IGI INC
Form 10-Q/A
May 14, 2004

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q/A
QUARTERLY REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For Quarter Ended	Commission File No.
September 30, 2003	001-08568

IGI, Inc.
(Exact name of registrant as specified in its charter)

Delaware	01-0355758
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

105 Lincoln Avenue, Buena, NJ	08310
(Address of principal executive offices)	(Zip Code)

856-697-1441
Registrant's telephone number, including area code

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 X No ___

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

Yes ___ No X

The number of shares outstanding of the issuer's class of common stock, as of the latest practicable date:

Common Shares Outstanding at October 28, 2003 is 11,355,965

EXPLANATORY STATEMENT

Prior to filing its Form 10-K for the fiscal year ended December 31, 2003, IGI, Inc. was informed by Johnson & Johnson Consumer Products, Inc. ("J&J") that there was an error in the calculation of the 2003 royalty due to the Company by J&J. The correction of the error resulted in a reduction of revenues, with a corresponding impact on net loss, of $42,000 in the second quarter of 2003 and $51,000 in the third quarter of 2003. The impact of the J&J error on the first quarter of 2003 was immaterial, and has been included in the second quarter adjustment.

Also, during the third quarter ended September 30, 2003, the Company entered into an employment agreement with Dr. Michael Holick to serve as the Company's Vice President of Research and Development and Chief Scientific Officer. In addition, the Company entered into a memorandum of agreement with Dr. Holick to license all of his rights to the parathyroid hormone related peptide technologies and the glycoside technologies that he had developed for various clinical usages (the PTH and Glycoside Technologies). Pursuant to this agreement, Dr. Holick was paid a $50,000 non-refundable payment. The payment was originally capitalized and included with prepaid expenses and other current assets as of September 30, 2003. Since the PTH and Glycoside Technologies are in a preliminary development phase and do not have any readily determinable alternative future use, it was subsequently determined that the payment should have been expensed. Product development and research expenses have been increased by $50,000 in the consolidated statements of operations for the three and nine months ended September 30, 2003.

Except as otherwise specifically noted, all information contained herein is as of September 30, 2003 and does not reflect any events or changes in information that may have occurred subsequent to that date.

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ITEM 1. Financial Statements

PART I FINANCIAL INFORMATION

IGI, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except share and per share information)
(Unaudited)

	Three months ended September 30,		Nine months end September 30,	
	2003 (as restated, see note 2)	2002	2003 (as restated, see note 2)	
Revenues:				
Sales, net	$ 748	$ 861	$ 2,271	$
Licensing and royalty income	151	285	480	

Total revenues	899	1,146	2,751	
Cost and expenses:				
Cost of sales	326	342	1,011	
Selling, general and administrative expenses	589	567	1,941	
Product development and research expenses	225	152	528	
Operating income (loss)	(241)	85	(729)	
Interest income (expense), net	-	9	8	
Other income, net	-	-	-	
Loss on early extinguishment of debt	-	-	-	
Income (loss) from continuing operations before provision for income taxes	(241)	94	(721)	
Provision for income taxes	1	935	3	
Loss from continuing operations	(242)	(841)	(724)	
Discontinued operations:				
Loss from operations of discontinued business	-	-	-	
Gain (loss) on sale of discontinued business	(15)	(36)	154	
Net income (loss)	(257)	(877)	(570)	
Mark to market for detachable stock warrants	-	-	-	
Net income (loss) attributable to common stock	$ (257)	$ (877)	$ (570)	$
Basic and Diluted Earnings (Loss) per Common Share				
Continuing operations	$ (.02)	$ (.07)	$ (.06)	$
Discontinued operations	-	-	.01	
Net income (loss) attributable to common stock	$ (.02)	$ (.07)	$ (.05)	$
Weighted Average of Common Stock and Common Stock Equivalents Outstanding				
Basic and diluted	11,355,965	11,766,288	11,379,905	11,4

The accompanying notes are an integral part of the consolidated financial statements.

