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UNITED GUARDIAN INC
Form 10QSB
November 08, 2006

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

FORM 10-QSB

(Mark One)

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

For the quarterly period ended September 30, 2006

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

For the transition period from _____ to _____

Commission File Number: 1-10526

UNITED-GUARDIAN, INC.

(Exact name of registrant as specified in its charter)

Delaware

11-1719724

(State or other jurisdiction of
incorporation or organization)

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

230 Marcus Boulevard, Hauppauge, New York 11788

(Address of principal executive offices)

(631) 273-0900

(Registrant's telephone number)

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

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

Yes No

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

Yes No

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

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

Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS

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

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

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

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UNITED-GUARDIAN, INC.

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Part I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

UNITED-GUARDIAN, INC.
CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

	NINE MONTHS ENDED SEPTEMBER 30,		THREE MONTHS SEPTEMBER
	2006	2005	2006
	-----	-----	-----
Revenue:			
Net sales	\$ 8,942,178	\$9,697,066	\$ 3,020,366
	-----	-----	-----
Costs and expenses:			
Cost of sales	4,235,851	4,408,053	1,442,052
Operating expenses	1,966,602	1,885,612	592,144
	-----	-----	-----
	6,202,453	6,293,665	2,034,196
	-----	-----	-----
Income from operations	2,739,725	3,403,401	986,170
Other income (expense):			
Investment income	303,718	235,466	108,616
Loss on sale of marketable securities	(1,134)	(113,888)	(785)
Other	(1,060)	(178)	(833)
	-----	-----	-----
Income before income taxes	3,041,249	3,524,801	1,093,168
Provision for income taxes	1,058,000	1,282,300	382,300
	-----	-----	-----
Net income	\$ 1,983,249	\$ 2,242,501	\$ 710,868
	=====	=====	=====
Earnings per common share			
(basic and diluted)	\$.40	\$.45	\$.14
	=====	=====	=====
Weighted average shares - basic	4,941,494	4,934,528	4,942,139
	=====	=====	=====
Weighted average shares - diluted	4,944,637	4,941,266	4,944,704
	=====	=====	=====

See notes to consolidated financial statements

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UNITED-GUARDIAN, INC.
CONSOLIDATED BALANCE SHEETS

	SEPTEMBER 30, 2006	DECEMBER 31, 2005
ASSETS	(UNAUDITED)	(AUDITED)
Current assets:		
Cash and cash equivalents	\$ 2,264,167	\$ 3,425,593
Temporary investments	764,550	699,363
Marketable securities	6,631,398	7,066,797
Accounts receivable, net of allowance for doubtful accounts of \$36,288 and \$47,500 at September 30, 2006 and December 31, 2005, respectively	1,540,320	1,083,992
Inventories (net)	2,007,113	1,031,563
Prepaid expenses and other current assets	365,480	440,380
Deferred income taxes	218,901	217,389
Total current assets	13,791,929	13,965,077
Property, plant and equipment:		
Land	69,000	69,000
Factory equipment and fixtures	3,108,142	3,068,050
Building and improvements	2,161,175	2,133,422
Waste disposal plant	133,532	133,532
	5,471,849	5,404,004
Less: Accumulated depreciation	4,599,873	4,455,524
	871,976	948,480
Other assets	148,430	108,680
	\$ 14,812,335	\$ 15,022,237

See notes to consolidated financial statements

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UNITED-GUARDIAN, INC.
CONSOLIDATED BALANCE SHEETS

	September 30, 2006	DECEMBER 31, 2005
	----- (UNAUDITED)	----- (AUDITED)
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Dividends payable	\$ -	\$1,086,391
Accounts payable	242,992	148,051
Accrued expenses	394,055	448,990
Taxes Payable	62,303	-
	-----	-----
Total current liabilities	699,350	1,683,432
	-----	-----
Deferred income taxes	59,817	59,817
	-----	-----
Stockholders' equity:		
Common stock \$.10 par value, authorized, 10,000,000 shares; 5,004,339 and 5,000,339 shares issued, respectively, and 4,942,139 and 4,938,139 shares outstanding, respectively	500,434	500,034
Capital in excess of par value	3,792,478	3,778,838
Accumulated other comprehensive loss	(71,939)	(84,365)
Retained earnings	10,191,825	9,444,111
Treasury stock, at cost; 62,200 shares	(359,630)	(359,630)
	-----	-----
Total stockholders' equity	14,053,168	13,278,988
	-----	-----
	\$ 14,812,335	\$ 15,022,237
	=====	=====

