectus pursuant to Article 3 of the Prospectus Directive.

As used above, the expression offered to the public in relation to any of our common stock in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and our common stock to be offered so as to enable an investor to decide to purchase or subscribe for our common stock, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State and the expression Prospectus Directive means Directive 2003/71/ EC and includes any relevant implementing measure in each Relevant Member State.

The EEA selling restriction is in addition to any other selling restrictions set out below.

UNITED KINGDOM

Our common stock may not be offered or sold and will not be offered or sold to any persons in the United Kingdom other than to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or as agent) for the purposes of their businesses and in compliance with all applicable provisions of the Financial Services and Markets Act 2000, or the FSMA, with respect to anything done in relation to our common stock in, from or otherwise involving the United Kingdom. In addition, each underwriter has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by it in connection with the issue or sale of our common stock in circumstances in which Section 21(1) of the FSMA does not apply to us. Without limitation to the other restrictions referred to herein, this prospectus is directed only at (1) persons outside the United Kingdom, (2) persons having professional experience in matters relating to investments who fall within the definition of investment professionals in Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005; or (3) high net worth bodies corporate, unincorporated associations and partnerships and trustees of high value trusts as described in Article 49(2) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005. Without limitation to the other restrictions referred to herein, investment or

investment activity to which this prospectus relates is available only to, and will be

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Notice to investors

engaged in only with, such persons, and persons within the United Kingdom who receive this communication (other than persons who fall within (2) or (3) above) should not rely or act upon this communication.

FRANCE

No prospectus (including any amendment, supplement or replacement thereto) has been prepared in connection with the offering of our common stock that has been approved by the Autorité des marchés financiers or by the competent authority of another State that is a contracting party to the Agreement on the European Economic Area and notified to the Autorité des marchés financiers; no common stock has been offered or sold and will be offered or sold, directly or indirectly, to the public in France except to permitted investors, consisting of persons licensed to provide the investment service of portfolio management for the account of third parties, qualified investors (investisseurs qualifiés) acting for their own account and/or corporate investors meeting one of the four criteria provided in Article 1 of Decree N7 2004-1019 of September 28, 2004 and belonging to a limited circle of investors (cercle restreint d investisseurs) acting for their own account, with qualified investors and limited circle of investors having the meaning ascribed to them in Article L. 411-2 of the French Code Monétaire et Financier and applicable regulations thereunder; none of this prospectus or any other materials related to the offer or information contained therein relating to our common stock has been released, issued or distributed to the public in France except to Permitted Investors; and the direct or indirect resale to the public in France of any common stock acquired by any Permitted Investors may be made only as provided by articles L. 412-1 and L. 621-8 of the French Code Monétaire et Financier and applicable regulations thereunder.

ITALY

The offering of shares of our common stock has not been cleared by the Italian Securities Exchange Commission (Commissione Nazionale per le Società e la Borsa, or the CONSOB) pursuant to Italian securities legislation and, accordingly, shares of our common stock may not and will not be offered, sold or delivered, nor may or will copies of this prospectus or any other documents relating to shares of our common stock or the offering be distributed in Italy other than to professional investors (operatori qualificati), as defined in Article 31, paragraph 2 of CONSOB Regulation No. 11522 of July 1, 1998, as amended, or Regulation No. 11522.

Any offer, sale or delivery of shares of our common stock or distribution of copies of this prospectus or any other document relating to shares of our common stock or the offering in Italy may and will be effected in accordance with all Italian securities, tax, exchange control and other applicable laws and regulations, and, in particular, will be:
(i) made by an investment firm, bank or financial intermediary permitted to conduct such activities in Italy in accordance with the Legislative Decree No. 385 of September 1, 1993, as amended, or the Italian Banking Law, Legislative Decree No. 58 of February 24, 1998, as amended, Regulation No. 11522, and any other applicable laws and regulations; (ii) in compliance with Article 129 of the Italian Banking Law and the implementing guidelines of the Bank of Italy; and (iii) in compliance with any other applicable notification requirement or limitation which may be imposed by CONSOB or the Bank of Italy.

Any investor purchasing shares of our common stock in the offering is solely responsible for ensuring that any offer or resale of shares of common stock it purchased in the offering occurs in compliance with applicable laws and regulations.

This prospectus and the information contained herein are intended only for the use of its recipient and are not to be distributed to any third party resident or located in Italy for any reason. No person

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Notice to investors

resident or located in Italy other than the original recipients of this document may rely on it or its content.

In addition to the above (which shall continue to apply to the extent not inconsistent with the implementing measures of the Prospective Directive in Italy), after the implementation of the Prospectus Directive in Italy, the restrictions, warranties and representations set out under the heading European Economic Area above shall apply to Italy.

GERMANY

Shares of our common stock may not be offered or sold or publicly promoted or advertised by any underwriter in the Federal Republic of Germany other than in compliance with the provisions of the German Securities Prospectus Act (Wertpapierprospektgestz WpPG) of June 22, 2005, as amended, or of any other laws applicable in the Federal Republic of Germany governing the issue, offering and sale of securities.

SPAIN

Neither the common stock nor this prospectus have been approved or registered in the administrative registries of the Spanish National Securities Exchange Commission (Comisión Nacional del Mercado de Valores). Accordingly, our common stock may not be offered in Spain except in circumstances which do not constitute a public offer of securities in Spain within the meaning of articles 30bis of the Spanish Securities Markets Law of 28 July 1988 (Ley 24/1988, de 28 de Julio, del Mercado de Valores), as amended and restated, and supplemental rules enacted thereunder.

SWEDEN

This is not a prospectus under, and has not been prepared in accordance with the prospectus requirements provided for in, the Swedish Financial Instruments Trading Act [lagen (1991:980) om handel med finasiella instrument] nor any other Swedish enactment. Neither the Swedish Financial Supervisory Authority nor any other Swedish public body has examined, approved, or registered this document.

SWITZERLAND

The common stock may not and will not be publicly offered, distributed or re-distributed on a professional basis in or from Switzerland and neither this prospectus nor any other solicitation for investments in our common stock may be communicated or distributed in Switzerland in any way that could constitute a public offering within the meaning of Articles 1156 or 652a of the Swiss Code of Obligations or of Article 2 of the Federal Act on Investment Funds of March 18, 1994. This prospectus may not be copied, reproduced, distributed or passed on to others without the underwriters prior written consent. This prospectus is not a prospectus within the meaning of Articles 1156 and 652a of the Swiss Code of Obligations or a listing prospectus according to article 32 of the Listing Rules of the Swiss Exchange and may not comply with the information standards required thereunder. We will not apply for a listing of our common stock on any Swiss stock exchange or other Swiss regulated market and this prospectus may not comply with the information required under the relevant listing rules. The common stock offered hereby has not and will not be registered with the Swiss Federal Banking Commission and has not and will not be authorized under the Federal Act on Investment Funds of March 18, 1994. The investor protection afforded to acquirers of investment fund certificates by the Federal Act on Investment Funds of March 18, 1994 does not extend to acquirers of our common stock.

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Legal matters

The validity of the shares of common stock issued in this offering will be passed upon for us by the law firm of Adams and Reese LLP, Nashville, Tennessee. Dewey & LeBoeuf LLP, New York, New York is counsel to the underwriters in connection with this offering.

Experts

The consolidated financial statements and schedule of our company as of December 31, 2007 and 2006, and for each of the years in the three-year period ended December 31, 2007, have been included herein and in the registration statement in reliance upon the report of KPMG LLP, independent registered public accounting firm, appearing elsewhere herein, and upon the authority of said firm as experts in accounting and auditing.

Where you can find additional information

We filed a registration statement on Form S-1 with the Commission with respect to the registration of the common stock offered for sale with this prospectus. This prospectus, which constitutes part of the registration statement, does not contain all of the information set forth in the registration statement and the exhibits to the registration statement. For further information about us, the common stock we are offering by this prospectus and related matters, you should review the registration statement, including the exhibits filed as a part of the registration statement. Statements contained in this prospectus about the contents of any contract or any other document that is filed as an exhibit to the registration statement are not necessarily complete, and we refer you to the full text of the contract or other document filed as an exhibit to the registration statement. A copy of the registration statement and the exhibits that were filed with the registration statement may be inspected without charge at the public reference facilities maintained by the Securities and Exchange Commission Headquarters Office, 100 F Street, N.E., Washington, D.C. 20549, and copies of all or any part of the registration statement may be obtained from the SEC upon payment of the prescribed fee. Information on the operation of the public reference facilities may be obtained by calling the SEC at 1-800-SEC-0330. The SEC maintains a world wide web site that contains reports, proxy and information statements and other information regarding registrants that file electronically with the SEC. The address of the site is *http://www.sec.gov*.

Upon completion of this offering, we will become subject to the information and periodic reporting requirements of the Exchange Act, and, in accordance with such requirements, will file periodic reports, proxy statements and other information with the SEC. These periodic reports, proxy statements and other information will be available for inspection and copying at the regional offices, public reference facilities and web site of the SEC referred to above.

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CUMBERLAND PHARMACEUTICALS INC. AND SUBSIDIARIES

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Report of Independent Registered Public Accounting Firm

The Board of Directors
Cumberland Pharmaceuticals Inc.:

We have audited the accompanying consolidated balance sheets of Cumberland Pharmaceuticals Inc. and subsidiaries (the Company) as of December 31, 2006 and 2007, and the related consolidated statements of income, shareholders equity (deficit) and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2007. In connection with our audits of the consolidated financial statements, we have also audited the financial statement Schedule II Valuation and Qualifying Accounts for each of the years in the three-year period ended December 31, 2007. These consolidated financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Cumberland Pharmaceuticals Inc. and subsidiaries as of December 31, 2006 and 2007, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth herein.

/s/ KPMG LLP

Nashville, Tennessee
February 15, 2008

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Cumberland Pharmaceuticals Inc. and Subsidiaries

Consolidated balance sheets
December 31, 2006 and 2007

	2006	2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 6,255,398	10,814,518
Accounts receivable, net of allowances	5,120,462	2,373,537
Inventories	671,098	949,109
Prepaid assets	142,569	288,241
Deferred tax assets	405,443	363,175
Other current assets	48,352	
Total current assets	12,643,322	14,788,580
Property and equipment, net	365,774	459,843
Intangible assets, net	9,834,270	9,153,751
Deferred tax assets	3,611,861	1,827,982
Other assets	25,897	2,688,511
Total assets	$ 26,481,124	28,918,667
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 1,833,332	1,833,332
Revolving line of credit		1,325,951
Current portion of other long-term obligations	2,052,501	410,423
Accounts payable	3,372,936	1,921,101
Accrued interest	101,913	70,758
Other accrued liabilities	1,337,472	2,557,695
Total current liabilities	8,698,154	8,119,260
Revolving line of credit	825,951	
Long-term debt, excluding current portion	2,750,000	916,664
Other long-term obligations, excluding current portion	3,081,359	3,136,574
Total liabilities	15,355,464	12,172,498

Commitments and contingencies (see notes)		
Shareholders equity:		
Convertible preferred stock no par value. Authorized 3,000,000 shares; issued and outstanding 855,495 shares at December 31, 2006 and 2007	2,742,994	2,742,994
Common stock no par value. Authorized 10,000,000 and 100,000,000 shares as of December 31, 2006 and 2007, respectively; issued and outstanding 9,844,150 and 10,091,260 shares at December 31, 2006 and 2007, respectively	15,742,590	17,318,713
Accumulated deficit	(7,359,924)	(3,315,538)
Total shareholders equity	11,125,660	16,746,169
Total liabilities and shareholders equity	$ 26,481,124	28,918,667

See accompanying notes to consolidated financial statements.

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Cumberland Pharmaceuticals Inc. and Subsidiaries

Consolidated Statements of Income
Years ended December 31, 2005, 2006, and 2007

	2005	2006	2007
Revenues:			
Net product revenue	$ 8,224,670	16,980,898	27,821,646
Revenue from co-promotion agreements	1,812,242	286,624	
Other revenue	652,752	547,958	241,943
Net revenues	10,689,664	17,815,480	28,063,589
Costs and expenses:			
Cost of products sold	533,263	2,399,133	2,669,628
Selling and marketing	5,647,254	7,348,540	10,053,355
Research and development	1,157,881	2,232,984	3,693,917
General and administrative	2,587,861	2,999,347	4,137,942
Amortization of product license right		515,181	686,905
Other	13,489	96,433	96,524
Total costs and expenses	9,939,748	15,591,618	21,338,271
Operating income	749,916	2,223,862	6,725,318
Interest income	89,239	208,677	382,919
Interest expense	(63,204)	(721,804)	(639,590)
Other expense	(5,632)	(2,800)	
Net income before income taxes	770,319	1,707,935	6,468,647
Income tax benefit (expense)	1,184,000	2,696,516	(2,424,261)
Net income	$ 1,954,319	4,404,451	4,044,386
Earnings per share basic	$ 0.21	0.45	0.40
Earnings per share diluted	$ 0.12	0.27	0.24
Weighted-average shares outstanding basic	9,495,732	9,797,190	10,032,083
Weighted-average shares outstanding diluted	16,305,790	16,454,112	16,581,902

See accompanying notes to consolidated financial statements.

