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UNITED GUARDIAN INC
Form 10QSB
August 10, 2006

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

(Mark One)

Quarterly report under Section 13 or 15(d) of the Securities
Exchange Act of 1934

For the quarterly period ended June 30, 2006

Transition report under Section 13 or 15(d) of the Exchange Act

For the transition period from _____ to _____

Commission File Number: 1-10526

UNITED-GUARDIAN, INC.

(Exact name of registrant as specified in its charter)

Delaware

11-1719724

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer Identification No.)

230 Marcus Boulevard., Hauppauge, New York 11788

(Address of principal executive offices)

(631) 273-0900

(Registrant's telephone number)

(Former name, former address and former fiscal year,
if changed since last report)

Indicate by check mark whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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Cover Page 1 of 2 Pages

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.)

Yes [] No [X]

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS
DURING THE PRECEDING FIVE YEARS

Indicate by check mark whether the Company filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by a court.

Yes [] No []

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date:

4,942,139 shares of common stock,
par value \$.10 per share,
as of August 1, 2006

Transitional Small Business Disclosure Format (Check one): Yes [] No [X]

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Cover Page 2 of 2 Pages

UNITED-GUARDIAN, INC.

INDEX

| | Page No. ----- |
|---|-------------------|
| Part I. FINANCIAL INFORMATION | |
| Item 1 - Financial Statements | |
| Consolidated Statements of Income - Six and Three Months Ended June 30, 2006 and 2005 (unaudited)..... | 2 |
| Consolidated Balance Sheets - June 30, 2006 (unaudited) and December 31, 2005..... | 3-4 |
| Consolidated Statements of Cash Flows - Six Months ended June 30, 2006 and 2005 (unaudited)..... | 5 |
| Consolidated Notes to (unaudited) Financial Statements..... | 6-12 |
| Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations..... | 12-16 |
| Item 3 - Controls and Procedures..... | 16 |
| Part II. OTHER INFORMATION | |
| Item 1 - Legal Proceedings..... | 17 |
| Item 2 - Changes in Securities and Use of Proceeds..... | 17 |
| Item 3 - Defaults Upon Senior Securities..... | 17 |
| Item 4 - Submission of Matters to a Vote of Security Holders..... | 17 |
| Item 5 - Other Information..... | 17 |
| Item 6 - Exhibits and Reports On Form 8-K..... | 17 |
| Signatures..... | 17 |

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Part I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

UNITED-GUARDIAN, INC. CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

| | SIX MONTHS ENDED June 30, | | THREE MONTHS JUNE |
|---------------------------------------|------------------------------|--------------|----------------------|
| | 2006 | 2005 | 2006 |
| Revenue: | | | |
| Net sales | \$ 5,921,812 | \$ 6,647,572 | \$ 3,057,015 |
| Costs and expenses: | | | |
| Cost of sales | 2,793,799 | 3,041,560 | 1,441,188 |
| Operating expenses | 1,374,458 | 1,325,339 | 733,334 |
| | 4,168,257 | 4,366,899 | 2,174,522 |
| Income from operations | 1,753,555 | 2,280,673 | 882,493 |
| Other income (expense): | | | |
| Investment income | 195,102 | 161,291 | 114,679 |
| Loss on sale of marketable securities | (349) | (114,231) | (349) |
| Other | (227) | (48) | (227) |
| | 1,948,081 | 2,327,685 | 996,596 |
| Income before income taxes | | | |
| Provision for income taxes | 675,700 | 860,900 | 346,200 |
| | \$ 1,272,381 | \$ 1,466,785 | \$ 650,396 |
| Net income | \$ 1,272,381 | \$ 1,466,785 | \$ 650,396 |
| Earnings per common share | | | |
| (basic and diluted) | \$.26 | \$.30 | \$.13 |
| Weighted average shares - basic | 4,941,167 | 4,932,761 | 4,942,139 |
| Weighted average shares - diluted | 4,944,600 | 4,940,239 | 4,944,876 |