See notes to consolidated financial statements

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UNITED-GUARDIAN, INC. CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	NINE MONTHS ENDED SEPTEMBER 30,	
	2006	2005
Cash flows provided by operating activities:		
Net income	\$ 1,983,249	\$ 2,242,501
Adjustments to reconcile net earnings to net cash flows from operations:		
Depreciation and amortization	144,349	149,269
Net realized loss on sale of marketable securities	1,134	116,512
Provision for doubtful accounts	(11,212)	(11,029)
Reduction of inventory obsolescence reserve	19,000	-
Increase (decrease) in cash resulting from changes in operating assets and liabilities:		
Accounts receivable	(445,116)	(617,022)
Inventories	(994,550)	425,882
Prepaid expenses and other current and non-current assets	26,438	74,933
Accounts payable	94,941	35,094
Accrued expenses and taxes payable	7,368	(32,241)
	825,601	2,383,899
Cash flows from investing activities:		
Acquisition of property, plant and equipment	(67,845)	(108,878)
Net change in temporary investments	(65,187)	(296,694)
Purchase of marketable securities	(1,646,827)	(4,683,147)
Proceeds from sale of marketable securities	2,100,718	4,116,413
	320,859	(972,306)
Cash flows from financing activities:		
Proceeds from exercise of stock options	14,040	19,905
Dividends paid	(2,321,926)	(2,120,812)
	(2,307,886)	(2,100,907)
Net decrease in cash and cash equivalents	(1,161,426)	(689,314)
Cash and cash equivalents at beginning of period	3,425,593	3,735,945
Cash and cash equivalents at end of period	\$ 2,264,167	\$ 3,046,631

See notes to consolidated financial statements

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UNITED-GUARDIAN, INC. CONSOLIDATED NOTES TO FINANCIAL STATEMENTS

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

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

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

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

At September 30, 2006 the Company had 4,300 share-based awards that were outstanding and exercisable, with a weighted average exercise price of \$3.29, an aggregate intrinsic value of \$25,833, and a weighted average remaining term of 5.08 years. All of those options were fully vested as of December 31, 2005. The Company did not grant any options during the nine months ended September 30, 2006 and 2005.

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

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

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

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

	Nine Months Ended September 30, 2005 -----
Net income as reported	\$2,242,501
Add back (deduct): Total stock-based employee compensation expense determined under APB 25 for all awards, net of related tax effects	--
Deduct: Total stock-based employee compensation expense determined under fair value-based method for all awards, net of related tax effects	--
Pro forma net income	\$2,242,501 =====
Income per share:	
Basic--as reported	\$.45
Basic--pro forma	\$.45
Diluted--as reported	\$.45
Diluted--pro forma	\$.45

4. Marketable Securities

September 30, 2006 -----	Cost -----	Fair Value -----	Unrealized Gain/(Loss) -----
Available for Sale:			
U.S. Treasury and agencies	\$2,347,646	\$2,349,453	\$ 1,807
Fixed income mutual funds	4,170,048	4,046,177	(123,871)
Equity and other mutual funds	228,643	235,768	7,125
	-----	-----	-----
	\$6,746,337	6,631,398	(114,939)
	=====	=====	=====

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December 31, 2005	Cost	Fair Value	Gain/(Loss)
-----	-----	-----	-----
Available for Sale:			
U.S. Treasury and agencies	\$2,046,900	\$2,028,984	\$ (17,916)
Corporate debt securities	900,595	892,110	(8,485)
Fixed income mutual funds	4,028,072	3,928,513	(99,559)
Equity and other mutual funds	225,793	217,190	(8,603)
	-----	-----	-----
	\$7,201,360	\$7,066,797	\$ (134,563)
	=====	=====	=====

5. Inventories - Net

Inventories consist of the following:	September 30, 2006	December 31, 2005
	-----	-----
Raw materials and work in process	\$ 338,140	\$ 376,308
Finished products and fine chemicals	1,668,973	655,255
	-----	-----
	\$2,007,113	\$1,031,563
	=====	=====