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IGI, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share information)

	September 30, 2003	December 31,
	(unaudited) (as restated,	

	see note 2)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 632	$ 1,999
Marketable securities	803	-
Accounts receivable, less allowance for doubtful accounts of $21 and $35 in 2003 and 2002, respectively	446	460
Licensing and royalty income receivable	99	166
Inventories	202	209
Prepaid expenses and other current assets	95	146
Total current assets	2,277	2,980
Property, plant and equipment, net	2,763	2,862
Other assets	75	87
Total assets	$ 5,115	$ 5,929
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 18	$ 18
Accounts payable	149	115
Accrued payroll	95	71
Other accrued expenses	330	551
Income taxes payable	11	16
Deferred revenue	187	145
Total current liabilities	790	916
Deferred revenue	239	340
Long term debt, net of current portion	195	164
Total liabilities	1,224	1,420
Stockholders' equity:		
Common stock $.01 par value, 50,000,000 shares authorized; 13,321,705 and 13,262,657 shares issued in 2003 and 2002, respectively	133	133
Additional paid-in capital	23,674	23,644
Accumulated deficit	(18,523)	(17,953
Less treasury stock at cost, 1,965,740 and 1,878,640 shares at cost in 2003 and 2002, respectively	(1,395)	(1,315
Accumulated other comprehensive income	2	-
Total stockholders' equity	3,891	4,509
Total liabilities and stockholders' equity	$ 5,115	$ 5,929

The accompanying notes are an integral part of the consolidated financial statements.

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IGI, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

(Unaudited)

	Nine months ended September 30, 2003 (as restated, see note 2)	2002
Cash flows from operating activities:		
Net income (loss)	$ (570)	$ 8,063
Reconciliation of net income (loss) to net cash used in operating activities:		
Gain on sale of discontinued operations	(154)	(12,432)
Gain on sale of marketable securities	-	(58)
Write down of EVSCO facility to net realizable value	-	632
Depreciation and amortization	196	235
Amortization of deferred financing costs and debt discount	-	275
Extraordinary loss on early extinguishment of debt	-	2,654
Provision for accounts and notes receivable and inventories	17	21
Recognition of deferred revenue	(101)	(101)
Interest expense related to subordinated note agreements	-	41
Directors' stock issuance	26	41
Changes in operating assets and liabilities:		
Accounts receivable	27	(203)
Inventories	(23)	(181)
Receivables due under licensing and royalty agreements	67	60
Prepaid expenses and other assets	51	86
Accounts payable and accrued expenses	(163)	(599)
Income taxes payable	(5)	926
Deferred revenue	42	-
Change in net assets of discontinued operations	-	(896)
Net cash used in operating activities	(590)	(1,436)
Cash flows from investing activities:		
Capital expenditures	(86)	(54)
Capital expenditures for discontinued operations	-	(8)
Purchase of marketable securities	(801)	-
Proceeds from sale of marketable securities	-	58
Proceeds from sale of property, plant and equipment	-	550
Increase in other assets	1	(32)
Proceeds from sale of discontinued operations	154	16,427
Net cash provided by (used in) investing activities	(732)	16,941
Cash flows from financing activities:		
Borrowings under revolving credit agreement	-	5,958
Repayment of revolving credit agreement	-	(8,284)
Repayment of debt	-	(9,516)
Borrowings from EDA loan	46	197
Repayment of EDA loan	(15)	(11)
Proceeds from exercise of common stock options and purchase of common stock	4	36
Treasury shares purchased	(80)	(1,315)
Net cash used in financing activities	(45)	(12,935)

Net increase (decrease) in cash and cash equivalents	(1,367)	2,570
Cash and cash equivalents at beginning of period	1,999	10
Cash and cash equivalents at end of period	$ 632	$ 2,580

The accompanying notes are an integral part of the consolidated financial statements.

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IGI, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The accompanying consolidated financial statements have been prepared by IGI, Inc. without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"), and reflect all adjustments which, in the opinion of management, are necessary for a fair presentation of the results for the interim periods presented. All such adjustments are of a normal recurring nature.

