

IGI INC
Form 10QSB
November 15, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form 10-QSB

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2006

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 No

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

Yes No

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

Common Shares Outstanding at November 10, 2006 was 13,064,110.

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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 September 30, | | Nine months ended September 30, | |
|--|-------------------------------------|----------------|------------------------------------|-----------------|
| | 2006 | 2005 | 2006 | 2005 |
| Revenues: | | | | |
| Product sales, net | \$ 537 | \$ 560 | \$ 1,393 | \$1,655 |
| R&D Revenues | 1 | - | 164 | - |
| Licensing and royalty income | 120 | 172 | 499 | 674 |
| Total revenues | 658 | 732 | 2,056 | 2,329 |
| Cost and expenses: | | | | |
| Cost of sales | 401 | 509 | 1,092 | 1,143 |
| Selling, general and administrative expenses | 447 | 381 | 1,324 | 1,016 |
| Litigation settlement costs | - | 100 | - | 100 |
| Product development and research expenses | 253 | 230 | 814 | 730 |
| Operating loss from continuing operations | (443) | (488) | (1,174) | (660) |
| Interest (expense) income, net | (29) | 3 | (99) | 8 |
| Income (loss) on sale of investment securities | - | 5 | - | (72) |
| Other (loss) income, net | - | (31) | - | 1 |
| Loss from continuing operations before provision for income taxes | (472) | (511) | (1,273) | (723) |
| Benefit for income taxes | - | - | - | 6 |
| Loss from continuing operations | (472) | (511) | (1,273) | (717) |
| Discontinued operations: | | | | |
| Loss from operations of discontinued component | (38) | (104) | (58) | (272) |
| Net loss | \$(510) | \$(615) | \$(1,331) | \$ (989) |

| | | | | |
|--|-----------------|-----------------|-----------------|-----------------|
| Basic and Diluted (Loss) per Share | | | | |
| Continuing operations | \$ (.04) | \$ (.04) | \$ (.10) | \$ (.06) |
| Discontinued operations | - | (.01) | - | (.02) |
| | <u>\$ (.04)</u> | <u>\$ (.05)</u> | <u>\$ (.10)</u> | <u>\$ (.08)</u> |
| Weighted Average of Common Stock and Common Stock Equivalents Outstanding | | | | |
| Basic and diluted | 12,888,186 | 12,113,256 | 12,767,341 | 11,886,263 |

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

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

| | September 30, 2006 | December 31, 2005* |
|--|-----------------------|-----------------------|
| | (unaudited) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 21 | \$ 365 |
| Restricted cash | 50 | 50 |
| Accounts receivable, less allowance for doubtful Accounts of \$7 in 2006 and \$30 in 2005 | 385 | 268 |
| Licensing and royalty income receivable | 105 | 147 |
| Inventories | 463 | 261 |
| Prepaid expenses and other current assets | 81 | 83 |
| Assets of discontinued operations held for sale | 350 | - |
| | <u>1,455</u> | <u>1,174</u> |
| Total current assets | 1,455 | 1,174 |
| Property, plant and equipment, net | 2,317 | 2,909 |
| License fee, net | 925 | 1,000 |
| Other assets | 79 | 52 |
| | <u>\$ 4,776</u> | <u>\$ 5,135</u> |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 614 | \$ 350 |
| Accrued expenses | 208 | 220 |
| Note payable - related party | 1,120 | 1,015 |

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| | | |
|---|----------|----------|
| Deferred income - current | 201 | 90 |
| Liabilities of discontinued operations | 89 | - |
| | <hr/> | <hr/> |
| Total current liabilities | 2,232 | 1,675 |
| Deferred income, long term | 58 | 102 |
| | <hr/> | <hr/> |
| Total liabilities | 2,290 | 1,777 |
| | <hr/> | <hr/> |
| Stockholders' equity: | | |
| Common stock \$.01 par value, 50,000,000 shares authorized; 15,029,850 and 14,484,519 shares Issued in 2006 and 2005 respectively | 151 | 145 |
| Additional paid-in capital | 25,526 | 25,073 |
| Accumulated deficit | (21,796) | (20,465) |
| Less treasury stock, 1,965,740 shares at cost | (1,395) | (1,395) |
| | <hr/> | <hr/> |
| Total stockholders' equity | 2,486 | 3,358 |
| | <hr/> | <hr/> |
| Total liabilities and stockholders' equity | \$ 4,776 | \$ 5,135 |
| | <hr/> | <hr/> |

