

13-Aug-2007

Quarterly Report

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION RESULTS OF OPERATIONS

The Company wound down and ceased its previous contract manufacturing operations at the end of 2004. Because of this, the past and future financial results related to contract manufacturing have been treated as discontinued operations for financial reporting purposes. Continuing operations consist of the Company's current structure as an intellectual property licensing and holding company. There were no costs involved for discontinued operations for the three and six months ended June 30, 2007 or 2006.

COMPARISON OF THE THREE AND SIX MONTHS ENDED JUNE 30, 2007 AND 2006

Results of Operations:

The Company did not record any royalty income during the three or six months ended June 30, 2007, compared to royalty income of \$0 and \$92,277 for the three and six months ended June 30, 2006, respectively. The decrease is attributable to the previously discussed product recall by Novartis, (See Note 5 of Notes to Condensed Financial Statements in this Form 10-QSB).

Operating expenses increased \$48,089, to \$171,558 for the second quarter ended June 30, 2007, from operating expenses of \$123,469 for the comparable quarter in 2006. The increase in operating expenses resulted primarily from an increase in consulting expenses relating to the Company's efforts to strengthen its patent protection rights. For the six months ended June 30, 2007, operating expenses increased \$21,937 to \$300,760, from \$278,823 for the six months ended June 30, 2006. The increase in operating expenses resulted from an increase in consulting expenses related to the Company's efforts to strengthen its patent protection rights, new patent costs, and general patent maintenance costs, which were partially offset by reductions in net lease expenses, legal and accounting costs, and general overall reductions in operating expenses. The Company anticipates that it can further reduce operating expenses. However, these savings may be offset with costs related to additional actions the Company decides to take with respect to protecting its intellectual property.

For the second quarter ended June 30, 2007, the Company recorded a net loss of \$(158,091), or \$(0.04) per basic and diluted share, compared to a net loss of \$(106,062), or \$(0.03) per basic and diluted share, for the same quarter in 2006. For the six months ended June 30, 2007, the Company recorded a net loss of \$(272,417), or \$(0.07) per basic and diluted share, compared to a net loss of \$(157,635), or \$(0.04) per basic and diluted share, for the same period in the 2006. The increase in net loss for the three and six month periods ended June 30, 2007 from the comparable periods in 2006 is due to the lack of royalty income during the three and six month periods ended June 30, 2007 and the increase in operating expenses discussed above.

Income Taxes:

The income tax benefit for the three and six months ended June 30, 2007 and 2006 was offset by a valuation allowance for deferred taxes. No federal or state income tax benefit was provided for the three and six months ended June 30, 2007 and 2006, as the realization of such benefits 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:

Cash and cash equivalents decreased \$227,986 for the six month period ended June 30, 2007, to \$1,053,799, from cash and cash equivalents of \$1,281,785 at December 31, 2006. The decrease in cash and cash equivalents resulted primarily from a lack of royalty income from Novartis relating to the previously discussed product recall and the reduction in cash resulting from the general outflow of operating expenses.

There were no material commitments for capital expenditures at June 30, 2007 or 2006.

The Company had working capital of \$898,696 and a current ratio of 5.40% at June 30, 2007 compared to working capital of \$1,130,196 and a current ratio of 6.19% at December 31, 2006. The decline in working capital and the current ratio at June 30, 2007, compared to December 31, 2006,

was primarily due to the net loss of (\$272,417) that the Company incurred during the six months ended June 30, 2007, and partially offset by the exercise of stock options and other working capital changes.

Shareholders' equity decreased \$263,367, to \$1,033,416 at June 30, 2007 from \$1,296,783 at December 31, 2006, primarily due to the net loss the Company incurred during the six months ended June 30, 2007, partially offset by stock option exercises by former employees of the Company.

The Company believes its existing cash and cash equivalents will be sufficient to fund operations through 2007 and 2008, based upon its current cash on hand, and the anticipated operating expenses the Company is likely to incur during 2007 and 2008. The Company earns interest on its available cash. Interest income earned during the three and six month periods ended June 30, 2007 was \$13,467 and \$28,343, respectively (4.9% average annual interest). Interest income earned during the three and six month periods ended June 30, 2006 was \$17,407 and \$28,911, respectively (4.2% average annual interest). Management has been proactive to rejuvenate its revenue stream from Novartis and other sources in order for the Company to be viable in the future. 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.

The Company's strategy is to pursue additional agreements with Novartis and concurrently pursue similar agreements with other domestic and foreign manufacturers to enable them to use the Company's proprietary patch technology in producing or selling topical patch products in the future. Furthermore, the Company is assessing the value of its patent portfolio to enhance its options with respect to future licensing opportunities, attraction of potential merger or acquisition candidates, or the sale of the Company or public shell as a whole. The Company is also taking steps to strengthen its primary patents for territories of use, including the United States, Europe, and other countries. This effort is also intended to strengthen the Company's position with respect to other companies that may be infringing on the patents the Company owns. It is currently management's intent to fund operations with royalty income from licensing agreements or from other income derived from the protection of patent rights pertaining to the Company's intellectual property.

The Company was recently granted a re-examination certificate which expands the Company's prior claims for a major patent the Company holds. This will enhance and strengthen the Company's position with respect to potential patent infringement in the marketplace and differentiate and clarify our claims under this particular patent. The Company is taking steps to evaluate its current position in light of this event, including market research studies and other efforts to gather and document information to solidify the Company's patent protection rights.

The Company's working capital requirements are dependent upon adequate levels of royalty and licensing income to fund operations. Without this income the Company will continue to use cash to fund continuing operations. Management has been proactive with Novartis in an effort to rejuvenate its revenue stream, and is pursuing other options including territory expansion, pediatric and adult market expansion, consideration of other licensing opportunities of products for which the Company has patents, and other efforts to protect the Company's patent rights. Royalty income is uncertain because it is subject to factors that the Company cannot control. 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 to the Company's annual report on Form 10-KSB for the fiscal year ended December 31, 2006.

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 operation or cash flows for the three months ended June 30, 2007 and 2006. The critical accounting policies appear in Note 2 of Notes to Condensed Financial Statements in this Form 10-QSB.

Reference:

<http://biz.yahoo.com/e/070813/lect.ob10qsb.html>