Certain information in footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the SEC, although the Company believes that the disclosures contained herein are adequate to make the information presented not misleading. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2002 (the "2002 10-K Annual Report").

Certain previously reported amounts have been reclassified to conform with the current year presentation.

2. Restatement

Prior to filing its Form 10-K for the fiscal year ended December 31, 2003, the Company was informed by Johnson & Johnson Consumer Products, Inc. ("J&J") that there was an error in the calculation of the 2003 royalty due to the Company by J&J. The correction of the error resulted in a reduction of revenues, with a corresponding impact on net loss, of $42,000 in the second quarter of 2003 and $51,000 in the third quarter of 2003. The impact of the J&J error on the first quarter of 2003 was immaterial, and has been included in the second quarter adjustment.

Also, during the third quarter ended September 30, 2003, the Company entered into an employment agreement with Dr. Michael Holick to serve as the Company's Vice President of Research and Development and Chief Scientific Officer. In addition, the Company entered into a memorandum of agreement with Dr. Holick to license all of his rights to the parathyroid hormone related peptide technologies and the glycoside technologies that he had developed for various clinical usages (the PTH and Glycoside Technologies). Pursuant to this agreement, Dr. Holick was paid a $50,000 non-refundable payment. The payment was originally capitalized and included with prepaid expenses and other current assets as of September 30, 2003. Since the PTH and Glycoside Technologies are in a preliminary development phase and do not have any readily determinable alternative future use, it was subsequently determined that the payment should have been expensed.

The consolidated statements of operations for the three and nine months ended September 30, 2003, the consolidated statement of cash flows for the nine months ended September 30, 2003, and the consolidated balance sheet as of September 30, 2003 have been restated to reflect the adjustments to royalty income and product development and research expenses. The following tables set forth the line items impacted in the consolidated statements of operations, consolidated balance sheet and the consolidated statement of cash flows.

	For the three months ended September 30, 20	
Selected statement of operations data:	As originally reported	As restated
Licensing and royalty income	$ 202	$ 151
Total revenues	950	899
Product development and research expenses	175	225
Operating loss	(140)	(241)
Loss from continuing operations before provision for income taxes	(140)	(241)
Loss from continuing operations	(141)	(242)
Net loss	(156)	(257)
Loss attributable to common stock	(156)	(257)
Basic and Diluted Earnings (Loss) per Common Share		
Continuing operations	$(.01)	$(.02)
Discontinued operations	-	-
Net income (loss) attributable to common stock	$(.01)	$(.02)

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IGI, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited), Continued

	For the nine months ended September 30, 200	
Selected statement of operations data:	As originally reported	As restated
Licensing and royalty income	$ 573	$ 480
Total revenues	2,844	2,751
Product development and research expenses	478	528
Operating loss	(586)	(729)

Loss from continuing operations before provision for income taxes	(578)	(721)
Loss from continuing operations	(581)	(724)
Net loss	(427)	(570)
Net loss attributable to common stock	(427)	(570)
Basic and Diluted Earnings (Loss) per Common Share		
Continuing operations	$ (.05)	$ (.06)
Discontinued operations	.01	.01
Net income (loss) attributable to common stock	$ (.04)	$ (.05)

	As of September 30, 2003	
Selected balance sheet data:	As originally reported	As restated
Licensing and royalty income receivable	$ 150	$ 99
Prepaid expenses and other current assets	145	95
Total current assets	2,378	2,277
Total assets	5,216	5,115
Deferred revenue	145	187
Total current liabilities	748	790
Total liabilities	1,182	1,224
Accumulated deficit	(18,380)	(18,523)
Total stockholders' equity	4,034	3,891
Total liabilities and stockholders' equity	5,216	5,115

	For the nine months ended September 30, 200	
Selected statement of cash flows data:	As originally reported	As restated
Net loss	$(427)	$(570)
Receivables due under licensing and royalty agreements	16	67
Prepaid expenses and other assets	1	51
Deferred revenue	-	42

