
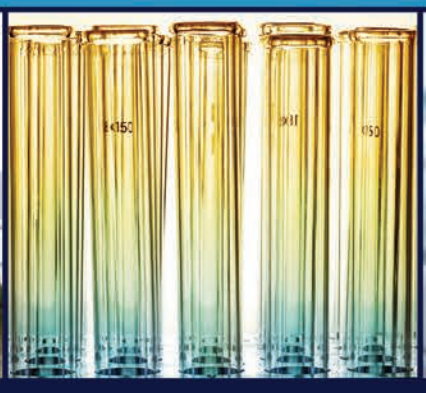

# 2012 ANNUAL REPORT

COSMETIC INGREDIENTS

PERSONAL & HEALTH CARE PRODUCTS

PHARMACEUTICALS

SPECIALTY INDUSTRIAL PRODUCTS

**United-Guardian, Inc.**

EXCELLENCE THROUGH INNOVATION®

UNITED-GUARDIAN, INC.

# Officers and Directors

**KENNETH H. GLOBUS**
President & Principal Executive Officer
Chairman of the Board of Directors
General Counsel

**ROBERT S. RUBINGER**
Executive Vice President, Secretary,
Chief Financial Officer, Director of Product
Development, and Director

**JOSEPH J. VERNICE**
Vice President
Director of Technical Services
Manager of Research & Development

**PETER A. HILTUNEN**
Vice President
Production Supervisor
Director of Plant Operations

**ARTHUR M. DRESNER**
Director; Counsel to the law firm of
Duane Morris LLP
New York, NY

**LAWRENCE F. MAIETTA**
Director; Partner in the accounting firm of
Bonamassa, Maietta & Cartelli, LLP
Brooklyn, NY

**ANDREW A. BOCCONE**
Director; Independent Business Consultant,
Former President of Kline & Company, Inc.
Little Falls, NJ (business consulting firm)

**CHRISTOPHER W. NOLAN, SR.**
Director; Managing Director, Mergers &
Acquisitions of Rabobank International
New York, NY

# Corporate Profile

United-Guardian, Inc. is a publicly traded (NASDAQ:UG) fully integrated research, development, manufacturing, and marketing company that has been supplying unique and innovative products to the personal care, health care, industrial, and pharmaceutical sectors since 1942. The company's products are developed and manufactured by its Guardian Laboratories Division, and many are proprietary formulations with unique combinations of properties and ingredients. The personal care and cosmetic ingredients are marketed through a worldwide network of marketing partners and distributors, and are used by many of the major multinational cosmetic companies. The pharmaceuticals are sold primarily to full-line drug wholesalers, which distribute them to pharmacies, hospitals, physicians, long-term care facilities, and other health care providers. The health care products are marketed directly to manufacturers of medical devices and other medical products, which incorporate them into their finished products and distribute them to hospitals, pharmacies, and other health care facilities. The specialty industrial products are sold directly to manufacturers in a wide range of industries.

The company's most important product line is its extensive LUBRAJEL® line of water-based moisturizing and lubricating gel products. The focus of the company's research at the present time is on developing additional products for the personal care and health care markets.

Over the years the company has been issued over 32 patents, and there are currently additional patent applications pending. In addition to patent protection, the company also relies on proprietary manufacturing methods and product formulations, which are protected as trade secrets. It has also received ISO 9001:2008 registration from Underwriters Laboratories, Inc., indicating that its documented procedures and overall operations have attained the very high level of quality needed for this certification level.

# 2012 ANNUAL REPORT

## to the Stockholders of

# UNITED-GUARDIAN, INC.

April 12, 2013

Dear Stockholder,

I am pleased to report that 2012 was another very profitable year for us, with earnings once again reaching a new high. Although sales were down slightly as a result of the supply problems we have been having with Renacidin® Irrigation, one of our pharmaceutical products (which I will discuss in more detail later in this letter), increased sales from our other product lines made up for some of the lost sales, and the settlement agreement we entered into with our Renacidin supplier made up for much of the lost profits. As a result, we were able to reach this record level of earnings even though sales were lower than last year.

As a result of the Renacidin supply problems, our sales for 2012 were down by 3.6%, from $14,338,512 to $13,825,764. Despite this decline, net income was up from $4,716,530 to $4,830,780, an increase of 2.4%. Because of our inability to fill orders for Renacidin, sales of that product were down by $790,512 compared with 2011. Some of those lost sales were offset by an increase in sales of our other product lines, particularly the Lubrajel® line of moisturizing and lubricating gels, which increased by 2% despite the continuing global economic downturn. Sales to our largest marketing partner, Ashland Specialty Ingredients ("ASI", formerly International Specialty Products) actually increased by 4.5% in 2012. Sales to our other distributors were mixed, with sales to our Korean distributor increasing while sales to our European marketing partners decreased, which we believe is attributable to the continuing economic problems in Europe.

Our balance sheet continues to remain strong, even though this year we paid out a special dividend in anticipation of a change in the tax treatment of dividends in 2013. Despite this additional payout we still ended the year with working capital of almost $12 million, and a current ratio of over 15 to 1, a number that many companies would envy.

I believe that our varied product line and large number of individual customers has enabled us to continue to maintain our sales and increase our profitability while many other companies are still feeling the negative effects of the continuing global economic problems, particularly in Europe and Japan. Because our product line consists primarily of cosmetic ingredients, medical products, and pharmaceutical products, many of which are proprietary formulations, and all of which are generally more resistant to recession problems than many other product lines, we have been able to maintain and even increase our level of sales. Since our cosmetic ingredients are used in both high-end and lower-end cosmetic products, we are more insulated against economic downturns than many other companies. We believe that this is why we have been able to maintain our profitability while many other companies continue to struggle. I also believe that the quality and reliability of our products is valued in the marketplace, which results in many loyal customers who prefer to continue to use our products even in certain markets where there might be lower-cost competitors.

Sales of our two pharmaceutical products, Clorpactin® and Renacidin, have typically been very steady from year-to-year, but as those of you who have been with us for a few years know, we have had supply problems with Renacidin since the end of 2010, when production was curtailed due to problems at the manufacturing site that were unrelated to Renacidin. Those production issues were resolved, but once again in 2012 there were more production issues, again resulting in a curtailment of all production at the site. Since this is an FDA regulated drug product we did not have the ability to find another manufacturer to make the product for us without going through an extensive regulatory approval process. Our inventory of Renacidin was depleted at the end of July, and there have been no Renacidin sales since that time.

As a result of the production problems, we entered into a settlement agreement with our supplier, whereby we were compensated for most of the profits we lost during each month that we were out of product. We are working with the supplier to resume production as soon as possible, but we currently estimate that we will not have new product to sell until the third quarter of this year. We will continue to receive compensation from the supplier to cover our lost profits until our contract with them ends in January 2014. We have already located a new manufacturer, and we are very excited about working with them to develop a new singe-dose unit that would be more user-friendly than our current glass bottle. Until now the product was packaged only in a 500 mL glass bottle, even though most patients needed only a fraction of that for each treatment. The new bottle that we are hoping to use will be a plastic bottle containing 30 mL of product, which is the most commonly used dose. We believe that this new bottle size has the potential to significantly increase our revenue from this product. The change to this more user-friendly size and new manufacturing site will require a new submission to the FDA. We hope to be able to begin marketing this product by the end of the third quarter of 2014. Our current supplier is expecting to resume production of Renacidin in the third quarter of this year, and we have already placed orders with them that, assuming they are able to fill them, should give us enough inventory to last until we receive FDA approval of our new manufacturer and bottle.