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Cumberland Pharmaceuticals Inc. and Subsidiaries

Consolidated statements of shareholders equity (deficit) and comprehensive income
Years ended December 31, 2005, 2006, and 2007

	Preferred stock		Common stock		Accumulated	Total shareholders equity
	Shares	Amount	Shares	Amount	deficit	(deficit)
Balance, December 31, 2004	855,495	$ 2,742,994	9,286,814	$ 10,953,312	$ (13,718,694)	$ (22,388)
Issuance of common stock			200,000	1,789,364		1,789,364
Offering costs settled with stock options				(51,806)		(51,806)
Issuance of common stock upon conversion of note payable			225,832	2,032,488		2,032,488
Issuance of common stock for services received			50,002	300,012		300,012
Stock options granted for services received				226,709		226,709
Exercise of options and related tax benefit, net of mature shares redeemed for the exercise price			17,650	4,950		4,950
Net and comprehensive income					1,954,319	1,954,319
Balance, December 31, 2005	855,495	2,742,994	9,780,298	15,255,029	(11,764,375)	6,233,648
Issuance of common stock for services received			27,518	273,298		273,298
Stock options granted for services received				37,751		37,751
Exercise of options and related tax benefit, net of mature shares redeemed for the exercise price			36,334	46,747		46,747
Stock-based compensation employee				104,085		104,085

stock options grants						
Issuance of common stock warrants				25,680		25,680
Net and comprehensive income					4,404,451	4,404,451
Balance, December 31, 2006	855,495	2,742,994	9,844,150	15,742,590	(7,359,924)	11,125,660
Issuance of common stock for services received			25,236	222,596		222,596
Stock options granted for services received				93,836		93,836
Exercise of options and related tax benefit, net of mature shares redeemed for the exercise price			221,874	960,479		960,479
Stock-based compensation employee stock options grants				299,212		299,212
Net and comprehensive income					4,044,386	4,044,386
Balance, December 31, 2007	855,495	$ 2,742,994	10,091,260	$ 17,318,713	$ (3,315,538)	$ 16,746,169

See accompanying notes to consolidated financial statements.

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Cumberland Pharmaceuticals Inc. and Subsidiaries

Consolidated statements of cash flows
Years ended December 31, 2005, 2006, and 2007

	2005	2006	2007
Cash flows from operating activities:			
Net income	$ 1,954,319	4,404,451	4,044,386
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization expense	53,537	587,742	762,222
Deferred tax (benefit) expense	(1,184,000)	(2,833,304)	2,230,596
Non-employee stock granted for services received	300,012	273,298	222,596
Non-employee stock option grant expense	174,903	37,751	93,836
Stock-based compensation employee stock options		104,085	299,212
Excess tax benefit derived from exercise of stock options		(37,747)	(449,528)
Non-cash interest expense		339,593	273,714
Net changes in assets and liabilities affecting operating activities:			
Accounts receivable	584,603	(2,705,649)	2,746,925
Inventory	254,492	(124,716)	(278,011)
Prepaid, other current assets, and other assets	(36,743)	(71,844)	(184,268)
Accounts payable, accrued interest, and other accrued liabilities	(518,922)	3,308,017	(811,107)
Other long-term obligations	833,806	(1,118,422)	(323,691)
Net cash provided by operating activities	2,416,007	2,163,255	8,626,882
Cash flows from investing activities:			
Purchase of intangible assets-license		(6,479,658)	
Additions to property and equipment	(301,908)	(59,714)	(152,420)
Additions to trademarks and patents	(16,591)	(13,558)	(11,069)
Net cash used in investing activities	(318,499)	(6,552,930)	(163,489)
Cash flows from financing activities:			
Costs of potential initial public offering			(2,031,416)
Proceeds from issuance of note payable		5,500,000	
Costs of financing for long-term debt and credit facility		(65,733)	
Principal payments on notes payable		(916,668)	(1,833,336)
Payment of other long-term obligations			(1,500,000)
Net borrowings (repayments) on line of credit	(871,839)	544,742	500,000
Proceeds from issuance of convertible note	1,999,998		
Proceeds from exercise of stock options	4,950	9,000	510,951
Excess tax benefit derived from exercise of stock options		37,747	449,528
Proceeds from issuance of stock and warrants	1,789,364		

Net cash provided by (used in) financing activities	2,922,473	5,109,088	(3,904,273)
Net increase in cash and cash equivalents	5,019,981	719,413	4,559,120
Cash and cash equivalents, beginning of year	516,004	5,535,985	6,255,398
Cash and cash equivalents, end of year	$ 5,535,985	6,255,398	10,814,518
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest	$ 63,809	377,202	419,100
Income taxes	18,000	55,659	89,075
Non-cash investing and financing activities:			
Liability for license acquired (note 6)		4,500,000	
Deferred financing costs (note 6)		25,680	
Exercise of options paid with mature shares of stock			22,031
Accrued but unpaid costs of potential initial public offering			645,934
Settlement of notes payable including accrued interest with issuance of common stock (note 6)	2,032,488		

See accompanying notes to consolidated financial statements.

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CUMBERLAND PHARMACEUTICALS INC. AND SUBSIDIARIES

Notes to consolidated financial statements

(1) ORGANIZATION

Cumberland Pharmaceuticals Inc. and its subsidiaries (the Company or Cumberland) is a specialty pharmaceutical company incorporated in Tennessee on January 6, 1999. Its mission is to provide high quality products to address underserved medical needs. Cumberland is focused on acquiring rights to, developing, and commercializing branded prescription products for the acute care and gastroenterology markets.

The Company s corporate operations and product acquisitions have been funded by a combination of equity and debt financings. The Company focuses its resources on maximizing the commercial potential of its products, as well as developing new product candidates, and has outsourced manufacturing and distribution to carefully selected entities with the appropriate expertise and infrastructure to support these activities.

In order to create access to a pipeline of early-stage product candidates, the Company formed a subsidiary, Cumberland Emerging Technologies, Inc. (CET), which assists universities and other research organizations to help bring biomedical projects from the laboratory to the marketplace. The Company s ownership in CET is 86%. The remaining interest is owned by Vanderbilt University and the Tennessee Technology Development Corporation. During 2002, CET s losses reduced its equity to a deficit position. Accordingly, the Company reduced minority interest to zero and has recorded 100% of the losses associated with the joint venture since that time in accordance with Accounting Research Bulletin No. 51, *Consolidated Financial Statements*. These losses amounted to approximately $22,000, $172,000, and $171,000 at December 31, 2005, 2006, and 2007, respectively. The Company will recover the cumulative loss of approximately $616,000 before any future income is allocated to the minority interest holders.

Beginning January 1, 2007, the Company s new wholly-owned subsidiary, Cumberland Pharma Sales Corp. (CPSC), began full operations for the purpose of employing the newly converted Hospital Sales Force that promotes the Company s products, Acetadote® and Kristalose®, in the acute care market. Previously, this sales force was contracted through a third-party contract sales organization.

The Company operates in a single operating segment of specialty pharmaceutical products. Management has chosen to organize the Company based on the type of products sold. All of the Company s assets are located in the United States. Total revenues are primarily attributable to U.S. customers. Net revenues from non-U.S. customers were less than $100,000 for the years ended December 31, 2005 and 2006, and totaled approximately $869,000 for the year ended December 31, 2007.

(2) SIGNIFICANT ACCOUNTING POLICIES

(a) Principles of Consolidation

These consolidated financial statements are stated in U.S. dollars and are prepared under U.S. generally accepted accounting principles. The consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. All significant intercompany transactions and accounts have been eliminated.

(b) Cash and Cash Equivalents

For the purpose of the consolidated statements of cash flows, cash and cash equivalents include highly-liquid investments with an original maturity of three months or less when purchased.

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Notes to consolidated financial statements

(c) Accounts Receivable

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. The Company records allowances for uncollectible amounts, cash discounts, chargebacks, and credits to be taken by customers for product damaged in shipment, based on historical experience. The Company reviews its customer balances on an individual account basis for collectibility. As of December 31, 2006 and 2007, the allowance for uncollectible amounts, cash discounts, chargebacks, and credits for damaged product was $298,913 and $146,972, respectively.

Cash discounts are reductions to invoiced amounts offered to customers for payment within a specified period of time from the date of the invoice. The majority of the Company s products are distributed through independent pharmaceutical wholesalers. In conjunction with recognizing a sale to a wholesaler, net product revenue and accounts receivable take into account the sale of the product at the wholesale acquisition cost, and an accrual is recorded to reflect the difference between the wholesale acquisition cost, and the estimated average end-user contract price. This accrual is calculated on a product-specific basis and is based on the estimated number of outstanding units sold to wholesalers that will ultimately be sold under end-user contracts. When the wholesaler sells the product to the end-user at the agreed upon end-user contract price, the wholesaler charges the Company for the difference between the wholesale acquisition price and the end-user contract price and that chargeback is offset against the initial accrual balance.

The Company s estimate of the allowance for damaged product is based upon historical experience of claims made for damaged product. At the time the transaction is recognized as a sale, the Company records a reduction in revenue for the estimate of product damaged in shipment.

(d) Inventories

The Company utilizes third parties to manufacture and package finished goods for sale, takes title to the finished goods at the time of shipment from the manufacturer, and warehouses such goods until distribution and sale. The Company s inventory was comprised completely of finished goods at December 31, 2006 and 2007. Inventories are stated at the lower of cost or market with cost determined using the first-in, first-out method.

(e) Prepaid Assets

Prepaid assets consist of the prepaid premium for directors and officers insurance, product liability insurance, prepaid consulting services, etc. The Company expenses all prepaid amounts as used or over the period of benefit on a straight-line basis, as applicable.

(f) Property and Equipment

Property and equipment, including leasehold improvements, are stated at cost. Depreciation is provided using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the shorter of the initial lease term plus its renewal options, if renewal is reasonably assured, or the remaining useful life of the asset. Upon retirement or disposal of assets, the asset and accumulated depreciation accounts are adjusted accordingly and any gain or loss is reflected in operations. Repairs and maintenance costs are expensed as incurred. Improvements that extend an asset s useful life are capitalized.

(g) Intangible Assets

The Company s intangible assets consist of costs incurred related to licenses, trademarks, and patents.

Notes to consolidated financial statements

In 2006, the Company acquired the exclusive U.S. commercialization rights (license) to Kristalose®. The cost of acquiring the licenses of products that are approved for commercial use are capitalized and amortized ratably over the estimated life of the products. At the time of acquisition, the product life is estimated based upon the term of the license agreement, patent life or market exclusivity of the products, and our assessment of future sales and profitability of the product. We assess this estimate regularly during the amortization period and adjust the asset value or useful life when appropriate. The total purchase price, which includes the cost of the U.S. commercialization rights and other related costs of obtaining the licenses, is being amortized on a straight-line basis over 15 years, which is management s estimate of the asset s useful life.

Trademarks are amortized on a straight-line basis over 10 years, which is management s estimate of the asset s useful life.

Patents consist of outside legal costs associated with obtaining patents for products that have already been approved for marketing by the Food and Drug Administration (FDA). Upon issuance of a patent, the finite useful economic life of the patent (or family of patents) is determined, and the patent is amortized over such useful life. If it becomes probable that a patent will not be issued, related costs associated with the patent application will be expensed at that time. All costs associated with obtaining patents for products that have not been approved for marketing by the FDA are expensed as incurred.

When the Company acquires license agreements, product rights, and other identifiable intangible assets, it records the aggregate purchase price as an intangible asset. The Company allocates the purchase price to the fair value of the various intangible assets in order to amortize their cost as an expense in its consolidated statements of income, over the estimated useful life of the related assets.

(h) Impairment of Long-Lived Assets

In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, long-lived assets, such as property and equipment and purchased intangible assets subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. If circumstances require a long-lived asset to be tested for possible impairment, the Company first compares undiscounted cash flows expected to be generated by an asset to the carrying value of the asset. If the carrying amount of the long-lived asset is not recoverable on an undiscounted cash flow basis, an impairment charge is recognized to the extent that the carrying value exceeds its fair value. Fair value is determined through various valuation techniques including quoted market prices, third-party independent appraisals, and discounted cash flow models, as considered necessary. Assets to be disposed of would be separately presented in the consolidated balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and no longer depreciated. The assets and liabilities of a disposed group classified as held for sale would be presented separately in the appropriate asset and liability sections of the consolidated balance sheet. The Company recorded no impairment charges during the three-year period ended December 31, 2007.