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

* Derived from the audited December 31, 2005 consolidated financial statements

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

| | Nine months ended September 30, | |
|---|---------------------------------|---------|
| | 2006 | 2005 |
| | <hr/> | <hr/> |
| Cash flows from operating activities: | | |
| Net (loss) | \$(1,331) | \$(989) |
| Net loss from discontinued operations | 58 | 272 |
| | <hr/> | <hr/> |
| Net loss from continuing operations | (1,273) | (717) |
| Reconciliation of net (loss) to net cash used in operating activities: | | |
| Bad debt expense | 1 | 1 |
| Depreciation and amortization | 201 | 207 |
| Loss on sale of investment securities | - | 72 |
| Recognition of deferred income | (72) | (126) |
| Stock option compensation expense | 19 | 2 |
| Amortization of license fee | 75 | - |

| | | |
|---|-------|--------|
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (119) | (34) |
| Inventories | (202) | 44 |
| Licensing and royalty income receivable | 42 | 42 |
| Prepaid expenses and other assets | (34) | (38) |
| Accounts payable and accrued expenses | 455 | (343) |
| Income taxes payable | (3) | (5) |
| Deferred income | 139 | 10 |
| | <hr/> | <hr/> |
| Net cash used in operating activities of continuing operations | (771) | (885) |
| Net cash (used) in provided by operating activities of discontinued operations | (13) | 92 |
| | <hr/> | <hr/> |
| Net cash used in operating activities | (784) | (793) |
| | <hr/> | <hr/> |
| Cash flows from investing activities: | | |
| Capital expenditures | - | (68) |
| Proceeds from sale of marketable securities | - | 337 |
| | <hr/> | <hr/> |
| Net cash provided by investing activities | - | 269 |
| | <hr/> | <hr/> |
| Cash flows from financing activities: | | |
| Proceed from private placement of common stock | 100 | - |
| Proceeds from exercise of common stock options and warrants | 340 | 340 |
| | <hr/> | <hr/> |
| Net cash provided by financing activities | 440 | 340 |
| | <hr/> | <hr/> |
| Net decrease in cash and cash equivalents | (344) | (184) |
| Cash and cash equivalents at beginning of period | 365 | 380 |
| | <hr/> | <hr/> |
| Cash and cash equivalents at end of period | \$ 21 | \$ 196 |
| | <hr/> | <hr/> |

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

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IGI, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Liquidity

The Company's principal sources of liquidity are cash and cash equivalents of approximately \$21,000 at September 30, 2006 and cash from operations. The Company sustained net losses of \$1,331,000 for the nine months ended September 30, 2006 and had a working capital deficiency of \$777,000 at September 30, 2006. The accompanying

consolidated financial statements have been prepared on the going concern basis which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business over a reasonable length of time. The Company's recurring operating losses and working capital deficiency raise substantial doubt about the Company's ability to continue as a going concern. The consolidated financial statements do not include any adjustments that might result from the outcome of this going concern uncertainty. Currently, the Company's cash from operations are not sufficient to maintain operations or provide financing for the Company's future growth and business plan. In order to generate the working capital needed, the Company has signed an agreement of sale for a sale-leaseback of our corporate building for \$1,600,000, to be accounted for as a financing transaction and a sale of a vacant parcel of land adjacent to our building for \$225,000. The closing of the sale-leaseback transaction is subject to a contingency which currently has not been met and therefore is terminable by either party after October 16, 2006. The Company received a \$30,000 refundable deposit in the first quarter of 2006 relating to the sale-leaseback transaction. Upon the earlier of the closing of the sale-leaseback transaction or December 31, 2006, the Company must repay the \$1,000,000 loan provided to the Company by an affiliate of Frank Gerardi, its Chief Executive Officer, together with accrued interest, which loan is secured by the property which is subject to the sale-leaseback and at the same time must repay a \$100,000 loan to Pharmachem, Inc. which was extended to the Company in October 2006 and which is also secured by such property. Accrued interest as of September 30, 2006 on the Gerardi loan, was approximately \$120,000. If the sale-leaseback transaction does not materialize, the Company will be forced to seek alternative funding, of which there can be no assurance. If consummated, this transaction accompanied by an increase in product sales that the Company hopes to achieve during the rest of 2006 and 2007 through new business arrangements may be sufficient to provide the capital needed to fund the Company through the end of December 2007. The Company's ability to continue as a going concern is ultimately dependent on its ability to increase sales to a level that will allow it to operate profitably and sustain positive operating cash flows.