See notes to consolidated financial statements

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UNITED-GUARDIAN, INC.
CONSOLIDATED BALANCE SHEETS

| | JUNE 30, 2006 | DECEMBER 31, 2005 |
|---|------------------|----------------------|
| ASSETS | (UNAUDITED) | (AUDITED) |
| Current assets: | | |
| Cash and cash equivalents | \$ 2,359,165 | \$ 3,425,593 |
| Temporary investments | 1,002,582 | 699,363 |
| Marketable securities | 6,461,173 | 7,066,797 |
| Accounts receivable, net of allowance for doubtful accounts of \$36,288 and \$47,500 at June 30, 2006 and December 31, 2005, respectively | 1,058,918 | 1,083,992 |
| Inventories (net) | 1,514,863 | 1,031,563 |
| Prepaid expenses and other current assets | 443,003 | 440,380 |
| Deferred income taxes | 255,189 | 217,389 |
| | ----- | ----- |
| Total current assets | 13,094,893 | 13,965,077 |
| | ----- | ----- |
| Property, plant and equipment: | | |
| Land | 69,000 | 69,000 |
| Factory equipment and fixtures | 3,087,972 | 3,068,050 |
| Building and improvements | 2,140,405 | 2,133,422 |
| Waste disposal plant | 133,532 | 133,532 |
| | ----- | ----- |
| | 5,430,909 | 5,404,004 |
| Less: Accumulated depreciation | 4,550,036 | 4,455,524 |
| | ----- | ----- |
| | 880,873 | 948,480 |
| | ----- | ----- |
| Other assets | 148,430 | 108,680 |
| | ----- | ----- |
| | \$ 14,124,196 | \$ 15,022,237 |
| | ===== | ===== |

See notes to consolidated financial statements

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CONSOLIDATED BALANCE SHEETS

| | June 30, 2006 | DECEMBER 31, 2005 |
|---|----------------------|----------------------|
| | ----- (UNAUDITED) | ----- (AUDITED) |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Dividends payable | \$ - | \$1,086,391 |
| Accounts payable | 190,067 | 148,051 |
| Accrued expenses | 605,342 | 448,990 |
| | ----- | ----- |
| Total current liabilities | 795,409 | 1,683,432 |
| | ----- | ----- |
| Deferred income taxes | 59,817 | 59,817 |
| | ----- | ----- |
| Stockholders' equity: | | |
| Common stock \$.10 par value, authorized, 10,000,000 shares; 5,004,339 and 5,000,339 shares issued, respectively, and 4,942,139 and 4,938,139 shares outstanding, respectively | 500,434 | 500,034 |
| Capital in excess of par value | 3,792,478 | 3,778,838 |
| Accumulated other comprehensive loss | (145,269) | (84,365) |
| Retained earnings | 9,480,957 | 9,444,111 |
| Treasury stock, at cost; 62,200 shares | (359,630) | (359,630) |
| | ----- | ----- |
| Total stockholders' equity | 13,268,970 | 13,278,988 |
| | ----- | ----- |
| | \$ 14,124,196 | \$ 15,022,237 |
| | ===== | ===== |

See notes to consolidated financial statements

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(UNAUDITED)

SIX MONTHS ENDED
JUNE 30,

| | 2006 | 2005 |
|--|--------------|--------------|
| | ----- | ----- |
| Cash flows provided by operating activities: | | |
| Net income | \$ 1,272,381 | \$ 1,466,785 |
| Adjustments to reconcile net earnings to net cash flows from operations: | | |
| Depreciation and amortization | 94,512 | 100,524 |
| Realized loss on sale of marketable securities | 349 | 116,855 |
| Provision for doubtful accounts | (11,212) | (11,029) |
| Reduction of inventory obsolescence | 19,000 | - |
| Increase (decrease) in cash resulting from changes in operating assets and liabilities: | | |
| Accounts receivable | 36,286 | (551,997) |
| Inventories | (502,300) | 336,239 |
| Prepaid expenses and other current and non-current assets | (42,373) | 186,925 |
| Accounts payable | 42,016 | 29,046 |
| Accrued expenses and taxes payable | 156,352 | 155,282 |
| | ----- | ----- |
| Net cash provided by operating activities | 1,065,011 | 1,828,630 |
| | ----- | ----- |
| Cash flows from investing activities: | | |
| Acquisition of property, plant and equipment | (26,905) | (85,509) |
| Net change in temporary investments | (303,219) | (295,764) |
| Purchase of marketable securities | (93,803) | (4,342,520) |
| Proceeds from sale of marketable securities | 600,374 | 3,465,351 |
| | ----- | ----- |
| Net cash provided by (used in) investing activities | 176,447 | (1,258,442) |
| | ----- | ----- |
| Cash flows from financing activities: | | |
| Proceeds from exercise of stock options | 14,040 | 5,865 |
| Dividends paid | (2,321,926) | (2,120,812) |
| | ----- | ----- |
| Net cash used in financing activities | (2,307,886) | (2,114,947) |
| | ----- | ----- |
| Net decrease in cash and cash equivalents | (1,066,428) | (1,544,759) |
| Cash and cash equivalents at beginning of period | 3,425,593 | 3,735,945 |
| | ----- | ----- |
| Cash and cash equivalents at end of period | \$ 2,359,165 | \$ 2,191,186 |
| | ===== | ===== |

