

30-Mar-2007

Annual Report

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

RESULTS OF OPERATIONS

In July 2004, management determined that the Company would wind down its contract manufacturing operations by December 31, 2004. Because of this, the past and future financial results related to contract manufacturing operations are treated as discontinued operations for financial reporting purposes. Continuing operations relate to the current structure of the Company as an intellectual property licensing and holding company. The Company accounts for its prior discontinued operations under the provisions of Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Accordingly, results of operations and the related charges for discontinued operations have been classified as "Loss from discontinued operations" in the accompanying Statements of Operations. Assets and liabilities of the discontinued operations have been classified and reflected in the accompanying Balance Sheets as "Discontinued operations" for the current and prior period presented.

COMPARISON OF THE YEARS ENDED DECEMBER 31, 2006 AND 2005

RESULTS OF CONTINUING OPERATIONS

The Company recorded royalty and licensing fees of \$126,660 for the year ended December 31, 2006, compared to \$443,352 for the year ended December 31, 2005. The royalty and licensing fees were earned during the last two years under the Agreement the Company has with Novartis. The 2006 and 2005 royalty income is attributable to sales of licensed products by Novartis to consumers at an agreed upon percentage under the terms of the Agreement. Net loss from continuing operations for 2006 was (\$335,532), or (\$0.08) per basic and diluted share, compared to a net loss from continuing operations for 2005 of (\$326,522), or (\$0.08) per basic and diluted share. The increase in the net loss from continuing operations for 2006 compared to 2005 was primarily due to reduced royalty and licensing fees as a result of the Novartis nationwide product recall, offset by reductions in operating expenses.

RESULTS OF DISCONTINUED OPERATIONS

The loss from discontinued operations for the year ended December 31, 2006 was (\$31,650) or (\$0.01) per basic and diluted share, compared to a loss from discontinued operations of (\$204,090), or (\$0.05) per basic and diluted share for 2005. The decrease in loss from discontinued operations for 2006 compared to 2005 is attributable to expense reductions related to the wind down of manufacturing operations partially offset by a charge of \$31,650 in 2006 related to an adjustment to the Company's reserve for sales returns and credits for sales prior to discontinuance of operations. The Company had no revenue from discontinued operations for the years ended December 31, 2006 and 2005.

NET RESULTS OF OPERATIONS

The net loss for 2006 was (\$367,182), or (\$0.09) per basic and diluted share, compared to net loss of (\$530,612), or (\$0.13) per basic and diluted share, for 2005. The reduction in net loss for the year ended December 31, 2006, compared to 2005 is due to the reasons stated above.

INCOME TAXES

There was no income tax benefit recorded for the years ended December 31, 2006 and 2005, as realization of available net operating loss carryforwards is not reasonably assured.

EFFECT OF INFLATION

Inflation has not had a significant impact on the Company's operations or cash flow.

LIQUIDITY AND CAPITAL RESOURCES

Total assets decreased \$310,168 to \$1,514,657 at December 31, 2006 from \$1,824,825 at December 31, 2005. Cash and cash equivalents decreased \$28,793 to \$1,281,785 at December 31, 2006 from \$1,310,578 at December 31, 2005. The decrease in total assets and the reduction in cash and cash equivalents is attributable to 2006 activities including the net loss from continuing operations, the absence of costs related to the wind down of manufacturing operations, and general reductions in operating costs during 2006.

Working capital was \$1,130,196 at December 31, 2006, compared to \$1,431,359 at December 31, 2005. The Company's current ratio was 6.19 at December 31, 2006, compared to 9.90 at December 31, 2005. The decline in working capital of \$301,163 for 2006 from 2005 was primarily due to the net loss the Company incurred for 2006.

Shareholders' equity decreased by the net loss for 2006 of (\$367,182) to \$1,296,783 as of December 31, 2006 from shareholders' equity of \$1,663,965 as of December 31, 2005. There were no equity financing transactions during 2006.