We are continuing our efforts to bring more unique products to both the cosmetic and medical markets. The new medical lubricant that we developed last year for a new customer, our new Lubrajel TF, has just begun sales, and we are optimistic

that this product will bring in additional revenue in 2013. We believe that the medical lubricant market will continue to be a growing market for us.

Our focus on the cosmetic side is primarily on the new Lubrajel Natural line. This is a completely new product formulation of Lubrajel. We are happy to report that our first product in this line has already received "natural" certification by Ecocert, a leading industry certification organization for natural and organic products. We believe that this product will be of interest to many companies looking to develop all-natural products. Our initial formulation is currently in the hands of our marketing partners for sampling to their customers, and we are awaiting their feedback. We are already working on additional formulations to add to this new line (see below). We expect the current interest in all-natural products to continue to grow, and are hopeful that all-natural Lubrajel formulations will be of interest to both new and existing customers.

This past year also saw the completion of development of a new oral care product called Lubrajel BA. This product was developed exclusively for ASI for marketing by its oral care products division, and ASI has already begun its marketing efforts.

The following are some of the other projects on which we are working right now:

- **LUBRAJEL FS:** Another new Lubrajel Natural variation that uses a polymer network based on marine plant sources. It uses "natural moisturizing factors" based on naturally occurring small molecules. The product has a very silky after-feel and no tackiness. We expect to send samples of this product to our marketing partners for their preliminary evaluation shortly.

- **LUBRAJEL OIL NATURAL:** A variation on our current Lubrajel Oil product that has similar lubricating properties but is based on fermented vegetable feed stock. Preliminary work has just begun on this product, and we hope to have it ready for preliminary evaluation by our marketing partners by the end of the third quarter of this year.

- **SENSORY MODIFIERS:** Skin-feel modifiers to enhance the skin feel of cosmetic products. The current development work is focusing on an olive oil complex based on a special blend of solid and liquid olive oil components. It has a silicone-like feel that adds lubricity and a smooth after-feel to creams and lotions.

Some of the projects mentioned above are in early stages of development, and as with any new product development work there is no guarantee that we will be successful in our development or marketing efforts. But we believe that all of them have market potential, and we plan to work closely with our marketing partners to determine the best use of our R&D resources.

For the 17th consecutive year were pleased to be able to share the company's success with our stockholders, distributing not only two semi-annual dividends totaling $0.86 a share, but also a special dividend of $0.50 a share. Like many other companies, we believed that there was enough uncertainly regarding the future tax treatment of dividends to justify paying this additional dividend to our stockholders. As it turned out, we were correct, and the tax rate on dividends to taxpayers at certain income levels did increase. We believe that paying this additional dividend before the tax rates increased was in the best interests of many of our stockholders, and that doing so would not adversely affect the ability of the company to fund any future projects. We think that our dividend payment policy is one of the reasons our stock price has continued to increase, with a high of about $20 a share in the fourth quarter of 2012 compared with a low of about $15 a share in the first quarter of the year.

It has been both a frustrating and exciting year for us, frustrating because of our inability fill orders for Renacidin from so many patients who desperately need it, while at the same time exciting as we look forward to bringing the new dosage size of Renacidin to market. Based on the number of calls we receive on a daily basis there is clearly a very strong need for this product, and there is nothing that we or the patients know of that can substitute for it. The FDA is aware of this and has determined that this product is "medically necessary". We are hopeful that they will work with us to get the new product approved as quickly as possible. While we will probably still feel the impact of the Renacidin shortage on sales during the first three quarters of 2013, the continuing compensation from our supplier will help reduce the impact on our earnings, and we are hopeful that we will have new inventory to sell before the end of the third quarter of 2013. Going forward, we expect the new product size to be very well received by our patients, and we are hopeful that with the assistance of our new manufacturing partner we may be able to expand the sales of this product outside the United States.

We are pleased with the continuing strength of our personal care products line, and we will continue expand that line with new innovations like the new Lubrajel Natural line. I am excited about the prospects for the future, and look forward to sharing with our stockholders the results of many more profitable years.

Sincerely,

UNITED-GUARDIAN, INC.

Ken Globus
President

UNITED-GUARDIAN, INC.

# STATEMENTS OF INCOME

| | Years ended December 31, 2012 | 2011 |
|---|---|---|
| Net sales | **$ 13,825,764** | $ 14,338,512 |
| Costs and expenses: | | |
| Cost of sales | **5,218,959** | 5,650,160 |
| Operating expenses | **2,508,334** | 2,552,790 |
| Total costs and expenses | **7,727,293** | 8,202,950 |
| **Income from operations** | **6,098,471** | 6,135,562 |
| Other income (expense): | | |
| Investment income | **325,017** | 332,652 |
| (Loss) gain on sale of assets | **(14,861**) | 18,251 |
| Income from damage settlement | **518,050** | 385,182 |
| Total other income, net | **828,206** | 736,085 |
| **Income from operations before income taxes** | **6,926,677** | 6,871,647 |
| Provision for income taxes | **2,095,897** | 2,155,117 |
| **Net income** | **$ 4,830,780** | $ 4,716,530 |
| Earnings per common share (basic and diluted) | **$ 1.05** | $ 1.03 |
| Weighted average shares (basic and diluted) | **4,596,439** | 4,596,439 |

# STATEMENTS OF COMPREHENSIVE INCOME

| | Years ended December 31, 2012 | 2011 |
|---|---|---|
| Net income | **$ 4,830,780** | $ 4,716,530 |
| Other comprehensive income: | | |
| Unrealized gain on marketable securities during period | **220,946** | 42,512 |
| Income tax expense related to other comprehensive income | **(76,579)** | (14,735) |
| Other comprehensive income, net of tax | **144,367** | 27,777 |
| **Comprehensive income** | **$ 4,975,147** | $ 4,744,307 |

See Notes to Financial Statements

UNITED-GUARDIAN, INC.

# BALANCE SHEETS

## ASSETS

| | December 31, 2012 | December 31, 2011 |
|---|---|---|
| Current assets: | | |
| Cash and cash equivalents | **$ 1,748,382** | $ 1,090,974 |
| Marketable securities | **7,743,946** | 9,295,755 |
| Accounts receivable, net of allowance for doubtful accounts of $29,000 in 2012 and $18,000 in 2011 | **1,017,627** | 1,653,440 |
| Receivable in connection with damage settlement | **518,050** | --- |
| Inventories (net) | **1,242,750** | 1,467,434 |
| Prepaid expenses and other current assets | **132,458** | 163,034 |
| Prepaid income taxes | **3,602** | 78,613 |
| Deferred income taxes | **216,588** | 223,546 |
| **Total current assets** | **12,623,403** | 13,972,796 |
| Property, plant, and equipment: | | |
| Land | **69,000** | 69,000 |
| Factory equipment and fixtures | **3,842,927** | 3,694,379 |
| Building and improvements | **2,725,993** | 2,714,780 |
| Waste disposal plant | **133,532** | 133,532 |
| Total property, plant and equipment | **6,771,452** | 6,611,691 |
| Less accumulated depreciation | **5,535,589** | 5,366,204 |
| **Net property, plant, and equipment** | **1,235,863** | 1,245,487 |
| Other asset | **---** | 37,672 |
| **Total assets** | **$ 13,859,266** | $ 15,255,955 |

See Notes to Financial Statements

UNITED-GUARDIAN, INC.