Our business operations have been partially funded over the past two years through the exercise of stock options by our directors and officers. If necessary, we may continue to seek additional capital through the sale of our equity. We may accomplish this via a strategic alliance with a third party. There may be additional acquisition and growth opportunities that may require external financing. There can be no assurance that such financing will be available or available on terms acceptable to the Company.

2. Basis of Presentation

IGI, Inc. ("IGI" or the "Company"), a Delaware corporation, operating in the State of New Jersey, is primarily engaged in the production and marketing of cosmetics, skin care products, and consumer products. IGI's Consumer Products business is primarily focused on the continued commercial use of the Novasome® microencapsulation technologies for skin care applications. These efforts have been directed toward the development of high quality skin care products marketed by the Company or through collaborative arrangements with cosmetic and consumer products companies. In the second quarter of 2006, we launched a new product line, MIAJ™ skincare. This new anti-aging skincare line consists of ten products all created using our Novasome® microencapsulation technology. We distribute these products via an Internet website, www.miaj.com, and are currently seeking other avenues of distribution for the product line as well. Sales of our Miaj™ product line were approximately \$4,000 through September 30, 2006.

License agreement to UCT Chemicals

In February 2004, the Company signed a license agreement with Universal Chemical Technologies, Inc. ("UCT") to utilize its patented technology for an electroless nickel boride metal finishing process. This was a new venture for the Company and the Company had capital expenditures of approximately \$913,000, of which \$308,000 related to building improvements and \$605,000 related to purchases of equipment, spread over 2004 and 2005 in order to set up the operations. The Company has an exclusive license within a 150 mile radius of its facility for commercial and military applications. In the start of the second quarter of 2005, the Company began production in our metal

finishing division, utilizing the patented UltraChem technology. However, certain customers of the consumer products division informed us that they are not comfortable with the metal finishing division being housed in the same facility as our consumer products division. In light of this new information, the Company has decided to cease operations of the metal finishing division at our corporate manufacturing facility. Management recorded an impairment charge of \$175,000 in the fourth quarter of 2005 on the equipment for the plating line.

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

On July 10, 2006, the Company's Board of Directors along with management accepted a plan to sell the equipment related to this line to a third party. In accordance with Statement of Financial Standards No.144, "Accounting for the Impairment of Disposal of Long-Lived Assets" ("FAS 144"), the related assets have been classified as held for sale at the lower of its carrying amount or fair value less cost to sell on the Balance Sheet at September 30, 2006. This reporting segment, the Metal Plating Division, is classified as discontinued operations for all periods presented. Management recorded an additional impairment expense of \$38,000 on the equipment in the third quarter of 2006 to record the estimated fair value of the equipment less cost to sell. In November 2006, the Company received a letter of interest from UCT to buy the equipment from the Company for a price of \$350,000. Because the Company owes UCT \$89,000, the Company will only receive \$261,000 if such transaction is consummated of which there can be no assurance. They intend to remove the equipment from our facility at their expense and relocate it to a new facility. They anticipate the transaction to be completed by March 31, 2007. Frank Gerardi, the Company's Chairman and Chief Executive Officer, 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.

Revenue Recognition

The Company recognizes revenue from its product sales, product research and development, and license agreements in accordance with SEC Staff Accounting Bulletin No. 104, "Revenue Recognition." Under these guidelines, revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred or services rendered, the price is fixed or determinable and payment is reasonably assured.

