IGI INC
Form 10QSB
May 15, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form 10-QSB

(Mark One)

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the quarterly period ended March 31, 2007

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from ______________________
to________________________

Commission File Number 001-08568

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

Delaware (State or other Jurisdiction of incorporation or organization)	01-0355758 (I.R.S. Employer Identification No.)
105 Lincoln Avenue Buena, New Jersey (Address of Principal Executive Offices)	08310 (Zip Code)

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

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

Yes [X] No [ ]

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

Yes [ ] No [X]

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

Common Shares Outstanding at May 3, 2007 was 14,612,899.

Transitional Small Business Disclosure Format Yes [ ] No [X]

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PART I
FINANCIAL INFORMATION

ITEM 1. Financial Statements

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

	Three months ended March 31,	
	2007	2006
Revenues:		
Revenues, net	$ 681	$ 396
Licensing and royalty income	140	185
Total revenues	821	581
Cost and expenses:		
Cost of sales	516	258
Selling, general and administrative expenses	585	457
Product development and research expenses	111	291
Operating loss	(391)	(425)
Interest income (expense)	(19)	(42)
Other income	-	24
Loss from continuing operations	(410)	(443)
Loss from discontinued operations	-	(9)
Net loss	$ (410)	$ (452)
Basic and Diluted Loss Per Common Share		
Continued operations net loss per share	$ (.03)	$ (.04)
Discontinued operations net loss per share	-	-
Net loss per share	$ (.03)	$ (.04)

Weighted Average of Common Stock and Common Stock

Equivalents Outstanding		
Basic and Diluted	13,393,234	12,632,604

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)

	March 31, 2007	December 31, 2006*
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 353	$ 619
Restricted cash	50	50
Accounts receivable, less allowance for doubtful accounts of $33 and $34 in 2007 and 2006, respectively	433	197
Licensing and royalty income receivable	83	91
Inventories	472	485
Prepaid expenses and other current assets	110	45
Assets of discontinued operations held for sale	350	350
Total current assets	1,851	1,837
Property, plant and equipment, net	2,437	2,396
License fee, net	875	900
Other assets	8	10

Total assets	$	5,171	$	5,143
LIABILITIES AND STOCKHOLDERS' EQUITY				
Current liabilities:				
Accounts payable	$	285	$	505
Accrued expenses		452		417
Note payable- related party		-		1,145
Note payable		500		306
Deferred income, current		403		400
Advance on sale of equipment of discontinued operations		130		-
Liabilities of discontinued operations		118		118
Total current liabilities		1,888		2,891
Deferred income		41		59
Total liabilities		1,929		2,950
Stockholders' equity:				
Common stock, $.01 par value, 50,000,000 shares authorized; 16,578,639 and 15,056,516 shares issued in 2007 and 2006, respectively		166		151
Additional paid-in capital		27,013		25,569

		(22,542)		(22,132)
Accumulated deficit				
Less treasury stock, 1,965,740 shares at cost		(1,395)		(1,395)
Total stockholders' equity		3,242		2,193
Total liabilities and stockholders' equity	$	5,171	$	5,143

The accompanying notes are an integral part of the consolidated financial statements.
* Derived from the audited December 31, 2006 financial statements

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

	Three months ended March 31,			
	2007		2006	
Cash flows from operating activities:				
Net loss	$	(410)	$	(452)
Reconciliation of net loss to net cash used in operating activities:				
Depreciation and amortization		57		80
Amortization of license fee		25		25
Recognition of deferred income		(63)		(17)
Stock based compensation expense		81		-
Changes in operating assets and liabilities:				
Accounts receivable		(236)		3
Inventories		13		(136)
Deferred income		48		19
Licensing and royalty income receivable		8		25
Prepaid expenses and other assets		(67)		(119)
Accounts payable and accrued expenses		(185)		190
Net cash used in operating activities		(729)		(382)

Cash flows from investing activities:

Capital expenditures	(94)	-
Proceeds from deposit on sale of assets of discontinued operations	130	-
Net cash provided by investing activities	36	-
Cash flows from financing activities:		
Borrowing from short term notes payable	500	-
Repayment of note payable- related party	(1,145)	-
Repayment of note payable	(306)	
Proceeds from exercise of common stock options	-	84
Proceeds from private placement of common stock, net of expenses	1,378	100
Net cash provided by financing activities	427	184
Net decrease in cash and equivalents	(266)	(198)
Cash and equivalents at beginning of period	619	365
Cash and equivalents at end of period	$ 353	$ 167
Supplemental cash flow information:		
Cash payments for interest	$ 169	$ -
Cash payment for taxes	-	-

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

IGI, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

IGI, Inc. ("IGI" or the "Company"), a Delaware corporation, operating in the State of New Jersey, is primarily engaged in the development and manufacturing of topical, semi solid and liquid products for the pharmaceutical cosmeceutical and cosmetics companies with or without its proprietary encapsulation technology.

On January 4, 2007, Rajiv Mathur joined the Company as its new President and CEO. Mr. Mathur has a diverse experience background of 30 years in pharmaceutical and consumer product companies. Most recently he was Vice President of Topical Division of Cardinal Health. He served on IGI's Board of Directors since September 2005. Due to his prior affiliation with IGI, Mr. Mathur has an in depth knowledge of our Novasome® technology.

Contract Manufacturing and Other Services

In December 2006, the Company purchased three high-speed filling lines to enable us to provide filling and packaging services to our current and future customers. The Company will be purchasing additional equipment in 2007 to complete this operation, which we anticipate being fully operational by the end of the second quarter of 2007. Also, in conjunction with our new business focus, we are now offering product development and analytical services to our customers in addition to our manufacturing and filling services.

Major Customers

The following summarizes the Company's customers, which individually account for more than 10% of the Company's revenue:

Vetoquinol USA accounted for 33% of 2007 revenues and 25% of 2006 revenues. Genesis Pharmaceuticals accounted 11% of the 2007 revenues and 15% of 2006 revenues. Albrian International accounted for 10% of 2007 revenues and 23% of 2006 revenues.

Our geographic area of operations is the United States with concentration of our customers located in Northeastern United States.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenue and expenses during the reporting period. Actual results may differ from these estimates. The significant estimates and assumptions made by the Company are in the areas of revenue recognition, inventory obsolescence, allowance for doubtful accounts, environmental accrual, valuation allowances for deferred tax assets, and valuation of equity instruments issued under Statement of Financial Accounting Standards ("SFAS") No. 123R, "Share-Based Payment" ("SFAS 123R").

Revenue Recognition

The Company considers revenue realized or realizable and earned when it has persuasive evidence of an arrangement, delivery has occurred or contractual services rendered, the sales price is fixed or determinable, and collection is reasonably assured in conformity with SAB No. 104, *Revenue Recognition*.
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IGI, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Continued

The Company derives its revenues from three basic types of transactions: sales of manufactured product, licensing of technology, and research and product development services performed for third parties. Due to differences in the substance of these transaction types, the transactions require, and the Company utilizes, different revenue recognition policies for each.

Product Sales: The Company recognizes revenue when title transfers to its customers, which is generally upon shipment of products. These shipments are made in accordance with sales commitments and related sales orders entered into with customers either verbally or in written form. The revenues associated with these transactions, net of appropriate cash discounts, product returns and sales reserves, are recorded upon shipment of the products.

Licensing Revenues: Revenues earned under licensing or sublicensing contracts are recognized ratably over the lives of the agreements. Advance payments by customers are initially recorded as deferred income on the Consolidated Balance Sheet and then recognized ratably over the life of the agreement or as contract obligations are completed.

Product Development Services*:* The Company establishes agreed upon product development agreements with its customers to perform product development services. Product development revenues are recognized in accordance with the product development agreement upon the completion of each phase of development and when we have no future performance obligations relating to that phase of development. Revenue recognition requires the Company to assess progress against contracted obligations to assure completion of each stage. These payments are generally non-refundable and are reported as deferred until they are recognizable as revenue. If no such agreement exists, product development fees are recognized ratably over the entire period during which the services are performed.

In making such assessments, judgments are required to evaluate contingencies such as potential variances in schedule and the costs, the impact of change orders, liability claims, contract disputes and achievement of contractual performance standards. Billings on research and development contracts are typically based upon terms agreed upon by the Company and customer and are stated in the contracts themselves and do not always align with the revenues recognized by the Company. On occasions when revenue recognized exceeds the milestone or progress billed to our customer, an "unbilled" receivable is recorded on our Consolidated Balance Sheet.

