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UNITED GUARDIAN INC  
Form 10KSB  
March 28, 2006

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

FORM 10-KSB

(Mark One)

ANNUAL REPORT UNDER SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934

For the fiscal year ended December 31, 2005.

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-10526

UNITED-GUARDIAN, INC.  
(Name of small business issuer in its charter)

Delaware  
-----  
(State or other jurisdiction  
of incorporation or organization)

11-1719724  
-----  
(I.R.S. Employer Identification No.)

230 Marcus Blvd., Hauppauge, NY  
-----  
(Address of principal executive offices)

11788  
-----  
(Zip Code)

Issuer's telephone number, including area code: (631) 273-0900  
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Securities registered pursuant to Section 12(b) of the Exchange Act: None

| Title of each class           | Name of each exchange on which registered |
|-------------------------------|---|
| Common Stock, \$.10 par value | American Stock Exchange                   |

Check whether the issuer: (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 if there is no disclosure herein of delinquent filers pursuant to Item 405 of Regulation S-B, and if, to the best of registrant's knowledge, no disclosure will be contained in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. [X]

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

Yes [ ] No [X]

The Registrant's revenues for the fiscal year ended December 31, 2005 were \$12,134,996.

On March 1, 2006 the aggregate market value of the Registrant's Common Stock (based upon the closing sales price of such shares on the American Stock Exchange as reported in The Wall Street Journal) held by non-affiliates of the Registrant was approximately \$24,719,000 (Aggregate market value has been estimated solely for the purposes of this report. For the purpose of this report it has been assumed that all officers and directors of the Registrant, as well as all stockholders holding 10% or more of Registrant's stock, are affiliates of the Registrant. The statements made herein shall not be construed as an admission for determining the affiliate status of any person.)

As of March 1, 2006 the Registrant had issued shares of 5,004,339 Common Stock, \$.10 par value per share ("Common Stock"), of which 4,942,139 shares were outstanding and 62,200 held as Treasury stock as of that date.

DOCUMENTS INCORPORATED BY REFERENCE:

Certain information required by Part III (portions of Item 9, as well as Items 10, 11, and 12) is incorporated by reference to the Registrant's definitive proxy statement for the 2006 annual meeting of stockholders ("2006 Proxy Statement"), which, pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, is to be filed with the Securities and Exchange Commission no later than 120 days after Registrant's fiscal year end.

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

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Cover Page 2 of 2 Pages

This annual report on Form 10-KSB contains both historical and "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, which provides a safe harbor for forward-looking statements by the Registrant about its expectations or beliefs concerning future events, such as financial performance, business prospects, and similar matters. The Registrant desires to take advantage of such "safe harbor" provisions and is including this statement for that express purpose. Words such as "anticipates", "believes", "expects", "intends", "future", and similar expressions identify forward-looking statements. Any such "forward-looking" statements in this report reflect the Registrant's current views with respect to future events and financial performance, and are subject to a variety of factors that could cause Registrant's actual results or performance to differ materially from historical results or from the anticipated results or performance expressed or implied by such forward-looking statements. Because of such factors, there can be no assurance that the actual results or developments anticipated by the Registrant will be realized or, even if substantially realized, that they will have the anticipated results. The risks and uncertainties that may affect Registrant's business include, but are not limited to: economic conditions, governmental regulations, technological advances, pricing and competition, acceptance by the marketplace of new products, retention of key personnel, the sufficiency of financial resources to sustain and expand Registrant's operations, and other factors described in this report and in prior filings with the Securities and Exchange Commission. Readers should not place undue reliance on such forward-looking statements, which speak only as of the date hereof, and should be aware that except as may be otherwise legally required of Registrant, Registrant undertakes no obligation to publicly revise any such forward-looking statements to reflect events or circumstances that may arise after the date hereof.

## PART I

### Item 1. Description of Business

#### (a) General Development of Business

United-Guardian, Inc. (the "Company") is a Delaware corporation that conducts research, product development, manufacturing and marketing of cosmetic ingredients, personal and health care products, pharmaceuticals, and specialty industrial products. The Company also distributes an extensive line of fine organic chemicals, research chemicals, test solutions, indicators, dyes and reagents through a wholly owned subsidiary, Eastern Chemical Corporation ("Eastern").

The Company's predecessor, United International Research Corp. (name later changed to United International Research, Inc.), was founded and incorporated in New York in 1942 by Dr. Alfred R. Globus, the Company's Chairman and Chief Executive Officer. On February 10, 1982, a merger took place between the Company and Guardian Chemical Corp. ("GCC"), an affiliate of the Company, whereby GCC was merged into the Company and the name was changed to United-Guardian, Inc. On September 14, 1987, United-Guardian, Inc. (New York) was merged with and into United-Guardian, Inc., a newly incorporated Delaware corporation formed for the purpose of changing the domicile of the Company.

The Company operates in two business segments:

(1) The Guardian Laboratories Division ("Guardian") conducts research, product development, manufacturing and marketing of cosmetic ingredients,

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personal and health care products, pharmaceuticals, and specialty industrial products. The Research and Development Department of Guardian engages in research and development in the fields of cosmetics, health care products, and specialty industrial chemical products, for the purpose of developing new products, and refining existing products that will be marketed or licensed by Guardian. Many of the products manufactured by Guardian, particularly its LUBRAJEL(R) line of products, are marketed worldwide through a network of distributors, and are currently used by many of the major multinational cosmetic companies.

Guardian presently has a broad range of products, some of which are currently marketed, some of which are marketable but are not currently marketed by the Company, and some of which are still in the developmental stage. Of the products being actively marketed, the two largest product lines are the LUBRAJEL line of cosmetic ingredients, which accounted for approximately 68% of the Company's sales in 2005, and its RENACIDIN(R) IRRIGATION, a pharmaceutical product that accounted for approximately 17% of the Company's sales in 2005. The Company actively seeks other companies as potential marketers for its products, particularly for those products that are not yet being actively marketed by the Company.

(2) Eastern is a distributor of fine organic chemicals, research chemicals, intermediates, reagents, indicators, dyes and stains. It has been in business for over 50 years, the last 30 or so as a part of the Company. It carries an extensive line of products which it sells throughout the United States as well as overseas. Eastern's products are primarily sold either to distributors for resale in smaller quantities or as intermediates and raw materials for further chemical processing. Sales quantities range from a few hundred grams to over a thousand kilos per shipment. Although Eastern carries out no chemical manufacturing, it does contract with several custom chemical manufacturers and also will package to order for those customers that require it.

Paragon Organic Chemicals, Inc. ("Paragon") is a wholly owned subsidiary of the Company that functions as a purchasing arm for Eastern. It has no assets or sales of its own.

### (b) Narrative Description of Business

#### Guardian Laboratories Division

Guardian conducts research, product development, manufacturing and marketing of many different cosmetic ingredients, personal and health care products, pharmaceuticals, and specialty industrial products, all of which are developed by the Company, and many of which have unique properties. The products manufactured by Guardian are marketed through marketing partners, distributors, direct advertising, mailings, and trade exhibitions. Guardian's proprietary cosmetic ingredients are sold through marketing partners and distributors and are incorporated into products marketed by many of the major international cosmetic companies. Many of Guardian's products are marketed through collaborative agreements with larger companies. The pharmaceutical products are sold to end users primarily through drug wholesalers. These sales include indirect sales to the Veteran's Administration and other government agencies. There are also a small number of direct sales to hospitals and pharmacies.

During 2005, Guardian's sales accounted for approximately 91% of Company's total product sales.

Guardian's products are sold under trademarks or trade names owned by the Company. The marks for the most important products, LUBRAJEL and RENACIDIN, are registered as trademarks in the United States Patent and Trademark Office. In 2005 sales from these two product lines accounted for approximately 93% of Guardian's sales, and 85% of the sales of the Company as a whole.

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### PRINCIPAL PRODUCTS:

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#### LUBRAJEL

LUBRAJEL is a line of nondrying water-based moisturizing and lubricating gels that have applications in the cosmetic industry primarily as a moisturizer and as a base for other cosmetic products, and in the medical field primarily as a lubricant. In the cosmetic industry it is used primarily as a stable gel for application around the eyes and on the face and as an ingredient in skin creams and moisturizers, makeup, body lotions, hair preparations, salves, and ointments. As a medical lubricant it has been used on catheters, prelubricated enema tips, and thermometers. The most important product in the LUBRAJEL line in 2005 was once again LUBRAJEL CG, the original form of LUBRAJEL; the second largest revenue producer in the Lubrajel line was LUBRAJEL MS.

LUBRAJEL RR and RC are special grades of LUBRAJEL that can withstand sterilization by gamma radiation, which is one of the methods of terminally sterilizing medical and hospital products. On April 11, 1995, the Company was granted a U.S. patent for this unique form of LUBRAJEL. In September, 1994 the Company entered into a marketing agreement with Avail Medical (formerly Horizon Medical), a California company engaged in the development and manufacturing of products and services to the medical device and pharmaceutical industries. Avail has been actively marketing LUBRAJEL RC since January, 1996. Lubrajel RR, the original radiation resistant form of Lubrajel, is sold to medical device manufacturers primarily for use in lubricating urethral catheters.

The Company believes that its ability to increase sales of its LUBRAJEL products will depend on (a) the ability of its marketing partners, especially ISP Technologies Inc. ("ISP"), its largest marketing partner, to continue to bring the product to the attention of new customers, and (b) the Company's success in bringing to market new forms of LUBRAJEL that will enable the product to be used in new applications. The Company is currently developing new varieties of LUBRAJEL for this purpose. In 2004 the Company introduced a new LUBRAJEL under the name "LUBRAJEL II XD", and intends to expand this new line further. At the end of 2004 it also introduced a new Lubrajel line using a different preservative system, which the Company believes will attract new customers and retain existing customers that might require a different preservative system. It also intends to develop some new skin care products that will have enhanced feel and additional luricating and/or moisturizing properties. The Company believes that there is still significant potential to expand the sales of its LUBRAJEL line of products through both product modifications and by geographic expansion, especially in developing markets such as mainland China, India, and eastern Europe.

The Company believes that any sales increases in the LUBRAJEL line of products may be offset somewhat by sales of competitive products. Despite this competition, the Company believes that it will still be able to expand the market for its LUBRAJEL product line. The Company believes that LUBRAJEL'S reputation for quality and customer service, as well as future additions to the LUBRAJEL line, will enable it to continue to compete effectively in the marketplace.

#### RENACIDIN

RENACIDIN is a urological prescription drug, approved in the U.S. only, which is used primarily to prevent the formation of and to dissolve calcifications in catheters implanted in the urinary bladder. It is marketed as a ready to use sterile solution under the name "RENACIDIN IRRIGATION". RENACIDIN IRRIGATION is also approved for use in dissolving certain types of kidney

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stones. On October 9, 1990, the Patent Office issued to the Company patent #4,962,208, which expires on October 9, 2007, covering the method of manufacturing RENACIDIN IRRIGATION.

### OTHER PRODUCTS:

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Other significant products that are manufactured and sold by Guardian but which did not individually comprise more than 5% of the Company's sales in 2005 are as follows:

CLORPACTIN(R) WCS-90 is a microbicidal product used primarily in urology and surgery as an antiseptic for treating a wide range of localized infections in the urinary bladder, the peritoneum, the abdominal cavity, the eye, ear, nose and throat, and sinuses. The product is a white powder that is mixed with water and used as a solution. It is a powerful disinfectant, fungicide, deodorizer, bleach, and detergent.

KLENSOFT(TM) is a surfactant (a surface active agent, such as a soap or detergent, that can reduce the surface tension of a liquid and thus allow it to foam or penetrate solids or act as a wetting agent) that can be used in shampoos, shower gels, makeup removers, and other cosmetic formulations. The primary customer for Klensoft for many years has been in Taiwan, but over the past few years there have been new customers for the product in the United Kingdom, Australia, France and Korea.

LUBRAJEL PF is a preservative-free form of LUBRAJEL currently being marketed primarily by Societe D'Etudes Dermatologiques ("Sederma") under the tradename "Norgel". Sederma is the Company's distributor of LUBRAJEL in France and a major European cosmetic ingredient supplier. It is also distributed by some of the Company's other marketing partners under the name LUBRAJEL PF. Tests conducted by Sederma indicated that the product self-preserved, and aided in the preservation of other cosmetic ingredients with which it was formulated.