Sales, net of appropriate cash discounts, product returns, and sales reserves are recorded upon shipment of products. Revenues earned under research contracts or sublicensing and supply agreements are either recognized when the related contract provisions are met, or, if under such contracts or agreements the Company has continuing obligations, the revenue is initially deferred and then recognized over the life of the agreement or at such time that the obligations are completed. Revenues resulting from research contracts are recognized upon completion of research being performed because the Company has no obligation to repay or refund any amounts recognized or to develop a product that is acceptable to the customer. In accordance with Amendment No.2 to our Manufacturing and Supply Agreement with Genesis Pharmaceutical ("Genesis"), the Company recognized \$30,000 of R&D revenues for product development for Genesis in the first quarter 2006 and \$133,000 in the second quarter 2006. The revenue recognized was for development completed on nine new products for Genesis. The Company recognized \$1,000 of R&D revenues in the third quarter 2006 from a new customer.

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

Certain information in footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations

of the SEC, although the Company believes the disclosures are adequate to make the information presented not misleading. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2005 (the "2005 10-KSB Annual Report"). The results of operations for the three month and nine month periods ended September 30, 2006 are not necessarily indicative of the results for the entire year ending December 31, 2006.

Subsequent Events

On October 11, 2006, the Company signed a an agreement with DermWorx, Inc. to license, develop and manufacture for DermWorx a series of dermatological specialty products that will utilize IGI's licensed Novasome® technology. Based on the agreement between the two companies, in return for an exclusive license of the products developed using the technology, IGI will receive product development revenue, manufacturing revenues and a 7% royalty on product sales. In addition, IGI will receive shares of DermWorx stock so that it holds approximately 19.9% of the issued and outstanding shares of common stock of DermWorx as of the date of the agreement. The agreement will become null and void if DermWorx does not pay IGI \$250,000 by November 30, 2006.

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

In addition, DermWorx must pay IGI an additional \$750,000 by February 15, 2007 to be credited against the development of other products. To date the Company has not received any payments under said agreement.

3. Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes". FIN 48 is an interpretation of FASB Statement No. 109 "Accounting for Income Taxes" and must be adopted by the Company no later than January 1, 2007. FIN 48 prescribes a comprehensive model for recognizing, measuring, presenting, and disclosing in the financial statements uncertain tax positions that the Company has taken or expects to take in its tax returns. We are currently evaluating the impact of adopting FIN 48 on our financial statements. We do not anticipate that the adoption of this statement will have a material effect on our financial position or results of operations.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 provides guidance on how to evaluate prior period financial statement misstatements for purposes of assessing their materiality in the current period. Correcting prior year financial statements for immaterial misstatements would not require amending previously filings; rather such corrections may be made in subsequent filings. The cumulative effect of initially applying SAB 108, if any, can be recorded as an adjustment to opening retained earnings. SAB 108 does not change the SEC staff's previous positions regarding qualitative considerations in assessing the materiality of misstatements. SAB 108 is effective for the Company beginning in the fourth quarter of this fiscal year and management does not currently anticipate any adjustments to opening retained earnings resulting from the application of SAB 108.

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements" ("FAS 157"). FAS 157 establishes a common definition of fair value to be used when the Company is required to use a fair value measure for recognition or disclosure purposes under GAAP. FAS 157 is effective for the Company beginning in 2008. The Company is currently evaluating the impact the adoption of FAS 157 will have on its consolidated financial statements.

4. Inventories

Inventories are valued at the lower of cost, using the first-in, first-out ("FIFO") method, or market. Inventories at September 30, 2006 and December 31, 2005 consist of:

| | September 30, 2006 | December 31, 2005 |
|------------------|------------------------|-------------------|
| | (amounts in thousands) | |
| Finished goods | \$271 | \$ 72 |
| Work in progress | 12 | 5 |
| Raw materials | 180 | 184 |
| Total | <u>\$463</u> | <u>\$261</u> |

The amount of finished goods inventory related to Miaj™ at September 30, 2006 was \$222,000