The Company believes its existing cash and cash equivalents will be sufficient to fund continuing operations through 2007 based upon its current cash on hand, and the anticipated operating expenses the Company is likely to incur during 2007. The Company earns interest on its available cash. Interest income earned was \$61,846 (4.8% average annual interest) and \$41,424 (2.4% average annual interest) for 2006 and 2005, respectively. Management also believes it is critical that the Company rejuvenate its revenue stream from Novartis or other sources in order for the Company to survive. Management has been working with Novartis to address the issues surrounding the product recall as well as exploring other licensing opportunities pertaining to the intellectual property the Company owns. However, there can be no assurance that the anticipated revenue stream or the anticipated expenses will be as planned, or that the Company will be successful in negotiating other licensing opportunities with Novartis or other companies, due to the uncertainties and risks described in the "Cautionary Statements" included as Exhibit 99.01 of this Form 10-KSB.

CRITICAL ACCOUNTING POLICIES

Management believes that the Company has not adopted any critical accounting policies, which, if changed, would result in a material change in financial estimates, financial condition, results of operations or cash flows for the years ended December 31, 2006 and 2005. Critical accounting policies are as follows:

REVENUE RECOGNITION

Royalty and licensing fees are recognized when earned under the terms of the Agreement with Novartis, based upon sales information of licensed products provided by Novartis, and collection is reasonably assured.

PATENT COSTS

The carrying value of patent costs is reviewed periodically or when factors indicating impairment are present. The amount of impairment loss is measured as the amount by which the carrying value of the assets exceeds the fair value of the assets. The Company believes that no impairment existed at December 31, 2006 or 2005.

ROYALTY RECEIVABLE

The Company grants credit to its only customer, Novartis, in the normal course of business and under the terms contained in the Agreement. Pursuant to the Agreement, Novartis pays royalty income within the terms defined in the Agreement and management believes, based upon past payment experience, that any and all amounts outstanding are fully collectible. At December 31, 2006, the Company did not have an outstanding royalty receivable with Novartis due to a voluntary nationwide recall of licensed products of the Company by Novartis. The Company is currently engaged in an audit of royalties due the Company pursuant to the Agreement. The audit period is from January 1, 2005, up to the point of the product recall in June 2006. Royalty income recognized during the years ended December 31, 2006 and 2005, are based on net sales information provided by Novartis, covering sales of products under the License Agreement for the applicable periods. The Company believes it has earned and been paid all royalty income due to the Company in the North America territory, up to the point of the product recall in June 2006. To date, the Company has not been able to audit the amount of royalties that may be due to the Company from sales of licensed products in Canada and Mexico, which are listed as additional fields of use, in the Agreement. The Company has contacted Novartis to obtain the additional information it needs to complete the audit. The Company has not recorded any additional royalty income due to the audit because of this uncertainty.

ACCOUNTING FOR DISCONTINUED OPERATIONS

The Company exited from manufacturing operations of topical patches and sold off all of its manufacturing assets related to the production of patches to its only remaining customer, Novartis, as of December 31, 2004. The assets related to the Company's manufacturing operations have been classified as discontinued operations due to the sale of the manufacturing assets by December 31, 2004. The operations and cash flows of the contract manufacturing operations were eliminated from the ongoing operations as a result of the sales transaction. The surviving entity (intellectual property licensing and holding company) will not have any significant involvement in the operations of the previously sold manufacturing operations. It is therefore management's position that the conditions for reporting the Company's financial statements, balance sheets and statements of cash flows under the requirements of Statement of Financial Accounting Standard ("SFAS") No. 144 as discontinued operations for the years ended December 31, 2006 and 2005 are appropriate.

The Company has used reasonable judgment combined with quantitative analysis in determining the amounts of assets, liabilities, revenues and expenses that were allocated between continuing operations and discontinued operations.

Reference:

<http://biz.yahoo.com/e/070330/lect.ob10ksb.html>