# BALANCE SHEETS
(continued)

## LIABILITIES AND STOCKHOLDERS' EQUITY

| | December 31, 2012 | December 31, 2011 |
|---|---|---|
| Current liabilities: | | |
| Accounts payable | **$ 151,385** | $ 400,389 |
| Accrued expenses | **676,123** | 676,959 |
| **Total current liabilities** | **827,508** | 1,077,348 |
| Deferred income taxes | **193,740** | 64,578 |
| Stockholders' equity: | | |
| Common stock, $.10 par value; 10,000,000 shares authorized; 4,596,439 shares issued and outstanding at December 31, 2012 and 2011, respectively | **459,644** | 459,644 |
| Accumulated other comprehensive income | **178,979** | 34,612 |
| Retained earnings | **12,199,395** | 13,619,773 |
| **Total stockholders' equity** | **12,838,018** | 14,114,029 |
| **Total liabilities and stockholders' equity** | **$ 13,859,266** | $ 15,255,955 |

See Notes to Financial Statements

UNITED-GUARDIAN, INC.

# STATEMENT OF STOCKHOLDERS' EQUITY

Years ended December 31, 2012 and 2011

| | Common Stock Shares | Common Stock Amount | Accumulated Other Comprehensive income | Retained earnings | Total |
|---|---|---|---|---|---|
| **Balance, January 1, 2011** | 4,596,439 | $ 459,644 | $ 6,835 | $ 12,580,394 | $ 13,046,873 |
| Change in unrealized gains on marketable securities, net of deferred income tax benefit of $14,735 | | | 27,777 | | 27,777 |
| Net income | | | | 4,716,530 | 4,716,530 |
| Dividends declared | | | | (3,677,151) | (3,677,151) |
| **Balance, December 31, 2011** | 4,596,439 | 459,644 | 34,612 | 13,619,773 | 14,114,029 |
| **Change in unrealized gains on marketable securities, net of deferred income tax of $76,579** | | | **144,367** | | **144,367** |
| **Net income** | | | | **4,830,780** | **4,830,780** |
| **Dividends declared** | | | | **(6,251,158)** | **(6,251,158)** |
| **Balance, December 31, 2012** | **4,596,439** | **$ 459,644** | **$ 178,979** | **$ 12,199,395** | **$ 12,838,018** |

See Notes to Financial Statements

UNITED-GUARDIAN, INC.

# STATEMENTS OF CASH FLOWS

| | Years ended December 31, 2012 | 2011 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income | **$ 4,830,780** | $ 4,716,530 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | **254,441** | 255,583 |
| Net loss (gain) on sale of assets | **14,861** | (18,251) |
| Realized loss on sales of marketable securities | **22,931** | 8,765 |
| Increase (reduction) in allowance for bad debts | **11,054** | (5,092) |
| Deferred income taxes | **59,541** | 40,999 |
| Increase (decrease) in cash resulting from changes in operating assets and liabilities: | | |
| Accounts receivable | **624,758** | (557,636) |
| Receivable from damage settlement | **(518,050)** | --- |
| Inventories | **224,684** | (146,045) |
| Prepaid expenses and other current and non-current assets | **30,576** | 89,168 |
| Prepaid income taxes | **75,011** | --- |
| Accounts payable | **(249,004)** | 192,145 |
| Accrued expenses and taxes payable | **(836)** | (139,037) |
| **Net cash provided by operating activities** | **5,380,747** | 4,437,129 |
| Cash flows from investing activities: | | |
| Acquisitions of plant and equipment | **(252,356)** | (274,645) |
| Proceeds from the sale of assets | **30,350** | 38,658 |
| Purchases of marketable securities | **(4,266,419)** | (3,987,606) |
| Proceeds from sales of marketable securities | **6,016,244** | 3,040,000 |
| **Net cash provided by (used in) investing activities** | **1,527,819** | (1,183,593) |
| Cash flows from financing activities: | | |
| Dividends paid | **(6,251,158)** | (3,677,151) |
| **Net cash used in financing activities** | **(6,251,158)** | (3,677,151) |
| Net increase (decrease) in cash and cash equivalents | **657,408** | (423,615) |
| Cash and cash equivalents, beginning of year | **1,090,974** | 1,514,589 |
| Cash and cash equivalents, end of year | **$ 1,748,382** | $ 1,090,974 |

See Notes to Financial Statements

# NOTES TO FINANCIAL STATEMENTS

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

### Nature of Business

United-Guardian, Inc. (the "Company") is a Delaware corporation that, through its Guardian Laboratories Division, conducts research, product development, manufacturing and marketing of cosmetic ingredients and other personal care products, pharmaceuticals, medical and health care products, and proprietary specialty industrial products. Two major product lines, LUBRAJEL® and RENACIDIN® IRRIGATION ("RENACIDIN") together accounted for 94.1% and 94.5% of revenue for the years ended December 31, 2012 and December 31, 2011, respectively. LUBRAJEL accounted for 86.5% and 81.8% of revenue for the years ended December 31, 2012 and December 31, 2011, respectively, and RENACIDIN accounted for 7.6% and 12.7% of revenue for the years ended December 31, 2012 and December 31, 2011, respectively.

### Accounts Receivable and Reserves

The carrying amount of accounts receivable is reduced by a valuation allowance that reflects our best estimate of the amounts that will not be collected. The reserve for accounts receivable comprises the allowance for doubtful accounts and sales returns. In addition to reviewing delinquent accounts receivable, we consider many factors in estimating our reserve, including historical data, experience, customer types and credit worthiness, and economic trends. From time to time, we adjust our assumptions for anticipated changes in any of these or other factors expected to affect collectability.

### Revenue Recognition

The Company recognizes revenue when products are shipped, title and risk of loss pass to customers, persuasive evidence of a sales arrangement exists, and collections are reasonably assured. All products are shipped Free On Board ("FOB") Hauppauge, New York, the location of the Company's plant. Both title and risk of loss are deemed by both the Company and its customers to have passed to the customers at the time the goods leave the Company's plant. Shipments are only made after confirmation that a valid purchase order has been received and that the future collection of the sale amount is reasonably assured. All sales of the Company's products are deemed final, and there is no obligation on the part of the Company to repurchase or allow the return of the goods unless they are defective. The Company does not make sales on consignment, and the collection of the proceeds of the sale is not contingent upon the customer being able to sell the goods to a third party.

Any 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. The Company deposits cash and cash equivalents with high credit quality financial institutions and believes that any amounts in excess of insurance limitations to be at minimal risk. Cash and cash equivalents held in these accounts are currently insured by the Federal Deposit Insurance Corporation up to a maximum of $250,000.