One of the Company's pharmaceutical products, Renacidin Irrigation, is currently manufactured for the Company by Hospira, Inc., formerly a division of Abbott Laboratories, in Rocky Mount, North Carolina. Hospira is changing the manufacturing facility for Renacidin Irrigation to Clayton, North Carolina, and as a result the Company is in the process of obtaining F.D.A. approval to change to the new facility. Since approval is not expected until the end of 2007, the Company brought in sufficient inventory to last until the new facility is approved. This has resulted in an increase of approximately \$1 million in the Company's finished goods inventory as compared with December 2005. The Company expects all of that inventory to be sold prior to its expiration date.

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

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

Cash payments for taxes were \$837,442 and \$983,553 for the nine months ended September 30, 2006 and 2005, respectively. During the nine months ended September 30, 2006 the Company paid \$798 in interest. No payments were made for interest in 2005.

The Company paid dividends of \$2,321,926 and \$2,120,812 for the nine months ended September 30, 2006 and 2005, respectively.

7. Comprehensive Income (Loss)

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

	Nine months ended 2006 -----	September 30, 2005 -----	Three months 2006 -----
Net income	\$1,983,249	\$2,242,501	\$ 710,868
Other comprehensive income (loss):			
Unrealized gain (loss) on marketable securities during period	18,468	(82,306)	117,500
Less: reclassification adjustment for net losses (gain) included in net income	1,158	116,512	7,000
Other comprehensive income (loss) before tax	19,626	34,206	118,300
Income tax expense (benefit) related to other comprehensive income	7,200	12,800	45,000
Other comprehensive income (loss), net of tax.....	12,426	21,406	73,300
Comprehensive income net of tax	\$1,995,675	\$2,263,907	\$ 784,100

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

8. Earnings Per Share

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

	Nine months ended September 30, 2006 2005 -----		Three months September 2006 -----	
Numerator:				
Net income	\$1,983,249	\$2,242,501	\$ 710,868	\$ 710,868
Denominator:				
Denominator for basic earnings per share (weighted average shares)	4,941,494	4,934,528	4,942,139	4,942,139
Effect of dilutive securities:				
Employee stock options	3,143	6,738	2,565	2,565
Denominator for diluted earnings per share (adjusted weighted-average shares) and assumed conversions	4,944,637	4,941,266	4,944,704	4,944,704
Basic and diluted earnings per share	\$ 0.40	\$ 0.45	\$ 0.14	\$ 0.14

9. The Company has two reportable business segments: the Guardian

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Laboratories Division ("Guardian"), which develops and manufactures cosmetic ingredients, personal and health care products, pharmaceuticals and specialty industrial products; and Eastern Chemical Corporation ("Eastern"), a wholly-owned subsidiary of the Company, which distributes a line of fine chemicals, test solutions, dyes and reagents.

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

	2006			Nine months ended September 30,
	GUARDIAN	EASTERN	TOTAL	GUARDIAN
Revenues from external customers	\$ 8,139,067	\$ 803,111	\$ 8,942,178	\$ 8,847,905
Depreciation and amortization	64,906	-	64,906	65,187
Segment income before income taxes	2,794,693	68,593	2,863,286	3,459,359
Segment assets	3,477,887	377,716	3,855,603	2,893,000
Capital expenditure	38,973	-	38,973	32,825
Reconciliation to Consolidated Amounts				
Income before income taxes				

Total earnings for reportable segments			\$ 2,863,286	
Other income, net			301,524	
Corporate headquarters expense			(123,561)	

Consolidated earnings before income taxes			\$ 3,041,249	
			=====	
Assets				

Total assets for reportable segments			\$ 3,855,603	
Corporate headquarters			10,956,732	

Total consolidated assets			\$14,812,335	
			=====	

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	2006			Three months ended September 30
	GUARDIAN	EASTERN	TOTAL	GUARDIAN
Revenues from external customers	\$ 2,755,062	\$ 265,304	\$ 3,020,366	\$ 2,793,515
Depreciation and amortization	22,659	-	22,659	20,437
Segment income before income taxes	1,010,398	22,529	1,032,927	1,131,460
Capital Expenditure	20,170	0	20,170	4,909