5. Stock-Based Compensation

On January 1, 2006, the Company adopted the fair value recognition provisions of FASB Statement No. 123(R), *Share-Based Payment*, using the modified prospective transition method. Under this transition method, compensation cost recognized in the three months and nine months ended September 30, 2006 include the costs for all share-based
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IGI, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Continued

payments granted subsequent to January 1, 2006, based upon the grant-date fair value estimated in accordance with the provisions of Statement 123(R). Prior to January 1, 2006, the Company accounted for this plan under the recognition and measurement provisions of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, (Opinion 25) and related interpretations, as permitted by FASB Statement No. 123, *Accounting for Stock-Based Compensation*. Generally, no stock-based employee compensation cost was recognized in the statements of operations, as options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of the grant. In accordance with this transition method, the Company's Consolidated Financial Statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R). All options issued prior to January 1, 2006 were fully vested as of December 31, 2005, therefore, no expense was recorded during the nine months ended September 30, 2006 for grants prior to January 1, 2006.

As a result of adopting Statement 123(R) on January 1, 2006, the Company's net loss for the three and nine months ended September 30, 2006 was \$19,000 higher.

For comparative purposes, the following table illustrates the effect on net loss and net loss per share if the Company had applied the fair value recognition provisions of Statement 123 to options granted under the Company's stock option plan for the three and nine months ended September 30, 2005:

| Three months ended | Nine months ended |
|--------------------|-------------------|
|--------------------|-------------------|

| | September 30, 2005 | September 30, 2005 |
|--|--|-----------------------|
| | <hr/> | <hr/> |
| | (in thousands, except per share information) | |
| Net (loss) - as reported | \$(615) | \$ (989) |
| Compensation expense determined under the fair-value based method (net of tax \$0) | (31) | (105) |
| | <hr/> | <hr/> |
| Net (loss) - pro forma | \$(646) | \$(1,094) |
| | <hr/> | <hr/> |
| (Loss) per share - as reported Basic and diluted | \$ (.05) | \$ (.08) |
| | <hr/> | <hr/> |
| (Loss) per share - pro forma Basic and diluted | \$ (.05) | \$ (.09) |
| | <hr/> | <hr/> |

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 months period and each Director receives an option for 15,000 shares with an additional grant to each committee Chairman.

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 2,000,000 shares of our common stock, of which, 1,693,800 shares were outstanding and 306,200 were available at September 30, 2006. 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.

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

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 are based upon the Company's historical volatility and other factors. The risk-free interest rates are based upon the U.S. Treasury yield curve in effect at the time of the grant.

| September 30, 2006 | September 30, 2005 |
|-----------------------|-----------------------|
|-----------------------|-----------------------|

| | | |
|--------------------------|-----------|---------|
| Expected volatility | 78.32% | 87.23% |
| Expected term (in years) | 5.5 years | 7 years |
| Risk-free rate | 5.10% | 3.96% |
| Expected dividends | 0% | 0% |

The Company used the safe harbor transition method to compute the expected term.

A summary of option activity under the Plan as of September 30, 2006 and changes during the period is presented below: (in thousands, except for weighted-average data)

| | Number of Options | Weighted Average Exercise Price |
|-----------------------------|-------------------------|--|
| Outstanding as of 1/1/2006 | 2,145,548 | \$1.63 |
| Issued | 85,000 | \$1.30 |
| Exercised | 332,000 | \$0.81 |
| Forfeited | - | |
| Outstanding as of 9/30/2006 | 1,898,548 | \$1.75 |
| Exercisable as of 9/30/2006 | 1,813,548 | \$1.78 |

Based upon application of the Black-Scholes option-pricing formula described above, the weighted-average grant-date fair value of options granted during the nine months ended September 30, 2006 was \$.90.