## Dividends

On May 16, 2012, the Company's Board of Directors declared a semi-annual cash dividend of $0.42 per share, which was paid on June 18, 2012 to all stockholders of record as of June 4, 2012. On December 4, 2012, the Company's Board of Directors declared a semi-annual cash dividend of $0.44 per share and a special dividend of $0.50 per share, which were paid on December 21, 2012 to all stockholders of record as of December 14, 2012. Total dividends declared and paid in 2012 were $6,251,158.

On May 11, 2011, the Company's Board of Directors declared a semi-annual cash dividend of $0.36 per share, which was paid on June 13, 2011 to all stockholders of record as of May 30, 2011. On December 7, 2011, the Company's Board of Directors declared a semi-annual cash dividend of $0.44 per share, which was paid on December 23, 2011 to all stockholders of record as of December 16, 2011. Total dividends declared and paid in 2011 were $3,677,151.

## Supplemental Disclosures of Non-cash Investing and Financing Activities

Cash payments for income taxes were $2,024,245 and $2,010,000 for the years ended December 31, 2012 and 2011, respectively.

## Marketable Securities

Marketable securities include investments in equity and fixed income mutual funds, government securities and corporate bonds, all of which have a high degree of liquidity, 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 and declines in value judged to be other than temporary, if any, are reported in other income with cost being determined on a specific identification basis. Fair values are based on quoted market prices. The Company evaluates its investments periodically for possible impairment and reviews factors such as the length of time and extent to which fair value has been below cost basis and the Company's ability and intent to hold the investment for a period of time which may be sufficient for anticipated recovery in market value.

## Inventories

Inventories are valued at the lower of cost or current market value. Cost is determined using the average cost method, which approximates cost determined by the first-in, first-out ("FIFO") method. Inventory 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 |

## Impairment of Long-Lived Assets

Long-lived assets and certain identifiable intangibles are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. No impairments were necessary at December 31, 2012 and 2011.

## Other Asset

Other asset consisted of a $188,360 payment made to a vendor for regulatory and validation work that was needed to qualify one of the vendor's manufacturing locations for the production of the Company's RENACIDIN product. This amount was capitalized and was amortized over its estimated 5-year benefit period at the rate of $37,672 per year, starting in 2008. As of December 31, 2012 this asset was fully amortized.

## Fair Value of Financial Instruments

Management of the Company believes that the fair value of financial instruments, consisting of cash and cash equivalents, accounts receivable, accounts payable, and accrued expenses approximates their carrying value due to their short payment terms.

## Concentration of Credit Risk

Accounts receivable potentially exposes the Company to concentrations of credit risk. The Company monitors the amount of credit it allows each of its customers, using the customer’s prior payment history to determine how much credit to allow or whether any credit should be given at all. It is the Company’s policy to discontinue shipments to any customer that is substantially past due on its payments. The Company sometimes requires payment in advance from customers whose payment record is questionable. As a result of its monitoring of the outstanding credit allowed for each customer, as well as the fact that the

majority of the Company's sales are to customers whose satisfactory credit and payment record has been established over a long period of time, the Company believes that its accounts receivable credit risk has been reduced.

For the year ended December 31, 2012, two customers, both of them distributors and marketing partners of the Company, accounted for approximately 62% of the Company's revenues during the year, and 52% of its outstanding accounts receivable at year end. For the year ended December 31, 2011, these same two customers accounted for a total of 58% of the Company's revenues during the year, and 54% of its outstanding accounts receivable at year end.

## Vendor Concentration

The principal raw materials used by the Company consist of common industrial organic and inorganic chemicals. Most of these materials are available in ample supply from numerous sources. The Company has five major raw material vendors that accounted for approximately 77% and 83% of the raw material purchases by the Company in 2012 and 2011, respectively.

## Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for future tax consequences attributable to the temporary differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date. 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.

Uncertain tax positions are accounted for utilizing a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. As of December 31, 2012 and 2011, the Company did not have any unrecognized income tax benefits. It is the Company's policy to recognize interest and penalties related to taxes as interest expense as incurred. During the years ended December 31, 2012 and 2011 the Company did not record any interest or penalties. The Company's tax returns are subject to examination by the United States Internal Revenue Service and the Department of Taxation of the State of New York for years 2009 through 2012.

## 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 $693,000 and $637,000 for the years ended December 31, 2012 and 2011, respectively.

## Shipping and Handling Costs

Shipping and handling costs are classified in operating expenses in the accompanying statements of income. Shipping and handling costs were approximately $65,000 and $109,000 for the years ended December 31, 2012 and 2011, respectively.

## Advertising Costs

Advertising costs are expensed as incurred. During 2012 and 2011 the Company incurred $24,000 and $28,000, respectively, in advertising costs.

## Stock-Based Compensation

In 2004, the Company approved a stock option plan ("2004 Stock Option Plan"). All share-based payments to employees, including grants of employee stock options, are recognized as compensation expense over the requisite service period (generally the vesting period) in the financial statements based on their fair values on grant date. For options with graded vesting, the Company fair values the stock option grants and recognizes compensation expense as if each vesting portion of the award was a separate award. The impact of forfeitures that may occur prior to vesting is also estimated and considered in the amount of expense recognized. In addition, the realization of tax benefits in excess of amounts recognized for financial reporting purposes will be recognized as a financing activity rather than as an operating activity.

## Earnings Per Share Information

Basic earnings per share are computed by dividing net income by the weighted average number of common shares outstanding during the year. Diluted earnings per share include 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, possible impairment of marketable securities, reserve for inventory obsolescence, and the allocation of overhead.

## New Accounting Standards

In May 2011, FASB issued update ASU No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS, impacting FASB ASC 820, Fair Value Measurement. Among the many areas affected by this update are the concept of highest and best use, fair value of an instrument included in shareholders' equity, disclosures about fair value measurement, and the fair value hierarchy, especially disclosures relating to the fair value measurements categorized within Levels 1, 2, and 3. This update became effective for interim and annual reporting periods beginning after December 15, 2011. The update does not have a material impact on the Company's results of operation and at the present time it does not apply to the Company.

In June 2011, the FASB issued an amendment to the disclosure requirements for the presentation of comprehensive income. The amendment requires that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This guidance is effective retrospectively for the interim periods and annual periods beginning after December 15, 2011. The Company adopted this amendment in the first quarter of 2012. The adoption of this amendment did not have a material impact on the Company's results of operations, cash flows or financial position.