(i) Costs of Initial Public Offering

Specific, incremental costs directly attributable to the initial public offering of the Company s common stock of approximately $2.7 million at December 31, 2007 have been deferred and included in other assets. These costs will be accounted for as a reduction to the proceeds received from a successful offering, or will be expensed in the event the

offering is postponed indefinitely or abandoned. As of December 31, 2007, approximately $646,000 of unpaid costs related to the initial public offering are included in accounts payable and other accrued liabilities.

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Notes to consolidated financial statements

(j) Revenue Recognition

The Company recognizes revenue in accordance with the Securities and Exchange Commission s (SEC) Staff Accounting Bulletin No. 101, *Revenue Recognition in Financial Statements,* as amended by Staff Accounting Bulletin No. 104, and SFAS No. 48, *Revenue Recognition When Right of Return Exists* (SFAS 48). Revenue is realized or realizable and earned when all of the following criteria are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services have been rendered; (3) the seller s price to the buyer is fixed and determinable; and (4) collectibility is reasonably assured. Delivery is considered to have occurred upon either shipment of the product or arrival at its destination, depending upon the shipping terms of the transaction.

The Company s net product revenue reflects reduction of gross product revenue for estimated allowances for chargebacks, discounts, and damaged goods and accruals for rebates, product returns, certain administrative fees, and fee for services. Allowances of $298,913 and $146,972 as of December 31, 2006 and 2007, respectively, for chargebacks, discounts, and allowances for product damaged in shipment reduce accounts receivable, and accrued liabilities of $742,678 and $738,362 as of December 31, 2006 and 2007, respectively, for rebates, product returns, and administrative fees increase other accrued liabilities.

As discussed in 2(c) above, the allowances for chargebacks, discounts, and damaged goods are determined on a product-by-product basis, and are established by management as the Company s best estimate at the time of sale based on each product s historical experience adjusted to reflect known changes in the factors that impact such allowances. These are established based on the contractual terms with direct and indirect customers and analyses of historical levels of chargebacks, discounts, and credits claimed for damaged product.

Other organizations, such as managed care providers, pharmacy benefit management companies, and government agencies, may receive rebates from the Company based on negotiated contracts to carry our product or reimbursements for filled prescriptions. These entities represent indirect customers of the Company. In addition, the Company may provide rebates to the end-user. In conjunction with recognizing a sale to a wholesaler, sales revenues are reduced and accrued expenses are increased by the Company s estimates of the rebates that will be owed.

Consistent with industry practice, the Company maintains a return policy that allows customers to return product within a specified period prior to and subsequent to the expiration date. The Company s estimate of the provision for returns is based upon historical experience with actual returns. Any changes in the assumptions used to estimate the provision for returns is recognized in the period those assumptions were changed.

The Company has agreements with certain key wholesalers, including fee for service costs. In accordance with Emerging Issues Task Force (EITF) No. 01-9, *Accounting for Consideration Given by a Vendor to a customer (Including a Reseller of the Vendor s Products)*, these administrative costs have been netted against product revenues.

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Notes to consolidated financial statements

The Company s net product revenue and revenue from co-promotional agreements consist of the following as of December 31:

2005

	Net Product Revenue	Revenue from Co-Promotional Agreements	Total
Acetadote	$ 10,111,483		10,111,483
Kristalose[1]		1,812,242	1,812,242
Other products[2]	(1,886,813)[3]		(1,886,813)
	$ 8,224,670	1,812,242	10,036,912

2006

	Net Product Revenue	Revenue from Co-Promotional Agreements	Total
Acetadote	$ 10,722,330		10,722,330
Kristalose[1]	6,223,931	286,624	6,510,555
Other products[2]	34,637		34,637
	$ 16,980,898	286,624	17,267,522

2007

	Net Product Revenue	Revenue from Co-Promotional Agreements	Total
Acetadote	$ 18,817,293		18,817,293
Kristalose[1]	9,012,789		9,012,789
Other products	(8,436)		(8,436)

$ 27,821,646	27,821,646

(1) During 2005 and for the period from January 1, 2006 through April 9, 2006, the Company sold Kristalose under a co-promotion arrangement.

(2) Includes revenues from products for which the Company no longer has the exclusive licensing rights.

(3) Includes the revenue reduction for promotional costs owed to a wholesaler.

For the first quarter of 2006 and the year ended December 31, 2005, the Company had two products for which it received a co-promotion fee under the related co-promotion agreements. The Company recognized the promotional fees as revenue from co-promotion agreements during the period in which the sales of the respective product occurred.

Other revenue is primarily comprised of revenue generated by CET through consulting services, development funding from private sector investment or federal Small Business (SBIR/STTR) grant programs, and lease income generated by CET s Life Sciences Center. The Life Sciences Center is a research center that provides scientists with access to flexible lab space and other resources to develop their products. Revenue related to grants is recognized when all conditions related to such grants have been met. Grant revenue totaled approximately $253,000, $375,000, and $83,000 for the years ended December 31, 2005, 2006, and 2007, respectively.

Notes to consolidated financial statements

(k) Income Taxes

The Company provides for deferred taxes using the asset and liability approach. Under this method, deferred tax assets and liabilities are recognized for future tax consequences attributable to operating loss and tax credit carryforwards, as well as differences between the carrying amounts of existing assets and liabilities and their respective tax bases. The Company s principal differences are related to timing of deductibility of certain items, such as depreciation, amortization, and expense for options issued to nonemployees. Deferred tax assets and liabilities are measured using enacted tax rates that are expected to apply to taxable income in the years such temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period of enactment. The Company does not recognize a tax position in its consolidated financial statements unless it is more likely than not that the position will be sustained by the taxing authority.

The Company adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 provides a recognition threshold and guidance for measurement of income tax positions taken or expected to be taken on a tax return. These standards require that the company eliminate the income tax benefits associated with any income tax position where it is not more likely than not that the position would be sustained upon examination by the taxing authorities. The adoption of FIN 48 requires an adjustment to retained earnings for the tax benefit of any uncertain tax positions existing prior to January 1, 2007. As of January 1, 2007, the Company s uncertain tax positions were previously reserved under SFAS No. 5, *Accounting for Contingencies* (SFAS 5). As a result, the adoption of FIN 48 did not result in any adjustment to shareholders equity.

The Company s accounting policy with respect to interest and penalties arising from income tax settlements is to recognize them as part of the provision for income taxes.

(l) Share-Based Payments

Prior to fiscal year 2006, the Company applied the intrinsic-value method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations and provided the required proforma disclosures of SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123), and SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure, an amendment of FASB Statement No. 123*. Under this method, compensation expense was recorded only if the current market price of the underlying stock exceeded the exercise price on the date of grant. All options granted by the Company had an exercise price equal to or greater than the market price of the underlying stock on the date of grant.

Effective January 1, 2006, the Company adopted the requirements of SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123(R)), utilizing the prospective method of adoption. Under this approach, SFAS 123(R) applies to new grants and the modification, repurchase, or cancellation of outstanding awards beginning on January 1, 2006. Under the prospective method of adoption, compensation cost recognized subsequent to the adoption of SFAS 123(R) includes only share-based compensation cost for all share-based payments granted or modified subsequent to January 1, 2006. The cost is measured based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R) and is recognized as expense over the employee s requisite service period. The Company calculates the fair value of options using the Black-Scholes option-pricing model. Because the Company used the minimum value method for purposes of estimating fair value under SFAS 123, no proforma disclosures (as required by

SFAS 123 related to 2005) are permitted under SFAS 123(R).

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(m) Research and Development

Research and development costs are expensed in the period incurred. Research and development costs are comprised mainly of clinical trial expenses, salary and wages, and other related costs such as materials and supplies. Development expense includes activities performed by third-party providers participating in the Company s clinical studies. The Company accounts for these costs based on estimates of work performed, patient enrollment, or fixed fee for services.

(n) Advertising Costs

Advertising costs are expensed as incurred and amounted to $479,361, $738,647, and $617,354 in 2005, 2006, and 2007, respectively.

(o) Distribution Costs

The Company expenses distribution costs as incurred. Distribution costs included in sales and marketing expenses amounted to $365,331, $436,115, and $756,268 in 2005, 2006, and 2007, respectively.

(p) Earnings per Share

The Company accounts for earnings per share in accordance with SFAS No. 128, *Earnings per Share*. Basic earnings per share is calculated by dividing net income by the weighted-average number of shares outstanding. Except where the result would be antidilutive to income from continuing operations, diluted earnings per share is calculated by assuming the conversion of convertible instruments and the elimination of related interest expense, if any, and the exercise of stock options, as well as their related income tax benefits.

The following table reconciles the numerator and the denominator used to calculate diluted earnings per share:

	Year ended December 31		
	2005	**2006**	**2007**
Numerator:			
Net income	$ 1,954,319	4,404,451	4,044,386
Denominator:			
Weighted-average shares outstanding basic	9,495,732	9,797,190	10,032,083
Preferred stock shares convertible to common	1,710,990	1,710,990	1,710,990
Dilutive effect of stock options and warrants	5,099,068	4,945,932	4,838,829
Weighted-average shares outstanding diluted	16,305,790	16,454,112	16,581,902

As of December 31, 2005, 2006, and 2007, options to purchase 24,276, 32,978, and 35,230 shares of common stock, respectively, were outstanding but were not included in the computation of diluted earnings per share because the effect would be antidilutive.

(q) Comprehensive Income

Total comprehensive income was comprised solely of net income for all periods presented.

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(r) Accounting Estimates

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management of the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Significant items subject to estimates and assumptions include those related to chargebacks, rebates, discounts, credits for damaged product and returns, the valuation and determination of useful lives of intangible assets and the rate such assets are amortized, the realization of deferred tax assets, and stock-based compensation. Actual results could differ from those estimates.

(s) Fair Value of Financial Instruments

The Company s financial instruments include cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities, revolving line of credit, long-term debt, and other long-term obligations. The carrying values for cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities approximate fair value due to their short-term nature. The terms of the revolving line of credit include variable interest rates, which approximate current market rates. The interest rates associated with the long-term debt approximate current market rates. The imputed interest rate on the other long-term obligations approximate current market rates.

(t) Reclassifications

Certain prior year amounts were reclassified to conform to current year presentation. These reclassifications included segregating the line of credit balance from the long-term debt balance.

(u) Recently Issued Accounting Standards

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. More specifically, this statement clarifies the definition of fair value, establishes a fair valuation hierarchy based upon observable (e.g., quoted prices, interest rates, yield curves) and unobservable market inputs, and expands disclosure requirements to include the inputs used to develop estimates of fair value and the effects of the estimates on income for the period. This statement does not require any new fair value measurements. This pronouncement is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company does not expect the adoption of SFAS 157 will have a material impact on its consolidated results of operations and financial position.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159), which permits entities to measure many financial instruments and certain other items at fair value. The objective of the statement is to improve financial reporting by allowing entities to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without applying complex hedge accounting provisions. The fair value option provided by this statement may be applied on an instrument-by-instrument basis, is irrevocable, and may be applied only to entire instruments and not portions of instruments. The Company is required to adopt SFAS 159 beginning on January 1, 2008. The Company does not expect the adoption of SFAS 159 will have a material impact on its consolidated results of operations and financial position.

In December 2007, the FASB issued SFAS No. 141 (revised), *Business Combinations* (SFAS 141(R)). SFAS 141(R) relates to business combinations and requires the acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date measured at fair

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values on the acquisition date. This statement must be adopted prospectively by the Company for all business combinations occurring on or after January 1, 2009. Early adoption is not allowed. The Company is currently evaluating the impact of SFAS 141(R) on its consolidated financial position and results of operations.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment to ARB No. 51* (SFAS 160). This statement establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. It also requires consolidated results of operations to include amounts attributable to both the parent and noncontrolling interest, with disclosure on the consolidated statement of operations of the amounts attributable to the parent and noncontrolling interest. The statement requires that equity transactions by and between each party be accounted for as equity transactions unless the parent company loses its controlling interest in the subsidiary. In the event the parent company loses its controlling interest, the investment in the subsidiary will be adjusted to fair value, and a gain or loss on investment will be recognized in the consolidated statement of operations. The statement is effective for the Company beginning on January 1, 2009. The Company is currently evaluating the impact the adoption of SFAS 160 will have on its consolidated financial position and results of operations.