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," to define fair value, establish a framework for measuring fair value in accordance with generally accepted accounting principles, and expand disclosures about fair value measurements. SFAS No. 157 will be effective for fiscal years beginning after November 15, 2007, the beginning of our 2008 fiscal year. We are assessing the impact that the adoption of SFAS No. 157 will have on our financial position and results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 permits an entity to irrevocably elect fair value on a contract-by-contract basis as the initial and subsequent measurement attribute for many financial assets and liabilities and certain other items including insurance contracts. Entities electing the fair value option would be required to recognize changes in fair value in earnings and to expense upfront cost and fees associated with the item for which the fair value option is elected. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of SFAS No. 157, Fair Value Measurements. The Company is currently evaluating the impact of adopting SFAS No. 159 on its financial condition and results of operations.

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

2. Inventories

Inventories are valued at the lower of cost, using the first-in, first-out ("FIFO") method, or market. Inventories at March 31, 2007 and December 31, 2006 consist of:

	March 31, 2007		December 31, 2006	
	(amounts in thousands)			
Finished goods	$	235	$	241
Work in progress		2		18
Raw materials		235		226
Total	$	472	$	485

3. Stock-Based Compensation

Stock Incentive Plans

The Company currently has a stock-based compensation plan for its Board of Directors, the 1999 Director Stock Option Plan (the "Director Plan") in place. In accordance with the Director Plan, each non-employee member of the Board is granted an option once a year as compensation for services rendered to the Company for that year. The options vest over a 12-month period. Each Director receives an option for 15,000 shares with an additional grant to each committee Chairman. The Company also provides each director with an amount of shares as compensation for each board meeting they attend throughout the year in accordance with the 1998 Director Stock Plan.

The Company also has a stock-based incentive plan in place for its eligible employees, officers, consultants, independent advisors and non-employee directors called the 1999 Stock Incentive Plan (the "Plan"). The Plan permits the grant of share options and shares for up to 2,500,000 shares of our common stock, of which, 2,193,800 shares were outstanding and 306,200 were available at March 31, 2007. Option awards are granted with an exercise price equal to or greater than the closing sale price per share of the Company's common stock on the AMEX Stock Exchange on the option grant date. Although the terms of any award vary, options awards generally vest based upon four years of continuous service and have 10-year contractual terms.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option-pricing formula that uses assumptions noted in the following table. Expected volatilities and risk-free interest rates are based upon the expected life of the grant. The interest rates used are the U.S. Treasury yield curve in effect at the time of the grant.

	March 31, 2007
Expected volatility	75.06%
Expected term (in years)	5.5 years
Risk-free rate	4.59%
Expected dividends	0%

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IGI, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Continued

A summary of option activity under the Plan and the Director Plan as of March 31, 2007 and changes during the period are presented below: (in thousands, except for weighted-average data)

	Number of Options	Weighted Average Exercise Price
Outstanding as of 1/1/2007	1,818,548	$1.56
Issued	558,750	$1.05
Exercised	-	-
Forfeited	(19,000)	$ .95
Outstanding as of 3/31/2007	2,358,298	$1.45
		$1.58
Exercisable as of 3/31/2007	1,714,548	

Based upon application of the Black-Scholes option-pricing formula described above, the weighted-average grant-date fair value of options granted during the three months ended March 31, 2007 was $.82.

The following table summarizes information regarding options outstanding and exercisable at March 31, 2007:

Outstanding:

Range of Exercise Prices		Stock options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life
$0.50	$1.00	332,250	$0.73	6.73
$1.01	$2.00	1,581,548	$1.32	6.82
$2.01	$3.00	414,500	$2.31	5.42
$3.01	$3.75	30,000	$3.75	0.75
Total		2,358,298	$1.45	6.48

Exercisable:

Range of Exercise Prices		Stock options Exercisable	Weighted Average Exercise Price
$0.50	$1.00	332,250	$0.73

$1.01	$2.00	937,798	$1.49
$2.01	$3.00	414,500	$2.31
$3.01	$5.00	30,000	$3.75
Total		1,714,548	$1.58

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

As of March 31, 2007, the intrinsic value of the options outstanding and exercisable is $39,000. The amount of options in the money at March 31, 2007 is the same amount for outstanding and exercisable. As of March 31, 2007, there was $411,000 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Plans. That cost is expected to be recognized over the remaining vesting periods of the options granted.