See notes to consolidated financial statements

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1. In the opinion of the Company, the accompanying unaudited financial statements contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the financial position as of June 30, 2006 and the results of operations for the six and three months ended June 30, 2006 and 2005. The accounting policies followed by the Company are set forth in the Company's financial statements included in its Annual Report to Shareholders for the year ended December 31, 2005.

2. The results of operations for the six and three months ended June 30, 2006 and 2005 are not necessarily indicative of the results to be expected for the full year.

3. Stock-Based Compensation: At June 30, 2006, the Company had two stock-based employee compensation plans, which are more fully described in the Company's Annual Report on Form 10-KSB, for the year ended 2005. As permitted under Statement of Financial Accounting Standards ("SFAS") No. 123, Accounting for Stock-based Compensation ("FAS 123"), through December 31, 2005, the Company elected to follow the guidance of APB Opinion No. 25, Accounting for Stock Issued to Employees ("APB 25"), and Financial Accounting Standards Board Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation - an Interpretation of APB Opinion No. 25 ("FIN 44"), in accounting for the Company's stock-based employee compensation arrangements. Accordingly, no compensation cost was recognized for any of the Company's fixed stock options granted to employees when the exercise price of each option equaled or exceeded the fair value of the underlying common stock as of the grant date for each stock option. The Company accounted for equity instruments issued to non-employees in accordance with the provisions of FAS 123.

In December 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123 (revised 2004), Share-Based Payment ("FAS 123R"), which replaced FAS 123 and supersedes APB 25 and FIN 44. FAS 123R requires that the fair value all share-based payments to employees, including grants of employee stock options, be recognized as expense in the financial statements. The pro forma disclosures previously permitted under FAS 123 are no longer an alternative to financial statement recognition. The Company adopted the provisions of FAS 123R on January 1, 2006 using the modified prospective application method of adoption which requires the Company to record compensation cost related to unvested stock awards as of December 31, 2005 by recognizing the unamortized grant date fair value of these awards over the remaining service periods of those awards with no change in historical reported earnings. Awards granted after December 31, 2005 are valued at fair value in accordance with provisions of FAS 123R and recognized on a straight line basis over the service periods of each award. The estimated forfeiture rates utilized for the six months ended June 30, 2006 were based on the Company's historical experience. Upon adoption of FAS 123R the Company elected to continue using the Black-Scholes option pricing model.

At June 30, 2006 the Company had 4,300 share-based awards that were outstanding and exercisable, with a weighted average exercise price of \$3.29, an aggregate intrinsic value of \$24,801, and a weighted average remaining term of 5.28 years. All of those options were fully vested as of December 31, 2005. The Company did not grant any options during the six months ended June 30, 2006 and 2005.

As of June 30, 2006 there was no remaining unrecognized compensation cost related to the non-vested share-based compensation arrangements granted under the Company's plans.

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The Company did not record any compensation expense during the six-months ended June 30, 2006 under the provisions of FAS 123R.

Cash received from option exercise under all share-based payment arrangements for the six-months ended June 30, 2006, was \$14,040.

The following table illustrates the effect on net income and income per share for the six-months ended June 30, 2005 if the Company had applied the fair value recognition provisions of FAS 123 since the original effective date of FAS 123 to stock-based employee compensation for options granted under the Company's arrangements as well as to the arrangement of the Company's subsidiaries:

| | Six Months Ended June 30, 2005 ----- |
|---|--|
| Net income as reported | \$1,466,785 |
| Add back (deduct): Total stock-based employee compensation expense determined under APB 25 for all awards, net of related tax effects | -- |
| Deduct: Total stock-based employee compensation expense determined under fair value-based method for all awards, net of related tax effects | -- |
| Pro forma net income | \$1,466,785 ===== |
| Income per share: | |
| Basic--as reported | \$.30 |
| Basic--pro forma | \$.30 |
| Diluted--as reported | \$.30 |
| Diluted--pro forma | \$.30 |