In June 2007, the FASB issued EITF 06-11, *Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards (*EITF 06-11), which applies to share-based payment arrangements in which the employee receives dividends on the award during the vesting period. Tax benefits received on dividends associated with share-based awards that are charged to retained earnings should be recorded in additional paid-in capital and included in the pool of excess tax benefits available to absorb potential future tax deficiencies on share-based payment awards. This statement is effective for fiscal years beginning after December 15, 2007. The Company does not anticipate paying any dividends in the foreseeable future. As a result, the Company does not expect the adoption of EITF 06-11 will have a material impact on its consolidated results of operations and financial position.

In June 2007, the FASB issued EITF 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities (*EITF 07-3). The scope of this issue is limited to nonrefundable advance payments for goods and services related to research and development activities. EITF 07-3 addresses whether such advanced payments should be expensed as incurred or capitalized. The Company is required to adopt EITF 07-3 effective January 1, 2008. The Company does not expect the adoption of EITF 07-3 will have a material impact on its consolidated results of operations or financial position.

In December 2007, the FASB issued EITF 07-1, *Accounting for Collaborative Arrangements Related to the Development and Commercialization of Intellectual Property* (EITF 07-1), that prohibits companies from applying the equity method of accounting to activities performed outside a separate legal entity by a virtual joint venture. Instead, revenues and costs incurred with third parties in connection with the collaborative arrangement should be presented gross or net by the collaborators based on the criteria in EITF 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*, and other applicable accounting literature. EITF 07-1 should be applied to collaborative arrangements in existence at the date of adoption using a modified retrospective method that requires reclassification in all periods presented for those arrangements still in effect at the transition date, unless that application is impracticable. EITF 07-1 is effective for the Company beginning on January 1, 2009. The Company currently collaborates with certain research institutions to identify and pursue promising pre-clinical programs. The Company has negotiated rights to develop and commercialize these product candidates. The Company is in the process of studying the potential financial statement impact of adopting EITF 07-1.

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(3) PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at December 31:

	Range of useful lives	2006	2007
Computer hardware and software	3-5 years	$ 119,143	140,621
Office equipment	3-15 years	24,167	30,722
Furniture and fixtures	5-10 years	140,866	246,202
Leasehold improvements	3-15 years, or remaining lease term	289,265	318,796
		573,441	736,341
Less accumulated depreciation and amortization		(207,667)	(276,498)
		$ 365,774	459,843

Depreciation expense, including amortization expense related to leasehold improvements, during 2005, 2006, and 2007 was $48,862, $67,884, and $70,635, respectively, and is included in general and administrative expense in the consolidated statements of income.

(4) INTANGIBLE ASSETS

Intangible assets consisted of the following at December 31:

	2006	2007
Trademarks	$ 46,986	46,986
Less accumulated amortization	(31,000)	(35,682)
Total trademarks	15,986	11,304
License	10,303,595	10,303,595
Less accumulated amortization	(515,181)	(1,202,086)
Total license	9,788,414	9,101,509
Patents	29,870	40,938
	$ 9,834,270	9,153,751

Amortization expense related to trademarks and license rights is expected to be approximately $690,000 in each of the years 2008 through 2012.

In April 2006, the Company acquired the exclusive U.S. commercialization rights (product license) for Kristalose® from Inalco Biochemicals, Inc. and Inalco S.p.A. (collectively Inalco) for $10,303,595. This amount includes cash paid on the effective date of the agreement of $6,500,000, an installment payment of $1,500,000 (inclusive of $102,440 of imputed interest) paid in April 2007, $2,426,377 (discounted using an interest rate of 7.33%) due in April 2009, and acquisition costs of $13,775, and is net of the fair value of services received by the Company in 2006 of $34,117 under a transition service agreement. The fair value of these services was expensed over the transition period in 2006 and was included in selling and marketing expenses.

Notes to consolidated financial statements

(5) OTHER ACCRUED LIABILITIES

Other accrued liabilities consisted of the following at December 31:

	2006	2007
Rebates, fee for services, and product returns	$ 742,678	738,362
Employee wages and benefits	558,321	664,518
Costs related to potential initial public offering		359,664
Outside sales force and related expenses		332,774
Other	36,473	462,377
	$ 1,337,472	2,557,695

(6) LONG-TERM DEBT

In April 2006, the Company completed its transaction with Inalco to acquire exclusive U.S. commercialization rights for Kristalose®. In order to complete this transaction, funding was obtained from Bank of America in the form of a three-year term loan for $5,500,000 and a new two-year revolving line of credit agreement, both with an interest rate of LIBOR plus 2.5% (7.4% as of December 31, 2007). The term loan is due in 2009, and is being paid off in quarterly principal installments of $458,334. Interest is paid quarterly. Through the expiration date of the agreement (April 2008), the Company can borrow under the revolving line of credit the lesser of $4.0 million, or 80% of eligible accounts receivable plus 50% of eligible inventory. The Company must pay an annual commitment fee of 1/2 of 1% on the unused portion of the commitment. The credit agreement provides that borrowings are collateralized by a first priority lien on all of the Company s assets, except for the Company s equity interest in Cumberland Emerging Technologies, Inc. The credit agreement contains an adverse subjective acceleration clause and also requires the Company maintain a lockbox. However, cash received in the lockbox is not required to be applied against amounts borrowed under the line of credit. This credit agreement contains various covenants and the Company was in compliance with all covenants at December 31, 2007. As of December 31, 2007, the Company has additional credit available of $989,853 under its line of credit.

In conjunction with these agreements, the Company issued warrants to purchase up to 3,958 shares of common stock at an exercise price of $9.00 per share, which expire in April 2016 and are outstanding and exercisable as of December 31, 2007. The estimated grant-date fair value of these warrants of $25,680, as determined using the Black-Scholes model utilizing an expected term of 10 years, risk-free interest rate of 4.89%, volatility of 60%, and 0% dividend yield, was recorded in the accompanying consolidated financial statements as equity and deferred financing costs. Deferred financing costs are a component of other assets, and are being expensed to interest expense using the effective-interest method over the respective terms of the line of credit and term note.

In the second quarter of 2005, the Company received approximately $2,000,000 from various individuals and companies in exchange for uncollateralized convertible promissory notes with a maturity date six months from the date of issuance. The notes bore interest at a fixed annual rate of 3.5%. In the fourth quarter of 2005, and pursuant to

the terms of the note, the principal value of the note of $2,000,000, plus accrued interest of $32,488, converted into 225,832 shares of the Company s common stock. Accrued interest of $2,205 was paid in cash at the request of a note holder.

Principal payments on the term note of $1,833,332 and $916,664 are due in 2008 and 2009, respectively.

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Notes to consolidated financial statements

(7) OTHER LONG-TERM OBLIGATIONS

Other long-term obligations consisted of the following components at December 31:

	2006	2007
Deferred purchase price, net of discount of $465,843 and $250,904, respectively	$ 4,034,157	2,749,096
Third-party development costs	410,846	615,846
Product promotional costs	578,111	
Other	110,746	182,055
	5,133,860	3,546,997
Less current portion	(2,052,501)	(410,423)
	$ 3,081,359	3,136,574

In connection with the acquisition of the exclusive commercialization rights for Kristalose®, the Company deferred a portion of the purchase price. The final payment of $3,000,000, inclusive of unamortized debt discount of $250,904 as of December 31, 2007, is due in April 2009. The discount was imputed at 7.33% on the acquisition date, and is being accreted using the effective-interest method.

During 2000, the Company signed an agreement with a third party to cover a variety of development efforts related to a specific pharmaceutical drug, including preparation of submissions to the FDA. In accordance with the agreement, the Company was billed, and the Company expensed, approximately $1,010,000 during the fiscal years 2001 through 2003. As of December 31, 2007, the Company has paid approximately $600,000 of this balance and accrued the remaining balance of approximately $410,000. The balance of approximately $410,000 is due in the following timeframe: (a) approximately $205,000 due no later than submission of an application to the FDA and (b) approximately $205,000 due no later than FDA approval. The Company has recognized the amount specified in (a) as a current portion of other long-term obligations in the consolidated balance sheet as of December 31, 2007. The remaining balance of approximately $205,000 is reflected as an other long-term obligation in the accompanying consolidated balance sheet. If neither the submission of the FDA application nor FDA approval occurs due to the Company terminating the project, the $410,000 will become due and payable and will accrue interest at 12.5% until paid.

The agreement also calls for contingent payments upon certain milestones. Upon meeting the first milestone, submission of a new drug application (NDA) and FDA acceptance of the submission for review, a contingent payment of approximately $205,000 will become due and payable. The Company has substantially completed all actions necessary to submit an application to the FDA. Consequently, the Company has recognized the first milestone payment of approximately $205,000 as a current portion of other long-term obligations in the consolidated balance sheet. Upon meeting the second milestone, FDA approval, a contingent payment of approximately $1,005,000 will become due and payable as follows: approximately $800,000 immediately and approximately $205,000 in twelve monthly installments starting on the date the milestone is met. Since the payment of the second milestone is

contingent on specific events that may or may not occur in the future, and which have not occurred or are deemed probable of occurring as of December 31, 2007, the contingent liability for this milestone has not been recognized in the consolidated financial statements.

In connection with the aforementioned agreement, the Company granted 100,000 stock options with contingent vesting clauses to purchase the Company s common stock at an exercise price of $1.63. Vesting for up to 40,000 of these options was contingent upon an NDA submission for the product

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candidate and FDA acceptance of the submission for review on or before January 31, 2004. None of the 40,000 options vested since the milestone was not met by January 31, 2004. The third party will have the ability to vest in 60,000 options if FDA approval occurs within 13 months after the NDA is accepted for review. If approval occurs within 14 and 15 months after acceptance for review, the third party will vest in 30,000 options. If approval occurs between 15 and 18 months after acceptance, the third party will vest in 15,000 options. No options will vest after 18 months. As of December 31, 2007, the NDA submission for the product candidate has not been submitted to the FDA for review. Because vesting for these options is contingent on FDA approval, which may or may not occur, the expense for these options has not been accounted for in the accompanying consolidated financial statements.

In 2005, the Company entered into an agreement with a key wholesaler for settlement of amounts owed under a contract in the amount of $2,100,000 to be paid in installments over 28 months. The Company initially recorded this liability based on its net present value of the payments of approximately $1,976,000 using an interest rate of 10%. At December 31, 2006, the Company recognized a current liability of approximately $578,000 related to this liability. The liability was paid in 2007. Interest expense in 2006 and 2007 included accretion of the discount of $101,709 and $21,889, respectively, related to this liability.

(8) INCOME TAXES

Income tax benefit (expense) includes the following components:

	2005	2006	2007
Current:			
Federal	$	(121,359)	(543,115)
State		(15,429)	(100,078)
		(136,788)	(643,193)
Deferred:			
Federal	1,146,580	2,861,859	(1,646,209)
State	37,420	(28,555)	(134,859)
	1,184,000	2,833,304	(1,781,068)
	$ 1,184,000	2,696,516	(2,424,261)

The Company s deferred tax benefits for 2005 and 2006 were the result of a combination of the utilization of deferred tax assets and a change in judgment about the realizability of deferred tax assets. The deferred tax expense in 2007 is primarily the result of the utilization of the deferred tax assets from federal and state net operating loss carryforwards. The deferred tax expense for 2007 does not agree to the change in the net deferred tax assets from December 31, 2006 to December 31, 2007 due to the reclassification of a reserve for unrecognized tax benefits from taxes payable to deferred tax assets upon the adoption of FIN 48 on January 1, 2007.

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The deferred income tax benefit (expense) is comprised of the following components for the years ended December 31:

	2005	2006	2007
Deferred tax (benefit) expense exclusive of components listed below	$ (309,894)	(287,624)	229,754
Benefits of operating loss carryforwards	602,073	764,495	(2,002,955)
Change in valuation allowance due to changes in net deferred tax asset balances	(292,179)	(476,871)	(7,867)
Adjustments to the valuation allowance because of a change in circumstances that caused a judgment about the realizability of the related deferred tax assets in future years	1,184,000	2,833,303	
Deferred income tax benefit (expense)	$ 1,184,000	2,833,303	(1,781,068)

In 2005, the Company reduced the valuation allowance by $1,184,000 due to positive evidence that deferred tax assets, primarily net operating losses, would be utilized in future years. In 2006, the Company further reduced the valuation allowance by $2,833,303 since additional positive evidence suggested that the majority of the deferred tax assets would be utilized in future years. The remaining valuation allowance at December 31, 2007 is primarily related to state tax benefits that will likely not be realized.