As a result of FASB Statement 123(R), the Company's net loss for the three months ended March 31, 2007 was $81,000 higher as a result of adopting Statement 123(R).

4. Income Taxes

Effective January 1, 2007, the Company adopted Financial Interpretation ("FIN") No. 48, *Accounting for Uncertainty in Income Taxes-An Interpretation of FASB Statement No. 109.* This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than fifty percent likely of being realized upon ultimate settlement. The interpretation also provides guidance on derecognition, classification, interest and penalties, and other matters. The adoption did not have an effect on the consolidated financial statements.

As a result of our continuing tax losses, we have historically not paid income taxes and have recorded a full valuation allowance against our net deferred tax asset. Therefore, we have not recorded a liability for unrecognized tax benefits prior to adoption of FIN 48 and there was no adjustment from the implementation. There continues to be no liability related to unrecognized tax benefits at March 31, 2007.

We recognize interest and penalties related to our unrecognized tax benefits at March 31, 2007. There was no accrued interest related to unrecognized tax benefits at March 31, 2007.

The tax years 2003-2006 remain open to examination by the major taxing jurisdictions to which we are subject.

5. License Agreements

On December 12, 2005, the Company extended its license agreement for an additional ten years with Novavax, Inc. for $1,000,000. This extension entitles the Company exclusive use of the Novasome® lipid vesicle encapsulation and certain other technologies ("Microencapsulation Technologies" or collectively the

"Technologies") in the fields of (i) animal pharmaceuticals, biologicals and other animal health products; (ii) foods, food applications, nutrients and flavorings; (iii) cosmetics, consumer products and dermatological over-the-counter and prescription products (excluding certain topically delivered hormones); (iv) fragrances; and (v) chemicals, including herbicides, insecticides, pesticides, paints and coatings, photographic chemicals and other specialty chemicals, and the processes for making the same (collectively, the "IGI Field") thru 2015. This payment is being amortized ratably over the ten-year period. The Company recorded amortization expense for $25,000 each year related to this agreement for the three-month periods ended March 31, 2007 and 2006.
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IGI, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Continued

6. Stock Subscription Agreement

On February 6, 2007 the Registrant and Pharmachem Laboratories, Inc ("Pharmachem") entered into a subscription agreement pursuant to which the Registrant agreed to sell to Pharmachem 1,500,000 shares ("Shares") of its common stock, $.01 par value ("Common Stock") at $1 per share for gross proceeds of $1,500,000. Pharmachem was granted certain piggyback registration rights with respect to the shares purchased. The American Stock Exchange approved this transaction and shares were issued on March 13, 2007. The Company used the proceeds from this equity investment to repay outstanding debts and accrued interest to Univest Management, an entity controlled by Frank Gerardi, former President and CEO of the Company and a significant shareholder. In connection with the transaction, the Company paid $112,500 in cash, issued 22,139 shares of common stock and a warrant to purchase 150,000 shares of common stock, expiring March 7, 2009, exercisable at $1.00 per share in fees to Landmark Financial Corporation. The Company incurred $10,000 of legal fees and paid $112,500 of commission in connection with this transaction for net proceeds to the Company of $1,377,500.

7. Note Payable

On December 12, 2005, the Company received $1,000,000 in the form of a short-term note payable from Univest Management, LLC, a company owned by Frank Gerardi, former President and CEO of the Company and a significant shareholder of the Company. The funds from this note were used to satisfy our obligation to renew our license fee with Novavax, Inc. for use of the Novasome® Technologies for an additional ten year period. The note and all accrued interest became due on the earlier of March 31, 2007 or when a sale leaseback of the land and building closed, with 30% interest per annum through February 1, 2006 and 12% interest per annum through October 1, 2006 and 10% interest per annum thereafter. The note was collateralized by a mortgage on real property owned by the Company. The Company accrued $18,000 and $45,000 of interest related to this note for the quarters ended March 31, 2007 and 2006 respectively. The note was paid in full on March 8, 2007 with the proceeds from the Pharmachem equity transaction consisting of $1,000,000 in principal balance and $163,000 of accrued interest (See Note 7).