Reconciliation to Consolidated Amounts

	2006			Three months ended September 30
	GUARDIAN	EASTERN	TOTAL	GUARDIAN
Income before income taxes				
Total earnings for reportable segments			\$ 1,032,927	
Other income, net			106,998	
Corporate headquarters expense			(46,757)	
Consolidated earnings before income taxes			\$ 1,093,168	
Other Significant items				

	2006			Nine months ended September 30
	Segment Totals	Corporate	Consolidated Totals	Segment Totals
Capital expenditures	\$ 38,973	\$ 28,872	\$ 67,845	\$ 32,825
Depreciation and amortization	64,906	79,443	144,349	65,187

Geographic Information

	2006		2005	
	Revenues	Long-Lived Assets	Revenues	Long-Lived Assets
United States	\$ 4,225,334	\$ 871,976	\$ 4,608,137	\$ 871,976
France	1,052,692		1,182,796	
Other countries	3,664,152		3,906,133	
	\$ 8,942,178	\$ 871,976	\$ 9,697,066	\$ 871,976

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	2006		2005	
	Revenues	Long-Lived Assets	Revenues	Lo
Major Customers				

Customer A (Guardian)**	\$ 3,071,648		\$ 3,721,307	
Customer B (Guardian)**	868,393		1,022,408	
All other customers	5,002,137		4,953,351	
	-----		-----	
	\$ 8,942,178		\$ 9,697,066	
	=====		=====	

** At September 30, 2006 Customers A and B had balances approximating 33% and 11% of net accounts receivable, respectively. At September 30, 2005 Customers A and B had balances approximating 37% and 15% of net accounts receivable, respectively.

RECENT ACCOUNTING PRONOUNCEMENTS

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

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin 108, "Considering the Effects on Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements," ("SAB 108"). SAB 108 requires registrants to quantify errors using both the income statement method (i.e. iron curtain method) and the rollover method and requires adjustment if either method indicates a material error. If a correction in the current year relating to prior year errors is material to the current year, then the prior year financial information needs to be corrected. A correction to the prior year results that are not material to those years, would not require a "restatement process" where prior financials would be amended. SAB 108 is effective for fiscal years ending after November 15, 2006. We do not anticipate that SAB 108 will have a material effect on our financial position, results of operations or cash flows.

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to define fair value, establish a framework for measuring fair value in accordance with generally accepted accounting principles, and expand disclosures about fair value measurements. SFAS No. 157 will be effective for fiscal years beginning after November 15, 2007, which for the Company will be the 2008 calendar (and fiscal) year. The Company is assessing the impact the adoption of SFAS No. 157 will have on the Company's consolidated financial position and results of operations.

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." SFAS No. 158 requires the recognition of the funded status of a benefit plan in the balance sheet; the recognition in other comprehensive income of gains or losses and prior service costs or credits arising during the period but which are not included as components of periodic benefit cost; the measurement of defined benefit plan assets and obligations as of the balance sheet date; and disclosure of additional information about the effects on periodic benefit cost for the following fiscal year arising from delayed recognition in the current period. In addition, SFAS No. 158 amends SFAS No. 87, "Employers' Accounting for Pensions," and SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," to include guidance regarding selection of assumed discount rates for use in measuring the benefit obligation. SFAS No. 158 is effective for our year ending December 31, 2006. The Company is not currently able to quantify the effects of the adoption of SFAS No. 158 since actual amounts will depend on year-end calculations.

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

FORWARD LOOKING STATEMENTS

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

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

Accordingly, results actually achieved may differ materially from those anticipated as a result of such forward-looking statements, and those statements

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speak only as of the date they are made. The Company does not undertake, and specifically disclaims, any obligation to update any forward-looking statements to reflect events or circumstances occurring after the date of such statements.

OVERVIEW

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

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

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

Eastern distributes a line of fine organic chemicals, research chemicals, test solutions, indicators, dyes and reagents. Eastern's products are marketed through advertising in trade publications and direct mailings. Since the Company's business activities and marketing efforts over the past several years have focused increasingly on the Guardian division, the Company has reduced Eastern's inventory levels in order to make it more marketable in the event the Company decides to sell it at some future date. This has resulted in some reduction in sales as compared with previous years. Sales of this division have also declined as a result of increased competition from new and existing competitors.