LUBRASIL(TM) and LUBRASIL DS are special types of LUBRAJEL in which silicone oil is incorporated into a LUBRAJEL base by microemulsification, while maintaining much of the clarity of regular LUBRAJEL. The products have a silky feel, and are water resistant while moisturizing the skin. (These sales are already included in the total Lubrajel sales figure mentioned previously).

Other products that do not have significant sales at the present time but have the potential for increased sales in the future, and which as a group constituted approximately 2% of the Company's sales in 2005, are as follows:

CONFETTI(TM) DERMAL DELIVERY FLAKES is a product line introduced in 2000 that incorporates various functional oil-soluble ingredients into colorful flakes that can be added to, and suspended in, various water-based products. The product color and ingredients can be customized to meet the needs of individual customers.

ORCHID COMPLEX(TM) is a successor product to the Company's previous Oil of Orchids product and is a base for skin creams, lotions, cleansers, and other cosmetics. This product is an extract of fresh orchids, modified by extractants, stabilizers, and preservatives, and is characterized by its excellent lubricity, spreadability and light emolliency. Because of its alcohol solubility, it may also be used in fragrance products such as perfumes and toiletries. Its light emolliency lends use in shampoos, bath products and facial cleansers. It is also a superior emollient for sunscreens, vitamin creams, toners and skin serums. It is sold in two forms, water-soluble and oil soluble.

UNITWIX(R) is a cosmetic additive used as a thickener for oils and oil-based liquids. It is a proprietary, unpatented product that does not require

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government approval to market.

LUBRASLIDE(TM) and a related product, B-122(TM), are powdered lubricants used in the manufacture of cosmetics such as pressed powders, eye liners, and rouges. They are used as binders for these products, increasing their drop strength and lowering the coefficient of friction and water-repellency.

RAZORIDE(TM) is a clear, hypo-allergenic, non-foaming, water-based shaving product that is surfactant and soap-free and has excellent lubricity and moisturizing properties.

DESELEX(R) is a replacement for phosphates in detergents.

HYDRAJEL PL and HYDRAJEL VM are personal lubricants and moisturizers developed specifically for the feminine personal care market.

### Development Activities

Guardian's Research and Development Department has developed a large number of products that can be used in many different industries, including the pharmaceutical, medical, cosmetic, health care, and specialty chemical industries. These products are in various stages of development, some being currently marketable and some being in the very early stages of development requiring a substantial amount of development work to bring them to market. Research is also being done on new uses for currently marketed products. Once a product is created, the initial development work on it may consist of one or more of the following: (a) laboratory refinements and adjustments to suit the intended uses of the product; (b) stability studies to determine the effective shelf-life of the product and suitable storage and transportation conditions for the product; and (c) laboratory efficacy tests to determine the effectiveness of the product under different conditions.

After the Research and Development Department has completed its initial work on a product and is satisfied with the results of that work, further development work to bring the product to market will continue, including some or all of the following: (a) animal and human clinical studies needed to determine safety and effectiveness of drug or medical device products, which would be needed for submissions to the appropriate regulatory agencies, such as the United States Food and Drug Administration ("FDA") or the United States Environmental Protection Agency ("EPA"); (b) preparatory work for the filing of Investigational New Drug Applications or New Drug Applications; (c) market research to determine the marketability of the product, including the potential

market size and most effective method of marketing the product; (d) scaling up from laboratory production batches to pilot batches, and then to full scale production batches, including the determination of the type of equipment necessary to produce the products; (e) upgrading or purchasing new equipment to manufacture the products; and (f) the negotiation of joint venture or distribution agreements to develop and/or market the product. Some of the foregoing work may be done by outside contractors.

While there can be no assurance that any particular project will result in a new marketable product or a commercially successful product, the Company believes that a number of its development projects, including those discussed below, may have commercial potential if the Company's development efforts are successful.

The Company's major research focus is the development of new and unique personal care ingredients. The following are some of the projects the Company is

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either working on at the present time or which the Company intends to work on in the near future:

**NEW FORM OF LUBRASIL:** This will be a new addition to the Company's Lubrasil product line that will contain a much higher level of silicone, which the Company believes will create an expanded market for these types of skin care products.

**SELF-PRESERVING POLYMERIC THICKENER:** This product will be a self-preserving raw material for cosmetic use that will enable cosmetic formulators to formulate preservative free cosmetic products.

**SKIN SENSORIAL AGENTS:** A line of products that will enhance the feel of skin care products. The new Lubrasil mentioned above might be one such product.

**MICROEMULSIFIED ANTIMICROBIAL:** This would be a new form of antimicrobial product for use in skin disinfection products. The product could be sold either as a raw material or as a finished product in a hand cleanser.

**LUBRAJEL II:** This product line was being developed to recapture some of the market share that the Company has lost over the years to some of its competitors. The first product in this line, LUBRAJEL II XD, was developed to be a drop-in replacement for one of those products, and is currently being actively marketed. The Company hopes to expand this product line over the next few years, introducing new formulations that have enhanced properties over competitive products. This new line is intended to be a supplement to, not replacement for, the current line of Lubrajel products. Its composition also will enable it to be used in certain countries, such as Japan, more easily than the current Lubrajel formulations. Because other projects have higher priority, it is not expected that there will be new products launched in this line in 2006.

**CLORONINE:** Cloronine is a powerful disinfectant, germicide, and sanitizer for disinfecting medical and surgical instruments and equipment (particularly where autoclaves are not available), and for the purification of water supplies. The product had been approved for certain uses in France and Canada, and is still being sold on a very limited basis in Canada. The Company is currently working with a new potential customer for this product that is exploring possible use by the government as a decontamination agent. However, before this product can be marketed in the United States for any purpose, additional tests

will have to be done to determine if the product can be registered with the EPA as a sterilant or germicide. These tests would comprise laboratory microbiological studies, compatibility studies, and specific studies on its intended uses. The product may also have to be registered with the FDA as an accessory to a medical device. Neither registration process has yet begun. Due to the expense and time required, the Company hopes to work jointly with other companies to obtain these registrations. The Company was granted two patents for this product.

**CLORONINE GEL:** This would be another form of Cloronine in gel form, which may increase its effectiveness and functionality.

The Company expects its research and development costs for FY-2006 to be comparable to those of the last two fiscal years. Any additional increase in development and/or production costs will depend on whether capital investments are required in order to continue development work on, or to manufacture, any of the new products under development.

Trademarks and Patents



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The Company strongly believes in protecting its intellectual property and intends whenever possible to make efforts to obtain patents in connection with its product development program. The Company currently owns many United States patents and trademarks relating to its products. The Company has patent and trademark applications pending with respect to a number of its research and development products. Patents formerly held by the Company on certain products have expired. There can be no assurance that any patents held by the Company will be valid or otherwise of value to the Company or that any patent applied for will be granted. However, the Company believes that its proprietary manufacturing techniques and procedures with respect to certain products offer it some protection from duplication by competitors regardless of the patent status of the products.

The various trademarks and trade names owned or used by the Company in Guardian's business are of varying importance to the Company. The most significant products for which the Company has a registered trademark are LUBRAJEL, RENACIDIN, and CLORPACTIN.

Set forth below is a table listing certain information with respect to all unexpired U.S. patents held by the Company:

| PATENT NAME<br>-----   | PATENT #<br>----- | FILING DATE<br>----- | ISSUE DATE<br>----- |
|--|-------------------|----------------------|---------------------|
| Iodophor; Polyethylene Glycol Alkylaryl-sulfonate<br>Iodine complex  | 4,873,354         | 4/1988               | 10/1989             |
| Thermal Resistant Microbial Agent ("Cloronine")  | 4,954,316         | 12/1988              | 9/1990              |
| Use of Clorpectin for the Treatment of Animal<br>Mastitis & the applicator used in that treatment<br>(owned jointly by the Company and Diversey Ltd.)      | 4,983,634         | 12/1988              | 1/1991              |
| Method of Preparing Time-Stable Solutions of Non-<br>Pyrogenic Magnesium Gluconocitrate ("Renacidin<br>Irrigation")  | 4,962,208         | 1/1989               | 10/1990             |
| Iodophor; biocide; reacting polyethylene glycol,<br>alkylarylsulfonate and Iodine water-propylene glycol<br>solvent refluxing                              | 5,013,859         | 9/1989               | 5/1991              |
| Stabilized Beta Carotene   | 5,023,355         | 1/1990               | 6/1991              |
| Stable, Active Chlorine Containing Anti-microbial<br>Compositions ("Cloronine")  | 5,128,342         | 8/1990               | 7/1992              |
| Gamma Radiation Resistant Lubricating Gel  | 5,405,622         | 12/1993              | 4/1995              |
| Delivery system for oil soluble actives in cosmetic/<br>personal care products   | 6,117,419         | 9/1996               | 9/2000              |
| Microemulsion of silicone in a water-based gel that<br>forms a clear, transparent, highly stable moisturizer<br>and lubricant for cosmetic and medical use | 6,348,199         | 1/1994               | 2/2002              |

The Company requires all employees and consultants who may receive proprietary information to agree in writing to keep such proprietary information confidential.

Eastern Chemical Corporation

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Eastern is a wholly owned subsidiary of the Company. It distributes an extensive line of fine organic chemicals, research chemicals, test solutions, indicators, dyes and stains, and reagents. In 2005 and 2004 Eastern's sales accounted for approximately 9% and 10% respectively of the total product sales of the Company. The Company's business activities and marketing efforts over the past several years have focused increasingly on the Guardian division, which the Company believes has greater growth potential than Eastern. As a result, the Company has been reducing the amount of inventory kept on hand by Eastern, which in turn has resulted in some decline in its sales. There also has been a general decrease in Eastern's business due to competition from new companies in this field. The Company has considered, and will continue to consider, the possibility of selling Eastern at such time as it determines that keeping the operation is no longer in the Company's best interests. The Company believes that if it were to sell Eastern, the loss of revenue from that subsidiary would not have a material impact on the Company's net income.

### Marketing

Guardian markets its products through (a) distributors; (b) advertising in medical and trade journals, by mailings to physicians and to the trade; and (c) exhibitions at appropriate medical meetings. The pharmaceutical products are sold in the United States primarily to drug wholesalers that distribute to drug stores for resale, and to hospitals, physicians, long-term care facilities, the Veteran's Administration, and other government agencies. The proprietary personal care and specialty chemical products are sold to distributors for resale and directly to manufacturers for use as ingredients or additives in the manufacture or compounding of their cosmetic, personal care, or industrial products.

Eastern's products are marketed through advertising in trade publications and direct mailings. They are sold to distributors and directly to users in a wide variety of applications. Eastern does not sell any unique products and is not dependent on any single customer or group of customers on a continuous basis.

### Domestic Sales

In the United States, the Company's cosmetic products are marketed exclusively by ISP in accordance with a marketing agreement entered into in 1996 and subsequently amended and expanded in 2000, 2002, and 2005 (see "Marketing Agreements" below). ISP also has certain rights to sell some of the Company's other industrial and medical products. In 2005, ISP's purchases for distribution in the United States were estimated to be approximately \$1,237,000 compared to \$1,394,000 in 2004, a decrease of 11%, and accounted for approximately 10% of the Company's sales (NOTE: ISP's domestic sales figure is an estimate based on sales information provided to the Company by ISP. The Company has no way of independently determining which of ISP's purchases from the Company are intended for domestic sale and which are intended for foreign sale.) The Company believes that the decrease in ISP's domestic sales of the Company's products was the result of the discontinuation by some of the Company's customers of some products that contained the Company's raw materials. However, this decrease in ISP's domestic sales was offset by an increase in ISP's foreign sales of the Company's product.

The Company's domestic sales of pharmaceutical products are handled primarily through the major full-line drug wholesalers and account for approximately 20% of the Company's sales. The Company's other products, such as its industrial products, are sold directly to end-users and account for less than 1% of sales.

