

14-Nov-2007

Quarterly Report

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

Current operations consist of the Company's structure as an intellectual property licensing and holding company. Previously, the Company wound down and ceased its contract manufacturing operations at the end of 2004. Because of this, any results related to contract manufacturing have been treated as discontinued operations for financial reporting purposes. There were no costs incurred for discontinued operations for the three and nine months ended September 30, 2007 or 2006.

COMPARISON OF THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006

Results of Operations:

The Company did not record any royalty income during the three or nine months ended September 30, 2007, compared to royalty income of \$34,383 and \$126,660 for the three and nine months ended September 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 \$356,216, to \$469,283 for the third quarter ended September 30, 2007, from operating expenses of \$113,067 for the comparable quarter in 2006. The increase in operating expenses during this period resulted primarily from an increase in compensation expense from the granting of fully vested options of \$332,925 (See Note 2 of Notes to Condensed Financial Statements in this Form 10-QSB), and increases in consulting and legal expenses relating to the Company's efforts to evaluate the value of the Company's Intellectual Property ("IP") portfolio for licensing, merger and acquisition opportunities, and also to evaluate infringement issues to protect the Company's IP portfolio.

For the nine months ended September 30, 2007, operating expenses increased \$378,153 to \$770,043, from \$391,890 for the nine months ended September 30, 2006. The increase in operating expenses during this period resulted primarily from the increase in compensation expense discussed above coupled with an increase in consulting expenses related to the Company's efforts surrounding its IP portfolio, 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 will further continue to

reduce general 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 third quarter ended September 30, 2007, the Company recorded a net loss of \$(456,995), or \$(0.11) per basic and diluted share, compared to a net loss of \$(61,925), or \$(0.01) per basic and diluted share, for the same quarter in 2006. For the nine months ended September 30, 2007, the Company recorded a net loss of \$(729,412), or \$(0.18) per basic and diluted share, compared to a net loss of \$(219,560), or \$(0.05) per basic and diluted share, for the same period in the 2006.

The increase in net loss for the three and nine month periods ended September 30, 2007 from the comparable periods in 2006 is due to the lack of royalty income during the three and nine month periods ended September 30, 2007, the increase in compensation expense of \$332,925 discussed above, and the general increase in operating expenses related to patent protection costs discussed above.

Income Taxes:

The income tax benefit for the three and nine months ended September 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 nine months ended September 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 \$338,387 for the nine month period ended September 30, 2007, to \$943,398, 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 September 30, 2007. The Company had working capital of \$799,425 and a current ratio of 4.73% at September 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 September 30, 2007, compared to December 31, 2006, was primarily due to the net loss of (\$729,412) that the Company incurred during the nine months ended September 30, 2007, and partially offset by non-cash compensation expense related to the grant of fully vested options of \$332,925, the exercise of stock

options, and other working capital changes.

Shareholders' equity decreased \$378,400 to \$918,383 at September 30, 2007 from \$1,296,783 at December 31, 2006, primarily due to the net loss the Company incurred during the nine months ended September 30, 2007, partially offset by compensation expense of \$332,925 discussed above and stock option exercises of \$18,087 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 earned during the three and nine months ended September 30, 2007 was \$12,288 and \$40,631, respectively (4.9% average annual interest). Interest earned during the three and nine months ended September 30, 2006 was \$16,759 and \$45,670, respectively (4.7% 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 IP the Company owns.

The Company's strategy is to evaluate and promote its current IP portfolio for licensing purposes, with 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. This effort will also enhance the Company's options with respect to future licensing opportunities, attraction of potential merger or acquisition candidates, or the sale of the Company. The Company is also taking steps to strengthen its patents for territories of use, including the United States, Europe, and other countries. The Company is also focused on strengthening its 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 IP.

In April 2007, the Company was granted a re-examination certificate which expanded the Company's prior claims related to a major patent the Company holds. This will differentiate and clarify our claims under this particular patent. The Company is taking steps to evaluate its current position in light of these events, including market research studies, using other outside resources, and other efforts to gather and document information to aid in the protection of the Company's patent rights. Novartis has informed the Company that they have launched an Adult Vapor Patch product in the United States for this upcoming cough/cold season. Product shipments are currently being made to U.S. retail customers. This is a significant development for the Company in its effort to rejuvenate its revenue stream. The Company will receive royalty income based upon sales

of these vapor patch products under the terms of the Licensing Agreement the Company has with Novartis. The Company has not recorded any royalty income resulting from the sales of the adult patch because of the recent launch of this vapor patch product and the uncertainty of the amount of royalty income earned from early sales of this new product.

On June 21, 2006, the Company issued a press release noting that Novartis had issued a nationwide recall of all of its Triaminic(R) Vapor Patch products. According to news reports, the recall was triggered by an adverse event experienced by a child who suffered a seizure after chewing on a patch.

In April 2007, the Company filed a provisional patent application with the U.S. Patent and Trademark Office for an Adhesive Patch With Aversive Agent. The Company's new child-proof/pet-proof patch technology is primarily designed to prevent children from ingesting a patch, but the aversive agent will protect anyone, including adults with dementia (i.e. Alzheimer disease) or even family pets, from chewing a discarded patch. It is expected this technology can be applied to numerous patch formulations, most importantly patches potentially harmful if ingested (i.e. nicotine patches, Alzheimer's patches, estrogen patches, osteoporosis patches, nitroglycerin patches, lidocaine patches, contraceptive patches and antidepressant patches). The Company has also received a pending trademark under the name of SAFEPATCH™.

In February 2007, the Company engaged a consulting firm to conduct an extensive market research and IP analysis of its patent portfolio and technology. The Company subsequently evaluated emerging markets as a strategic growth opportunity for the company, and has identified India as the top priority. The Company is considering establishing a presence in India, and is specifically evaluating R&D offshoring, strategic partnerships, and licensing opportunities in India.

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, re-entry into R&D, strategic partnerships, 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 during the quarter ended September 30, 2007 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 September 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/071114/lect.ob10qsb.html>