## NOTE B - MARKETABLE SECURITIES

The fair values of the Company's marketable securities are determined in accordance with GAAP, with fair value being defined as the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, the Company utilizes the three-tier value hierarchy, as prescribed by GAAP, which prioritizes the inputs used in measuring fair value as follows:

- Level 1 - inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 - inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 – inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The following available-for-sale securities, which comprise all of the Company's marketable securities, are re-measured to fair value on a recurring basis and are valued using Level 1 inputs using quoted prices (unadjusted) for identical assets in active markets:

**December 31, 2012**

| | Cost | Fair Value | Unrealized Gain/(Loss) |
|---|---|---|---|
| Available for sale: | | | |
| Corporate bonds (maturities of 1-5 years) | $ **203,920** | $ **203,357** | $ **(563)** |
| Fixed income mutual funds | **6,991,181** | **7,242,998** | **251,817** |
| Equity and other mutual funds | **274,926** | **297,591** | **22,665** |
| | $ **7,470,027** | $ **7,743,946** | $ **273,919** |

**December 31, 2011**

| | Cost | Fair Value | Unrealized Gain/(Loss) |
|---|---|---|---|
| Available for sale: | | | |
| U.S. treasury and agencies (maturities of less than 1 year) | $ **249,137** | $ **234,388** | $ **(14,749)** |
| Corporate bonds | | | |
| Maturities of less than 1 year | 267,251 | 247,719 | (19,532) |
| Maturities of 1-5 years | 203,920 | 195,899 | (8,021) |
| Total corporate bonds | **471,171** | **443,618** | **(27,553)** |
| Fixed income mutual funds | **8,268,624** | **8,372,216** | **103,592** |
| Equity and other mutual funds | **253,850** | **245,533** | **(8,317)** |
| | $ **9,242,782** | $ **9,295,755** | $ **52,973** |

Proceeds from the sale and redemption of marketable securities amounted to $6,016,244 and $3,040,000 for the years ended December 31, 2012 and 2011, respectively. Realized losses were $22,931 and $8,765 for the years ended December 31, 2012 and 2011, respectively.

Investment income consisted principally of unrealized and realized gains and losses, interest income from bonds and money market funds, and dividend income from bond funds and mutual funds.

## NOTE C - INVENTORIES

Inventories consist of the following:

| | December 31, | |
|---|---|---|
| | **2012** | 2011 |
| Raw materials and work-in-process | **$ 481,544** | $ 470,532 |
| Finished products | **761,206** | 996,902 |
| | **$1,242,750** | $ 1,467,434 |

Finished product inventories at December 31, 2012 and 2011 are stated net of a reserve of $20,000 for slow moving and obsolete items.

## NOTE D – INCOME TAXES

The provision for income taxes consists of the following:

| | Years ended December 31, | |
|---|---|---|
| Current | **2012** | 2011 |
| Federal | **$ 2,015,345** | $ 2,093,065 |
| State | **21,011** | 21,053 |
| | **2,036,356** | 2,114,118 |
| Deferred | | |
| Federal | **57,823** | 39,817 |
| State | **1,718** | 1,182 |
| | **59,541** | 40,999 |
| Total provision for income taxes | **$ 2,095,897** | $ 2,155,117 |

The following is a reconciliation of the Company's effective income tax rate to the Federal statutory rate (dollar amounts have been rounded to the nearest thousand):

| | Years ended December 31, | | | |
|---|---|---|---|---|
| | **2012** | | 2011 | |
| | **($)** | **Tax rate** | ($) | Tax rate |
| Income taxes at statutory federal income tax rate of 34% | **$ 2,355,000** | **34.0 %** | $ 2,337,000 | 34.0 % |
| State income taxes, net of Federal benefit | **14,000** | **0.2** | 14,000 | --- |
| Domestic Production Activities tax benefit | **(167,000)** | **(2.4)** | (164,000) | (2.0) |
| Nondeductible expenses | **1,000** | **---** | 1,000 | --- |
| Prior year over-accrual | **(24,000)** | **(0.4)** | (9,000) | --- |
| R&D credits | **(83,000)** | **(12.1)** | (20,000) | |
| Other, misc | **1,000** | | --- | |
| Tax exempt income | **(1,000)** | **---** | (4,000) | --- |
| Actual income tax expense | **$ 2,096,000** | **30.0 %** | $ 2,155,000 | 32.0 % |

During 2012 and 2011, the Company realized the tax benefits of the Domestic Production Activities deduction, which amounted to approximately 9% of net taxable income from domestic production activities in each year.

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

| | Years ended December 31, | |
|---|---|---|
| | **2012** | 2011 |
| Deferred tax assets | | |
| Current | | |
| Accounts receivable | **$ 9,933** | $ 6,101 |
| Inventories | **14,348** | 15,905 |
| Accrued expenses | **192,307** | 201,540 |
| | **216,588** | 223,546 |
| Deferred tax liabilities | | |
| Non-current | | |
| Depreciation | **(98,800)** | (46,207) |
| Unrealized gain on marketable securities | **(94,940)** | (18,361) |
| | **(193,740)** | (64,578) |
| Net deferred tax asset | **$ 22,848** | $ 158,968 |

## NOTE E - BENEFIT PLANS

### Defined Contribution Plan

The Company sponsors a 401(k) defined contribution plan ("DC Plan") that provides for a dollar-for-dollar employer matching contribution of the first 4% of each employee's pay. Employees become fully vested in employer matching contributions after one year of employment. Company 401(k) matching contributions were approximately $96,000 and $97,000 for each of the years ended December 31, 2012 and 2011. In 2012 and 2011 employees were able to defer up to $17,000 and $16,500, respectively (plus $5,500 for employees over the age of 50) of their yearly pay as a pre-tax investment in the 401(k)plan, in accordance with limits set by the IRS. (Those limits will increase to $17,500 (plus an additional $5,500 for employees over the age of 50) in 2013).

The Company also makes discretionary contributions to each employee's account based on a "pay-to-pay" safe-harbor formula that qualifies the 401(k) plan under current IRS regulations. In December 2012 and 2011 the Company's Board of Directors authorized discretionary contributions in the amount of $175,000 per year, to be allocated among all eligible employees, for the 2012 and 2011 plan years. The 2012 contribution was paid in 2012, and the 2011 contribution was paid in 2011. Employees become vested in the discretionary contributions as follows: 20% after two years of employment, and 20% for each year of employment thereafter until the employee becomes fully vested after six years of employment.

### 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 plan authorizes the granting of options for up to 500,000 shares, and covers both employees and directors. The adoption and implementation of the new plan was ratified by the shareholders of the Company at the Company's annual meeting of shareholders on May 19, 2004.

As of December 31, 2012 and 2011, no stock options had been issued under this plan.

As of December 31, 2012 and 2011, 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 share-based compensation expense during the years ended December 31, 2012 and 2011.

## NOTE F - GEOGRAPHIC and OTHER INFORMATION

Through its Guardian Laboratories division the Company manufactures and markets cosmetic ingredients, personal care products, pharmaceuticals, medical and health care products, and specialty industrial products. It also conducts research and development, primarily related to the development of new and unique cosmetic and personal care products. The Company's R&D department not only develops new products but also modifies and refines existing products, with the goal of expanding the potential markets for the Company's products. Many of the cosmetic ingredient products manufactured by Guardian, particularly its LUBRAJEL line of water-based moisturizing and lubricating gels, are currently used by many of the major multinational personal care products companies.

The Company operates in one business segment. The Company's products are separated into four distinct product categories: pharmaceuticals, personal care products (including cosmetic ingredients), medical products, and industrial products. Each product category is marketed differently. The cosmetic ingredient/personal care products are marketed through a global network of marketing partners and distributors. These marketing partners purchase product outright from the Company and market and re-sell those products to the end users. The Company does not make any sales on consignment.

No prior regulatory approval was needed by the Company to sell any products other than its pharmaceutical products. The end users of its products may or may not need regulatory approvals, depending on the intended claims and uses of those products.

