



2016 ANNUAL REPORT

to the stockholders of

UNITED-GUARDIAN, INC.

April 14, 2017

Dear Stockholder,

As most of you already know, 2016 was not as strong a year as we had hoped it would be, primarily because of the disappointing sales we experienced in the first half of the year. I will go into detail later in this letter about why the year progressed the way it did, and why we expect 2017 to be a better year.

Despite the slow start, it was still a profitable year for us, with net income of \$2,581,142 (\$0.56 per share) on sales of \$10,776,867. In comparison, in 2015 we had net income of \$4,606,929 (\$1.00 per share) on sales of \$14,006,244. Despite the lower earnings, the Board still felt confident enough about the future revenue of the company to distribute a total of \$0.75 per share in dividends for the year, compared with the \$1.00 per share that we distributed during 2015. Since the dividend payment exceeded the earnings for the year, stockholders' equity declined from \$14,581,814 on December 31, 2015 to \$13,820,489 as of December 31, 2016, but our balance sheet remains very strong, having ended the year with a very healthy current ratio of 13.4 to 1.

The decline in sales in the first half of 2016 was due primarily to a significant drop in sales of one of our products in China, which began in the fourth quarter of 2015 and continued into the third quarter of 2016. I have discussed this issue in previous stockholders' letters, but for those of you who might have become stockholders recently, this decline in sales was primarily the result of a regulatory issue in China that was unrelated to our product but which affected some of the finished products in which ours was also being used. As a result, many of those finished products had to be taken off the market and reformulated. Since our distributor for China, Ashland Specialty Ingredients ("ASI"), had based its inventory requirements on the demand it had experienced prior to the withdrawal from the market of some of those products, it resulted in ASI exporting to China significantly more product than it needed to fill the reduced demand. Although ASI continued to sell our product in China during this period, this excess inventory had to be reduced before it could bring in new product. As a result, there were no sales of that product to ASI for distribution in China from the end of the third quarter of 2015 until August 2016.

With that regulatory issue having been addressed, and the products that had been affected by it going back on the market during 2016, the overstock situation in China was gradually corrected. In August 2016 ASI resumed its purchases of products intended for sale in China, although at a lower rate than we had experienced during the first three quarters of 2015.

The situation in China was certainly very disappointing to us, but we have received assurances from ASI that it has addressed the inventory control issues that caused the problem. It is still too early to determine what the new level of sales for China will be, since the competitive situation in China over the past few years has increased as Asian competitors have marketed their products at very aggressive pricing levels. But ASI is actively promoting our products in China, and is determined to increase sales of our products there, despite the fact that we will probably have to be more competitive with our pricing in order to continue to compete in that marketplace. That is also the situation in other markets, such as Europe, where we are also seeing more competition than we had experienced in previous years, and we have already implemented more aggressive pricing structures when necessary to retain existing business or secure new business.

While our personal care product sales were not what we hoped they would be for the year, we did have good news in regard to our pharmaceutical products sales. As I have mentioned in previous letters, in December 2015 we received approval from the FDA to market our new 30mL single-dose size of Renacidin®, our most important pharmaceutical product, which is used primarily to prevent and to dissolve calcifications in urethral catheters and the urinary bladder. Previously it was available only in 500mL glass bottles. The new, single-dose unit was engineered to dispense the product directly into an indwelling catheter, eliminating the need to use a separate syringe to extract a small amount of product from the Company's previous 500mL glass bottle.



Sales of the new, sterile single-dose product began in April 2016, and it is already generating significantly more revenue than the product it replaced. We are hopeful that this more user-friendly packaging will enable us to continue to increase our revenue from Renacidin in the coming years.

We are continuing to work with our global marketing partners to develop new and innovative products for the personal care and medical markets. Our R&D efforts over the past few years have focused on developing “natural” ingredients, with Lubrajel® Natural being the first of those products. We are gradually starting to see an increase in demand for that product as cosmetic manufacturers begin to incorporate it into new cosmetic formulations. Our most recent product in this line, Lubrajel Marine, uses components derived from marine vegetation. That product, as well as the original Lubrajel Natural, have both been certified as “natural” by Ecocert, one of the global organizations responsible for certifying natural cosmetic ingredients. We believe that the Ecocert certification will make these products more attractive to potential customers looking to formulate “natural” cosmetic products.

Since the Lubrajel Marine was developed by us jointly with ASI, ASI will have the exclusive global marketing rights for the product. ASI is very excited about its sales potential, and is introducing and highlighting the product at the upcoming In-Cosmetics conference in London in April. However, like any new cosmetic ingredient, it can take 1-2 years for cosmetic companies to bring new products to market, so it is unlikely that we will see any significant income from this product until next year.

Here are some other products on which we have been working to further expand our product line:

- **Lubrajel Oil Natural**, a natural version of our current Lubrajel Oil, which has been our largest selling Lubrajel product for a number of years. We expect to have the formulation for this product finalized within the next few months, and hope to begin sampling to our distributors early in the third quarter of this year.
- **Preservative-free version of Lubrajel Oil**, which will be sold alongside our other preservative-free product, Lubrajel PF (also sold in France as “Norgel”). We believe that there is going to be increased demand for cosmetic ingredients that are completely preservative-free, since it makes it easier for cosmetic companies to formulate without concerns about incompatibilities between preservatives. Work on this project has just begun, but we feel that this could be a new area of growth for us if we are successful in our development efforts.
- **Lubrajel Terra**, a product consisting of polysaccharides sourced from soil-grown raw materials. This product is still in an early stage of development.
- A **natural preservative** than can be used to enhance the preservative properties of other commonly used preservatives. Initial results have been very positive, but there is still significant development work and testing that needs to be done before this product can be sampled.
- **Amla Complex**, which is a unique product that contains an extract of the Amla fruit (Indian Gooseberry), which is believed to have many health benefits, including improved skin health and healthier hair. The development work on this product has been completed and it is being evaluated by our marketing partners to determine market potential.

With the overstock situation in China behind us, we are optimistic that we will see an increase in sales in Asia this year. While we expect to continue to experience strong competition from Asian competitors, we also believe that our reputation for developing innovative, high-quality products and providing excellent technical support will help offset some of the pricing issues that will continue to confront us. We are also hopeful that we will see increased sales of Renacidin as the year progresses. We will continue to use our long experience in developing unique personal care ingredients to set ourselves apart from some of the lower-cost Asian competitors that we are competing against, and look forward to a strong year in 2017.

UNITED-GUARDIAN, INC.

Ken Globus
President