### Foreign Sales

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In 2005 and 2004 the Company derived approximately 51% and 49% respectively of its sales from customers in foreign countries, primarily from sales of its cosmetic products in Europe and Asia. The Company currently has six distributors for its personal care products outside the United States, with ISP being the largest. ISP has global distribution rights with the exception of the following: S. Black Ltd. in the United Kingdom; Sederma in France; Luigi & Felice Castelli S.R.L. in Italy; S. Black GmbH in Switzerland; and C&M International in Korea. The Company's foreign sales attributable to each of its foreign distributors as a percentage of the Company's total sales were as follows: ISP: 27% (an estimate of ISP's purchases intended for sale outside the U.S., based on sales figures provided to the Company by ISP); Sederma: 11%; S. Black: 4%; C&M International: 4%; and Castelli: 1%. The Company also has two foreign customers for its medical products that each account for approximately 1% of the Company's total sales.

### Marketing Agreements

In 1994 the Company entered into a marketing agreement with ISP whereby ISP would distribute the Company's personal care products, as well as some medical and industrial products, in certain parts of Europe, Asia, Australia, and Africa. ISP manufactures and markets an extensive line of personal care, pharmaceutical, and industrial products on a global basis. In 1996 the parties entered into another agreement, extending those distribution rights to the

United States, Canada, Mexico, Central and South America. In July, 2000 the parties entered into an Exclusive Marketing Agreement (the "2000 Agreement"), which modified, extended, and consolidated the 1994 and 1996 agreements. The 2000 Agreement also gave the Company greater flexibility in appointing other marketing partners in areas where ISP was not active or had not been successful, gave ISP certain additional territories, and granted ISP exclusivity in the territories assigned to it as long as annual minimum purchase requirements were met.

In December, 2002 the parties entered into a letter agreement ("2002 Agreement") that extended and modified the 2000 Agreement and provided for automatic extensions of the 2000 Agreement through December, 2008 provided ISP met certain purchase requirements during each calendar year of the agreement. ISP was not able to meet the minimum purchase requirement for calendar year 2003, but the Company agreed to continue ISP's marketing rights based on its satisfaction with ISP's marketing efforts.

In December, 2005 the parties entered into another letter agreement ("2005 Agreement" modifying and extending the 2000 Agreement and superceding and replacing the 2002 Agreement. The 2005 Agreement extended ISP's marketing rights until December, 2008, and provided for the possibility of additional automatic extensions until December, 2010 if specified minimum annual purchase levels were attained. It also specified guidelines and provisions for future price increases by the Company.

The Company believes that in the event ISP were to cease marketing the Company's products, alternative arrangements could be made to continue to supply product to the customers currently using the Company's products without any significant interruption of supply.

The Company has other marketing arrangements with marketing partners in the U.K, France, Switzerland, Korea, and Italy, but all of these other arrangements are operating under either verbal agreements or expired written agreements, and are subject to termination at any time by either party.

### Raw Materials

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The principal raw materials used by the Company consist of common industrial organic chemicals, laboratory reagents, and common inorganic chemicals. Most of these materials are available in ample supply from numerous sources. The Company's principal raw material suppliers are Procter and Gamble, Callahan Chemical Company, Univar USA, Inc., Noveon, Inc., Ishihara U.S.A., Nissei Trading Co., Varessa, Ltd., E.I. duPont, S.A. Fine Chemicals, and Loba Chemie.

### Inventories; Returns and Allowances

The Company's business requires that it maintain moderate inventories of certain of its finished goods. Historically, returns and allowances have not been a significant factor in the Company's business.

### Backlog

The Company currently does not have any significant backlog.

### Competition

Guardian has many products or processes that 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, personal care, chemical, or health care companies. However, the pharmaceutical, health care, and cosmetic industries are all highly competitive, and the Company expects competition to intensify as advances in the field are made and become widely known. There may be many domestic and foreign companies that are engaged in the same or similar areas of research as those in which the Company is engaged, many of which have substantially greater financial, research, manpower, marketing and distribution resources than the Company. In addition, there are many large, integrated and established pharmaceutical, chemical and cosmetic companies that have greater capacity than the Company to develop and to commercialize types of products upon which the Company's research and development programs are based. However, the Company believes that the expense of testing and evaluating possible substitutes for Company's products that are already in customers' formulations, as well as the expense to the customer in relabeling its products, is a significant barrier to displacing the Company's products in current customer formulations. These cost factors make it less likely that a customer would choose a competitive product unless there was a significant cost savings in doing so. The Company believes that manufacturing, regulatory, distribution and marketing expertise will be increasingly important competitive factors in favor of the Company. In this regard, the Company believes that its marketing arrangements with its global marketing partners will be important in the commercialization of many of the products which it is currently developing.

Eastern faces competition from many other chemical manufacturers and distributors, many of which have much greater financial resources than those of the Company. Eastern's competition is based primarily upon price, service and quality. Eastern attempts to maintain its competitive position in the industry through its ability to (i) locate and make wholesale arrangements to purchase the chemicals with suppliers located all over the world, (ii) maintain a sufficient inventory of its most popular items at all times, and (iii) customize each order as to quantity of the item requested and to tailor the price of the order to such quantity. Eastern's primary competitors are SA Fine Chemicals, Acros Organics, Pfaltz & Bauer, Inc., and Spectrum Chemical Mfg. Corp.

### ISO-9001:2000 REGISTRATION

In December, 2003 the Company earned ISO 9001:2000 registration from Underwriters Laboratories, Inc., indicating that the Company's documented

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procedures and overall operations had attained the high level of quality needed to comply with this new ISO certification level, and has been in continual compliance with that new standard since that initial approval. Prior to that, in November, 1998 the Company had earned ISO-9002 registration. The Company will continue to be evaluated every six months for continued compliance with the new ISO-9001:2000 standard.

### Government Regulation

Regulation by governmental authorities in the United States and other countries is a significant factor in the manufacturing and marketing of many of the Company's products. The Company and many of the Company's products are

subject to certain government regulations. Products that may be developed and sold by the Company in the United States may require approval from federal regulatory agencies, such as the FDA, as well as state regulatory agencies. Products that may be developed and sold by the Company outside of the United States may require approval from foreign regulatory agencies. Any medical device products developed by the Company will be subject to regulation by the Center for Devices and Radiological Health of the FDA, and will usually require a 510(k) pre-market notification. Most pharmaceutical products will require clinical evaluation under an Investigational New Drug ("IND") application prior to submission of a New Drug Application ("NDA") for approval of a new drug product.

A drug product normally must go through several phases in order to obtain FDA approval. The research phase involves work up to and including discovery, research, and initial production. Next is the pre-clinical phase, which involves studies in animal models necessary to support an IND application to the FDA and foreign health registration authorities to commence clinical testing in humans. Clinical trials for pharmaceutical products are conducted in three phases. In Phase I, studies are conducted to determine safety and dosages. In Phase II, studies are conducted to gain preliminary evidence as to the efficacy of the product. In Phase III, studies are conducted to provide sufficient data for the statistical proof of safety and efficacy, including dose regimen. Phase III is the final stage of such clinical studies prior to the submission of an application for approval of an NDA. The amount of time necessary to complete any of these phases cannot be predicted with any certainty.

In all cases, the Company is required to comply with all pertinent Good Manufacturing Practices of the FDA for medical devices and drugs. Accordingly, the regulations to which the Company and certain of its products may be subject, and any changes with respect thereto, may materially affect the Company's ability to produce and market new products developed by the Company.

The Company's present and future activities are, and will likely continue to be, subject to varying degrees of additional regulation under the Occupational Safety and Health Act, Environmental Protection Act, import, export and customs regulations, and other present and possible future foreign, federal, state and local regulations.

Portions of the Company's operating expenses are directly attributable to complying with federal, state, and local environmental statutes and regulations. In 2005 and 2004 the Company incurred approximately \$49,000 and \$48,000 respectively, in environmental compliance costs. There was no material financial or other impact on the Company as a result of compliance with environmental laws.

### Research and Development Expense

Portions of the Company's operating expenses are directly attributable to

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research and development the Company performs. In 2005 and 2004, the Company incurred approximately \$423,000 and \$415,000 respectively in research and development expenses. No portion of the research and development expenses was directly paid by the Company's customers.

### Employees

The Company presently employs 43 people, 8 of whom serve in an executive capacity, 23 in research, quality control and manufacturing, 5 in maintenance and construction, and 7 in office and administrative work. Of the total number

of employees, 40 are full time employees. None of the Company's employees are covered by a collective bargaining agreement. The Company believes that its relations with its employees are satisfactory.

### Item 2. Description of Property.

The Company maintains its principal office, factory, and conducts most of its research at 230 Marcus Boulevard, Hauppauge, New York 11788. These premises, which the Company owns, contain approximately 30,000 square feet of manufacturing space, 15,000 square feet of warehouse space, and 5,000 square feet of office and laboratory space on approximately 2.7 acres of land. The Company has now fully developed the 2.7 acres, and fully utilizes the buildings occupying the land. The Company believes that the aforementioned property is adequate for its immediately foreseeable needs. The property is presently unencumbered and is adequately insured.

### Item 3. Legal Proceedings

None.

### Item 4. Submission of Matters to a Vote of Security Holders.

None.

## PART II

### Item 5. Market for Common Equity, Related Stockholder Matters and Small Business Issuer Purchases of Equity Securities

#### Market Information

The Common Stock of the Company is traded on the American Stock Exchange (the "AMEX") under the symbol "UG". The following table sets forth for the periods indicated the high and low closing sale prices of the shares of Common Stock, as reported by the AMEX Market Statistics for the period January 1, 2004 to December 31, 2005. The quotations represent prices between dealers and do not include retail markup, markdown or commission:

| Quarters<br>-----     | Year Ended        |      | Year Ended        |      |
|-----------------------|-------------------|------|-------------------|------|
|                       | December 31, 2005 |      | December 31, 2004 |      |
|                       | High              | Low  | High              | Low  |
|                       | ----              | ---  | ----              | ---  |
| First (1/1 - 3/31)    | 8.45              | 7.35 | 8.93              | 7.48 |
| Second (4/1 - 6/30)   | 8.20              | 7.00 | 8.15              | 5.75 |
| Third (7/1 - 9/30)    | 8.58              | 7.30 | 7.03              | 5.60 |
| Fourth (10/1 - 12/31) | 12.01             | 8.05 | 8.58              | 6.26 |

#### Holder of Record

As of March 1, 2006 there were 1,161 holders of record of Common Stock.

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### Cash Dividends

On January 5, 2005 the Company paid a regular annual cash dividend of \$.18 per share to all stockholders of record as of December 15, 2004. On June 15, 2005 the Company paid a special cash dividend of \$.25 per share to all stockholders of record as of June 1, 2005. In December, 2005 the Company declared and accrued a regular annual cash dividend of \$.22 per share, which was paid on January 6, 2006 to all stockholders of record as of December 15, 2005.

### Item 6. Management's Discussion and Analysis or Plan of Operation

#### Results Of Operations:

Year Ended December 31, 2005 Compared to  
Year Ended December 31, 2004

#### Revenue

Consolidated revenue in 2005 increased by \$1,011,521 (9.1%) compared to 2004 due to an increase in the Guardian Division of \$1,070,803 (10.7%) partially offset by a decrease in revenues in the Eastern Division of \$59,282 (5.3%).

The increase in Guardian's sales was mainly due to an increase in sales of the company's Lubrajel product line, which accounted for approximately \$795,000 of the increase. Most of the increase was attributable to increases in sales of the two largest selling products in that line, supplemented by additional sales of two forms of Lubrajel sold for medical uses. A smaller portion of the increase was due to an increase in revenue from the company's Renacidin Irrigation product, which was the result of both an increase in volume as well as a price increase. The decrease in Eastern's sales is believed to be due mainly to normal fluctuations in the purchasing patterns of its customers. The company does not anticipate any significant increase or decrease in Eastern's sales in the near future.

#### Cost of Sales

Cost of sales as a percentage of sales in 2005 increased to 46.9% from 45.6% in the prior year. Excluding realized savings from obsolete inventory, cost of sales, as a percentage of sales, would have been 46.4% in the year ended December 2004 compared to 47.1% for the year ended December 31, 2005.

In 2004 the company sold approximately \$91,000 of inventory previously reserved as obsolete.

#### Operating Expenses

Operating expenses increased by \$3,181 (.1%) in 2005 compared to the prior year.