The Company s effective income tax rate for 2005, 2006, and 2007 reconciles with the federal statutory tax rate as follows:

	2005	2006	2007
Federal tax expense at statutory rate	(34)%	(34)%	(34)%
State income tax benefit (net of federal income tax benefit)	(3)	(2)	(3)
Permanent differences	1		(1)
Other	(2)		1
Change in deferred tax asset valuation allowance	192	194	
Net income tax benefit (expense)	154%	158%	(37)%

Notes to consolidated financial statements

Components of the net deferred tax assets at December 31 are as follows:

	2006	2007
Net operating loss and tax credits	$ 2,834,870	999,665
Depreciation and amortization	71,412	148,502
Allowance for accounts receivable	30,841	54,294
Reserve for expired product		119,309
Rebate liability		38,328
Inventory write-off	175,961	416
Deferred charges	399,010	294,764
Investment income	(10,448)	
Employee stock-based compensation	37,747	
Expense for options and stock grants to nonemployees	517,523	583,358
Total deferred tax assets	4,056,916	2,238,636
Less deferred tax asset valuation allowance	(39,612)	(47,479)
Net deferred tax assets	$ 4,017,304	2,191,157

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. In order to fully realize the deferred tax assets, the Company will need to generate future taxable income of approximately $14,100,000 prior to the expiration of the net operating loss carryforwards in 2026. Taxable income for the years ended December 31, 2005, 2006, and 2007 was $1,938,296, $2,139,954, and $5,478,309, respectively. Based upon the level of taxable income over the last three years and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of these deductible differences, net of the existing valuation allowances, at December 31, 2007. The valuation allowance at December 31, 2007 represents the deferred tax assets associated with CPSC and CET that the Company believes are not more likely than not will be utilized. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced.

As of December 31, 2007, the Company has federal credit carryforwards of $491,227 that expire starting in 2021. The federal and state net operating loss carryforwards will expire as follows:

Year of expiration	Federal	State

2015 2017	$	2,841,279
2018 2020		3,106,121
2021 2023	443,009	289,172
2024 2026	265,489	
	$ 708,498	6,236,572

The Company s cumulative unrecognized benefits at January 1, 2007, net of federal benefits, were $357,178. The nature of these unrecognized benefits did not result in any accrual of interest and

Notes to consolidated financial statements

penalties. The tax benefits related to these amounts had been previously reserved under the provisions of SFAS 5. Therefore, the cumulative unrecognized benefits existing at January 1, 2007 did not result in an adjustment to beginning retained earnings. SFAS 5 reserves were evaluated under FIN 48 standards, and were reclassed as the beginning of period unrecognized tax benefits.

Changes in the beginning balance of unrecognized tax benefits during 2007 were as follows:

	Gross	Federal Unrecognized Benefits	State Unrecognized Benefit	Total
Unrecognized tax benefits, January 1, 2007	$ 357,178	357,178		357,178
Increase from current period tax positions	21,558	21,558		21,558
Unrecognized tax benefits, December 31, 2007	$ 378,736	378,736		378,736

If the total amount of unrecognized tax benefits were recognized in the computation of income tax expense for 2007, the effective tax rate would decrease by 6%.

In determining the unrecognized tax benefits as of December 31, 2007, the Company evaluated its tax positions for all years that remain subject to examination by the taxing authorities. Federal tax years that remain open to examination are 2004 to 2007. State tax years that remain open to examination are 2003 to 2007. The Company is currently undergoing an examination of its federal taxes, which could result in a change in the realizability of the unrecognized tax benefits in the next twelve months. The Company is currently unable to estimate a range of possible changes in the realizability of these unrecognized tax benefits.

(9) SHAREHOLDERS EQUITY

(a) Stock Split

On July 6, 2007, the Board of Directors declared a two-for-one stock split of the Company s common stock effective on such date. All applicable common stock share and per share amounts have been retroactively adjusted in the accompanying consolidated financial statements for such stock split. In accordance with the anti-dilution provisions of the respective agreements, the share and per share amounts associated with the Company s stock option grants, warrants, and preferred stock conversion rights reflected in the accompanying consolidated financial statements have also been adjusted to reflect the effects of the stock split.

(b) Preferred Stock

The Company s outstanding shares of preferred stock consist of Series A Convertible Preferred Stock. These shareholders are entitled to vote with the holders of common stock, as each preferred share is entitled to the number of votes the holder would be entitled to if converted to shares of common stock immediately prior to the vote. They are

also entitled to receive dividends on an equal basis with holders of common stock on an if-converted equivalent.

The Series A Convertible Preferred Stock shareholders are entitled to receive a $3.25 per share liquidation preference in the event of the dissolution, liquidation, or winding up of the Company. If assets are insufficient to permit full payment, preferred shareholders are entitled to ratable distribution of the available assets. Preferred shares are convertible, at the option of the holder, at any time after issuance at the rate of two shares of common stock for each share of preferred stock. The preferred stock will automatically be converted into common stock in the event of an underwritten public offering of the Company s common stock or in the event of a consolidation, merger, or sale of

Notes to consolidated financial statements

substantially all of the assets of the Company. In addition, preferred shareholders are entitled to adjustment of the ratio of conversion of Series A Convertible Preferred Stock into common stock to reduce dilution in the event that the Company issued additional equity securities at a purchase price of less than $3.25 per share.

The Company is also authorized to issue an additional 20,000,000 shares of preferred stock. The Board of Directors is authorized to divide these shares into classes or series, and to fix and determine the relative rights, preferences, qualifications, and limitations of the shares of any class or series so established.

(c) Common Stock

In March 2005, the Company initiated a private placement offering of its common stock. The purpose of this offering was for working capital and for other general corporate purposes, including, but not limited to, the acquisition and development of pharmaceutical products. The offering was a private, limited offering by the Company in reliance upon exemptions from the federal registration provisions of the Securities Act of 1933, as amended, promulgated by the SEC under Regulation D. This offering was completed in 2005, and the Company issued 200,000 shares of common stock at $9.00 per share, for total net proceeds of $1,789,364 (gross proceeds of $1,800,000, net of cash offering costs of $10,636). The Company issued 7,000 stock options with a fair value of $51,806 to a non-employee as compensation for consulting services associated with the private placement. The fair value of these options has been recorded as additional offering costs and as stock options granted for services received.

In 2005, the Company issued 225,832 shares of common stock upon conversion of certain promissory notes into shares of the Company s common stock. See Note 6 for a more in-depth discussion of these transactions.

During 2005, 2006, and 2007, the Company issued 50,002, 27,518, and 25,236 shares of common stock, respectively, valued at $300,012, $273,298, and $222,596, respectively, to executives, related parties, and advisors as compensation for services, and is included in general and administrative expenses in the consolidated statements of income. Included in these amounts are shares of common stock granted to board members of 46,240, 24,818, and 11,036 in 2005, 2006, and 2007, respectively, for consulting services rendered. The expense associated with these grants to board members was $277,400, $248,998, and $121,396 in 2005, 2006, and 2007, respectively. In addition, the Company issued 17,650, 36,334, and 10,304 net shares of common stock to key executives and an advisor, who exercised options in 2005, 2006, and 2007, respectively.

In April 2007, the shareholders approved an amendment to the Company s charter, which increased the number of authorized shares to 100,000,000.

(d) Warrants

In 2003, the Company issued a stock purchase warrant to purchase 25,000 shares of common stock at an exercise price of $6.00 per share as partial consideration for a modification to its line of credit. The warrants expire 10 years from the date of issuance. All of these warrants were outstanding and exercisable as of December 31, 2007.

In connection with the issuance of shares of stock to a related party in 2004, the Company issued a stock purchase warrant to purchase 40,000 shares of stock at $6.00 per share at any time within ten years of issuance. All of these warrants were outstanding and exercisable as of December 31, 2007.

In 2006, the Company signed a new line of credit agreement along with a term loan agreement with a financial institution. In conjunction with these agreements, the Company issued warrants to purchase

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Notes to consolidated financial statements

up to 3,958 shares of common stock at $9.00 per share, which expire in April 2016, and are outstanding and exercisable as of December 31, 2007. The estimated fair value of these warrants of $25,680, as determined using the Black-Scholes model utilizing an expected term of 10 years, risk-free interest rate of 4.89%, volatility of 60% and 0% dividend yield, has been recorded in the accompanying consolidated financial statements as equity and deferred financing costs, a component of other assets.

(10) STOCK OPTIONS

The Cumberland Pharmaceuticals Inc. 1999 Stock Option Plan (the 1999 Plan) that includes both incentive stock options and nonqualified stock options to be granted to employees, officers, consultants, directors, and affiliates of the Company was superseded and replaced by the 2007 Long-Term Incentive Compensation Plan (the 2007 Plan) and 2007 Directors Incentive Plan (the Directors Plan). The new plans were approved by the Company s board of directors and shareholders in April 2007. The implementation of the new plans did not result in a modification of the terms and conditions of the outstanding awards granted under the 1999 Plan that would result in the awards being treated as an exchange of the original award for a new award.

The purposes of the 2007 Plan are to encourage the Company s employees and consultants to acquire stock and other equity-based interests and to replace the 1999 Plan. The Company has reserved 2.4 million shares of common stock for issuance under the 2007 Plan.

The purposes of the Directors Plan are to strengthen the Company s ability to attract, motivate, and retain Directors of experience and ability, and to encourage the highest level of performance by providing Directors with a proprietary interest in the Company s financial success and growth. The Directors Plan supersedes and replaces the provisions pertaining to grants of stock options to Directors in the 1999 Plan, but does not impair the vesting or exercise of any options granted under the 1999 Plan. The Company has reserved 250,000 shares of common stock under the Directors Plan.

Incentive stock options must be granted at an exercise price not less than the fair market value of the common stock on the grant date. The options granted to shareholders owning more than 10% of the common stock on the grant date must be granted at an exercise price not less than 110% of fair market value of the common stock on the grant date.

The options are exercisable on the dates established by each grant; however, options granted to officers or directors are not exercisable until at least six months after grant date. The maximum exercise life of an option is ten years from grant date and is five years for stock options issued to 10% shareholders. Vesting is determined on a grant-by-grant basis in accordance with the terms of the plans and the related grant agreements.

Notes to consolidated financial statements

Stock option activity for the three-year period ended December 31, 2007, was as follows:

	Number of shares	Weighted-average exercise price per share
Options outstanding, December 31, 2004	8,065,216	$ 1.17
Options granted	262,700	6.49
Options exercised	(19,110)	0.95
Options outstanding, December 31, 2005	8,308,806	1.34
Options granted	95,950	9.19
Options exercised	(38,968)	0.96
Options expired	(9,000)	9.00
Options forfeited	(346,832)	2.63
Options outstanding, December 31, 2006	8,009,956	1.37
Options granted	90,920	11.00
Options exercised	(223,878)	2.38
Options forfeited	(23,246)	8.35
Options outstanding, December 31, 2007	7,853,752	1.44

Of the options outstanding at December 31, 2005, 2006, and 2007, 4,776,036, 4,783,728 and 4,771,420, respectively, were options issued to a key executive.

The following table summarizes information concerning outstanding options as of December 31, 2007:

Year	Range of Exercise Prices	Number outstanding and expected to vest	Remaining contractual life (in years)	Weighted average exercise price	Aggregate intrinsic value
1999	$0.10-0.11	845,680	1.06	$ 0.11	$ 9,212,062
1999	0.50-0.55	4,644,758	1.70	0.54	48,565,105
2000	0.93	128,400	2.54	0.93	1,292,988
2001	1.63	781,366	3.21	1.63	7,321,399
2002	1.63	311,908	4.03	1.63	2,922,577

2002	3.13-3.50	14,644	4.52	3.15	115,022
2003	3.13-6.00	454,752	5.26	4.11	3,134,790
2004	6.00-6.60	256,570	6.29	6.01	1,280,810
2005	6.00-9.00	256,304	6.13	6.49	1,154,920
2006	9.00-9.90	69,450	7.07	9.26	120,900
2007	11.00	89,920	9.08	11.00	
		7,853,752			$ 75,120,573

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Notes to consolidated financial statements

The following table summarizes information concerning exercisable options as of December 31, 2007:

Year	Range of exercise prices	Options exercisable	Remaining contractual life (in years)	Weighted average exercise price	Aggregate intrinsic value
1999	$0.10-0.11	845,680	1.06	$ 0.11	$ 9,212,062
1999	0.50-0.55	4,644,758	1.70	0.54	48,565,105
2000	0.93	128,400	2.54	0.93	1,292,988
2001	1.63	781,366	3.21	1.63	7,321,399
2002	1.63	311,908	4.03	1.63	2,922,577
2002	3.13-3.50	14,644	4.52	3.15	115,022
2003	3.13-6.00	454,752	5.26	4.11	3,134,790
2004	6.00-6.60	256,570	6.29	6.01	1,280,810
2005	6.00-9.00	141,384	5.76	6.85	586,680
2006	9.00-9.90	36,950	7.17	9.24	64,900
2007	11.00	34,430	9.08	11.00	
		7,650,842			$ 74,496,333

The fair value of employee options granted during 2006 and 2007 were estimated using the Black-Scholes option-pricing model and the following assumptions:

	2006	2007
Dividend yield	%	%
Expected term (years)	3-7	5.5 - 6.4
Expected volatility	47%-54%	58%-64%
Risk-free interest rate	4.68%-5.08%	4.6%-4.8%

The fair value of non-employee options was estimated using the Black-Scholes option-pricing model and the following assumptions:

	2005	2006	2007
Dividend yield	%	%	%

Expected term (years)	10	.17-10	10
Expected volatility	77%	37%-63%	74%
Risk-free interest rate	4.13%-4.39%	4.34%-4.42%	4.83%

The Company determined the expected life of employee share options based on the simplified method allowed by SEC Staff Accounting Bulletin No. 107. Under this approach, the expected term is presumed to be the average between the weighted-average vesting period and the contractual term. The expected term for options granted to non-employees is generally the contractual term of the option. The expected volatility over the term of the respective option was based on the volatility of similar entities. In evaluating similarity, the Company considered factors such as industry, stage of life cycle, size, and financial leverage. The risk-free rate is based on a zero-coupon U.S. Treasury bond with a term substantially equal to the corresponding option s expected term. The Company has never declared or paid any cash dividends and does not presently plan to pay cash dividends in the foreseeable future.