3. Discontinued Operations

On May 31, 2002, the shareholders of the Company approved, and the Company consummated, the sale of the assets and transfer of the liabilities of the Companion Pet Products division, which marketed companion pet care related products. The Companion Pet Products division, which is presented as a discontinued operation, incurred a loss of $36,000 from the sale of the Companion Pet Products division for the three months ended September 30, 2002 related to post-closing adjustments. For the three months ended September 30, 2003, the Company incurred a loss of $15,000 related to regulatory expenses at the Companion Pet Products site. For the nine months ended September 30, 2002, the Company incurred a loss from discontinued operations of $401,000 and a $12,432,000 gain on the sale of the Companion Pet Products division. For the nine months ended September 30, 2003, the Company had a net gain of $154,000, which represented an insurance settlement, net of legal costs, of $169,000 for damages incurred by the Company as a result of the heating oil leak at the Companion Pet Products manufacturing site (see Note 8), reduced by the $15,000 of regulatory expenses.

4. Marketable Securities

Marketable securities at September 30, 2003 consists of an investment in a short term bond mutual fund. The Company currently classifies all marketable securities as available-for-sale. Securities classified as available-for-sale are required to be reported at fair value with unrealized gains and losses, net of taxes, excluded from earnings and shown separately as a component of accumulated other comprehensive income within stockholders' equity. Realized gains and losses on the sale of securities available-for-sale are determined using the specific-identification method.

The amortized cost, gross unrealized gains and losses and fair value of the available-for-sale marketable securities as of September 30, 2003 are as follows (amounts in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Mutual Funds				
2003	$800	$3	$ -	$803

There were $0 and $58,000 of sales of available-for-sale marketable securities during the nine months ended September 30, 2003 and 2002, respectively.

5. Debt

In the prior year, the Company received a $246,000 loan commitment from NJEDA to provide partial funding for the costs of investigation and remediation of the environmental contamination discovered at the Companion Pet Products facility in March 2001. The loan requires monthly principal payments over a term of ten years at a rate of interest of 5%. The Company has received funding of $242,000 through September 30, 2003. The current balance of the loan at September 30, 2003 is $213,000.

6. Inventories

Inventories are valued at the lower of cost, using the first-in, first-out ("FIFO") method, or market. Inventories at September 30, 2003 and December 31, 2002 consist of:

	September 30, 2003	December 31, 2002
	(amounts in thousands)	
Finished goods	$ 32	$ 52
Raw materials	170	157
Total	$202	$209

7. Stock-Based Compensation

Compensation costs attributable to stock option and similar plans are recognized based on any difference between the quoted market price of the stock on the date of grant over the amount the employees and directors are required to pay to acquire the stock (the intrinsic value method). No stock-based employee or director compensation cost is reflected in net income (loss) for options that have been granted, as all options granted under the plans had an exercise price equal to the market value of the underlying common stock on the date of grant. Since the Company uses the intrinsic value method, it makes pro forma disclosures of net income (loss) and net income (loss) per share as if the fair-value based method of accounting had been applied.

If compensation cost for all grants under the Company's stock option plans had been determined based on the fair value at the grant date consistent with the provisions of Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation," the Company's net income (loss) attributable to common stock and net income (loss) per share would have changed to the pro forma amounts indicated below (amounts in thousands):

	Three months ended September 30,		Nine months ende
	2003	2002	2003
	(as restated)		(as restated)
Net income (loss) attributable to common stock - as reported	$(257)	$(877)	$(570)
Deduct: Total stock-based employee			

and directors compensation expense determined under fair value based method	(5)	(14)	(20)
Net income (loss) attributable to common stock - pro forma	$(262)	$(891)	$(590)
Net income (loss) per share - as reported Basic and diluted	$(.02)	$(.07)	$(.05)
Net income (loss) per share - pro forma Basic and diluted	$(.02)	$(.08)	$(.05)

8. Regulatory Proceedings and Legal Proceedings

On April 6, 2000, officials of the New Jersey Department of Environmental Protection inspected the Company's storage site in Buena, New Jersey and issued Notices of Violation (NOV's) relating to the storage of waste materials in a number of trailers at the site. The Company established a disposal and cleanup schedule and completed the removal of materials from the site. The Company continues to discuss with the authorities a resolution of any potential assessment under the NOV's and has accrued the estimated penalties related to such NOV's.