#### Other Income

Net other income increased \$14,818 (6.7%) for the year ended December 31, 2005. This increase is mainly attributable to the net effect of an increase in income from securities of \$120,889 and the sale of a portfolio of marketable securities during 2005, primarily bonds, the bulk of which had been managed for the company by Merrill Lynch. The sale of this portfolio resulted in a realized loss of approximately \$116,000, of which approximately \$107,000 had been previously recorded in the equity section of the balance sheet as an "accumulated other comprehensive loss". Approximately \$108,000 of the loss was due to the sale of the bond portfolio managed by Merrill Lynch, which, over the 18 months the company held it, realized interest income net of broker fees of approximately \$154,000.

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### Provision for Income Taxes

The provision for income taxes increased \$263,450 (21.8%). This increase is due to the net effect of (a) increased earnings before taxes of \$405,875; (b) the non-deductibility of the approximately \$116,000 capital loss from the sale of the Merrill Lynch bond portfolio, which loss is available to offset any realized capital gains, to be carried forward for five years following the year of the loss; and (c) and a decrease in the foreign tax exclusion, which was more than offset by the new manufacturer's production deduction.

### Liquidity and Capital Resources

Working capital increased to \$12,281,645 at December 31, 2005 from \$11,967,840 at December 31, 2004, an increase of \$313,805 (2.6%). The current ratio decreased to 8.3 to 1 at December 31, 2005 from 9.2 to 1 at December 31, 2004. The decrease in the current ratio was due primarily to (a) an increase of approximately \$199,000 in dividends payable; (b) a decrease of approximately \$344,000 in inventory; and (c) an increase of approximately \$54,000 in accrued expenses, partially offset by an increase in accounts receivable of approximately \$166,000 and an increase in marketable securities of approximately \$815,000.

The Company has a line of credit agreement with a bank for borrowings of up to \$700,000, which expires in May, 2006 and which the Company plans to renew. As of December 31, 2005, there were no outstanding borrowings on this line of credit.

The Company generated cash from operations of \$3,172,030 in 2005 compared to \$2,172,576 in 2004. The increase in 2005 was primarily due to the net effect of an increase in net income from operations as well as decreases in prepaid expenses and inventory costs which were partially offset by an increase in accounts receivable.

Cash used in investing activities was \$1,381,475 for the year ended December 31, 2005 whereas cash provided by investing activities was \$788,398 for the year ended December 31, 2004. The change is mainly due to the net effect of the sale (primarily bonds) and purchases (primarily bond funds) of marketable securities and temporary investments.

Cash used in financing activities was \$2,100,904 and \$1,935,058 during the years ended December 31, 2005 and 2004, respectively. The increase was primarily due to the increase in the dividend declared in December 2005 payable in January 2006 to \$.22 per share from \$.18 per share for the dividend declared in December 2004 paid in January 2005. The Company believes that its working capital is sufficient to support its operating requirements for the next fiscal year. The Company's long-term liquidity position will be dependent upon its ability to generate sufficient cash flow from profitable operations. The Company has no material commitments for future capital expenditures.

### Commitments

The Company currently has approximately \$12,700 in lease commitments, which expire in 2008, of which approximately \$5,300 is payable each year in 2006 and 2007 with the remaining \$2,100 payable in 2008.

### Patent Expirations

The Company has three patents that will be expiring in the next two years. Two of them are for products no longer marketed. The third is for the Company's Renacidin Irrigation. The Company does not anticipate that the expiration of any



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of these patents will have a material impact on the Company's revenues.

### Item 7. Financial Statements.

Annexed hereto starting on page F-1

### Item 8. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None

### Item 8A. Controls and Procedures

As of December 31, 2005, an evaluation was performed by the management of the Company with the participation of the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in ensuring that information required to be disclosed by the Company in the reports that it files under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. There have been no significant changes in the the Company's internal controls over financial reporting during the Company's most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

### Item 8B. Other Information

None

## PART III

### Item 9. Directors, Executive Officers, Promoters and Control Persons; Compliance With Section 16(a) of the Exchange Act.

#### Directors and Executive Officers

Set forth in the table below is certain information as of March 1, 2005 with respect to the executive officers and directors of the Company:

| Name                 | Age | Position(s) with the Company                                     |
|----------------------|-----|--|
| Dr. Alfred R. Globus | 85  | Chairman of the Board, Chief Executive Officer and Director      |
| Kenneth H. Globus    | 54  | President, Chief Financial Officer, General Counsel and Director |
| Robert S. Rubinger   | 63  | Executive Vice President, Secretary and Director                 |
| Charles W. Castanza  | 73  | Senior Vice President and Director                               |
| Derek Hampson        | 66  | Vice President   |
| Joseph J. Vernice    | 47  | Vice President   |
| Peter A. Hiltunen    | 47  | Vice President   |
| Cecile M. Brophy     | 57  | Treasurer and Controller   |

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|                           |    |          |
|---------------------------|----|----------|
| Lawrence F. Maietta       | 48 | Director |
| Henry P. Globus           | 83 | Director |
| Arthur M. Dresner         | 64 | Director |
| Andrew A. Boccone         | 60 | Director |
| Christopher W. Nolan, Sr. | 41 | Director |

Dr. Alfred Globus has been Chairman of the Board and Chief Executive Officer of the Company since July 1988. He served as Chairman of the Board and President of the Company from the inception of the Company in 1942 until July 1988. He has been a director of the Company since 1942.

Kenneth H. Globus has been President and General Counsel of the Company since July 1988. He served as Vice President and General Counsel of the Company from July 1983 until July 1988. He has been a director of the Company since 1984. He became the Chief Financial Officer in November 1997.

Robert S. Rubinger has been Executive Vice President and Secretary of the Company since July 1988, and served as Treasurer from May 1994 until May 2004. He served as Vice President and Secretary of the Company from February 1982 until July 1988. He has been a director of the Company since 1982.

Charles W. Castanza has been Senior Vice President of the Company since March 2000. He served as Vice President from April 1986 until March 2000. He served as Operations Manager of Chemicals and Pharmaceuticals of the Company from February 1982 until April 1986. He has been a director of the Company since 1982.

Derek Hampson has been a Vice President of the Company since October 1987. He has served as Manager of the Eastern Chemical Corp. subsidiary since 1971.

Joseph J. Vernice has been a Vice President of the Company since February, 1995. He served as Assistant Vice President of the Company from November 1991 until February 1995. He has been Manager of Research and Development for the Company since 1988 and Director of Technical Services since 1991.

Peter A. Hiltunen has been a Vice President of the Company since July 2002. He served as Assistant Vice President of the Company from November 1991 until July 2002. He has been Production Manager of the Company since 1982.

Cecile M. Brophy has been Treasurer of the Company since May 2004. She has served as Controller of the Company since November 1997. From May 1994 until November 1997 she served as manager of the Company's accounting department.

Lawrence F. Maietta has been a partner in the public accounting firm of Bonamassa, Maietta & Cartelli, LLP in Brooklyn, NY since October 1991. For more than five years prior to that he was a partner in the public accounting firm of Wilfred, Wyler & Co. in New York, NY. He was controller for the Company from October 1991 until November 1997, and a director of the Company since February 1994.

Henry P. Globus has been a consultant to the Company since July 1988. He served as Executive Vice President of the Company from February 1982 until July 1988. He has been a director of the Company since 1947.

Arthur M. Dresner has been a partner in the law firm Reed Smith, LLP since January 2003. From 1998 to 2003 he had been "Of Counsel" to that firm as well as to the law firm of McAulay, Nissen, Goldberg & Kiel LLP, which combined with Reed Smith in 2000. From 1974 until 1997 he was employed as a Vice President in

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corporate development and general management of ISP in Wayne, New Jersey. He has been a director of the Company since April 1997.

Andrew A. Boccone is an independent business consultant. From 1990 to his retirement in 2001 he was President of Kline & Company, a leading international business consulting and research firm that he first joined in 1974, developing growth strategies and providing business solutions for many multinational chemical companies. Prior to joining Kline & Company Mr. Boccone served in various management positions at American Cyanamid. He has been a Director of the Company since November 2002.

Christopher W. Nolan, Sr. has been a Managing Director (since March 2006) and Executive Director (2002 to 2006) in Mergers & Acquisitions ("M&A") for Rabobank International, New York, NY. From 2000 to 2002 he was a V.P. in M&A for Deutsche Bank Securities, Inc., New York, NY. In 2000 he was a V.P. with Salomon Smith Barney, New York, NY. From 1992-2000 he was a V.P. in Corporate Development and Investor Relations for ISP in Wayne, NJ.

Dr. Alfred R. Globus and Henry P. Globus are brothers. Kenneth H. Globus is the son of Henry P. Globus and the nephew of Dr. Alfred R. Globus. There are no other family relationships between any directors or officers of the Company.

The directors are elected to serve for one year or until the next Annual Meeting of Stockholders and until their successors have been elected and qualified.

### Audit Committee Members and Financial Expert

The Board of Directors has an Audit Committee that meets with the Company's independent auditors to review the plan, scope and results of its audits. The Audit Committee consists of three of the Company's directors, each of whom is considered an independent, outside director. The Chairman of the Audit Committee is Arthur Dresner; the other two members are Andrew A. Boccone and Christopher W. Nolan, Sr.

The Company does not have a "financial expert" (as that term is defined by SEC regulations) on its audit committee due to the expense involved in placing another independent director on its Board of Directors and Audit Committee who would qualify as such. While all three Audit Committee members have experience in reading and analyzing financial statements, none has the experience necessary to qualify as a "financial expert" under the SEC guidelines. One of the Company's other directors, Lawrence F. Maietta, is a Certified Public Accountant with experience in preparing and analyzing financial statements and would qualify as a "financial expert" if it were not for the fact that he receives payment from the Company to assist in the preparation of its financial reports, and for that reason he is not considered "independent" and cannot serve on the audit committee. Mr. Maietta now serves as an expert financial advisor to the audit committee in lieu of having a financial expert on the committee.

### Code of Ethics

The Company has adopted a Code of Business Conduct and Ethics that applies to all officers, directors, and employees, serving in any capacity to the Company, including the Chief Executive Officer, Chief Financial Officer, and principal accounting Officer. A copy of the Company's Code of Conduct and Ethics is available on the Company's web site at <http://www.u-g.com/corporate>. The Company intends to satisfy the disclosure requirement under Item 10 of Form 8-K relating to amendments to or waivers from any provision of its Code of Conduct and Ethics applicable to Chief Executive Officer, Chief Financial Officer and principal accounting officer by posting this information on the Company's web

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site.

Compliance with Section 16(a) of the Exchange Act

The information required by this section is incorporated herein by reference to the section entitled "Directors and Executive Officers - Section 16(a) Beneficial Ownership Reporting Compliance" of Company's 2006 Proxy Statement.

Item 10. Executive Compensation.

The information required by this Item is incorporated herein by reference to the section entitled "Compensation of Directors and Executive Officers - Summary Compensation Table" of the Company's 2006 Proxy Statement.

Item 11. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The information required by this Item is incorporated herein by reference to the sections entitled "Voting Securities and Principal Stockholders - Security Ownership of Management" and "Compensation of Directors and Executive Officers" of the 2006 Proxy Statement.

Item 12. Certain Relationships and Related Transactions.

Information required to be set forth hereunder has been omitted and will be incorporated by reference, when filed, from the Company's 2006 Proxy Statement.

Item 13. Exhibits

- 3(a) Certificate of Incorporation of the Company as filed April 22, 1987. Incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K, dated September 21, 1987 (the "1987 8-K").
- 3(b) Certificate of Merger of United-Guardian, Inc. (New York) with and into the Company as filed with the Secretary of State of the State of Delaware on September 10, 1987. Incorporated by reference to Exhibit 3(b) to the Company's Annual Report on Form 10-K for the fiscal year ended February 29, 1988 (the "1988 10-K").
- 3(c) By-laws of the Company. Incorporated by reference to Exhibit 4.2 to the 1987 8-K.
- 4(a) Specimen Certificate for shares of common stock of the Company. Incorporated by reference to Exhibit 4(a) to the 1988 10-K.
- 10(a) Qualified Retirement Income Plan for Employees of the Company, as restated April 1, 1976. Incorporated by reference to Exhibit 11(c) of the Company's Registration Statement on Form S-1 (Registration No. 2-63114) declared effective February 9, 1979.
- 10(b) Employment Termination Agreement dated July 8, 1988 between the Company and Henry Globus. Incorporated by reference to Exhibit 10(i) to the Company's Annual Report on Form 10-K for the 10-month transition period from March 1, 1991 to December 31, 1991.
- 10(c) Exclusive Distributor Agreement between the Company and ISP

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Technologies Inc., dated July 5, 2000. Incorporated by reference to Exhibit 10(d) to the Company's Annual Report on Form 10-KSB for the fiscal year ended December 31, 2000.