The weighted-average grant date fair value of share options granted during the years ended December 31, 2005, 2006, and 2007 was approximately $2.87, $4.95, and $7.21, respectively. Upon exercise, the Company issues new shares of stock. During the years ended December 31, 2005, 2006,

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Notes to consolidated financial statements

and 2007, the aggregate intrinsic value of options exercised under the 1999 Plan was $153,899, $357,730, and $1,929,259, respectively, determined as of the date of option exercise.

Stock compensation expense is presented as a component of general and administrative expenses in the accompanying consolidated statements of income. At December 31, 2007, there was approximately $556,570 of unrecognized compensation cost related to share-based payments granted, which is expected to be recognized over a period of four years. This amount consists of non-employee unrecognized compensation cost of $51,530 and employee unrecognized compensation cost of $505,040.

The Company issued a total of 47,600, 24,000, and 14,000 stock options to non-employees for services rendered by these individuals in 2005, 2006, and 2007 as compensation for assisting the Company s management and supporting operations. The amount of compensation expense recorded for such services was $226,709, $37,751, and $93,836 in 2005, 2006, and 2007, respectively. Such expense is presented as a component of general and administrative expenses. Included in these amounts are options to purchase 22,000 shares of common stock at an exercise price of $9.00 in 2005 that were granted to two board members.

(11) LEASES

The Company is obligated under long-term real estate leases for office space expiring at various times through December 2011. The Company also subleases a portion of the space under these leases. Rent expense is recognized over the expected term of the lease, including renewal option periods, on a straight-line basis. Rent expense for 2005, 2006, and 2007 was $151,479, $286,037, and $387,862, respectively, and sublease income was $49,131, $71,173, and $77,071, respectively. Future minimum lease payments under noncancelable operating leases (with initial or remaining lease terms in excess of one year) are:

Year ending December 31:	
2008	$ 499,612
2009	504,875
2010	470,988
2011	46,711
2012	
Thereafter	
Total minimum lease payments	$ 1,522,186

(12) MANUFACTURING AND SUPPLY AGREEMENTS

The Company utilizes one supplier to manufacture each of its products and product candidates. Although there are a limited number of manufacturers of pharmaceutical products, management believes that they could utilize other suppliers to manufacture their prescription products on comparable terms. A change in suppliers, any problems with such manufacturing operations or capacity, or contract disputes with the suppliers, however, could cause a delay in manufacturing and a possible loss of sales, which would adversely affect operating results.

The Company s manufacturing and supply agreements with the manufacturers of its products contain minimum purchase obligations. These obligations require the Company to purchase approximately $2.3 million during 2008, $2.6 million during 2009, $2.9 million during 2010, and $2.4 million during 2011. Beginning in October 2011 and continuing through the life of the agreement, which expires in

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Notes to consolidated financial statements

2021, one of the manufacturing and supply agreements requires minimum purchases of not less than 65% of the average purchases in each of the three immediately preceding annual periods. The Company met its purchase obligations for 2007 under these agreements.

(13) COMMITMENTS AND CONTINGENCIES

The Company outsources some of its sales force activities through an agreement with a third party. Under the terms of the agreement, the Company makes monthly payments to the third party of approximately $258,000 for these activities. The original two-year agreement expires in August 2008 and has a one-year renewal option. Should the Company not continue to receive these services from this third party, the Company would have to consider an alternative source such as another service organization or hiring an internal sales force.

In connection with its manufacturing and supply agreement for Acetadote and its licensing agreement for Kristalose, the Company is required to pay a royalty based on net sales over the life of the contract. Royalty expense is recognized as a component of selling and marketing expense in the period that revenue is recognized.

During the second quarter of 2006, the Company s Chief Executive Officer, a Company Vice President, and the Company were named as co-defendants in *Parniani v. Cardinal Health, Inc. et al.*, Case No. 0:06-cv-02514-PJS-JJG in the U.S. District Court in the District of Minnesota for unspecified damages based on workers compensation and related claims. On July 27, 2007, the federal district court dismissed the case against the Company and the Company s Chief Executive Officer and Vice President. The plaintiff has appealed the ruling to the Eighth Circuit Court of Appeals. The plaintiff is a former employee of a third-party service provider to the Company. The service provider, which was also named as a co-defendant, agreed to assume control of the Company s defense at its cost pursuant to a contract between it and the Company. Based upon the information available to the Company to date, the Company believes that all asserted claims against the Company and the individual defendants are without merit. However, if the plaintiff appeals the ruling and any of the claims are deemed meritorious on appeal, the Company expects to be indemnified by the service provider so that resolution of this matter is not expected to have a material adverse effect on the Company s future financial results or financial condition.

(14) EMPLOYMENT AGREEMENTS

The Company has entered into employment agreements with its full-time and part-time employees. Each employment agreement provides for a salary basis for services performed, a potential annual bonus, and, if applicable, a grant of incentive options to purchase the Company s common shares pursuant to an option agreement. Three of the employment agreements address expense reimbursements for relevant and applicable licenses and continuing education. Employment agreements are amended each successive one-year period, unless terminated.

(15) MARKET CONCENTRATIONS

The Company currently focuses on acquiring, developing, and commercializing branded prescription products for the acute care and gastroenterology markets. The Company s principal financial instruments subject to potential concentration of credit risk are accounts receivable, which are unsecured, and cash equivalents. The Company s cash equivalents consist primarily of money market funds. Certain bank deposits may at times be in excess of the Federal Deposit Insurance Corporation (FDIC) insurance limits.

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Notes to consolidated financial statements

The Company s primary customers are wholesale pharmaceutical distributors in the U.S. Total revenues from customers representing 10% or more of total revenues for the respective years are summarized as follows:

	2005	2006	2007
Customer 1	34%	22%	35%
Customer 2	33	20	26
Customer 3	13	25	31

Additionally, 67% and 92% of the Company s accounts receivable balances were due from these three customers at December 31, 2006 and 2007, respectively.

(16) EMPLOYEE BENEFIT PLAN

The Company sponsors an employee benefit plan that was established on January 1, 2006, the Cumberland Pharmaceuticals 401(k) Plan (the Plan), under Section 401(k) of the Internal Revenue Code of 1986, as amended, for the benefit of all employees over the age of 21, having been employed by the Company for at least six months. The Plan provides that participants may contribute up to the maximum amount of their compensation as set forth by the Internal Revenue Service each year. Employee contributions are invested in various investment funds based upon elections made by the employees. There were no contributions made by the Company to the Plan in 2006 or 2007.

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Cumberland Pharmaceuticals Inc. and Subsidiaries

Schedule II valuation and qualifying accounts

Column A Description	Column B Balance at beginning of period	Column C Charged to costs and expenses	Charged to other accounts describe	Column D Deductions describe(1)	Column E Balance at end of period
Allowance for uncollectible amounts, cash discounts, chargebacks, and credits issued for damaged products:					
For the period ended:					
December 31, 2005	$ 189,959	553,460		(559,085)	184,334
December 31, 2006	184,334	1,152,927		(1,038,348)	298,913
December 31, 2007	298,913	1,184,711		(1,336,652)	146,972
Valuation allowance for deferred tax assets:					
For the period ended:					
December 31, 2005	$ 4,825,965	(1,476,179)(2)			3,349,786
December 31, 2006	3,349,786	(3,310,174)(3)			39,612
December 31, 2007	39,612	7,867			47,479

(1) Write-off of uncollectible accounts, net of recoveries, discounts, chargebacks, and credits taken by customers.

(2) Includes a $1,184,000 reduction in the valuation allowance reflecting the Company s belief that the future recognition of this amount of deferred tax assets is more likely than not. Remaining decrease is due to the utilization of deferred tax assets.

(3) Includes a $2,833,303 reduction in the valuation allowance reflecting the Company s belief that the future recognition of this amount of deferred tax assets is more likely than not. Remaining decrease is due to the utilization of deferred tax assets.

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Cumberland Pharmaceuticals Inc. and Subsidiaries

Condensed consolidated balance sheets
(Unaudited)

	As of	
	December 31, 2007	**March 31, 2008**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 10,814,518	$ 11,912,357
Accounts receivable, net of allowance	2,373,537	2,917,657
Inventories	949,109	1,173,805
Prepaid assets	288,241	220,576
Deferred tax assets	363,175	363,175
Total current assets	14,788,580	16,587,570
Property and equipment, net	459,843	470,802
Intangible assets, net	9,153,751	8,993,798
Deferred tax assets	1,827,982	1,659,504
Other assets	2,688,511	2,919,610
Total assets	$ 28,918,667	$ 30,631,284
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 1,833,332	$ 1,833,336
Revolving line of credit	1,325,951	1,325,951
Current portion of other long-term obligations	410,423	410,423
Accounts payable	1,921,101	3,287,122
Other accrued liabilities	2,628,453	1,901,955
Total current liabilities	8,119,260	8,758,787
Long-term debt, excluding current portion	916,664	458,326
Other long-term obligations, excluding current portion	3,136,574	3,179,100
Total liabilities	12,172,498	12,396,213
Commitments and contingencies (see note 6)		
Shareholders equity:		
Convertible Preferred stock no par value; 3,000,000 shares authorized; 855,495 shares issued and outstanding	2,742,994	2,742,994
Common stock no par value; 100,000,000 shares authorized; 10,091,260 and 10,095,160 shares issued and outstanding as of December 31, 2007 and	17,318,713	17,412,365

March 31, 2008, respectively		
Accumulated deficit	(3,315,538)	(1,920,288)
Total shareholders equity	16,746,169	18,235,071
Total liabilities and shareholders equity	$ 28,918,667	$ 30,631,284

See accompanying notes to unaudited condensed consolidated financial statements.

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Cumberland Pharmaceuticals Inc. and Subsidiaries

Condensed consolidated statements of operations
(Unaudited)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2008
Net revenues	$ 5,906,785	$ 8,303,827
Costs and expenses:		
Cost of products sold	571,092	755,491
Selling and marketing	2,417,053	3,364,006
Research and development	452,199	1,109,942
General and administrative	1,019,129	1,083,094
Amortization of product license right	171,727	171,726
Other	24,978	26,029
Total costs and expenses	4,656,178	6,510,288
Operating income	1,250,607	1,793,539
Interest income	90,157	82,372
Interest expense	(192,071)	(113,604)
Net income before income taxes	1,148,693	1,762,307
Income tax expense	(409,589)	(367,057)
Net income	$ 739,104	$ 1,395,250
Net income per share basic	$ 0.07	$ 0.14
Net income per share diluted	$ 0.04	$ 0.09
Weighted-average shares outstanding basic	9,869,314	10,093,831
Weighted-average shares outstanding diluted	16,620,808	16,411,672

See accompanying notes to unaudited condensed consolidated financial statements.