The pharmaceutical products are two urological products that are sold to end users primarily through distribution agreements with the major drug wholesalers. For these products, the Company does the marketing, and the drug wholesalers supply the product to the end users, such as hospitals and pharmacies. These products are drug products that required the Company to obtain regulatory approval before marketing.

The medical products are not pharmaceutical products. They consist primarily of medical lubricants, which are marketed by the Company directly to manufacturers that incorporate them into urologic catheters and other medical devices and products that they sell. These products are distinguished from the pharmaceutical products in that, unlike the pharmaceutical products, the Company is not required to obtain regulatory approval prior to marketing these products. Approvals are the responsibility of the company that markets the medical device. However, the Company is responsible for manufacturing these products in accordance with current Good Manufacturing Practices for medical devices.

The industrial products are also marketed by the Company directly to manufacturers, and generally do not require that the Company obtain regulatory approval. However, the manufacturers of the finished products may have to obtain such regulatory approvals before marketing these products.

The geographic information set forth in table "(b)" below is partially based on sales information provided to the Company by Customer A (shown in table "(c)" below), which exclusively markets the Company's cosmetic ingredients in Canada and China, and also sells some of the Company's products into France on a non-exclusive basis along with Customer B.

**(a) Net Sales**

| | Years ended December 31, | |
|---|---|---|
| | **2012** | 2011 |
| Personal Care | **$ 9,438,345** | $ 9,236,704 |
| Pharmaceuticals | **1,524,581** | 2,315,093 |
| Medical | **2,904,327** | 2,897,699 |
| Industrial and other | **153,498** | 133,826 |
| | **14,020,751** | 14,583,322 |
| Less: Discounts and allowances | **(194,987)** | (244,810) |
| | **$ 13,825,764** | $ 14,338,512 |

**(b) Geographic Information**

| | Years ended December 31, | | | |
|---|---|---|---|---|
| | **2012** | | 2011 | |
| | **Revenues** | **Long-Lived Assets** | Revenues | Long-Lived Assets |
| United States | **$ 4,648,472** | **$ 1,235,863** | $ 5,805,331 | $ 1,245,487 |
| Canada | **2,860,154** | **---** | 2,551,980 | --- |
| China | **2,462,967** | **---** | 2,144,451 | --- |
| France | **903,137** | **---** | 1,029,382 | --- |
| Other countries | **2,951,034** | **---** | 2,807,368 | --- |
| | **$ 13,825,764** | **$ 1,235,863** | $ 14,338,512 | $ 1,245,487 |

**(c) Sales to Major Customers**

| | Years ended December 31, | |
|---|---|---|
| | **2012** | 2011 |
| Customer A | **$ 7,664,805** | $ 7,333,581 |
| Customer B | **837,220** | 909,111 |
| All other customers | **5,323,739** | 6,095,820 |
| | **$ 13,825,764** | $ 14,338,512 |

## NOTE G - INCOME FROM DAMAGE SETTLEMENT

In May 2012 the Company's supplier of RENACIDIN curtailed production due to manufacturing issues. That curtailment continues as of the date of this report. As a result of that curtailment the Company's inventory was fully depleted at the end of July 2012, and since that time the Company has been unable to fill orders for that product. The Company and its supplier entered into a settlement agreement, whereby the Company was paid the sum of $518,050, which the Company believes covers most of the RENACIDIN profit the Company lost in 2012. The settlement agreement calls for continuing payments to be made until the supply contract ends in January 2014 or until production resumes, whichever occurs first.

At the end of 2010 the Company experienced a similar suspension of RENACIDIN production, again due to manufacturing issues at the supplier's production facility. Production did not resume until May 2011. As a result, the Company determined that it lost approximately $390,000 in gross profit that would have been generated from sales of the product if production had not been curtailed. The Company and its supplier entered into a settlement agreement to resolve claims related to that period of curtailment. The

miscellaneous income of $385,182 in FY-2011 represents the amount that was repaid to the Company in 2011. Further information can be found in the Company's filing on Form 10-K for 2011.

## NOTE H - ACCRUED EXPENSES

Accrued expenses at December 31, 2012 and 2011 consist of:

| | 2012 | 2011 |
|---|---|---|
| Accrued bonuses | **$ 229,000** | $ 200,000 |
| Accrued distribution fees | **196,617** | 191,171 |
| Payroll and related expenses | **72,306** | 80,986 |
| Accrued annual report | **66,000** | 72,000 |
| Accrued audit fee | **68,467** | 70,000 |
| Other | **43,733** | 62,802 |
| | **$ 676,123** | $ 676,959 |

## NOTE I - RELATED PARTY TRANSACTIONS

For the year ended December 31, 2012, the Company made no payments to Henry Globus, a former officer and director of the Company who passed away in December 2011, as compared to the year ended December 31, 2011 in which the Company paid him $22,296. The payments were for consulting services in accordance with his employment termination agreement of 1988.

During each of the years ended December 31, 2012 and 2011 the Company paid to Bonamassa, Maietta, and Cartelli, LLP, $13,000, and $11,000, respectively, for accounting and tax services. Lawrence Maietta, a partner in Bonamassa, Maietta, and Cartelli, LLP, is a director of the Company.

During the first quarter of 2011 the Company sold one of its vehicles, with a book value of $20,407, to one of its Vice Presidents for $15,154 (the vehicle's fair market value) as part of his severance package. As a result, the Company recognized a non-cash loss of $5,253.

During the fourth quarter of 2012 the President of the Company, Kenneth H. Globus, was reimbursed $24,408 and in the third quarter of 2011 he was reimbursed $11,406 for the value of the trade-in of personal vehicles that were used to purchase two Company vehicles.

# Management's Discussion and Analysis of Financial Condition and Results of Operations

## Critical Accounting Policies

The Company’s financial statements have been prepared in accordance with U.S. generally accepted accounting principles. Preparation of financial statements requires the Company to make estimates and assumptions affecting the reported amounts of assets, liabilities, revenues, and expenses and the disclosure of contingent assets and liabilities. The Company uses its historical experience and other relevant factors when developing its estimates and assumptions, which are continually evaluated. Note A, Nature of Business and Summary of Significant Accounting Policies, of the Notes to Financial Statements,

included in Item 8, Financial Statements and Supplementary Data, of this Annual Report on Form 10-K includes a discussion of the Company's significant accounting policies. The following accounting policies are those that the Company considers critical to an understanding of the financial statements because their application places the most significant demands on the Company's judgment. The Company's financial results might have been different if other assumptions had been used or other conditions had prevailed.

### Marketable Securities

The Company classifies its marketable securities as available-for-sale at the time of purchase and re-evaluates such designation as of each balance sheet date. The Company's marketable securities include investments in equity and fixed income mutual funds, government securities, and corporate bonds. The Company's marketable securities are reported at fair value with the related unrealized gains and losses included in accumulated other comprehensive income (loss), a component of stockholders' equity. Realized gains or losses on mutual funds are determined using the average cost method, while realized gains or losses on government securities and bonds are determined using the specific-identification method. Realized gains or losses on the Company's marketable securities are insignificant for the years ended December 31, 2012 and 2011. The Company evaluates its investments periodically for possible other-than-temporary impairment by reviewing factors such as the length of time and extent to which fair value had been below cost basis, the financial condition of the issuer and the Company's ability and intent to hold the investment for a period of time which may be sufficient for anticipated recovery of market value. The Company would record an impairment charge to the extent that the cost of the available-for-sale securities exceeds the estimated fair value of the securities and the decline in value is determined to be other-than-temporary. During 2012 the Company did not record an impairment charge regarding its investment in marketable securities because management believes, based on its evaluation of the circumstances, that the decline in fair value below the cost of certain of the Company's marketable securities is temporary.