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

Critical Accounting Policies

As disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2005, the discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in conformity with U.S. generally accepted accounting principles. The preparation of those financial statements required us to make estimates and assumptions that affect the amount of assets, liabilities, revenues and expenses reported in those financial statements. Those estimates

and assumptions can be subjective and complex, and consequently actual results could differ from those estimates and assumptions. Our most critical accounting

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policies relate to revenue recognition, concentration of credit risk, inventory, pension costs, patents and other intangible assets, and income taxes. Since December 31, 2005, there have been no significant changes to the assumptions and estimates related to those critical accounting policies.

The following discussion and analysis covers material changes in the financial condition of the Company since the year ended December 31, 2005, and a comparison of the results of operations for the nine and three months ended September 30, 2006 and September 30, 2005. This discussion and analysis should be read in conjunction with "Management's Discussion and Analysis or Plan of Operation" included in the Company's Form 10-KSB for the year ended December 31, 2005.

RESULTS OF OPERATIONS

Revenue -----

For the nine-month period ended September 30, 2006 net sales decreased \$754,888 (7.8%) versus the comparable period in 2005. Guardian had a sales decrease of \$708,838 (8.0%) and Eastern had a sales decrease of \$46,050 (5.4%).

For the three-month period ended September 30, 2006, net sales decreased \$29,128 (1.0%) versus the comparable period in 2005. Guardian had a sales decrease of \$38,453 (1.4%) and Eastern had a sales increase of \$9,325 (3.6%).

The decline in Guardian's sales for the nine-month period ended September 30, 2006 compared to the same period in 2005 was due to a number of factors:

(a) On March 1, 2005 the Company increased prices on its pharmaceutical products, which resulted in an unusually high volume of sales of those products in the first quarter of 2005 compared to the first quarter of 2006. This extra buying in the first quarter of 2005 continued to impact sales through the first nine months, with sales of the Company's pharmaceutical products for the first nine months of 2006 down 5% from the first nine months of 2005. It is anticipated that sales of these products for the full year in 2006 will be substantially the same as 2005.

(b) In the first quarter of 2005 the Company experienced an unusual number of shipments of orders that some customers had requested not be shipped out at the very end of 2004. That situation did not recur in 2006.

(c) Sales of the Company's personal care products to the Company's largest customer ("Customer A") and second largest customer ("Customer B") were down in the first 9 months of 2006 compared to the same period in 2005 by 17% and 15% respectively. However, sales to Customer A in October were almost double sales to that customer in October 2005, so the Company believes that much of the decrease in sales for the nine-month period was due to the timing of orders. This is supported by information provided to the Company by Customer A that showed that Customer A's sales of the Company's products to its own customers were actually up for the nine-month period. For this reason the Company does not believe that the reduced purchases from that customer are an indication or trend of any loss of customers or sales.

The overall decrease of 1% in Guardian sales for the third quarter of 2006 was primarily due to a decrease in sales to the Company's two largest customers, which was almost entirely offset by higher sales to a number of its existing

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customers. The Company believes that this temporary decline in sales is primarily the result of the timing of inventory purchases versus sales, and does not indicate any real reduction in the sales level of Guardian products by its customers.

The changes in Eastern sales for the three- and nine-month period ended September 30, 2006, is believed to be due to normal fluctuations in the purchasing patterns of its customers.

Cost of Sales

Cost of Sales as a percentage of sales increased to 47.4% for the nine months ended September 30, 2006, from 45.5% for the comparable period in 2005. For the three months ended September 30, 2006 Cost of Sales as a percentage of sales increased to 47.7% as compared with 44.8% for the three months ended September 30, 2005. These increases were due to increases in standard overhead rates for Guardian that resulted primarily from increases in insurance and payroll and payroll-related costs.

Operating Expenses

Operating Expenses increased \$80,990 (4.3%) for the nine months ended September 30, 2006 compared with the comparable period in 2005. This increase was mainly attributable to increases in payroll and payroll-related expenses partially offset by the reduction of the Company's bad debt reserve. For the three-month period ended September 30, 2006, Operating Expenses increased \$31,871 (5.7%) when compared with the comparable period ended September 30, 2005. This increase was due mainly to increases in payroll and payroll related expenses.