10(d) Letter Amendment between the Company and ISP Technologies Inc. dated December 20, 2005 amending the Exclusive Distributor Agreement between the Company and ISP Technologies Inc. dated July 5, 2000.

21 Subsidiaries of the Company:

| Name                                    | Jurisdiction of Incorporation | Name Under Which it does Business |
|---|-------------------------------|-----------------------------------|
| Eastern Chemical Corporation            | New York                      | (same)                            |
| Dieselite Corporation **                | Delaware                      | N/A                               |
| Paragon Organic Chemicals, Inc.         | New York                      | (same)                            |
| Transcontinental Processes (Pty.) Ltd.* | Australia                     | N/A                               |

\* Inactive without assets      \*\* Inactive

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

31.2 Certification of Kenneth H. Globus, President and Chief Financial 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.

### Item 14. Principal Accountant Fees and Services

#### Audit Fees

The aggregate fees billed by Eisner LLP for the audit of the Company's annual financial statements and the reviews of the financial statements included in the Company's quarterly reports on Form 10-QSB for FY-2005 were approximately \$65,600, including out of pocket expenses. The aggregate fees billed by Eisner LLP for the audit of the Company's annual financial statements for FY-2004 were approximately \$55,500.

#### Audit-Related Fees

During FY-2005 Eisner LLP billed the Company \$2,972 for fees related to its review of the Company's compliance with section 404 of the Sarbanes-Oxley Act ("SOX"). During FY-2004 there were no fees billed by Eisner LLP that were related to SOX compliance. No other fees were billed by Eisner LLP for the last two fiscal years that were reasonably related to the performance of the audit or review of the Company's financial statements and not reported under "Audit Fees" above.

#### All Other Fees

There were no other fees billed by Eisner LLP during the last two fiscal years for other products and services provided by Eisner LLP.

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Pre-Approval Policies and Procedures

The Audit Committee of the Company's Board of Directors meets periodically to review and approve the scope of the services to be provided to the Company by its Independent Registered Public Accounting Firm, as well to review and discuss any issues that may arise during an engagement. The Audit Committee is responsible for the prior approval of every engagement of the Company's Independent Registered Public Accounting Firm to perform audit and permissible non-audit services for the Company (such as quarterly reviews, tax matters, consultation on new accounting and disclosure standards, and, in future years, reporting on management's internal controls assessment.)

Before the auditors are engaged to provide those services, the chief financial officer and controller will make a recommendation to the Audit Committee regarding each of the services to be performed, including the fees to be charged for such services. At the request of the Audit Committee the Independent Registered Public Accounting Firm and/or management shall periodically report to the Audit Committee regarding the extent of services being provided by the Independent Registered Public Accounting Firm, and the fees for the services performed to date.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the Company has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

UNITED-GUARDIAN, INC.

Dated: March 22, 2006

By: /s/ Alfred R. Globus  
 -----  
 Alfred R. Globus  
 Chief Executive Officer & Director

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the Company and in the capacities and on the dates indicated.

| Signature  | Title   | Date           |
|--|---|----------------|
| By:/s/ Alfred R. Globus<br>-----<br>Alfred R. Globus       | Chief Executive Officer, Director<br>(Principal Executive Officer)  | March 22, 2006 |
| By:/s/ Kenneth H. Globus<br>-----<br>Kenneth H. Globus     | President, General Counsel,<br>Director, Chief Financial<br>Officer | March 22, 2006 |
| By:/s/ Robert S. Rubinger<br>-----<br>Robert S. Rubinger   | Executive Vice President,<br>Secretary, Director                    | March 22, 2006 |
| By:/s/ Charles W. Castanza<br>-----<br>Charles W. Castanza | Senior Vice President, Director                                     | March 22, 2006 |

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|   |  |                |
|---|--|----------------|
| By:/s/ Cecile M. Brophy<br>-----<br>Cecile M. Brophy                    | Treasurer, Principal Accounting<br>Officer, and Controller | March 22, 2006 |
| By:/s/ Henry P. Globus<br>-----<br>Henry P. Globus                      | Director   | March 22, 2006 |
| By:/s/ Lawrence F. Maietta<br>-----<br>Lawrence F. Maietta              | Director   | March 22, 2006 |
| By:/s/ Arthur M. Dresner<br>-----<br>Arthur M. Dresner                  | Director   | March 22, 2006 |
| By: /s/ Andrew A. Boccone<br>-----<br>Andrew A. Boccone                 | Director   | March 22, 2006 |
| By: /s/ Christopher W. Nolan, Sr.<br>-----<br>Christopher W. Nolan, Sr. | Director   | March 22, 2006 |

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

|  | Page<br>----- |
|--|---------------|
| Report of Independent Registered Public Accounting Firm  | F-2           |
| Financial Statements   |               |
| Consolidated Balance Sheets as of December 31,<br>2005 and 2004  | F-3 - F-4     |
| Consolidated Statements of Income for the Years<br>Ended December 31, 2005 and 2004  | F-5           |
| Consolidated Statement of Stockholders' Equity<br>and Comprehensive Income for the Years Ended<br>December 31, 2005 and 2004 | F-6           |
| Consolidated Statements of Cash Flows for the<br>Years Ended December 31, 2005 and 2004                                      | F-7           |
| Notes to Consolidated Financial Statements   | F-8 - F-24    |

F-1

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders  
United-Guardian, Inc.

We have audited the accompanying consolidated balance sheets of United-Guardian, Inc. and subsidiaries as of December 31, 2005 and 2004 and the related consolidated statements of income, changes in stockholders' equity and consolidated cash flows for each of the years in the two year period ended December 31, 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing 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. An audit also includes 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 financial statements enumerated above present fairly, in all material respects, the consolidated financial position of United-Guardian, Inc. and subsidiaries as of December 31, 2005 and 2004 and the consolidated results of their operations and their consolidated cash flows for each of the years in the two-year period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.



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/s/ EISNER LLP

New York, New York  
February 27, 2006

F-2

UNITED-GUARDIAN, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

ASSETS

|   | December 31, |             |
|---|--------------|-------------|
|   | 2005         | 2004        |
|   | -----        | -----       |
| CURRENT ASSETS  |              |             |
| Cash and cash equivalents .....   | \$3,425,593  | \$3,735,945 |
| Temporary investments.....  | 699,363      | 402,288     |
| Marketable securities .....   | 7,066,797    | 6,251,764   |
| Accounts receivable, net of allowance for doubtful<br>accounts of \$47,500 and \$45,000, respectively | 1,083,992    | 918,085     |
| Inventories .....   | 1,031,563    | 1,375,880   |
| Prepaid expenses and other current assets .....   | 440,380      | 515,425     |
| Deferred income taxes .....   | 217,389      | 223,617     |
|   | -----        | -----       |
| Total current assets .....  | 13,965,077   | 13,423,004  |
|   | -----        | -----       |
| PROPERTY, PLANT AND EQUIPMENT   |              |             |
| Land .....  | 69,000       | 69,000      |
| Factory equipment and fixtures .....  | 3,068,050    | 2,975,305   |
| Building and improvements .....   | 2,133,422    | 2,089,547   |
| Waste disposal plant.....   | 133,532      | 133,532     |
|   | -----        | -----       |
|   | 5,404,004    | 5,267,384   |
| Less accumulated depreciation .....   | 4,455,524    | 4,269,713   |

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|              |              |              |
|--------------|--------------|--------------|
|              | -----        | -----        |
|              | 948,480      | 997,671      |
|              | -----        | -----        |
| OTHER ASSETS |              |              |
| Other .....  | 108,680      | 700          |
|              | -----        | -----        |
|              | 108,680      | 700          |
|              | -----        | -----        |
|              | \$15,022,237 | \$14,421,375 |
|              | =====        | =====        |

See notes to consolidated financial statements

F-3

UNITED-GUARDIAN, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

LIABILITIES AND STOCKHOLDERS' EQUITY

|   | December 31, |            |
|---|--------------|------------|
|   | 2005         | 2004       |
|   | -----        | -----      |
| CURRENT LIABILITIES                           |              |            |
| Dividends payable .....                       | \$1,086,391  | \$ 887,677 |
| Accounts payable .....                        | 148,051      | 172,320    |
| Accrued expenses .....                        | 448,990      | 395,167    |
|   | -----        | -----      |
| Total current liabilities .....               | 1,683,432    | 1,455,164  |
|   | -----        | -----      |
| DEFERRED INCOME TAXES .....                   | 59,817       | 10,000     |
|   | -----        | -----      |
| COMMITMENTS AND CONTINGENCIES                 |              |            |
| STOCKHOLDERS' EQUITY                          |              |            |
| Common stock, \$.10 par value; 10,000,000     |              |            |
| shares authorized; 5,000,339 and 4,994,739    |              |            |
| shares issued, respectively; and 4,938,139    |              |            |
| and 4,932,539 outstanding, respectively ..... | 500,034      | 499,474    |
| Capital in excess of par value.....           | 3,778,838    | 3,756,943  |
| Accumulated other comprehensive loss.....     | (84,365)     | (86,730)   |
| Retained earnings .....                       | 9,444,111    | 9,146,154  |
| Treasury stock, at cost; 62,200 shares .....  | (359,630)    | (359,630)  |
|   | -----        | -----      |

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|              |              |
|--------------|--------------|
| 13,278,988   | 12,956,211   |
| -----        | -----        |
| \$15,022,237 | \$14,421,375 |
| =====        | =====        |

See notes to consolidated financial statements

F-4

UNITED-GUARDIAN, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

|   | Year ended December 31, |              |
|---|-------------------------|--------------|
|   | 2005                    | 2004         |
|   | -----                   | -----        |
| Revenue                                   |                         |              |
| Net sales .....                           | \$12,134,996            | \$11,123,475 |
|   | -----                   | -----        |
| Costs and expenses                        |                         |              |
| Cost of sales .....                       | 5,690,966               | 5,072,033    |
| Operating expenses .....                  | 2,592,215               | 2,589,034    |
|   | -----                   | -----        |
|   | 8,283,181               | 7,661,067    |
|   | -----                   | -----        |
| Income from operations .....              | 3,851,815               | 3,462,408    |
| Other income (expense)                    |                         |              |
| Investment income.....                    | 351,503                 | 230,614      |
| Loss on sale of marketable securities.... | (113,865)               | (7,794)      |
| Loss sale of assets.....                  | -                       | (1,724)      |
| Other expense                             | (179)                   | (105)        |
|   | -----                   | -----        |
| Income before income taxes .....          | 4,089,274               | 3,683,399    |
| Provision for income taxes .....          | 1,471,791               | 1,208,341    |
|   | -----                   | -----        |

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|   |              |              |
|---|--------------|--------------|
| Net Income .....                                      | \$ 2,617,483 | \$ 2,475,058 |
|   | =====        | =====        |
| Earnings per common share (basic<br>and diluted)..... | \$ .53       | \$ .50       |
|   | =====        | =====        |
| Weighted average shares-basic .....                   | 4,935,472    | 4,928,785    |
|   | =====        | =====        |
| Weighted average shares-diluted .....                 | 4,941,858    | 4,938,026    |
|   | =====        | =====        |