The following table summarizes information regarding options outstanding and exercisable at September 30, 2006:

Outstanding:

| Range of Exercise Prices | | Stock options Outstanding | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life |
|-----------------------------|--------|------------------------------|--|--|
| \$0.50 | \$1.00 | 344,250 | \$0.73 | 7.30 |
| \$1.01 | \$2.00 | 1,029,798 | \$1.47 | 5.72 |
| \$2.01 | \$3.00 | 414,500 | \$2.31 | 5.92 |
| \$3.01 | \$5.00 | 30,000 | \$3.75 | 1.25 |
| \$5.01 | \$6.00 | 50,000 | \$5.75 | 0.19 |
| \$6.01 | \$6.75 | 30,000 | \$6.75 | 0.25 |

| | | | |
|-------|-----------|--------|------|
| Total | 1,898,548 | \$1.75 | 5.75 |
|-------|-----------|--------|------|

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

Exercisable:

| Range of Exercise Prices | | Stock Options Exercisable | Weighted Average Exercise Price |
|-----------------------------|--------|---------------------------------|---------------------------------------|
| \$0.50 | \$1.00 | 344,250 | \$0.73 |
| \$1.01 | \$2.00 | 944,798 | \$1.49 |
| \$2.01 | \$3.00 | 414,500 | \$2.31 |
| \$3.01 | \$5.00 | 30,000 | \$3.75 |
| \$5.01 | \$6.00 | 50,000 | \$5.75 |
| \$6.01 | \$6.75 | 30,000 | \$6.75 |
| Total | | 1,813,548 | \$1.78 |

As of September 30, 2006, the intrinsic value of the options outstanding and exercisable was \$70,360. The options in the money at September 30, 2006 was the same for outstanding and exercisable. As of September 30, 2006, there was \$57,000 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 a vesting period of nine months.

6. Net Loss Per Share

The Company calculates net loss per share in accordance with SFAS No. 128, "Earnings Per Share". Basic and diluted net loss per share is calculated based upon the weighted-average outstanding shares of the Company's common stock for each period presented. The weighted-average number of shares for the nine months ended September 30, 2006 and September 30, 2005 excludes the Company's potentially dilutive shares, representing principally warrants and stock options, since the effect of including them would be anti-dilutive.

7. Legal and U.S. Regulatory Proceedings

On April 6, 2000, officials of the New Jersey Department of Environmental Protection ("DEP") inspected the Company's storage site in Buena, New Jersey, and issued Notices of Violation ("NOVs") relating to the storage of waste materials in a number of trailers at the site. The Company established a disposal and cleanup schedule and completed the removal of materials from the site. In March 2006, the Company received a judge's decision for a fine in the amount of \$35,000 in respect to the NOV's the Company received from the DEP. Due to the criminal settlement that was reached between the Company and the DEP in 2002, the Company had a credit of \$40,000 to be used against any fines determined as a result of the civil matter, therefore, the Company did not have to pay any

money to the DEP for the settlement amount. As a result, the balance accrued for the NOV was reversed and is reflected in other income in the amount of \$24,000 for the nine month period ended September 30, 2006. The Company was notified in June 2006 that the DEP has appealed the judge's decision and the decision is pending before an appellate court.

On March 2, 2001, the Company discovered the presence of environmental contamination resulting from an unknown heating oil leak at its Companion Pet Products manufacturing site. The remediation was completed by September 30, 2003. The Company has spent approximately \$540,000 to date on the cleanup and associated costs and \$50,000 remains accrued as of September 30, 2006. There will be periodic monitoring performed, which is projected to span the next three years. The estimated cost of the monitoring is included in the accrual.

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

8. 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 license is being amortized over the ten year period. The Company recorded amortization of \$75,000 related to this agreement for the nine months ended September 30, 2006.

9. Stock Warrants

In connection with the private placement of common stock consummated in December 2005, the Company granted a warrant to purchase 26,666 shares of IGI common stock at an exercise price of \$.90 a share to each participant of the private placement. A total of four warrants were granted to purchase 106,664 shares of stock, the last one being issued in January 2006. The warrants expire two years from the date of issue. In the quarter ended September 30, 2006, three of the warrants were exercised for a total of 79,998 shares.

10. 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, CEO and Chairman 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 becomes due on the earlier of December 31, 2006 or when a sale leaseback of the land and building closes, with 30% interest per annum through February 1, 2006, 12% interest through September 30, 2006 and 10% per annum thereafter. The note is collateralized by a mortgage on real property owned by the Company. The Company accrued \$120,000 of interest related to this note for the nine months ended September 30, 2006. The note amount at September 30, 2006 includes all accrued interest since inception.