On March 2, 2001, the Company discovered the presence of environmental contamination resulting from a heating oil leak at its Companion Pet Products site. The Company immediately notified the New Jersey Department of Environmental Protection and the local authorities, and hired a certified environmental contractor to assess the exposure and required clean up. Based on the initial information from the contractor, the Company originally estimated the cost for the cleanup and remediation to be $310,000. In September 2001, the contractor updated the estimated total cost for the cleanup and remediation to be $550,000. A further update was performed in December 2002, and the final estimated cost was increased to $620,000, of which $112,000 remains accrued as of September 30, 2003. The remediation has been completed as of September 30, 2003. Subsequently, there will be periodic testing and removal performed, which is projected to span over the next five years. The estimated cost of such future monitoring is included in the accrual.

9. Recent Pronouncements

The Company adopted SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13 and Technical Corrections", effective January 1, 2003. As a result of adoption, the Company's loss from early extinguishment of debt realized in the second quarter of 2002 has been presented within continuing operations, rather than presented as an extraordinary item.

The Company adopted SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" effective January 1, 2003. SFAS No. 146 addresses the financial accounting and reporting of expenses related to restructurings initiated after 2002, and applies to costs associated with an exit activity (including a restructuring) or with a disposal of long-lived assets. Those activities can include eliminating or reducing product lines, terminating employees and contracts, and relocating plant facilities or personnel. Under SFAS No. 146, a company will record a liability for a cost associated with an exit or disposal activity when the liability is incurred and can be measured at fair value. The provisions of SFAS No. 146 are effective prospectively for exit or disposal activities initiated after December 31, 2002, and therefore did not have an impact on the Company's consolidated financial statements.

10. Employment and License Agreements

On September 26, 2003, the Company signed an employment agreement with Dr. Michael Holick. Dr. Holick will serve as the Company's Vice President of Research and Development and Chief Scientific Officer for a three year term. On the same date, the Company entered into a Memorandum of Agreement with Dr. Holick stating that before December 31, 2003, the Company would enter into a License Agreement with Dr. Holick, whereby Dr. Holick will grant the Company an exclusive license to all of his rights to the parathyroid hormone related peptide technologies

and the glycoside technologies that he developed for various clinical usages, including treatment of psoriasis, hair loss and other skin disorders. In consideration for entering the Memorandum of Agreement, Dr. Holick received a $50,000 non-refundable payment. The $50,000 was expensed because the technologies are in a preliminary development phase and do not have any readily determinable alternative future use.

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

Prior to filing its Form 10-K for the fiscal year ended December 31, 2003, IGI, Inc. was informed by J&J that there was an error in the calculation of the 2003 royalty due to the Company by J&J. The correction of the error resulted in a reduction of revenues, with a corresponding impact on net loss, of $42,000 in the second quarter of 2003 and $51,000 in the third quarter of 2003. The impact of the J&J error on the first quarter of 2003 was immaterial, and has been included in the second quarter adjustment.

Also, during the third quarter ended September 30, 2003, the Company entered into an employment agreement with Dr. Michael Holick to serve as the Company's Vice President of Research and Development and Chief Scientific Officer. In addition, the Company entered into a memorandum of agreement with Dr. Holick to license all of his rights to the parathyroid hormone related peptide technologies and the glycoside technologies that he had developed for various clinical usages (the PTH and Glycoside Technologies). Pursuant to this agreement, Dr. Holick was paid a $50,000 non-refundable payment. The payment was originally capitalized and included with prepaid expenses and other current assets as of September 30, 2003. Since the PTH and Glycoside Technologies are in a preliminary development phase and do not have any readily determinable alternative future use, it was subsequently determined that the payment should have been expensed. Product development and research expenses have been increased by $50,000 in the consolidated statements of operations for the three and nine months ended September 30, 2003.

Except as otherwise specifically noted, all information contained herein is as of September 30, 2003 and does not reflect any events or changes in information that may have occurred subsequent to that date.