4. Marketable Securities

| June 30, 2006 ----- | Cost ----- | Fair Value ----- | Unrealized Gain/(Loss) ----- |
|-------------------------------|---------------|---------------------|------------------------------------|
| Available for Sale: | | | |
| U.S. Treasury and agencies | \$1,747,433 | \$1,735,247 | \$ (12,186) |
| Corporate debt securities | 599,688 | 597,921 | (1,767) |
| Fixed income mutual funds | 4,120,106 | 3,904,795 | (215,311) |
| Equity and other mutual funds | 227,785 | 223,210 | (4,575) |
| | \$6,695,012 | 6,461,173 | (233,839) |
| | ===== | ===== | ===== |

7

| December 31, 2005 ----- | Cost ----- | Fair Value ----- | Unrealized Gain/(Loss) ----- |
|----------------------------|---------------|---------------------|------------------------------------|
| Available for Sale: | | | |
| U.S. Treasury and agencies | \$2,046,900 | \$2,028,984 | \$ (17,916) |
| Corporate debt securities | 900,595 | 892,110 | (8,485) |
| Fixed income mutual funds | 4,028,072 | 3,928,513 | (99,559) |

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| | | | |
|-------------------------------|-------------|-------------|--------------|
| Equity and other mutual funds | 225,793 | 217,190 | (8,603) |
| | ----- | ----- | ----- |
| | \$7,201,360 | \$7,066,797 | \$ (134,563) |
| | ===== | ===== | ===== |

5. Inventories - Net

| | | |
|---------------------------------------|------------------|----------------------|
| Inventories consist of the following: | June 30, 2006 | December 31, 2005 |
| | ----- | ----- |
| Raw materials and work in process | \$ 335,835 | \$ 376,308 |
| Finished products and fine chemicals | 1,179,028 | 655,255 |
| | ----- | ----- |
| | \$1,514,863 | \$1,031,563 |
| | ===== | ===== |

At June 30, 2006 and December 31, 2005, the Company has reserved \$89,000 and \$108,000 respectively for slow moving and obsolete inventory.

6. For purposes of the Statement of Cash Flows, the Company considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents.

Cash payments for taxes were \$551,122 and \$585,674 for the six months ended June 30, 2006 and 2005, respectively. There were no payments for interest during these periods.

Dividends paid were \$1,235,535 and \$1,233,135 for the six months ended June 30, 2006 and 2005, respectively.

7. Comprehensive Income (Loss)

The components of comprehensive income (loss) are as follows:

| | | | |
|---|-----------------------------------|-------------|------------------|
| | Six months ended June 30, 2006 | 2005 | Three mo 2006 |
| | ----- | ----- | ----- |
| Net income | \$1,272,381 | \$1,466,785 | \$ 650,3 |
| | ----- | ----- | ----- |
| Other comprehensive income (loss): | | | |
| Unrealized (loss) gain on marketable securities during period | (99,078) | (43,880) | (62,3 |
| Less: reclassification adjustment for net losses included in net income | 374 | 116,855 | 3 |
| | ----- | ----- | ----- |
| Other comprehensive (loss) income before tax | (98,704) | 72,975 | (61,9 |

(table continued from previous page)

| | | | |
|--|-----------------------------------|--------|-----------------|
| | Six months ended June 30, 2006 | 2005 | Three m 2006 |
| | ----- | ----- | ----- |
| Income tax expense (benefit) related to other comprehensive income | (37,800) | 27,200 | (24,0 |

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| | | | |
|--|-------------|-------------|----------|
| Other comprehensive (loss) income, net of tax..... | (60,904) | 45,775 | (37,9 |
| Comprehensive income net of tax | \$1,211,477 | \$1,512,560 | \$ 612,4 |

Accumulated other comprehensive income (loss) is comprised of unrealized gains and losses on marketable securities, net of the related tax effect.

8. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share for the six and three months ended June 30, 2006 and 2005.

| | Six months ended June 30, | | Three months June 30, |
|---|------------------------------|-------------|--------------------------|
| | 2006 | 2005 | 2006 |
| Numerator: | | | |
| Net income | \$1,272,381 | \$1,466,785 | \$ 650,396 |
| Denominator: | | | |
| Denominator for basic earnings per share (weighted average shares) | 4,941,167 | 4,932,761 | 4,942,139 |
| Effect of dilutive securities: | | | |
| Employee stock options | 3,433 | 7,478 | 2,737 |
| Denominator for diluted earnings per share (adjusted weighted-average shares) and assumed conversions | 4,944,600 | 4,940,239 | 4,944,876 |
| Basic and diluted earnings per share | \$ 0.26 | \$ 0.30 | \$ 0.13 |

9. The Company has two reportable business segments: the Guardian Laboratories Division ("Guardian") conducts research, development and manufacturing of cosmetic ingredients, personal and health care products, pharmaceuticals and specialty industrial products. Eastern Chemical Corporation ("Eastern"), a wholly-owned subsidiary of the Company, distributes a line of fine chemicals, solutions, dyes and reagents.

The accounting policies used to develop segment information correspond to those described in the summary of significant accounting policies as set forth in the Annual Report for the year ended December 31, 2005. Segment earnings or losses are based on earnings or losses from operations before income taxes. The reportable segments are distinct business units operating in different industries. They are separately managed, with separate marketing and distribution systems. The following information about the two segments is for the six and three months ended June 30, 2006 and 2005.

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| | 2006 | | | Six months ended June 30, |
|---|--------------|------------|--------------|---------------------------|
| | GUARDIAN | EASTERN | TOTAL | GUARDIAN |
| | ----- | ----- | ----- | ----- |
| Revenues from external customers | \$ 5,384,005 | \$ 537,807 | \$ 5,921,812 | \$ 6,054,390 |
| Depreciation and amortization | 42,247 | - | 42,247 | 44,750 |
| Segment income before income taxes | 1,784,295 | 46,064 | 1,830,359 | 2,327,899 |
| Segment assets | 3,022,098 | 540,685 | 3,562,783 | 2,648,972 |
| Capital expenditure | 18,803 | - | 18,803 | 27,916 |
| Reconciliation to Consolidated Amounts | | | | |
| Income before income taxes | | | | |
| ----- | | | | |
| Total earnings for reportable segments | | | \$ 1,830,359 | |
| Other income, net | | | 194,526 | |
| Corporate headquarters expense | | | (76,804) | |
| | | | ----- | |
| Consolidated earnings before income taxes | | | \$ 1,948,081 | |
| | | | ===== | |
| Assets | | | | |
| ----- | | | | |
| Total assets for reportable segments | | | \$ 3,562,783 | |
| Corporate headquarters | | | 10,561,413 | |
| | | | ----- | |
| Total consolidated assets | | | \$14,124,196 | |
| | | | ===== | |

| | 2006 | | | Three months ended June 30, |
|------------------------------------|--------------|------------|--------------|-----------------------------|
| | GUARDIAN | EASTERN | TOTAL | GUARDIAN |
| | ----- | ----- | ----- | ----- |
| Revenues from external customers | \$ 2,802,971 | \$ 254,044 | \$ 3,057,015 | \$ 2,486,642 |
| Depreciation and amortization | 20,079 | - | 20,079 | 23,415 |
| Segment income before income taxes | 897,102 | 23,730 | 920,832 | 857,842 |

10

(table continued from previous page)

Reconciliation to Consolidated Amounts

| | 2006 | | | Three months ended June 30, |
|--|----------|---------|-------|-----------------------------|
| | GUARDIAN | EASTERN | TOTAL | GUARDIAN |
| | ----- | ----- | ----- | ----- |

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| | | |
|---|--|------------|
| Income before income taxes | | |
| ----- | | |
| Total earnings for reportable segments | | \$ 920,832 |
| Other income, net | | 114,103 |
| Corporate headquarters expense | | (38,339) |
| ----- | | |
| Consolidated earnings before income taxes | | \$ 996,596 |
| ===== | | |
| Other Significant items | | |
| ----- | | |

| | | | | |
|-------------------------------|---------------------------|-----------|--------------|-----------|
| | Six months ended June 30, | | | |
| | 2006 | | | |
| | ----- | | | |
| | Segment | | Consolidated | Segment |
| | Totals | Corporate | Totals | Totals |
| | ----- | | | |
| Capital expenditures | \$ 18,803 | \$ 8,102 | \$ 26,905 | \$ 27,916 |
| Depreciation and amortization | 42,247 | 52,265 | 94,512 | 44,750 |