See notes to consolidated financial statements

F-5

UNITED-GUARDIAN, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
AND COMPREHENSIVE INCOME

Years ended December 31, 2005 and 2004

|  | Common stock |           | Capital in             | other                          | Retained    | T     |
|--|--------------|-----------|------------------------|--------------------------------|-------------|-------|
|  | Shares       | Amount    | excess of<br>par value | comprehensive<br>income (loss) | earnings    |       |
|  | -----        | -----     | -----                  | -----                          | -----       | ----- |
| Balance, December 31, 2003   | 4,984,439    | \$498,444 | \$3,717,160            | \$ (30,614)                    | \$8,791,158 | \$ (  |
| Issuance of common stock in<br>connection with exercise<br>of stock options .....            | 10,300       | 1,030     | 34,033                 |                                |             |       |
| Tax Benefit from exercise of<br><br>stock options .....                                      |              |           | 5,750                  |                                |             |       |
| Unrealized loss on marketable<br>securities, net of deferred<br>income tax of \$33,300 ..... |              |           |                        | (56,116)                       |             |       |
| Net income .....   |              |           |                        |                                | 2,475,058   |       |
| Dividends declared .....   |              |           |                        |                                | (2,120,062) |       |
| Comprehensive income   | -----        | -----     | -----                  | -----                          | -----       | ----- |

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|  |                  |                   |                     |                    |                     |             |
|--|------------------|-------------------|---------------------|--------------------|---------------------|-------------|
| Balance, December 31, 2004   | 4,994,739        | 499,474           | 3,756,943           | (86,730)           | 9,146,154           | (           |
| Issuance of common stock in connection with exercise of stock options .....          | 5,600            | 560               | 19,345              |                    |                     |             |
| Tax Benefit from exercise of stock options .....                                     |                  |                   | 2,550               |                    |                     |             |
| Unrealized loss on marketable securities, net of deferred income tax of \$1,400..... |                  |                   |                     | 2,365              |                     |             |
| Net income .....   |                  |                   |                     |                    | 2,617,483           |             |
| Dividends declared .....   |                  |                   |                     |                    | (2,319,526)         |             |
| Comprehensive income .....   |                  |                   |                     |                    |                     |             |
| Balance, December 31, 2005   | <u>5,000,339</u> | <u>\$ 500,034</u> | <u>\$ 3,778,838</u> | <u>\$ (84,365)</u> | <u>\$ 9,444,111</u> | <u>\$ (</u> |

See notes to consolidated financial statements

F-6

UNITED-GUARDIAN, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

|  | Year ended December 31, |                  |
|--|-------------------------|------------------|
|  | 2005                    | 2004             |
| Cash flows from operating activities   |                         |                  |
| Net income .....   | \$2,617,483             | \$2,475,058      |
| Adjustments to reconcile net income to net cash provided by operating activities       |                         |                  |
| Depreciation and amortization .....  | 205,811                 | 209,792          |
| Realized loss on sale of marketable securities..                                       | 116,512                 | -                |
| Net loss on sale of equipment.....   | -                       | 1,724            |
| Provision for bad debts.....   | 23,254                  | 18,000           |
| Tax Benefit from exercise of stock options .....                                       | 2,550                   | 5,750            |
| Deferred income taxes .....  | 54,645                  | 17,500           |
| Provision for inventory obsolescence .....   | 20,000                  | 91,000           |
| Increase (decrease) in cash resulting from changes in operating assets and liabilities |                         |                  |
| Accounts receivable .....  | (189,161)               | 70,970           |
| Inventories .....  | 324,317                 | (373,568)        |
| Prepaid expenses and other current and non current assets.....                         | (32,935)                | (250,447)        |
| Accounts payable .....   | (24,269)                | (137,601)        |
| Accrued expenses and taxes payable .....   | 53,823                  | 44,398           |
| Net cash provided by operating activities .....  | <u>3,172,030</u>        | <u>2,172,576</u> |
| Cash flows from investing activities   |                         |                  |
| Acquisition of plant and equipment.....  | (156,620)               | (198,371)        |

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|   |             |             |
|---|-------------|-------------|
| Proceeds from the sale of plant and equipment.....        | -           | 15,500      |
| Net change in temporary investments.....                  | (297,075)   | 1,213,463   |
| Purchase of marketable securities.....                    | (5,293,131) | (2,274,468) |
| Proceeds from sale of marketable securities.....          | 4,365,351   | 2,032,274   |
|   | -----       | -----       |
| Net cash (used in) provided by investing activities ..... | (1,381,475) | 788,398     |
|   | -----       | -----       |
| Cash flows from financing activities                      |             |             |
| Proceeds from exercise of stock options .....             | 19,905      | 35,063      |
| Dividends paid .....                                      | (2,120,812) | (1,970,121) |
|   | -----       | -----       |
| Net cash used in financing activities .....               | (2,100,907) | (1,935,058) |
|   | -----       | -----       |
| Net (decrease) increase in cash and cash equivalents..    | (310,352)   | 1,025,916   |
| Cash and cash equivalents, beginning of year .....        | 3,735,945   | 2,710,029   |
|   | -----       | -----       |
| Cash and cash equivalents, end of year .....              | \$3,425,593 | \$3,735,945 |
|   | =====       | =====       |

See notes to consolidated financial statements

F-7

### UNITED-GUARDIAN, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005 and 2004

#### NOTE A - NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### Nature of Business

United-Guardian, Inc. (the "Company") is a Delaware corporation that operates in two business segments: (1) the Guardian Laboratories Division conducts research, product development, manufacturing and marketing of pharmaceuticals, cosmetic ingredients, health care products, and proprietary specialty industrial products, and (2) the Eastern Chemical Corporation subsidiary distributes a line of fine organic chemicals, research chemicals, test solutions, indicators, intermediates, dyes and reagents. Two major product lines, Lubrajel and Renacidin, included in the Guardian Laboratories Division, accounted for approximately 85% and 83% of consolidated sales for each of the years ended December 31, 2005 and 2004, with Lubrajel accounting for 68% and 67% and Renacidin accounting for 17% and 16% of consolidated sales for each of those years.

##### Principles of Consolidation

The consolidated financial statements of the Company include the accounts of United-Guardian, Inc. and its wholly-owned subsidiaries, Eastern Chemical Corporation and Paragon Organic Chemicals, Inc. (a purchasing agent for Eastern). All inter-company accounts and transactions have been eliminated.

##### Revenue Recognition

The Company recognizes revenue as products are shipped, collections are

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reasonably assured, and title passes to customers. An allowance for returns is taken as a reduction of sales within the same period the revenue is recognized. Such allowances are based on historical experience. The Company has not experienced significant fluctuations between estimated allowances and actual activity.

### Cash and Cash Equivalents

For financial statement purposes the Company considers as cash equivalents all highly liquid investments with an original maturity of three months or less at inception.

### Dividends

On May 19, 2005 the Company declared a special dividend of \$.25 per share payable on June 15, 2005 to stockholders of record as of June 1, 2005, for a total payout of \$1,233,135, and on December 1, 2005 the Company declared a cash dividend of \$.22 per share payable on January 6, 2006 to stockholders of record as of December 15, 2005, for a total payout of \$1,086,391. On September 9, 2004 the Company declared a special dividend of \$.25 per share payable on October 8, 2004 to stockholders of record as of September 24, 2004, for a total payout of \$1,232,385, and on December 2, 2004, the Company declared a dividend of \$.18 per share payable on January 5, 2005 to stockholders of record as of December 15, 2004, for a total payout of \$887,677.

F-8

## UNITED-GUARDIAN, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

December 31, 2005 and 2004

#### NOTE A (continued)

##### Statements of Cash Flows

Cash payments for income taxes were \$1,321,853 and \$1,399,522 for the years ended December 31, 2005 and 2004, respectively. There were no cash payments for interest during the years ended December 31, 2005 and 2004.

##### Marketable Securities and Temporary Investments

Marketable securities include investments in equity mutual funds, government securities and corporate bonds which are classified as "Available for Sale" securities and are reported at their fair values. Unrealized gains and losses on "Available for Sale" securities are reported as accumulated other comprehensive income (loss) in stockholders' equity, net of the related tax effects. Investment income is recognized when earned. Realized gains and losses on sales of investments are determined on a specific identification basis. Fair values are based on quoted market prices.

Temporary investments consist of certificates of deposit and treasury bills that mature in one year or less.

##### Inventories

Inventories are valued at the lower of cost or current market value. Cost is determined using the average cost method (which approximates FIFO). Inventory

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costs include material, labor and factory overhead.

### Property, Plant and Equipment

Property, plant and equipment are carried at cost, less accumulated depreciation. Major replacements and betterments are capitalized while routine maintenance and repairs are expensed as incurred. Assets are depreciated under both accelerated and straight-line methods. Depreciation charged to income as a result of using accelerated methods was not materially different than that which would result from using the straight-line method for all periods presented. Certain factory equipment and fixtures are constructed by the Company using purchased materials and in-house labor. Such assets are capitalized and depreciated on a basis consistent with the Company's purchased fixed assets.

Estimated useful lives are as follows:

|                                |                                   |
|--------------------------------|-----------------------------------|
| Factory equipment and fixtures | 5 - 7 years                       |
| Building                       | 40 years                          |
| Building improvements          | Lesser of useful life or 20 years |
| Waste disposal system          | 7 years                           |

F-9

### UNITED-GUARDIAN, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

December 31, 2005 and 2004

#### NOTE A (continued)

##### Long-Lived Assets

It is the Company's policy to evaluate and recognize an impairment to its long-lived assets if it is probable that the recorded amounts are in excess of anticipated undiscounted future cash flows.

##### Other Assets

Other assets consist of deposits given to vendors of which \$108,430 represents a 50% deposit to one of our vendors for regulatory and validation work being done in order to qualify one of the vendor's other locations for the production of our Renacidin Irrigation product. This is necessitated by the vendor's relocation of production of this type of product to another of their facilities.

##### Fair Value of Financial Instruments

The Company has estimated the fair value of financial instruments using available market information and other valuation methodologies in accordance with Statement of Financial Accounting Standards ("SFAS") No. 107, "Disclosures About Fair Value of Financial Instruments." Management of the Company believes that the fair value of financial instruments, consisting of cash, temporary investments, marketable securities, accounts receivable, accounts payable, dividends payable and accrued expenses approximates their carrying value due to their short payment terms.



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### Concentration of Credit Risk

Accounts receivable potentially expose the Company to concentrations of credit risk. The Company routinely addresses the financial strength of its customers and, as a consequence, believes that its accounts receivable credit risk exposure is limited. For each of the years ended December 31, 2005 and 2004, two customers, both of them distributors and marketing partners of the Company, accounted for revenues aggregating 48% and 49% respectively. At December 31, 2005 and December 31, 2004 those same two customers had accounts receivable balances aggregating 32%.

### Income Taxes

Deferred tax assets and liabilities reflect the future tax consequences of the differences between the financial reporting and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

### Research and Development

The Company's research and development expenses, included in operating expenses, are recorded in the year incurred. Research and development expenses were approximately \$423,000 and \$415,000 for the years ended December 31, 2005 and 2004, respectively.

F-10

### UNITED-GUARDIAN, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

December 31, 2005 and 2004

#### NOTE A (continued)

##### Shipping and Handling Costs

Shipping and handling costs are classified in operating expenses in the accompanying consolidated statements of income. Shipping and handling costs were approximately \$106,000 and \$107,000 for the years ended December 31, 2005 and 2004 respectively.

##### Advertising Costs

Advertising costs are expensed as incurred. During 2005 and 2004 the Company incurred \$76,765 and \$71,911 of advertising costs, respectively.

##### Stock-Based Compensation

In 2004 the Company approved a new stock option plan ("2004 Stock Option Plan"). As permitted under SFAS NO. 123 as amended, "Accounting for Stock-Based Compensation", the Company has elected to continue to follow the intrinsic value method in accounting for its stock-based employee compensation arrangements as defined by Accounting Principle Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees", and related interpretations including Financial Accounting Standards Board Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation, and interpretations of APB No. 25". The following table illustrates the effect on net income and earnings per share if the company had applied the fair value recognition provisions of SFAS No.123 to stock-based employee compensation.

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|  | Year Ended December 31, |                       |
|--|-------------------------|-----------------------|
|  | 2005                    | 2004                  |
| Reported net income .....  | \$ 2,617,483            | \$ 2,475,058          |
| Stock-based employee compensation<br>expense included in reported net<br>income, net of related tax effect .....     | 0                       | 0                     |
| Stock-based employee compensation<br>determined under the fair value based<br>method, net of related tax effect..... | 0                       | 0                     |
| Pro forma net income.....  | \$ 2,617,483<br>=====   | \$ 2,475,058<br>===== |
| Earnings per share (basic and diluted)   |                         |                       |
| As reported .....  | \$ .53<br>=====         | \$ .50<br>=====       |
| Pro forma .....  | \$ .53<br>=====         | \$ .50<br>=====       |

F-11

UNITED-GUARDIAN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

December 31, 2005 and 2004

No stock options were granted in 2005 or 2004 under the 2004 Stock Option Plan.