### Revenue Recognition

The Company recognizes revenue when products are shipped, title and risk of loss pass to customers, persuasive evidence of a sales arrangement exists, and collections are reasonably assured. Any allowances for returns are taken as a reduction in sales within the same period the revenue is recognized. Such allowances are based on historical experience as well as other factors that, in the Company's judgment, could reasonably be expected to cause sales returns or doubtful accounts to differ from historical experience.

### Accounts Receivable Allowance

The Company performs ongoing credit evaluations of the Company's customers and adjusts credit limits, as determined by a review of current credit information. The Company continuously monitors collection and payments from customers and maintains an allowance for doubtful accounts based upon historical experience, the Company's anticipation of uncollectible accounts receivable and any specific customer collection issues that have been identified. While the Company's credit losses have historically been low and within expectations, the Company may not continue to experience the same credit loss rates that have historically been attained. The receivables are highly concentrated in a relatively small number of customers. Therefore, a significant change in the liquidity, financial position, or willingness to pay timely, or at all, of any one of the Company's significant customers would have a significant impact on the Company's results of operations and cash flows.

### Inventory Valuation Allowance

In conjunction with the Company's ongoing analysis of inventory valuation, management constantly monitors projected demand on a product-by-product basis. Based on these projections, management evaluates the levels of write-downs required for inventory on hand and inventory on order from contract manufacturers. Although the Company believes that it has been reasonably successful in identifying write-downs in a timely manner, sudden changes in buying patterns from customers, either due to a shift in product interest and/or a complete pull back from their expected order levels, may result in the recognition of larger-than-anticipated write-downs.

## Results Of Operations

Year ended December 31, 2012 compared with the year ended December 31, 2011:

### Net Sales

Net sales in 2012 decreased by $512,748 (3.6%) compared with 2011. The net decrease was the result of the following changes in sales in the different product categories:

(a) **Personal care products**: Sales of the Company's personal care products, including cosmetic ingredients, increased by $201,641 (2.2%) for the year ended December 31, 2012 when compared with 2011. The increase was attributable primarily to an increase in sales to ASI, the Company's largest marketing partner. Sales to ASI in 2012 increased 4.5% compared with 2011. Sales to the Company's five other marketing partners showed a net decrease of $90,166 (4.9%) in 2012 compared with 2011. Sales to four of those five, all in Western Europe, decreased, while sales to the Company's marketing partner in South Korea increased.

The Company believes that the net increase in sales of its personal care products was the result of improving economic conditions in Asia and North America, which resulted in new consumer product introductions utilizing its products. The overall increase in sales was almost entirely attributable to an increase in sales of the Company's extensive line of LUBRAJEL® products.

The Company's increased sales to ASI are believed to be the result of both normal fluctuations in ASI's buying patterns, as well as new consumer product introductions and new customers for the Company's products. The decrease in sales to the Company's European marketing partners is believed to be due to the continuing economic decline in the Western European economies, which has resulted in a decrease in demand for personal care and cosmetic ingredients in those areas.

Total sales of all of the Company's LUBRAJEL products for both personal care and medical uses increased by $229,013 (2.0%) in 2012 compared with 2011. The unit volume of all LUBRAJEL products sold, both for personal care and medical uses, increased by approximately 2.4% in 2012 compared with 2011.

(b) **Pharmaceuticals**: Sales of the Company's two pharmaceutical products, RENACIDIN and CLORPACTIN, decreased by $790,512 (34.1%) for the year ended December 31, 2012 compared with 2011, with RENACIDIN accounting for almost the entire decrease. RENACIDIN accounted for approximately 8% of the Company's sales in 2012 compared with 13% in 2011. The decrease in sales of the Company's pharmaceutical products in 2011 was due to a decrease in sales of RENACIDIN. Although the Company had normal demand for the product, it was unable to fill orders

during the second half of 2012 because it could not get product from its supplier. The product has been manufactured for the Company under a long-term contract with a major U.S. drug manufacturer that experienced regulatory problems in 2010 that caused it to suspend production from November 2010 until May 2011, and then experienced a production curtailment again beginning in May 2012 and continuing as of the date of this report. As a result, the Company began to allocate product to its customers beginning in May 2012, and continued to do so until its inventory was depleted on August 1, 2012. The supplier has paid the Company $518,050, which the Company believes covers most of the RENACIDIN profit the Company lost in 2012. The Company is hopeful that production will resume and that it will be able to bring in more inventory in the third quarter of 2013. The Company will not be continuing with this supplier past January 2014, and is currently working with a new supplier that will produce the product in a new single-dose unit that may increase the Company's revenue from this product in future years. The Company hopes to have the new dosage form on the market in the second half of 2014.

(c) **Medical products**: Sales of the Company's medical products increased $6,628 (0.2%) in 2012 compared with 2011. Sales of the primary products in this category all increased, but those increases were partially offset by lower sales of LUBRAJEL RR, which decreased by 16.1% due to the ordering patterns of the customers for this product. The Company expects increased sales in 2013 as a result of anticipated sales of its new LUBRAJEL TF medical lubricant, which was developed for a new customer and began shipping late in 2012.

(d) **Industrial and other products:** Sales of the Company's industrial products, as well as other miscellaneous products, increased by $19,672 (14.7%) in 2012 when compared with 2011.

Sales were positively impacted in 2012 by a decrease of $49,822 (20.4%) in sales discounts and allowance reserves as compared with 2011. The decrease in sales discounts and allowances was mainly due to decreases in the allowance for distribution fees, rebates, and sales discounts attributable to the lower sales of RENACIDIN in 2012 as compared with 2011.

## Cost of Sales

Cost of sales as a percentage of net sales in 2012 decreased to 37.7% from 39.4% in the prior year. The decrease was primarily the result of the change in the Company's product mix as a result of the lower sales of RENACIDIN in 2012 (as discussed above) and increased sales in 2012 of the Company's higher margin LUBRAJEL products, as well as a decrease in insurance expense.

## Operating Expenses

Operating expenses decreased by $44,457 (1.7%) in 2012 compared with the prior year. This decrease was mainly due to a reduction in insurance expense.

Portions of the Company's operating expenses are directly attributable to the research and development that the Company performs. In 2012 and 2011, the Company incurred approximately $693,000 and $637,000, respectively, in research and development expenses, which are included in operating expenses. The increase in R&D costs incurred in 2012 was primarily attributable to increases in payroll costs. No portion of the research and development expenses was directly paid by the Company's customers.