Geographic Information

| | | | | |
|-----------------|--------------|----------------------|--------------|----|
| | 2006 | | 2005 | |
| | ----- | | ----- | |
| | Revenues | Long-Lived Assets | Revenues | Lo |
| | ----- | | ----- | |
| United States | \$ 2,413,974 | \$ 880,873 | \$ 3,391,534 | \$ |
| France | 732,393 | | 781,473 | |
| Other countries | 2,775,445 | | 2,474,565 | |
| | ----- | | ----- | |
| | \$ 5,921,812 | \$ 880,873 | \$ 6,647,572 | \$ |
| | ===== | | ===== | |

11

(table continued from previous page)

| | | | | |
|--|----------|----------------------|----------|----|
| | 2006 | | 2005 | |
| | ----- | | ----- | |
| | Revenues | Long-Lived Assets | Revenues | Lo |
| | ----- | | ----- | |

Major Customers

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| | | |
|-------------------------|--------------|--------------|
| Customer A (Guardian)** | \$ 2,085,254 | \$ 2,313,604 |
| Customer B (Guardian)** | 607,277 | 665,793 |
| All other customers | 3,229,281 | 3,668,175 |
| | ----- | ----- |
| | \$ 5,921,812 | \$ 6,647,572 |
| | ===== | ===== |

** At June 30, 2006 Customers A and B had balances approximating 36% and 25% of net accounts receivable, respectively. At June 30, 2005 Customers A and B had balances approximating 49% and 15% of net accounts receivable, respectively.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 2006, the Financial Accounting Standards Board ("FASB") issued interpretation No. 48, "Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109" ("FIN 48"), regarding accounting for, and disclosure of, uncertain tax positions. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact FIN 48 will have on its results of operations and financial position.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

FORWARD LOOKING STATEMENTS

Statements made in this Form 10-QSB which are not purely historical are forward-looking statements with respect to the goals, plans, objectives, intentions, expectations, financial condition, results of operations, future performance and business of the Company. Forward-looking statements may be identified by the use of such words as "believes," "may," "will," "should," "intends," "plans," "estimates," or "anticipates" or other similar expressions.

Forward-looking statements involve inherent risks and uncertainties, and important factors (many of which are beyond our control) could cause actual results to differ materially from those set forth in the forward-looking statements. In addition to those specific risks and uncertainties set forth in the Company's reports currently on file with the SEC, some other factors that may affect the future results of operations of the Company are: the development of products that may be superior to those of the Company; changes in the quality or composition of the Company's products; lack of market acceptance of the Company's products; the Company's ability to develop new products; general economic or industry conditions; intellectual property rights; changes in interest rates; new legislation or regulatory requirements; conditions of the securities markets; the Company's ability to raise capital; changes in accounting principals, policies or guidelines; financial or political instability; acts of war or terrorism; and other economic, competitive,

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governmental, regulatory and technical factors that may affect the Company's operations, products, services and prices.

Accordingly, results actually achieved may differ materially from those anticipated as a result of such forward-looking statements, and those statements speak only as of the date they are made. The Company does not undertake, and specifically disclaims, any obligation to update any forward-looking statements to reflect events or circumstances occurring after the date of such statements.

OVERVIEW

The Company is a Delaware corporation that operates in two business segments. Guardian conducts research, product development, manufacturing and marketing of cosmetic ingredients, personal and health care products, pharmaceuticals, and specialty industrial products. The products manufactured by Guardian are marketed through marketing partners, distributors, direct advertising, mailings, and trade exhibitions. Its most important personal care product line is its LUBRAJEL(R) line of water based moisturizing and lubricating gels. It also sells two pharmaceutical products, which are distributed primarily through drug wholesalers and surgical supply houses. There are also indirect sales to the Veteran's Administration and other government agencies, and to some hospitals and physicians.

While the Company does have competition in the marketplace for some of its products, many of its products or processes are either unique in their field or have some unique characteristics, and therefore are not in direct competition with the products or processes of other pharmaceutical, chemical, or health care companies. Guardian's research and development department is actively working on the development of new products to expand the Company's personal care line.

The Company has been issued many patents and trademarks, and intends whenever possible to make efforts to obtain patents in connection with its product development program.