Earnings Per Share Information

Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding during the year. Diluted earnings per share includes the dilutive effect of outstanding stock options.

Use of Estimates

In preparing financial statements in conformity with U.S. generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Actual results could differ from those estimates. Such estimated items include the allowance for bad debts, reserve for inventory obsolescence, and the allocation of overhead.

Segment Reporting

SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information," requires that the Company disclose certain information about its business segments defined as "components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing

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performance."

New Accounting Pronouncements

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections--a replacement of APB Opinion No. 20 and FASB Statement No. 3 ("SFAS 154"). This Statement replaces APB Opinion No. 20, Accounting Changes, and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements, and changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS 154 requires retrospective application to prior period financial statements of a voluntary change in accounting principle unless it is impractical to determine period specific changes. This statement is effective for fiscal periods beginning after December 15, 2005 and is not expected to have a significant impact on the Company's financial statements.

In December 2004, the FASB issued a revision of SFAS No. 123, "Share-Based Payment" (SFAS 123(R)), which supercedes APB Opinion No. 25 and revised SFAS 123. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro-forma disclosure is no longer an alternative. As such,

F-12

UNITED-GUARDIAN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

December 31, 2005 and 2004

the company is required to adopt the provisions of SFAS 123(R) in the first quarter of 2006, While the company currently discloses the pro-forma earnings effects of its stock-based grants, it is currently evaluating the impact of the implementation guidance and revisions required under SFAS 123(R) on the consolidated financial statements.

In November 2004, the Financial Accounting Standards Board, or FASB issued FASB Statement No. 151 "Inventory Costs, an Amendment of ARB No. 43 Chapter 4" ("FAS 151"). FAS 151 is applicable for Inventory costs incurred during fiscal years beginning after June 15, 2005. FAS 151 requires that items such as idle facility expense, excessive spoilage, double freight, and rehandling be recognized as current-period charges rather than being included in inventory regardless of whether the costs meet the criterion of abnormal as defined in ARB 43. The Company does not believe the adoption of the standard will have a material impact on the Company upon adoption in 2006 as the Company has historically expensed such costs as incurred.

NOTE B - MARKETABLE SECURITIES

Marketable securities at December 31, 2005 and 2004 were as follows:

| Cost  | Fair Value | Unrealized<br>Gain/ (Loss) |
|-------|------------|----------------------------|
| ----- | -----      | -----                      |

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December 31, 2005  
-----

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

December 31, 2004  
-----

Available for sale:

|                               |             |             |              |
|-------------------------------|-------------|-------------|--------------|
| U.S. Treasury and agencies    | \$4,014,855 | \$3,942,247 | \$ (72,608)  |
| Corporate debt securities     | 2,080,114   | 2,032,065   | (48,049)     |
| Fixed income mutual funds     | 45,162      | 50,193      | 5,031        |
| Equity and other mutual funds | 249,963     | 227,259     | (22,704)     |
|                               | -----       | -----       | -----)       |
|                               | \$6,390,094 | \$6,251,764 | \$ (138,330) |
|                               | =====       | =====       | =====        |

F-13

UNITED-GUARDIAN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

December 31, 2005 and 2004

NOTE C - INVENTORIES

Inventories consist of the following:

|  | December 31, |             |
|--|--------------|-------------|
|  | 2005         | 2004        |
|  | -----        | -----       |
| Raw materials and work-in-process .....  | \$ 376,308   | \$ 332,798  |
| Finished products and fine chemicals ... | 655,255      | 1,043,082   |
|  | -----        | -----       |
|  | \$1,031,563  | \$1,375,880 |
|  | =====        | =====       |

At December 31, 2005 and 2004, the company has reserved \$108,000 and \$128,000 respectively for slow moving and obsolete inventory.

NOTE D - NOTES PAYABLE - BANKS

The Company has a line of credit agreement with a bank which provides for borrowings of up to \$700,000 and expires on May 31, 2006. It is the Company's intention to renew the line of credit agreement before it expires. Interest under the line is at the bank's prime rate plus 1/2%. The line of credit agreement contains financial covenants relating to minimum net worth, working capital, current ratio, a debt to capitalization ratio and maintenance of compensating balances. There were no outstanding borrowings at December 31, 2005 and 2004.

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### NOTE E - INCOME TAXES

The provision for income taxes consists of the following:

|                                      | Year ended December 31, |             |
|--------------------------------------|-------------------------|-------------|
|                                      | 2005                    | 2004        |
| Current                              |                         |             |
| Federal .....                        | \$1,219,309             | \$1,014,625 |
| State .....                          | 197,837                 | 176,216     |
|                                      | -----                   | -----       |
|                                      | 1,417,146               | 1,190,841   |
| Deferred                             |                         |             |
| Federal .....                        | 47,321                  | 15,154      |
| State .....                          | 7,324                   | 2,346       |
|                                      | -----                   | -----       |
|                                      | 54,645                  | 17,500      |
|                                      | -----                   | -----       |
| Total provision for income taxes ... | \$1,471,791             | \$1,208,341 |
|                                      | =====                   | =====       |

F-14

### UNITED-GUARDIAN, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

December 31, 2005 and 2004

The following is a reconciliation of the Company's effective income tax rate to the Federal statutory rate:

|                                     | Year ended December 31, |       |         |       |
|-------------------------------------|-------------------------|-------|---------|-------|
|                                     | 2005                    |       | 2004    |       |
|                                     | (000's)                 | %     | (000's) | %     |
|                                     | -----                   | ---   | -----   | ---   |
| Income taxes at statutory Federal   |                         |       |         |       |
| income tax rate .....               | \$1,390                 | 34%   | \$1,252 | 34%   |
| State income taxes, net of Federal  |                         |       |         |       |
| benefit .....                       | 126                     | 3     | 118     | 3     |
| Foreign Sales Exclusion .....       | (81)                    | (2)   | (102)   | (3)   |
| Domestic Production Exclusion ..... | (41)                    | (1)   | -       | -     |
| Nondeductible expenses.....         | 3                       | -     | 2       | -     |
| Change in deferred tax asset        |                         |       |         |       |
| valuation allowance .....           | 39                      | 1     | -       | -     |
| Other, net .....                    | 36                      | 1     | (62)    | (2)   |
|                                     | -----                   | ---   | -----   | ---   |
| Actual income tax expense .....     | \$1,472                 | 36%   | \$1,208 | 32%   |
|                                     | =====                   | ===== | =====   | ===== |

During 2005 and 2004, the Company realized the tax benefit of the Foreign Sales exclusion and in 2005 the Company realized the tax benefit of the Domestic Production Activities Deduction. The American Jobs Creation Act repealed the Extraterritorial Income Exclusion for transactions after 2004 subject to

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transitional rules. As such, the company is entitled to claim 80% and 100% of the pre repeal exclusion for transactions during 2005 and 2004 respectively.

The Domestic Production Activities Deduction was created to replace the Extraterritorial Income Exclusion. In 2005, this deduction amounted to 3% of net income from domestic production activities.

The tax effects of temporary differences which comprise the deferred tax assets and liabilities are as follows:

|  |    | December 31 |            |
|--|----|-------------|------------|
|  |    | 2005        | 2004       |
|  |    |             |            |
| Deferred tax assets                        |    |             |            |
| Current                                    |    |             |            |
| -----                                      |    |             |            |
| Accounts receivable .....                  | \$ | 17,718      | \$ 16,785  |
| Unrealized loss on marketable securities.. |    | 50,200      | 51,600     |
| Inventories .....                          |    | 40,284      | 47,744     |
| Accrued Expenses .....                     |    | 71,469      | 71,217     |
|  |    |             |            |
| F-15                                       |    |             |            |
| Capital Loss .....                         |    | 42,472      | -          |
| Other.....                                 |    | 37,718      | 36,271     |
|  |    | 259,861     | 223,617    |
| Valuation Allowance .....                  |    | (42,472)    | -          |
|  |    | 217,389     | 223,617    |
| Deferred tax liabilities                   |    |             |            |
| Non-current                                |    |             |            |
| -----                                      |    |             |            |
| Prepaid pension.....                       |    | (59,817)    | (10,000)   |
|  |    | (59,817)    | (10,000)   |
| Net deferred tax asset .....               | \$ | 157,572     | \$ 213,617 |
|  |    | =====       | =====      |

There was no valuation allowance at December 31, 2004. The valuation allowance at December 31, 2005 was due to the capital loss carry forwards that the company does not expect to utilize in the future.

## NOTE F - BENEFIT PLANS

### Pension Plan

The Company has a noncontributory defined benefit pension plan which covers substantially all of its employees. Benefits are based on years of service and employees' compensation prior to retirement. Amounts are funded in accordance with the requirements of ERISA (Employee Retirement Income Security Act of 1974) and the plan is administered by a trustee who is responsible for payments to retirees. The plan assets primarily consist of cash equivalents, bonds, commercial paper and mortgage-backed securities, and are recorded at fair value

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within the plan.

The unamortized prior year service cost as of October 1, 2005 ("Measurement Date") is \$39,459 and \$46,920 for 2005 and 2004 respectively.

The net pension asset recorded by the Company at December 31, 2005 and 2004 is \$160,368 and \$119,720, respectively.

The percentage of the fair value of total plan assets as of the Measurement Date is as follows:

|  | 2005<br>----- | 2004<br>----- |
|--|---------------|---------------|
| Equity securities                            | 29%           | 26%           |
| Debt securities - General Investment Account | 71%           | 74%           |
|  | -----         | -----         |
| Total  | 100%          | 100%          |
|  | =====         | =====         |

F-16

UNITED-GUARDIAN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

December 31, 2005 and 2004

Note F (continued)

Investment strategies are determined by the Board of Directors in which all new monies are invested in debt securities operated by the Principal Financial Group comprised of private placed loans including residential and commercial mortgages and private placement bonds. This fund is a "book value" fund and its value is not adjusted for changing market conditions.

Historical returns of multiple asset classes were analyzed to develop a risk free real rate of return and risk premiums for each asset class. The overall rates for each asset class was developed by combining a long-term inflation component, the risk free real rate of return, and the associated risk premium. A weighted average rate was developed based on those overall rates and target asset allocation of the plan.

In March, 1998, the Board of Directors authorized a one time investment of some of the assets of the plan into two equity funds operated by the Principal Financial Group. In addition, in 2001, when the Principal Financial Group became a publicly traded company, a distribution of their stock was made to all investors. This investment has resulted in a third equity investment. No additional contributions have been made to any of the three equity investments. Any future investments will continue to be determined by the Board of Directors.

The accumulated benefit obligation is \$2,476,741 and \$2,272,390 at December 31, 2005 and 2004 respectively.

Based on current data and assumptions, the following benefit payments,

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which reflect expected future employee service, as appropriate, are expected to be paid over the next ten years as follows:

NOTE F (continued)

| Year Ending | Expected Future Benefits Payable |
|-------------|----------------------------------|
| 2006        | \$ 71,000                        |
| 2007        | 120,000                          |
| 2008        | 120,000                          |
| 2009        | 120,000                          |
| 2010        | 140,000                          |
| 2011-2015   | 970,000                          |

The company estimates that it will make contributions to the pension plan of approximately \$200,000 during 2006 which includes required and discretionary contributions.

A measurement period from October 1, 2004 to October 1, 2005 has been used for the year ended December 31, 2005. The liabilities and assets are calculated at October 1, 2005. Assets are adjusted for known contributions received by the Company between October 1, 2005 and December 31, 2005.

