



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 single-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 we 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 uncertainty 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