Eastern distributes a line of fine organic chemicals, research chemicals, test solutions, indicators, dyes and reagents. Eastern's products are marketed through advertising in trade publications and direct mailings. Since the Company's business activities and marketing efforts over the past several years have focused increasingly on the Guardian division, the Company has reduced Eastern's inventory levels in order to make it more marketable in the event the

Company decides to sell it at some future date. This has resulted in some reduction in sales as compared with previous years. Sales of this division have also declined as a result of increased competition from new and existing competitors.

Guardian's pharmaceutical products are distributed primarily in the United States. Its personal care products are marketed worldwide primarily by its marketing partners, the largest of which is International Specialty Products ("ISP"). Approximately half of Guardian's personal care products will be sold to foreign customers, either directly or through its marketing partners.

The following discussion and analysis covers material changes in the financial condition of the Company since the year ended December 31, 2005, and a comparison of the results of operations for the six and three months ended June 30, 2006 and June 30, 2005. This discussion and analysis should be read in

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conjunction with "Management's Discussion and Analysis or Plan of Operation" included in the Company's Form 10-KSB for the year ended December 31, 2005.

RESULTS OF OPERATIONS

Gross revenue from operations

For the six-month period ended June 30, 2006 net sales decreased \$725,760 (10.9%) versus the comparable period in 2005. Guardian had a sales decrease of \$670,385 (11.1%) and Eastern had a sales decrease of \$55,375 (9.3%).

For the three-month period ended June 30, 2006, net sales increased \$289,560 (10.5%) versus the comparable period in 2005. Guardian had a sales increase of \$316,329 (12.7%) and Eastern had a sales decrease of \$26,769 (9.5%).

The decline in Guardian's sales for the six-month period ended June 30, 2006 versus the comparable period in 2005 was due to lower sales in the first quarter that were partially offset by higher sales in the second quarter. The lower first quarter sales were due primarily to a price increase for the company's pharmaceutical products that went into effect on March 1, 2005, the anticipation of which resulted in an unusually high volume of sales of the company's pharmaceutical products in the first quarter of 2005. That situation was not repeated in the first quarter of 2006, resulting in more typical sales levels for the pharmaceutical products. In addition, the first quarter of 2005 experienced an unusual number of shipments of orders that customers had requested not be shipped out at the very end of 2004. That situation did not recur this year. The increase in Guardian's sales in the second quarter of 2006 was due mainly to an increase in sales of the company's pharmaceutical products compared with the same period in 2005.

The decrease in Eastern's sales is believed to be due to normal fluctuations in the purchasing patterns of its customers.

Cost of sales

Cost of sales as a percentage of sales increased to 47.2% for the six months ended June 30, 2006 from 45.8% for the comparable period ended June 30, 2005. For the three months ended June 30, 2006 compared with the three months ended June 30, 2005, cost of sales as a percentage of sales increased from 46.0% to 47.1%. These increases were due to increases in standard overhead rates for

14

Guardian that resulted primarily from increases in insurance and payroll and payroll-related costs.

Operating Expenses

Operating expenses increased \$49,119 (3.7%) for the six months ended June 30, 2006 compared with the comparable period in 2005. This increase was mainly attributable to the net effect of increases in payroll and payroll-related expenses and the reduction of the Company's bad debt reserve. For the three-month period ended June 30, 2006, operating expenses increased \$76,688 (11.7%) when compared with the comparable period ended June 30, 2005. This increase was due mainly to increases in payroll and payroll related expenses.

Other Income

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Other Income increased to \$194,526 from \$47,012 for the six month period ended June 30, 2006 and June 30, 2005, respectively, an increase of \$147,514 (313.8%). This increase was mainly attributable to the net effect of an increase in investment income of \$33,811 in 2006 and substantially lower losses on the sale of marketable securities in 2005. In 2005 the sale of a portfolio of securities, primarily bonds, the bulk of which had been managed for the Company by a financial institution, resulted in a realized loss of approximately \$116,000, of which approximately \$107,000 had previously been recorded in the equity section of the balance sheet as an "accumulated other comprehensive loss". Approximately \$108,000 of the above loss was due to the sale of the bond portfolio managed by a financial institution, which, over the 18 months the company held it, had realized interest income net of broker fees of approximately \$154,000. The sale of bonds in the second quarter of 2006 resulted in a loss of \$349. Investment income is recorded net of brokerage fees.