## Other Income (Expense)

Other income (net) increased $92,121 (12.5%) for the year ended December 31, 2012 when compared with 2011. The increase was mainly attributable to $518,050 in income the Company accrued from the settlement of a claim for damages between the Company and its RENACIDIN supplier. The claim resulted from the temporary suspension of production of the Company's RENACIDIN product by its supplier at the end of 2011 due to production problems unrelated to RENACIDIN. Production is not expected to resume until the third quarter of 2013. As a result, the Company and its supplier entered into a settlement agreement whereby the Company would be compensated for most of its lost profits caused by its inability to bring in inventory. The $518,050 reimburses the Company for most of the profit the parties agreed the Company would have received from RENACIDIN sales in 2012 had it not been for the production curtailment. The settlement agreement also provides for continuing payments to the Company until production resumes or until the Company's contract with the supplier ends in January 2014. In 2011 the Company recognized $385,182 in income from a previous production curtailment by the same supplier that negatively impacted RENACIDIN sales in 2011. Further information on that previous production curtailment can be found in the Company's Annual Report on Form 10-K for 2011.

The Company earns interest income from money market funds and bonds, and dividend income from both stock and bond mutual funds. Other income was reduced in 2012 by a decrease in investment income of $7,635, which primarily resulted from lower interest rates and dividend returns compared with 2011.

The Company also had a net loss on the sale of assets of $14,861 in 2012 compared to a net gain of $18,251 in 2011.

## Provision for Income Taxes

The provision for income taxes decreased by $59,220 (2.7%) in 2012 compared with 2011. This decrease was mainly due to income tax refunds for research and development tax credits for the years 2008 through 2010. The Company's effective income tax rate was approximately 30% in 2012 and 31% in 2011, and is lower than the federal statutory rate of 34% primarily due to the additional tax deduction for domestic production activities as well as the utilization of research and development tax credits.

## Liquidity and Capital Resources

Working capital decreased from $12,895,448 at December 31, 2011 to $11,795,895 at December 31, 2012, a decrease of $1,099,553 (8.5%). The current ratio increased to 15.25 to 1 at December 31, 2012 from 12.97 to 1 at December 31, 2011. The decrease in working capital was due to a decrease in marketable securities, which was partially used to fund a special dividend that the Company paid in December 2012. The increase in the current ratio was primarily the result of a decrease in accounts payable.

Accounts receivable (net of allowance for doubtful accounts) as of December 31, 2012 decreased by $635,813 as compared with 2011. The average period of time that an account receivable was outstanding was approximately 35 days in 2012 and in 2011. The Company has a bad debt reserve of $29,000 and $18,000 for 2012 and 2011, respectively, and believes that the net balance of its accounts receivable is fully collectable as of December 31, 2012.

The Company does not maintain a line of credit with a financial institution because the Company has no foreseeable need for a line of credit, and therefore management believes that the cost of maintaining a line of credit cannot be justified, especially considering the strong financial condition of the Company.

The Company generated cash from operations of $5,380,747 in 2012 compared with $4,437,129 in 2011. The increase in 2012 was primarily due to decreases in accounts receivable and inventories.

Net cash provided by investing activities was $1,527,819 for the year ended December 31, 2012 when compared with net cash used in investing activities of $1,183,593 for the year ended December 31, 2011. This increase was mainly due to proceeds from the sale of marketable securities in 2012.

Cash used in financing activities was $6,251,158 and $3,677,151 during the years ended December 31, 2012 and 2011, respectively. The increase was mainly due to a special dividend of $0.50 per share the Company paid in December 2012 due to uncertainty regarding the tax treatment of qualified dividends after December 31, 2012.

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.

## OFF-BALANCE-SHEET ARRANGEMENTS

The Company has no off-balance-sheet transactions that have, or are reasonably likely to have, a current or future effect on the Company’s financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

## CONTRACTUAL OBLIGATIONS AND COMMITMENTS

The information to be reported under this item is not required of smaller reporting companies.

## NEW ACCOUNTING PRONOUNCEMENTS

See Note "A" to the financial statements regarding new accounting pronouncements.

# Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities

## Market Information

The Common Stock of the Company has traded on the NASDAQ Global Market since March 16, 2009, under the symbol "UG". From December 1, 2008 through March 13, 2009, following the merger of the American Stock Exchange with the New York Stock Exchange, the Company's Common Stock was traded on the NYSE Amex Stock Exchange under the same symbol. Prior to December 1, 2008 its stock traded on the American Stock Exchange under the same symbol.

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 NASDAQ, for the period January 1, 2011 to December 31, 2012. The quotations represent prices between dealers and do not include retail markup, markdown or commission:

| Quarters | | **Year Ended December 31, 2012** | | Year Ended December 31, 2011 | |
|---|---|---|---|---|---|
| | | **High** | **Low** | High | Low |
| First | (1/1 - 3/31) | **$ 18.35** | **$ 14.91** | $ 15.30 | $ 14.09 |
| Second | (4/1 - 6/30) | **23.63** | **18.00** | 15.63 | 14.04 |
| Third | (7/1 - 9/30) | **20.00** | **16.78** | 15.00 | 12.96 |
| Fourth | (10/1 - 12/31) | **19.78** | **17.10** | 15.25 | 14.50 |

## Holders of Record

As of March 1, 2013, there were 893 holders of record of Common Stock.

## Cash Dividends

On May 16, 2012, the Company's Board of Directors declared a semi-annual cash dividend of $0.42 per share, which was paid on June 18, 2012 to all stockholders of record as of June 4, 2012. On December 4, 2012, the Company's Board of Directors declared a semi-annual cash dividend of $0.44 per share and a special dividend of $0.50 per share, which were paid on December 21, 2012 to all stockholders of record as of December 14, 2012.

On May 11, 2011, the Company's Board of Directors declared a semi-annual cash dividend of $0.36 per share, which was paid on June 13, 2011 to all stockholders of record as of May 30, 2011. On December 7, 2011, the Company's Board of Directors declared a semi-annual cash dividend of $0.44 per share, which was paid on December 23, 2011 to all stockholders of record as of December 16, 2011.

UNITED-GUARDIAN, INC.

## Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
United-Guardian, Inc.
Hauppauge, New York

We have audited the accompanying balance sheets of United-Guardian, Inc. (the "Company") as of December 31, 2012 and 2011, and the related statements of income, comprehensive income, stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also 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 referred to above present fairly, in all material respects, the financial position of United-Guardian, Inc. as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Holtz Rubenstein Reminick LLP
Melville, New York
March 20, 2013


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Continental Stock Transfer & Trust Company
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Upon written request, a copy of the Company's most recent Annual Report on Form 10-K will be furnished without charge. A fee will be charged for copies of any exhibits attached to such report. Contact: Corporate Secretary, United-Guardian, Inc., P.O. Box 18050, Hauppauge, NY 11788.

PLEASE NOTE: This document contains both historical and "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements about the company's expectations or beliefs concerning future events, such as financial performance, business prospects, and similar matters, are being made in reliance upon the "safe harbor" provisions of that Act. Such statements are subject to a variety of factors that could cause our actual results or performance to differ materially from the anticipated results or performance expressed or implied by such forward-looking statements. For further information about the risks and uncertainties that may affect the company's business please refer to the company's reports and filings with the Securities and Exchange Commission.


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**United-Guardian, Inc.**

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