On January 30, 2007, IGI, Inc. "entered into a revolving $1,000,000 secured line of credit agreement ("Credit Agreement") with Pinnacle Mountain Partners, LLC, ("Pinnacle"), a company owned by Dr. and Mrs. Hager, significant shareholders of the Company, a term of eighteen months. Loans under the Credit Agreement bear interest at prime (8.25% at March 31, 2007), plus 1.5% and are secured by assets of the Company (other than real property). All accrued and unpaid interest is payable monthly in arrears on the first of each month. The Company has borrowed $500,000 against this line of credit as of March 31, 2007.

Prior to signing the letter of credit with Pinnacle, the Company terminated the $1,000,000 line of credit agreement ("Agreement") with Pharmachem Laboratories, Inc. ("Pharmachem"). All monies borrowed under that agreement plus accrued interest was paid to Pharmachem on January 29, 2007. The terms of the agreement were substantially the same as the Pinnacle credit agreement except for the length of the agreement was for twelve months and the Pinnacle credit agreement is for eighteen months.

8. Discontinued Operations

On July 10, 2006, the Company's Board of Directors along with management accepted a plan to sell the equipment related to the Metal Plating Division to a third party. This reporting segment, the Metal Plating Division, is classified as discontinued operations for all periods presented. Frank Gerardi, the Company's former President and CEO, as well as a major IGI stockholder, has personally invested $350,000 in UCT, which represented less than a 1% ownership interest in UCT at the time it was made.

In the first quarter of 2007, the Company received a purchase order and deposit in the amount of $130,000 toward the re-purchase of the plating equipment from UCT. The selling price of the equipment is $378,000, which consists of $260,000 in cash which is net of $118,000 owed to UCT by the Company. As of May 14, 2007, UCT has substantially completed removal of the equipment at their expense and relocating it to a new facility.

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

A summary of the data related to the Company's discontinued operations for the periods ended March 31, 2007 and March 31, 2006 appear below: (amounts in thousands)

Discontinued operations Summary Income Statement	Three months ended March 31, 2007	Three months ended March 31, 2006
Product sales	$ -	$ -
Cost of sales	-	-
Sales and marketing expenses	-	(9)
Loss from discontinued operations	$ -	$ (9)

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IGI, INC. AND SUBSIDIARIES

ITEM 2. Management's Discussion and Analysis or Plan of Operations

Statements in this Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as in certain other parts of this Quarterly Report on Form 10-QSB that look forward in time, are forward looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward looking statements include statements concerning plans, objectives, goals, strategies, future events or performance, expectations, predictions, and assumptions and other statements which are other than statements of historical facts. All such forward looking statements are based on the current expectations of management and are subject to, and are qualified by, risks and uncertainties that could cause actual results to differ materially from those expressed or implied by those statements. These risks and uncertainties include, without limitation, competitive factors, outsourcing trends in the pharmaceutical industry, levels of industry research and development spending, the Company's ability to continue to attract and retain qualified personnel, the fixed price nature of product development agreements or the loss of customers and other factors described in IGI's filings with the Securities and Exchange Commission, including its Annual Report on Form 10-KSB.

The Company undertakes no obligation to release the results of any revision to these forward-looking statements, which may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of anticipated events.

Our business plan for 2007 includes the upgrading of our manufacturing and expanding our production services to include filling and packaging capabilities. These additions will provide turnkey solutions to our existing and potential customers. Previously, we provided manufactured materials in bulk form and customers had to retain filling services from a third party. We anticipate that our high-speed packaging services will be completely operational by the second quarter of 2007. We currently have orders in house from several of our existing customers to provide turnkey operations. We will also be marketing our other capabilities to our customers, such as product development services and analytical services, all together or separately. In addition to this, we will be exploring ways to expand our intellectual property portfolio and increase our R&D product pipeline.

Results of Operations

Three months ended March 31, 2007 compared to March 31, 2006

Revenues (in thousands):

Components of Revenue:	2007	2006	$ Change	% Change
Product Sales	$604	$366	$238	65%
R&D Revenues	77	30	47	