F-17

### UNITED-GUARDIAN, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

December 31, 2005 and 2004

Note F (continued)

The following table sets forth the plan's funded status:

|  | Year ended December 31, |              |
|--|-------------------------|--------------|
|  | 2005                    | 2004         |
| <b>Change in Benefit Obligation:</b>                 |                         |              |
| Projected benefit obligation at beginning of year... | \$2,805,529             | \$2,360,399  |
| Service cost.....                                    | 107,786                 | 88,597       |
| Interest cost.....                                   | 152,104                 | 139,588      |
| Actuarial loss.....                                  | 244,413                 | 270,112      |
| Benefits paid.....                                   | (255,486)               | (53,167)     |
|  | \$3,054,346             | \$2,805,529  |
|  | =====                   | =====        |
| <b>Change in Plan Assets:</b>                        |                         |              |
| Fair value of plan assets at beginning of year...    | \$2,235,475             | \$1,957,256  |
| Actual return on plan assets.....                    | 134,373                 | 152,387      |
| Employer contributions.....                          | 200,000                 | 179,000      |
| Benefits paid.....                                   | (255,486)               | (53,167)     |
|  | \$2,314,362             | \$2,235,476  |
|  | =====                   | =====        |
| <b>Reconciliation of Funded Status:</b>              |                         |              |
| Funded status (underfunded).....                     | \$ (739,984)            | \$ (570,053) |
| Unrecognized net actuarial loss.....                 | 860,893                 | 642,853      |



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|                                      |            |            |
|--------------------------------------|------------|------------|
| Unrecognized prior service cost..... | 39,459     | 46,920     |
|                                      | -----      | -----      |
| Prepaid benefit cost.....            | \$ 160,368 | \$ 119,720 |
|                                      | =====      | =====      |

The net periodic benefit cost includes the following components:

|  | Year ended December 31, |            |
|--|-------------------------|------------|
|  | 2005                    | 2004       |
|  | -----                   | -----      |
| Components of net periodic benefit cost: |                         |            |
| Service cost.....                        | \$ 107,786              | \$ 88,597  |
| Interest cost.....                       | 152,104                 | 139,588    |
| Expected return on plan assets.....      | (148,983)               | (134,031)  |
| Recognized net actuarial loss.....       | 40,984                  | 18,910     |
| Amortization of prior service cost.....  | 7,461                   | 7,461      |
|  | -----                   | -----      |
| Net periodic benefit cost.....           | \$ 159,352              | \$ 120,525 |
|  | =====                   | =====      |

F-18

UNITED-GUARDIAN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

December 31, 2005 and 2004

NOTE F (continued)

Weighted-average assumptions as of December 31:

|   | 2005          | 2004          |
|---|---------------|---------------|
|   | -----         | -----         |
| Discount rate.....                                | 5.50%         | 6.00%         |
| Expected long term rate of return.....            | 7.00%         | 7.00%         |
| Weighted average rate of compensation increase... | 5.51%         | 5.69%         |
| Amortization method.....                          | Straight-Line | Straight-Line |

401(k) Plan

The Company maintains a 401(k) Plan for all of its eligible employees. Under the plan, employees may defer up to 15% of their weekly pay as a pretax investment in a savings plan. In addition, in 2005 and 2004 the Company made contributions of 50% of the first 6% and 4%, respectively, of each employee's elective deferral up to a maximum employer contribution of 3% and 2%, respectively, of biweekly pay. Employees become fully vested in Company contributions after one year of employment. 401(k) Company contributions were approximately \$57,000 and \$38,000 for the years ended December 31, 2005 and 2004, respectively.

Stock Option Plans

At its meeting on March 19, 2004 the Board of Directors of the Company approved the adoption of the 2004 Stock Option Plan. The new plan covers both employees and Directors. The adoption and implementation of the new plan was

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ratified by the shareholders of the Company at the Company's annual meeting of shareholders on May 19, 2004.

The following summarizes the stock option transactions from the expired Employee Incentive Stock Option Plan ("EISOP") and Non-Statutory Stock Option Plan for Directors ("NSSOPD"):

|  | Number      | Weighted average |
|--|-------------|------------------|
| EISOP  | outstanding | exercise price   |
| -----  | -----       | -----            |
| Options outstanding January 1, 2004....                          | 10,200      | 3.44             |
| Exercised  | (4,300)     | 3.49             |
|  | -----       |                  |
| Options outstanding and exercisable at<br>December 31, 2004      | 5 900       | 3.39             |
| Exercised  | (1,600)     | 3.67             |
|  | -----       |                  |
| Options outstanding and exercisable at<br>December 31, 2005..... | 4,300       | 3.29             |
|  | =====       |                  |
| Available for grant at December 31, 2005                         | 0           |                  |
|  | =====       |                  |

F-19

### UNITED-GUARDIAN, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

December 31, 2005 and 2004

NOTE F (continued)

NSSOPD

-----

|   |         |      |
|---|---------|------|
| Options outstanding at January 1, 2004..                    | 14,000  | 3.44 |
| Exercised   | (6,000) | 3.34 |
|   | -----   |      |
| Options outstanding and exercisable at<br>December 31, 2004 | 8,000   | 3.51 |
| Exercised   | (4,000) | 3.51 |
|   | -----   |      |
| Options outstanding and exercisable at<br>December 31, 2005 | 4,000   | 3.51 |
|   | =====   |      |
| Available for grant at December 31, 2005                    | 0       |      |
|   | =====   |      |

In 2004 the Company authorized up to 500,000 shares to be granted under the 2004 Stock Option Plan.

Summarized information about stock options outstanding under these plans at December 31, 2005 is as follows:

| Options Outstanding |          |          | Options Exercisable |          |          |
|---------------------|----------|----------|---------------------|----------|----------|
| Number of Shares    | Weighted | Weighted | Number of Shares    | Weighted | Weighted |

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| Range of Exercise Prices | Outstanding at December 31, 2005 | Average Remaining Contractual Life | Average Exercise Price | Exercisable at December 31, 2005 | Average Exercise Price |
|--------------------------|----------------------------------|------------------------------------|------------------------|----------------------------------|------------------------|
| EISOP                    |                                  |                                    |                        |                                  |                        |
| \$2.06 - \$3.00          | 1,100                            | 2.54                               | \$2.66                 | 1,100                            | \$2.66                 |
| \$3.51                   | 3,200                            | 6.90                               | 3.51                   | 3,200                            | 3.51                   |
| \$2.06 - \$3.51          | 4,300                            | 5.78                               | \$3.29                 | 4,300                            | \$3.29                 |
| NSSOPD                   |                                  |                                    |                        |                                  |                        |
| \$3.51                   | 4,000                            | 1.90                               | 3.51                   | 4,000                            | 3.51                   |

F-20

UNITED-GUARDIAN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

December 31, 2005 and 2004

NOTE G - EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share at December 31, 2005 and 2004:

|   | 2005         | 2004         |
|---|--------------|--------------|
| Numerator:  |              |              |
| Net income  | \$ 2,617,483 | \$ 2,475,057 |
| Denominator:  |              |              |
| Denominator for basic earnings per share (weighted average shares)                                    | 4,935,472    | 4,928,785    |
| Effect of dilutive securities:  |              |              |
| Employee stock options  | 6,386        | 9,241        |
| Denominator for diluted earnings per share (adjusted weighted-average shares) and assumed conversions | 4,941,858    | 4,938,026    |
| Basic and diluted earnings per share  | \$ 0.53      | \$ 0.50      |

In 2005 and 2004 there were no options excluded from the computation of diluted earnings per share.

NOTE H - NATURE OF BUSINESS AND SEGMENT INFORMATION

The Company has the following two reportable business segments: Guardian Laboratories and Eastern Chemical. The Guardian segment conducts research, development and manufacturing of cosmetic ingredients, personal and health care

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products, pharmaceuticals and specialty industrial products. The Eastern segment distributes 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. Segment earnings or loss is based on earnings or loss 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 years ended December 31, 2005 and 2004.

F-21

### UNITED-GUARDIAN, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

December 31, 2005 and 2004

NOTE H (continued)

|  | 2005         |              |              |              |
|--|--------------|--------------|--------------|--------------|
|  | GUARDIAN     | EASTERN      | TOTAL        | GUARDIAN     |
| Revenues from external customers                 | \$11,075,696 | \$ 1,059,300 | \$12,134,996 | \$10,004,893 |
| Depreciation and amortization                    | 94,810       | -            | 94,810       | 91,845       |
| Segment income (loss) before income tax expense* | 3,937,574    | 80,355       | 4,017,929    | 3,725,217    |
| Segment assets                                   | 2,599,895    | 387,570      | 2,987,465    | 2,532,195    |
| Capital expenditure                              | 82,748       | -            | 82,748       | 125,616      |

\* On January 1, 2005 the Company revised the estimated overhead allocated to the Eastern Chemical subsidiary due to reductions in personnel and inventory and an overall downsizing of the Eastern operation. This has resulted in a reduction in the amount of overhead allocated to Eastern and a commensurate increase in the amount of overhead being absorbed by the Guardian division. This has also resulted in an increase in the overhead rate for the Guardian division. If the current allocation had been used for the Eastern subsidiary, Eastern would have had earnings from operations of \$33,527 for the year ended December 31, 2004.

Income before income taxes  
-----

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|   |              |              |
|---|--------------|--------------|
| Total income for reportable segments    | \$ 4,017,929 | \$ 3,633,229 |
| Other income, net                       | 237,459      | 220,991      |
| Corporate headquarters expense          | (166,114)    | (170,821)    |
|   | -----        | -----        |
| Consolidated income before income taxes | \$ 4,089,274 | \$ 3,683,399 |
|   | =====        | =====        |
| <br>Assets                              |              |              |
| -----                                   |              |              |
| Total assets for reportable segments    | \$ 2,987,465 | \$ 2,890,999 |
| Corporate headquarters                  | 12,034,772   | 11,530,376   |
|   | -----        | -----        |
| Total consolidated assets               | \$15,022,237 | \$14,421,375 |
|   | =====        | =====        |

F-22

### UNITED-GUARDIAN, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

December 31, 2005 and 2004

NOTE H (continued)

#### Other Significant Items

|                               | 2005              |           |                        | Segment<br>Totals |
|-------------------------------|-------------------|-----------|------------------------|-------------------|
|                               | Segment<br>Totals | Corporate | Consolidated<br>Totals |                   |
| Capital expenditures          | \$82,748          | \$ 73,872 | \$156,620              | \$125,616         |
| Depreciation and amortization | \$94,810          | \$111,001 | \$205,811              | \$ 91,845         |

#### Geographic Information

|                 | 2005         |                      | 2004         |                      |
|-----------------|--------------|----------------------|--------------|----------------------|
|                 | Revenues     | Long-Lived<br>Assets | Revenues     | Long-Lived<br>Assets |
| United States   | \$ 5,891,221 | \$ 948,480           | \$ 5,634,832 | \$ 997,671           |
| France          | 1,579,943    |                      | 1,275,612    |                      |
| Other countries | 4,663,832    |                      | 4,213,031    |                      |
|                 | -----        | -----                | -----        | -----                |
|                 | \$12,134,996 | \$ 948,480           | \$11,123,475 | \$ 997,671           |
|                 | =====        | =====                | =====        | =====                |

#### Major Customers

|                       |              |              |
|-----------------------|--------------|--------------|
| Customer A (Guardian) | \$ 4,497,547 | \$ 4,289,603 |
|-----------------------|--------------|--------------|

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|                       |              |              |
|-----------------------|--------------|--------------|
| Customer B (Guardian) | 1,357,764    | 1,086,869    |
| All other customers   | 6,279,685    | 5,747,003    |
|                       | -----        | -----        |
|                       | \$12,134,996 | \$11,123,475 |
|                       | =====        | =====        |

### NOTE I - CONTINGENCIES

While the Company has claims that arise from time to time in the ordinary course of its business, the Company is not currently involved in any material claims.

F-23

### UNITED-GUARDIAN, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

December 31, 2005 and 2004

### NOTE J - RELATED PARTY TRANSACTIONS

During the years ended December 31, 2005 and 2004 the Company paid to Henry Globus, a former officer and current Director of the Company, \$19,608 and \$18,852 respectively, for consulting services in accordance with his employment termination agreement of 1998.

During the years ended December 31, 2005 and 2004 the Company paid to Bonamassa, Maietta, and Cartelli, LLP, \$10,500 for accounting and tax services. Lawrence Maietta, a partner in Bonamassa, Maietta, and Cartelli, LLP, is currently a Director of the Company.

During 2004, the Company sold an asset to an officer of the Company. Based upon its estimated fair value on the date of sale, the Company recorded a loss of \$1,724.

F-24