The following discussion and analysis may contain forward-looking statements. Such statements are subject to certain risks and uncertainties, including without limitation those discussed below or in the Company's 2002 10-K Annual Report, that could cause actual results to differ materially from the Company's expectations. See "Factors Which May Affect Future Results" below and in the 2002 10-K Annual Report. Readers are cautioned not to place undue reliance on any forward-looking statements, as they reflect management's analysis as of the date hereof. The Company undertakes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

Results of Operations

Three months ended September 30, 2003 compared to September 30, 2002

The Company had a net loss attributable to common stock of $257,000, or $(.02) per share, for the quarter ended September 30, 2003 compared to net loss attributable to common stock of $877,000, or $(.07) per share, for the quarter ended September 30, 2002.

Total revenues for the quarter ended September 30, 2003 were $899,000, compared to $1,146,000 for the quarter ended September 30, 2002. The decrease in revenues was primarily due to lower product sales to Estee Lauder and Vetoquinol and a decrease in J&J royalty income.

As a percentage of product sales, cost of sales increased from 40% in the quarter ended September 30, 2002 to 44% in the quarter ended September 30, 2003. The resulting decrease in gross profit from product sales from 60% in the quarter ended September 30, 2002 to 56% in the quarter ended September 30, 2003 is due to the change in mix to lower gross profit products and underabsorbed fixed costs.

Selling, general and administrative expenses increased $22,000, or 4%, from $567,000 in the quarter ended September 30, 2002. As a percentage of revenues, these expenses were 49% of revenues in the third quarter of 2002 compared to 66% in the third quarter of 2003. The increase is primarily due to higher legal expenses offset by lower salary and travel and entertainment expenses.

Product development and research expenses increased $73,000, or 48%, compared to the quarter ended September 30, 2002. The increase is a result of additional projects that are being worked on for existing and potential new customers and a $50,000 non-refundable payment to Dr. Holick based on a Memorandum of Agreement the Company signed with Dr. Holick on September 26, 2003 (see Note 10).

Interest income, net decreased $9,000 from interest income, net of $9,000 in the quarter ended September 30, 2002. The decrease is a result of lower cash reserves and interest rates.

Discontinued operations in the quarter ended September 30, 2002 consisted of a loss of $36,000 related to post-closing adjustments from the sale of the Companion Pet Products division, which occurred on May 31, 2002.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

The $15,000 loss on the sale of discontinued business in the quarter ended September 30, 2003 is a result of regulatory expenses at the Company's Companion Pet Products site.

Nine months ended September 30, 2003 compared to September 30, 2002

The Company had a net loss attributable to common stock of $570,000, or $(.05) per share, for the nine months ended September 30, 2003 compared to net income attributable to common stock of $7,930,000, or $.69 per share, for the nine months ended September 30, 2002.

Total revenues for the nine months ended September 30, 2003 were $2,751,000, which represents a decrease of $522,000, or 16%, from revenues of $3,273,000 for the nine months ended September 30, 2002. The decrease in revenues was primarily due to lower product sales to Estee Lauder and two other customers and lower J&J royalty income offset by increased product sales to Vetoquinol, Genesis and new customers.

As a percentage of product sales, cost of sales increased from 42% for the nine months ended September 30, 2002 to 45% for the nine months ended September 30, 2003. The resulting decrease in gross profit from product sales from 58% for the nine months ended September 30, 2002 to 55% for the nine months ended September 30, 2003 is the result of the change in mix to lower gross profit products and underabsorbed fixed costs.

Selling, general and administrative expenses increased $46,000, or 2%, from $1,895,000 for the nine months ended September 30, 2002. As a percent of revenues, these expenses were 58% of revenues for the first nine months of 2002 compared to 71% for the first nine months of 2003. The increase is primarily due to a $202,000 severance expense accrued in the second quarter of 2003 for the cost of the benefits to be provided by the Company under a severance package to one of the Company's executives, offset by a decline in salary expense due to staff reductions after the sale of the Companion Pet Products division.