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Cumberland Pharmaceuticals Inc. and Subsidiaries

Condensed consolidated statements of cash flows
(Unaudited)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2008
Cash flows from operating activities:		
Net cash provided by operating activities	$ 3,314,509	$ 1,869,841
Cash flows from investing activities:		
Additions to property and equipment	(28,611)	(33,192)
Additions to patents	(3,157)	(12,946)
Net cash used in investment activities	(31,768)	(46,138)
Cash flows from financing activities:		
Costs of potential initial public offering	(80,328)	(267,530)
Principal payments on note payable	(458,347)	(458,334)
Net cash used in financing activities	(538,675)	(725,864)
Net increase in cash and cash equivalents	2,744,066	1,097,839
Cash and cash equivalents at beginning of period	6,255,398	10,814,518
Cash and cash equivalents at end of period	$ 8,999,464	$ 11,912,357
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest	$ 121,616	$ 77,588
Income taxes	4,325	138,485
Non-cash investing and financing activities:		
Increase in accrued but unpaid costs of potential initial public offering	613,918	

See accompanying notes to unaudited condensed consolidated financial statements.

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CUMBERLAND PHARMACEUTICALS INC. AND SUBSIDIARIES

Notes to condensed consolidated financial statements
(Unaudited)

(1) BASIS OF PRESENTATION

In the opinion of management, the accompanying unaudited condensed consolidated financial statements (condensed consolidated financial statements) of Cumberland Pharmaceuticals Inc. and its subsidiaries (collectively, the Company or Cumberland) have been prepared on a basis consistent with the December 31, 2007 audited consolidated financial statements and include all adjustments, consisting of only normal recurring adjustments, necessary to fairly present the information set forth herein. The condensed consolidated financial statements have been prepared in accordance with the regulations of the Securities and Exchange Commission (SEC), and omit certain information and footnote disclosure necessary to present the statements in accordance with U.S. generally accepted accounting principles. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2007. The results of operations for the first three months of 2008 are not necessarily indicative of the results to be expected for the entire fiscal year or any future period.

Total comprehensive income was comprised solely of net income for the three months ended March 31, 2007 and 2008.

Accounting Policies:

In preparing the condensed consolidated financial statements in conformity with U.S. generally accepted accounting principles, management must make decisions that impact the reported amounts and the related disclosures. Such decisions include the selection of the appropriate accounting principles to be applied and the assumptions on which to base accounting estimates. In reaching such decisions, management applies judgments based on its understanding and analysis of the relevant circumstances, historical experience, and other available information. Actual amounts could differ from those estimated at the time the consolidated financial statements are prepared.

Note 2 in the Company s consolidated financial statements for the year ended December 31, 2007 provides a summary of significant accounting policies followed in the preparation of the condensed consolidated financial statements. Other footnotes in the Company s 2007 consolidated financial statements describe various elements of the condensed consolidated financial statements and the assumptions made in determining specific amounts.

Initial public offering costs of $2.9 million are included in non-current assets and will be accounted for as equity or expense based on the outcome of the initial public offering. As of March 31, 2008, approximately $0.6 million of unpaid costs related to our initial public offering are included in accounts payable and other accrued liabilities.

The condensed consolidated financial statements include the accounts of Cumberland Pharmaceuticals Inc. and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

(2) ADOPTION OF NEW ACCOUNTING PRONOUNCEMENTS

Effective January 1, 2008, the Company adopted the provisions of Statement of Financial Accounting (SFAS) No. 157, *Fair Value Measurements* (SFAS 157). This pronouncement did not require any new fair value measurements. The adoption of this pronouncement did not impact the condensed consolidated financial statements

for the three months ended March 31, 2008.

SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159), was effective on January 1, 2008. SFAS 159 permits entities to measure many financial instruments and

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Notes to condensed consolidated financial statements

certain other items at fair value. As of the date of adoption, the Company elected to recognize its financial assets and liabilities at historical cost. The Company may elect, on a case-by-case basis, to recognize new assets acquired or liabilities assumed at fair value.

Effective January 1, 2008, the Company adopted the provisions of EITF 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities*. During the first quarter of 2008, the Company did not make any nonrefundable advance payments for research and development activities. Consequently, the adoption of this pronouncement did not impact the condensed consolidated financial statements for the three months ended March 31, 2008.

(3) INCOME TAXES

Effective January 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainties in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48), which clarified the accounting and disclosure for uncertainty in income tax positions. Changes in the beginning balance of unrecognized tax benefits during the three months ended March 31, 2008 were as follows:

	Gross	Federal Unrecognized Benefits	State Unrecognized Benefit	Total
Unrecognized tax benefits, December 31, 2007	$ 378,736	$ 378,736	$	$ 378,736
Decrease due to settlement with taxing authority	(378,736)	(378,736)		(378,736)
Unrecognized tax benefits, March 31, 2008	$	$	$	$

Based on the results of the examination of its federal taxes, the Company reevaluated its previously unrecognized tax positions and determined it was more likely than not that the benefits would be realized. As a result, the Company recognized these tax benefits during the first quarter of 2008.

Income tax expense for the first quarter of 2008 has been provided for based on an estimated effective tax rate of 38.8% expected to be applicable for the 2008 fiscal year.

(4) NET INCOME PER SHARE

The following tables reconcile the numerator and the denominator used to calculate diluted net income per share for the three months ended March 31, 2007 and 2008:

	Three Months Ended March 31,	
	2007	2008

Numerator:		
Net income	$ 739,104	$ 1,395,250
Denominator:		
Weighted-average shares outstanding basic	9,869,314	10,093,831
Preferred stock shares	1,710,990	1,710,990
Dilutive effect of stock options and warrants	5,040,504	4,606,851
Weighted-average shares outstanding diluted	16,620,808	16,411,672

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Notes to condensed consolidated financial statements

As of March 31, 2007 and 2008, options to purchase 55,710 and 30,961 shares of common stock, respectively, were outstanding but were not included in the computation of diluted EPS because the effect would be antidilutive.

(5) SEGMENT REPORTING

We operate in one segment, specialty pharmaceutical products. Management has chosen to organize the Company based on the type of products sold. All of the Company s assets are located in the United States. The Company did not have any sales to non-U.S. customers during the three months ended March 31, 2007 and 2008.

	Three Months Ended March 31,	
	2007	2008
Products		
Acetadote	$ 3,863,280	$ 5,799,482
Kristalose	1,982,054	2,478,183
Other		
Other	61,451	26,162
Total	$ 5,906,785	$ 8,303,827

(6) CONTINGENCIES

During the second quarter of 2006, our Chief Executive Officer, a Vice President of ours, and we were named as co-defendants in *Parniani v. Cardinal Health, Inc. et al.*, Case No. 0:06-cv-02514-PJS-JJG in the U.S. District Court in the District of Minnesota for unspecified damages based on workers compensation and related claims. On July 27, 2007, the federal district court dismissed the case against us and our Chief Executive Officer and Vice President. The plaintiff has appealed the ruling to the Eighth Circuit Court of Appeals. The plaintiff is a former employee of a third-party service provider to us. The service provider, which was also named as a co-defendant, agreed to assume control of our defense at its cost pursuant to a contract between it and us. Based upon the information available to us to date, we believe that all asserted claims against us and the individual defendants are without merit. However, if any of the claims are deemed meritorious on appeal, we expect to be indemnified by the service provider so that resolution of this matter is not expected to have a material adverse effect on our future financial results or financial condition.

(7) SUBSEQUENT EVENTS

In April 2008, the Company amended its line of credit to extend the maturity date to April 6, 2009. The terms of the amended line of credit are consistent with its original terms. In accordance with SFAS 6, *Classification of Short-Term Obligations Expected to Be Refinanced*, the line of credit is presented as a current liability in the condensed consolidated balance sheet as of March 31, 2008. The Company did not pay any bank fees associated with the line of credit.

In April 2008, the Company amended its agreement with Inalco and paid the remaining obligation related to the purchase of the Kristalose license right. The terms of the amendment provided for an 8% discount on the $3.0 million face value of the obligation for a net payment of $2,760,000.

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Part II

Information not required in prospectus

ITEM 13. OTHER EXPENSES OF ISSUANCE AND DISTRIBUTION.

The expenses relating to the registration of the shares of common stock being offered hereby, other than underwriting discounts and commissions, will be borne by us. Such expenses are estimated to be as follows:

Item		Amount
SEC registration fee	$	4,000
FINRA filing fee	$	12,000
NASDAQ Global Market listing fee	$	100,000
Printing expenses	$	371,000
Legal fees and expenses	$	975,000
Accounting fees and expenses	$	1,200,000
Blue sky, qualification fees and expenses	$	20,000
Transfer agent and registrar expenses	$	15,000
Miscellaneous	$	803,000
Total	$	3,500,000

ITEM 14. INDEMNIFICATION OF DIRECTORS AND OFFICERS.

Our charter and bylaws provide for indemnification of our directors to the fullest extent permitted by the Tennessee Business Corporation Act, as amended from time to time. Our directors shall not be liable to the corporation or its shareholders for monetary damages for breach of fiduciary duty as a director. The Tennessee Business Corporation Act provides that a Tennessee corporation may indemnify its directors and officers against expenses, judgments, fines and amounts paid in settlement actually and reasonably incurred by them in connection with any proceeding, whether criminal or civil, administrative or investigative if, in connection with the matter in issue, the individual s conduct was in good faith, and the individual reasonably believed: in the case of conduct in the individual s official capacity with the corporation, that the individual s conduct was in its best interest; and in all other cases, that the individual s behavior was at least not opposed to its best interest; and in the case of a criminal proceeding, the individual had no reason to believe the individual s conduct was unlawful. In addition, we have entered into indemnification agreements with our directors. These provisions and agreements may have the practical effect in certain cases of eliminating the ability of our shareholders to collect monetary damages from directors. We believe that these contractual agreements and the provisions in our charter and bylaws are necessary to attract and retain qualified persons as directors.

ITEM 15. RECENT SALES OF UNREGISTERED SECURITIES.

In September 2003, we borrowed $500,000 from nine existing and accredited shareholders pursuant to uncollateralized secured notes payable with original maturity dates of 130 days. These notes bore interest at 12% for the first 30 days and 15% thereafter. The holders of the notes had, at their option, until the maturity date of the notes payable, the right to convert all or a portion of the unpaid principal and interest into shares of our common stock at a rate of $6.00 per share. We also issued to these lenders options to purchase shares of our common stock, at an exercise

price of $6.00 per share, and at the rate of 3,080 shares of common stock per $50,000 face value of the notes. If we had not prepaid all amounts due and owing under the notes, we agreed to grant additional options at the rate of 1,540 shares of common stock per $50,000 face value on each of (i) the 30th day after the date of the notes and (ii) on a continuing basis, each successive 30-day period thereafter, or portion thereof, as the notes remained outstanding. At December 31, 2003, the notes payable had not been prepaid, so we

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granted options to acquire an additional 61,600 shares. We amended the notes agreements in January 2004 to extend the maturity date 130 days. The amendments granted an additional option to purchase 3,080 shares per $50,000 face value upon extension of the notes and contained similar provisions for granting options in the event of nonpayment on the agreed-upon due dates. Based on the extension of the maturity date, rights to purchase a total of 123,200 shares were earned by the holders of the notes in 2004. We repaid these notes or settled these notes in shares in May 2004. The issuance of these securities was exempt from registration under the Securities Act in reliance on Section 4(2) of the Securities Act.

In September 2003, we borrowed $1,000,000 from S.C.O.U.T. Healthcare Fund, L.P., or S.C.O.U.T., in the form of a convertible promissory note with a maturity date of September 2004. The President and majority shareholder of the general partner of S.C.O.U.T., Dr. Lawrence W. Greer, serves on our board of directors. Pursuant to the terms of the note, on its maturity date, S.C.O.U.T. converted the principal value of the note plus all interest accrued at a fixed rate of ten percent per annum into 183,334 shares of our common stock at a price of $6.00 per share.

On April 15, 2004, we issued 86,000 common shares at $6.00 per share, for an aggregate consideration of $516,000 and a five-year warrant to purchase 40,000 common shares at $6.00 per share to S.C.O.U.T., which represented to us that it was an accredited investor. This issuance was exempt from registration under the Securities Act in reliance on Section 4(2) of the Securities Act.

By an offering memorandum dated April 1, 2005, we offered 200,000 shares of our common stock at a purchase price of $9.00 per share. Thirty investors subscribed for 200,000 shares in the aggregate, for an aggregate consideration of $1,800,000. This issuance was exempt from registration under the Securities Act in reliance on Section 4(2) of the Securities Act.

By an offering memorandum dated May 5, 2005, we received approximately $2,000,000 from approximately 41 investors in exchange for uncollateralized convertible promissory notes with a maturity date six months from the date of issuance. Upon maturity, the principal and accrued interest payable on the notes converted into 225,832 shares of common stock at a rate of $9.00 per share. This issuance was exempt from registration under the Securities Act in reliance on Section 4(2) of the Securities Act.