For the three months ended June 30, 2006 Other Income increased \$19,151 (20.2%) which was mainly attributable to higher investment income due to an increase in interest rates.

Provision for income taxes

The provision for income taxes decreased \$185,200 (21.5%) for the six months ended June 30, 2006 when compared with the comparable period in 2005. This decrease was due to (a) decreased earnings before taxes of \$379,604 in 2006, and (b) the adding back of the approximately \$116,000 in capital loss from the sale of the bond portfolio in 2005, which loss will be available to offset any realized capital gains in 2005 and any excess may be carried forward for five years following the year of the loss.

The provision for income taxes increased \$24,300 (7.5%) for the three months ended June 30, 2006 which is mainly due to an increase in earnings before taxes of \$63,628.

The company had effective income tax rates of 34.7% and 37.0% for the six months ended June 30, 2006 and June 30, 2005, respectively, and 34.7% and 34.5% for the three months ended June 30, 2006 and June 30, 2005 respectively. Differences in the effective income tax rate from the statutory federal income tax rate arise primarily from capital loss carryforwards, state taxes net of federal benefits, and other differences.

15

LIQUIDITY AND CAPITAL RESOURCES

Working capital increased from \$12,281,645 at December 31, 2005 to \$12,299,484 at June 30, 2006. The current ratio increased from 8.3 to 1 at December 31, 2005 to 16.5 to 1 at June 30, 2006. The increase in current ratio was primarily due to the net effect of a decrease in dividends payable offset by increases in inventories, and decreases in cash and investments.

The Company has no commitments for any further significant capital expenditures during the remainder of 2006, and believes that its working capital is and will continue to be sufficient to support its operating requirements for at least the next twelve months.

The Company generated cash from operations of \$1,065,011 and \$1,828,630 for the six months ended June 30, 2006 and June 30, 2005, respectively. The decrease

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was primarily due to the decreases in net income from operations, losses on sale of investments, and the net effect of increases in inventory and prepaid expenses.

During the six-month period ended June 30, 2006, \$176,447 was provided by investment activities, as compared with the six-month period ended June 30, 2005, when \$1,258,442 was used in investing activities. The change is mainly due to the net effect of the sale (primarily bonds) and purchases (primarily bond funds) of marketable securities during the six months ending June 30, 2005.

Cash used in financing activities was \$2,307,886 and \$2,114,947 for the six months ended June 30, 2006 and June 30, 2005, respectively. The increase was due primarily to an increase in dividends paid during the six months ended June 30, 2006.

Item 3. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

Within 90 days prior to the filing of this Quarterly Report on Form 10-QSB the Company's principal executive officer and principal financial officer evaluated the effectiveness of the design and operation of Company's disclosure controls and procedures (as defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934 (the "Exchange Act")) and concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its officers, as appropriate to allow timely decisions regarding required disclosure, and are effective to ensure that such information is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

(b) Changes in Internal Controls

The Company's principal executive officer and principal financial officer have also concluded there were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

16

PART II - OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS: NONE
ITEM 2 - CHANGES IN SECURITIES AND USE OF PROCEEDS: NONE
ITEM 3 - DEFAULTS UPON SENIOR SECURITIES: NONE
ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS: NONE
ITEM 5 - OTHER INFORMATION: NONE
ITEM 6 - EXHIBITS AND REPORTS ON FORM 8-K

a. Exhibits

31.1 Certification of Alfred R. Globus, Chairman and Chief Executive Officer of the Company, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

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- 31.2 Certification of Kenneth H. Globus, President and Chief Financial Officer of the Company, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Alfred R. Globus, Chairman and Chief Executive Officer of the Company, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Kenneth H. Globus, President and Chief Financial Officer of the Company, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

b. Reports on Form 8-K

There were two reports on Form 8-K filed during the fiscal quarter ended June 30, 2006. One was filed on May 10, 2006 and related to the issuance of an earnings release by the Company on May 8, 2006. The second was filed on May 19, 2006, and related to the declaration of a special dividend by the Company's Board of Directors on May 18, 2006.

SIGNATURES

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

UNITED-GUARDIAN, INC.
(Registrant)

By: /s/ Alfred R. Globus

Alfred R. Globus
Chief Executive Officer

By: /s/ Kenneth H. Globus

Kenneth H. Globus
Chief Financial Officer

Date: August 10, 2006