Product development and research expenses increased $109,000, or 26%, compared to the nine months ended September 30, 2002. The increase is a result of additional projects that are being worked on for existing and potential new customers and a $50,000 non-refundable payment to Dr. Holick based on a Memorandum of Agreement the Company signed with Dr. Holick on September 26, 2003 (see Note 10).

Interest income (expense), net went from interest expense, net of $294,000 for the nine months ended September 30, 2002 to interest income, net of $8,000 for the nine months ended September 30, 2003. The change is due to lower interest rates and the pay down of the Company's debt on May 31, 2002 using the proceeds from the sale of the Companion Pet Products division.

Discontinued operations for the nine months ended September 30, 2002 consisted of a $401,000 loss from discontinued operations offset by a $12,432,000 gain from the sale of the Companion Pet Products division. The $154,000 of income from discontinued operations for the nine months ended September 30, 2003 consists of a $169,000 insurance settlement, net of legal costs, received for damages incurred by the Company as a result of the heating oil leak at the Company's Companion Pet Products site, offset by $15,000 of regulatory expenses.

Liquidity and Capital Resources

The Company's operating activities used $590,000 of cash during the nine months ended September 30, 2003 compared to $1,436,000 used in the comparable period in 2002. In addition to the loss from operations, payments for environmental remediation costs were the other major use of cash in 2003. In 2002, cash from the proceeds from the sale of the Companion Pet Products division was utilized to pay down accounts payable and accrued expenses.

The Company used $732,000 of cash during the nine months ended September 30, 2003 for investing activities compared to cash of $16,941,000 provided by investing activities for the comparable period in 2002. The majority of the 2003 investing activities were for the purchase of marketable securities, computers, and machinery and equipment, while 2002's activity primarily was cash generated from the sale of the Companion Pet Products division, a former corporate office building and marketable securities.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

The Company's financing activities utilized $45,000 of cash in the nine months ended September 30, 2003 compared to $12,935,000 used in the comparable period in 2002. The cash utilized in 2003 was primarily for the purchase of Company stock as part of a stock buy-back program which was authorized in December 2002, offset by funding of the EDA loan. In 2002, cash was utilized to payoff the Fleet Capital Bank and American Capital Strategies debt using the proceeds from the sale of the Companion Pet Products division.

The Company's principal sources of liquidity are cash flows from operations, cash and cash equivalents and marketable securities. Management believes that existing cash and cash equivalents, marketable securities and cash flows from operations will be sufficient to meet the Company's foreseeable cash needs for at least the next year. However, there may be acquisition and other growth opportunities that require additional external financing. Management may, from time to time, seek to obtain additional funds from the public or private issuances of equity or debt securities. There can be no assurance that such financings will be available or available on terms acceptable to the Company.

There have been no material changes to the Company's contractual commitments as reflected in the 2002 10-K Annual Report.

Regulatory Proceeding and Legal Proceedings

On April 6, 2000, officials of the New Jersey Department of Environmental Protection inspected the Company's storage site in Buena, New Jersey and issued Notices of Violation (NOV's) relating to the storage of waste materials in a number of trailers at the site. The Company established a disposal and cleanup schedule and completed the removal of materials from the site. The Company continues to discuss with the authorities a resolution of any potential assessment under the NOV's and has accrued the estimated penalties related to such NOV's.

On March 2, 2001, the Company discovered the presence of environmental contamination resulting from a heating oil leak at its Companion Pet Products site. The Company immediately notified the New Jersey Department of Environmental Protection and the local authorities, and hired a certified environmental contractor to assess the exposure and required clean up. Based on the initial information from the contractor, the Company originally estimated the cost for the cleanup and remediation to be $310,000. In September 2001, the contractor updated the estimated total cost for the cleanup and remediation to be $550,000. A further update was performed in December 2002, and the final estimated cost was increased to $620,000, of which $112,000 remains accrued as of September 30, 2003. The remediation has been completed as of September 30, 2003. Subsequently, there will be periodic testing and removal performed, which is projected to span over the next five years. The estimated cost of such future monitoring is included in the accrual.