In April 2006, we issued a ten-year warrant to purchase 3,958 common shares at $9.00 per share to Bank of America. The issuance of this security was exempt from registration under the Securities Act in reliance on Section 4(2) of the Securities Act.

Since January 1, 2004, we have granted options to purchase 575,220 shares of our common stock under the 1999 Option Plan to our employees, directors and consultants at exercise prices ranging from $6.00 to $11.00 per share. Of these, an aggregate of 1,650 shares of our common stock were issued upon the exercise of stock options.

Since January 1, 2004, we also issued an aggregate of 151,290 shares of common stock as compensation for services pursuant to contracts. Restricted-stock legends were affixed to the securities issued in these transactions. Our board of directors determined that the fair value of the services received equaled the value of the stock granted with values ranging from $6.00 to $11.00 per share. The issuances of common stock in connection with awards of restricted stock were exempt either pursuant to Rule 701 or pursuant to Section 4(2) of the Securities Act as transactions by an issuer not involving a public offering.

The issuances of securities described in the first six paragraphs of Item 15 were exempt from registration under the Securities Act of 1933, as amended, in reliance on Section 4(2) of the Securities Act of 1933, as amended, and/or Regulation D promulgated thereunder, as transactions by an issuer not

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involving any public offering. The purchasers of the securities in these transactions represented that they were accredited investors and they were acquiring the securities for investment only and not with a view toward the public sale or distribution thereof. Such purchasers received written disclosures that the securities had not been registered under the Securities Act of 1933, as amended, and that any resale must be made pursuant to a registration statement or an available exemption from registration. All purchasers either received adequate financial statement or non-financial statement information about the registrant or had adequate access, through their relationship with the registrant, to financial statement or non-financial statement information about the registrant. The sale of these securities was made without general solicitation or advertising.

The issuances of securities described in the seventh and eighth paragraphs of Item 15 were exempt from registration under the Securities Act of 1933, as amended, in reliance on either (1) Rule 701 of the Securities Act of 1933, as amended, as offers and sales of securities pursuant to compensatory benefit plans and contracts relating to compensation in compliance with Rule 701 or (2) Section 4(2) of the Securities Act as transactions by an issuer not involving any public offering.

All certificates representing the securities issued in these transactions described in this Item 15 included appropriate legends setting forth that the securities had not been offered or sold pursuant to a registration statement and describing the applicable restrictions on transfer of the securities. There were no underwriters employed in connection with any of the transactions set forth in this Item 15.

ITEM 16. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

(a)

No.	**Description**
1.1**	Form of Underwriting Agreement.
3.1**	Second Amended and Restated Charter of Cumberland Pharmaceuticals Inc.
3.2**	Amended and Restated Bylaws of Cumberland Pharmaceuticals Inc.
4.1**	Specimen Common Stock Certificate of Cumberland Pharmaceuticals Inc.
4.2**	Warrant to Purchase Common Stock of Cumberland Pharmaceuticals Inc., issued to Bank of America, N.A. on October 21, 2003.
4.3**	Stock Purchase Warrant, issued to S.C.O.U.T. Healthcare Fund L.P. on April 15, 2004.
4.4**	Warrant to Purchase Common Stock of Cumberland Pharmaceuticals Inc., issued to Bank of America, N.A. on April 6, 2006.
4.5#**	Form of Option Agreement under 1999 Stock Option Plan of Cumberland Pharmaceuticals Inc.
4.6.1#**	Form of Incentive Stock Option Agreement under 2007 Long-Term Incentive Compensation Plan of Cumberland Pharmaceuticals Inc.
4.6.2#**	Form of Nonstatutory Stock Option Agreement under 2007 Long-Term Incentive Compensation Plan of Cumberland Pharmaceuticals Inc.
4.7#**	Form of Nonstatutory Stock Option Agreement under 2007 Directors Compensation Plan of Cumberland Pharmaceuticals Inc.
5.1**	Opinion of Adams and Reese LLP.

10.1 **	Manufacturing and Supply Agreement for N-Acetylcysteine, dated January 15, 2002, by and between Bioniche Life Sciences, Inc. and Cumberland Pharmaceuticals Inc.
10.2**	Novation Agreement, dated January 27, 2006, by and among Bioniche Life Sciences, Inc., Bioniche Pharma Group Ltd., and Cumberland Pharmaceuticals Inc.

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No.	Description
10.3 **	First Amendment to Manufacturing and Supply Agreement for N-Acetylcysteine, dated November 16, 2006, by and between Bioniche Teoranta and Cumberland Pharmaceuticals Inc.
10.3.1 **	Second Amendment to Manufacturing and Supply Agreement for N-Acetylcysteine, dated March 25, 2008, by and between Bioniche Teoranta and Cumberland Pharmaceuticals Inc.
10.4 **	Cardinal Health Contract Sales and Services for Cumberland Pharmaceuticals Inc. Dedicated Sales Force Agreement, dated May 16, 2006, by and between Cardinal Health PTS, LLC and Cumberland Pharmaceuticals Inc.
10.5 **	First Amendment to Contract Sales and Service Agreement, dated July 19, 2006, by and between Cardinal Health PTS, LLC and Cumberland Pharmaceuticals Inc.
10.6**	Second Amendment to Contract Sales and Service Agreement, dated June 1, 2007, by and between Cumberland Pharmaceuticals Inc. and Inventiv Commercial Services, LLC, as successor in interest to Cardinal Health PTS, LLC.
10.6.1 **	Third Amendment to Contract Sales and Service Agreement, dated March 26, 2008, by and between Cumberland Pharmaceuticals Inc. and Ventiv Commercial Services, LLC.
10.7 **	Distribution Services Agreement, dated August 3, 2000, by and between CORD Logistics, Inc. and Cumberland Pharmaceuticals Inc.
10.8 **	Strategic Alliance Agreement, dated July 21, 2000, by and between F.H. Faulding & Co. Limited and Cumberland Pharmaceuticals Inc., including notification of assignment from F.H. Faulding & Co. Limited to Mayne Pharma Pty Ltd., dated April 16, 2002
10.9 **	Kristalose Agreement, dated April 7, 2006, by and among Inalco Biochemicals, Inc., Inalco S.p.A., and Cumberland Pharmaceuticals Inc.
10.9.1 **	Amendment to Kristalose Agreement, dated April 3, 2008, by and between Inalco S.p.A., Inalco Biochemicals, Inc., and Cumberland Pharmaceuticals Inc.
10.10 **	License Agreement, dated May 28, 1999, by and between Vanderbilt University and Cumberland Pharmaceuticals Inc.
10.11#**	Employment Agreement effective as of January 1, 2008 by and between A.J. Kazimi and Cumberland Pharmaceuticals Inc.
10.12#**	Employment Agreement effective as of January 1, 2008 by and between Jean W. Marstiller and Cumberland Pharmaceuticals Inc.
10.13#**	Employment Agreement effective as of January 1, 2008 by and between Leo Pavliv and Cumberland Pharmaceuticals Inc.
10.14#**	Employment Agreement effective as of January 1, 2008 by and between J. William Hix and Cumberland Pharmaceuticals Inc.
10.15#**	Employment Agreement effective as of January 1, 2008 by and between David L. Lowrance and Cumberland Pharmaceuticals Inc.
10.16.1 **	Second Amended and Restated Loan Agreement by and between Cumberland Pharmaceuticals Inc. and Bank of America, N.A., dated April 6, 2006.
10.16.2**	First Amendment to Second Amended and Restated Loan Agreement by and between Cumberland Pharmaceuticals Inc. and Bank of America, N.A., dated December 31, 2006.
10.16.3**	Second Amendment to Second Amended and Restated Loan Agreement by and between Cumberland Pharmaceuticals Inc. and Bank of America, N.A., dated July 18, 2007.

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No.	Description
10.16.4**	Third Amendment to Second Amended and Restated Loan Agreement, by and between Cumberland Pharmaceuticals Inc. and Bank of America, N.A., dated April 6, 2008.
10.17#**	1999 Stock Option Plan of Cumberland Pharmaceuticals Inc.
10.18#**	2007 Long-Term Incentive Compensation Plan of Cumberland Pharmaceuticals Inc.
10.19#**	2007 Directors Compensation Plan of Cumberland Pharmaceuticals Inc.
10.20**	Form of Indemnification Agreement between Cumberland Pharmaceuticals Inc. and all members of its Board of Directors.
10.21 **	Lease Agreement, dated September 10, 2005, by and between Nashville Hines Development, LLC and Cumberland Pharmaceuticals Inc.
10.21.1 **	First Amendment to Office Lease Agreement, dated April 25, 2008, by and between 2525 West End, LLC (successor in interest to Nashville Hines Development LLC) and Cumberland Pharmaceuticals Inc.
10.22.1 **	Sublease Agreement, dated December 14, 2006, by and between Robert W. Baird & Co. Incorporated and Cumberland Pharmaceuticals Inc.
10.22.2**	Addendum to Sublease Agreement, dated May 5, 2007, by and between Robert W. Baird & Co. Incorporated and Cumberland Pharmaceuticals Inc. and consented to by Nashville Hines Development, LLC.
10.23 **	Amended and Restated Lease Agreement, dated November 11, 2004, by and between The Gateway to Nashville LLC and Cumberland Emerging Technologies, Inc.
10.24**	First Amendment to Amended and Restated Lease Agreement, dated August 23, 2005, by and between The Gateway to Nashville LLC and Cumberland Emerging Technologies, Inc.
10.24.1**	Second Agreement to Amended and Restated Lease Agreement, dated January 9, 2006, by and between The Gateway to Nashville LLC and Cumberland Emerging Technologies, Inc.
10.25	Manufacturing Agreement, dated February 6, 2008, by and between Bayer HealthCare, LLC, and Cumberland Pharmaceuticals Inc.
21**	Subsidiaries of Cumberland Pharmaceuticals Inc.
23.1	Consent of KPMG LLP.
23.2**	Consent of Adams and Reese, LLP (contained in Exhibit 5).
23.3	Consent of Morgan Joseph & Co. Inc.
24**	Powers of Attorney (contained on the signature page of Registration Statement on Form S-1 filed on May 1, 2007).

** Previously filed.

# Indicates a management contract or compensatory plan.

Confidential treatment has been granted for portions of this exhibit. These portions have been omitted from the Registration Statement and submitted separately to the Securities and Exchange Commission.

Confidential treatment has been requested for portions of this exhibit. These portions have been omitted from the Registration Statement and submitted separately to the Securities and Exchange Commission.

(b) See Schedule II Valuation and qualifying accounts included in our audited financial statements included elsewhere in this registration statement.

All other schedules have been omitted because they are not applicable.

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Part II

ITEM 17. UNDERTAKINGS.

The undersigned registrant hereby undertakes to provide to the underwriters at the closing specified in the underwriting agreement certificates in such denominations and registered in such names as required by the underwriters to permit prompt delivery to each purchaser.

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers, and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act of 1933 and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer, or controlling person of the registrant in the successful defense of any action, suit, or proceeding) is asserted by such director, officer, or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act of 1933 and will be governed by the final adjudication of such issue.

The undersigned registrant hereby undertakes that:

1) For purposes of determining any liability under the Securities Act of 1933, the information omitted from the form of prospectus filed as part of this Registration Statement in reliance upon Rule 430A and contained in a form of prospectus filed by the Registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act shall be deemed to be part of this Registration Statement as of the time it was declared effective.

2) For the purpose of determining any liability under the Securities Act of 1933, each post-effective amendment that contains a form of prospectus shall be deemed to be a new Registration Statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial *bona fide* offering thereof.

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Signatures

Pursuant to the requirements of the Securities Act of 1933, the registrant has duly caused this Amendment No. 12 to the Registration Statement to be signed on its behalf by the undersigned, thereunto duly authorized in the City of Nashville, State of Tennessee, on the 20th day of June, 2008.

CUMBERLAND PHARMACEUTICALS INC.

By: /s/ a.j. kazimi
A.J. Kazimi
Chairman and CEO
(Principal Executive Officer)

Pursuant to the requirements of the Securities Act of 1933, this Amendment No. 12 to the Registration Statement has been signed by the following persons in the capacities and on the dates indicated.

Signature	Title	Date
/s/ a.j. kazimi A.J. Kazimi	Chairman and CEO (Principal Executive Officer)	June 20, 2008
/s/ david l. lowrance David L. Lowrance	Vice President and CFO (Principal Financial and Accounting Officer)	June 20, 2008
* Robert G. Edwards	Director	June 20, 2008
* Thomas R. Lawrence	Director	June 20, 2008
* Lawrence W. Greer	Director	June 20, 2008
* Martin E. Cearnal	Director	June 20, 2008

*By: /s/ a.j. kazimi

A.J. Kazimi
Attorney-in-Fact

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