Other Income

Other Income increased to \$301,524 from \$121,400 for the nine month period ended September 30, 2006 and September 30, 2005, respectively, an increase of \$180,124 (148.4%). This increase was mainly attributable to the net effect of an increase in investment income of \$68,252 in 2006 and a decrease in losses on the sale of marketable securities of \$112,754 in 2006. In 2005 the sale of a portfolio of securities, primarily bonds, the bulk of which had been managed for the Company by a financial institution, resulted in a realized loss of approximately \$116,000, of which approximately \$107,000 had previously been recorded in the equity section of the balance sheet as an "accumulated other comprehensive loss". Approximately \$108,000 of the above loss was due to the sale of the bond portfolio managed by a financial institution, which, over the 18 months the Company held it, had realized interest income net of broker fees of approximately \$154,000. The sale of bonds in the second quarter of 2006 resulted in a loss of \$349. Investment income is recorded net of brokerage fees.

For the three months ended September 30, 2006, Other Income increased \$32,610 (43.8%) which was mainly attributable to higher investment income due to an increase in interest rates.

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Provision for Income Taxes

The Provision for Income Taxes decreased \$224,300 (17.5%) for the nine

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months ended September 30, 2006 when compared with the comparable period in 2005. This decrease was due to (a) decreased earnings before taxes of \$483,552 in 2006, and (b) the reduction in taxable capital gains in 2006 by capital losses carried forward from when the Company recorded \$116,000 in losses upon the sale of its bond portfolio in 2005.

The Provision for Income Taxes decreased \$39,100 (9.3%) for the three months ended September 30, 2006 which is mainly due to a decrease in earnings before taxes of \$103,948.

The Company had effective income tax rates of 34.8% and 36.4% for the nine months ended September 30, 2006 and September 30, 2005, respectively, and 35% and 35.2% for the three months ended September 30, 2006 and September 30, 2005 respectively. Differences in the effective income tax rate from the statutory federal income tax rate arise primarily from capital loss carryforwards, state taxes net of federal benefits, and other differences.

LIQUIDITY AND CAPITAL RESOURCES

Working capital increased from \$12,281,645 at December 31, 2005 to \$13,092,579 at September 30, 2006. The current ratio increased from 8.3 to 1 at December 31, 2005 to 19.7 to 1 at September 30, 2006. The increase in current ratio was primarily due to the net effect of a decrease in dividends payable and increases in inventories, partially offset by decreases in cash and investments. The increase in inventory was due primarily to the Company bringing in additional inventory of Renacidin Irrigation while it is awaiting F.D.A. approval to change the manufacturing site for the product, which is expected to take about a year. The Company believes that all of the additional inventory will be sold prior to its expiration date.

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

The Company generated cash from operations of \$825,601 and \$2,383,899 for the nine months ended September 30, 2006 and September 30, 2005, respectively. The decrease was primarily due to decreases in net income from operations and increases in inventory.

During the nine month period ended September 30, 2006, \$320,859 was provided by investment activities, as compared with the nine month period ended September 30, 2005, when \$972,306 was used in investing activities. The change is mainly due to the net effect of the sale (primarily bonds) and purchases (primarily bond funds) of marketable securities during the nine months ending September 30, 2005 and an increase in investments due to reinvested income from mutual funds and temporary investments in the nine months ending September 30, 2006.

Cash used in financing activities was \$2,307,886 and \$2,100,907 for the nine months ended September 30, 2006 and September 30, 2005, respectively. The increase was due primarily to an increase in dividends paid during the nine months ended September 30, 2006.

Item 3. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

Within 90 days prior to the filing of this Quarterly Report on Form 10-QSB

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

(b) Changes in Internal Controls

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

PART II - OTHER INFORMATION

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

a. Exhibits

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

b. Reports on Form 8-K

There was one report on Form 8-K filed during the fiscal quarter ended September 30, 2006. It was filed on August 10, 2006 and related to the issuance of an earnings release by the Company on August 9, 2006.

SIGNATURES

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

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UNITED-GUARDIAN, INC.
(Registrant)

By: /S/ ALFRED R. GLOBUS

Alfred R. Globus
Chief Executive Officer

By: /S/ KENNETH H. GLOBUS

Kenneth H. Globus
Chief Financial Officer

Date: November 5, 2006