Factors Which May Affect Future Results

The industry in which the Company competes is subject to intense competitive pressures. The following sets forth some of the risks which the Company faces.

Intense Competition in Consumer Products Business

The Company's Consumer Products business competes with large, well-financed cosmetics and consumer products companies with development and marketing groups that are well established and experienced in the industry and possess far greater financial and other resources than those available to the Company. There is no assurance that the Company's Consumer Products business can compete successfully against its competitors or that it can develop and market new products that will be favorably received in the marketplace. In addition, certain of the Company's customers that use the Company's Novasome(R) lipid vesicles in their products may decide to reduce their purchases from the Company or shift their business to other suppliers.

Effect of Rapidly Changing Technologies

In the future, the Company expects to sublicense its Novasome(R) technologies to third parties, who would manufacture and market products incorporating the technologies. If the Company's competitors develop superior

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

technologies, the Company's technologies could be less acceptable in the marketplace and therefore the Company's planned technology sublicensing could be materially adversely affected.

American Stock Exchange (AMEX) Continuing Listing Standards

On March 28, 2002, the Company was notified by AMEX that it was below certain of the Exchange's standards for continued listing. Specifically, under applicable AMEX listing standards, in order to remain listed the Company was required to reflect income from continuing operations and net income for 2002 and a minimum of $4,000,000 in stockholders' equity by December 31, 2002. On April 25, 2002, the Company submitted a plan of compliance to AMEX. On June 12, 2002, AMEX notified the Company that it had accepted the Company's plan of compliance and had granted the Company an extension of time to regain compliance with the continued listing standards by December 31, 2002. The loss from continuing operations for the year ended December 31, 2002 reflected tax expense resulting from a change in the New Jersey tax law that was retroactive to January 1, 2002. As a result of this tax expense, the Company determined during the third quarter of 2002 that it would have a loss from continuing operations for 2002. The Company notified AMEX of this issue on November 14, 2002 after release of the Company's 2002 third quarter results.

In February 2003, the Company contacted AMEX after release of the Company's 2002 year-end results. On April 14, 2003, the Company received formal notification from AMEX that the Company was deemed to be in compliance with all AMEX requirements for continued listing on AMEX.

Critical Accounting Policies

There have been no material changes to the Company's critical accounting policies as reflected in the 2002 10-K Annual Report.

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

The Company does not utilize financial instruments for trading purposes and holds no derivative financial instruments which could expose the Company to significant market risk. The Company's primary market risk exposure with regard to financial instruments is changes in interest rates. The Company's cash equivalents and marketable securities consist primarily of investments in mutual funds. Management believes, based on the current interest rate environment, that a 100 basis point change in interest rates would have an immaterial impact on interest income.

ITEM 4. Controls and Procedures

The Company's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the design and operation of its disclosure controls and procedures as of September 30, 2003, and based on their evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective.

The evaluation referred to above did not identify any changes in the Company's internal control over financial reporting that occurred during the quarter ended September 30, 2003 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

IGI, INC. AND SUBSIDIARIES
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

*11.01 Severance Agreement between John Ambrose and IGI, Inc. dated as of August 15, 2003.

*11.02 Employment Agreement between Michael F. Holick MD, Ph.D. and IGI, Inc. dated as of September 26, 2003.

*11.03 Memorandum of Agreement between Michael F. Holick, MD, Ph.D. and IGI, Inc. dated as of September 26, 2003.

31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as enacted under Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as enacted under Section 906 of the Sarbanes-Oxley Act of 2002.

* Incorporated by reference to the stated Exhibit to the Company's quarterly report on Form 10-Q for the quarter ended September 30, 2003.

(b) Reports on Form 8-K

None.

IGI, INC. AND SUBSIDIARIES

SIGNATURES

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

IGI, Inc.
(Registrant)

Date: May 14, 2004

By: /s/ Frank Gerardi

Frank Gerardi
Chairman and Chief Executive Officer

Date: May 14, 2004

By: /s/ Domenic N. Golato

Domenic N. Golato
Senior Vice President and Chief Financial Officer

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