11. Discontinued Operations

On July 10, 2006 the Company and the Board of Directors decided to discontinue the operations for the Metal Plating division and sell the related equipment to a third party. In accordance with Statement of Financial Standards No.144, "Accounting for the Impairment of Disposal of Long-Lived Assets" ("FAS 144"), the related assets have been classified as held for sale at the lower of its carrying amount or fair value less cost to sell on the Balance Sheet at September 30, 2006. This reporting segment, the Metal Plating Division, is classified as discontinued operations for all periods presented. Management recorded an additional impairment expense of \$38,000 on the equipment in the third quarter of 2006 to record the value of the equipment at fair value less to cost to sell. In November 2006, the Company received a letter of interest from UCT to buy the equipment from the Company for \$350,000. Because the Company owes UCT \$89,000, the Company will receive only \$261,000 if such transaction is consummated of which there can be no assurance. They intend to remove the equipment from our facility at their expense and relocate it to a new facility. They anticipate the transaction to be completed by March 31, 2007. Frank Gerardi, the Company's Chairman and Chief Executive Officer, 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.

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

A summary of the data related to the Company's reportable segments for the periods ended September 30, 2006 and September 30, 2005 appear below: (amounts in thousands)

| | Three months ended September 30, 2006 | Three months ended September 30, 2005 | Nine months ended September 30, 2006 | Nine months ended September 30, 2005 |
|--|--|--|---|---|
| Discontinued operations | | | | |
| <u>Summary Income Statement</u> | | | | |
| Product sales | \$ - | \$ 7 | \$ - | \$ 10 |
| Cost of sales | - | (63) | (20) | (196) |
| Impairment charge related to fixed assets | (38) | - | (38) | - |
| Sales and marketing expenses | - | (48) | - | (86) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Loss from discontinued operations | \$(38) | \$(104) | \$ (58) | \$(272) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

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IGI, INC. AND SUBSIDIARIES

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

The following discussion and analysis may contain forward-looking statements. Such statements are subject to certain risks and uncertainties, including those discussed below or in the Company's 2005 10-KSB Annual Report that could cause actual results to differ materially from the Company's expectations. See "Factors Which May Affect

Future Results" below and in the 2005 10-KSB Annual Report. Readers are cautioned not to place undue reliance on any forward-looking statements, as they reflect management's analysis as of the date hereof. The Company undertakes no obligation to 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.

Results of Operations

Three months ended September 30, 2006 compared to September 30, 2005

Revenues (in thousands):

| | 2006 | 2005 | \$ Change | % Change |
|-----------------|-------|-------|-----------|----------|
| Product Sales | \$537 | \$560 | \$-23 | -4% |
| R&D Revenues | 1 | - | 1 | 100% |
| Royalty Revenue | 120 | 172 | -52 | -30% |
| Total Revenues | \$658 | \$732 | \$-74 | -10% |

The decrease in product sales is due to higher product sales to Estee Lauder and Infusion Biotechnologies in the three months ended September 30, 2005 of \$71,000 and \$93,000, respectively, compared to the three months ended September 30, 2006. This decrease in product sales was offset by higher product sales to Albrian International of \$36,000, Vetoquinol USA of \$70,000, and Genesis Pharmaceuticals of \$50,000 in the three months ended September 30, 2006. The R&D revenues relate to fees paid to the Company by Complexions, a new customer, for product development services in the fourth quarter of 2006. The decrease in royalty revenue was related to a decline in royalties from J&J and Genesis Pharmaceuticals in 2006.

Costs and expenses (in thousands):

| | 2006 | 2005 | \$ Change | % Change |
|-------------------------------------|---------|---------|-----------|----------|
| Cost of sales | \$ 401 | \$ 509 | \$-108 | -21% |
| Selling, general and administrative | 447 | 381 | 66 | 17% |
| Litigation settlement costs | - | 100 | -100 | -100% |
| Product development and research | 253 | 230 | 23 | 10% |
| Totals costs and expenses | \$1,101 | \$1,220 | \$-119 | -10% |

As a percentage of product sales, cost of sales was 75% for the quarter ended September 30, 2006 and 91% for the quarter ended September 30, 2005. The decrease in cost of sales as a percentage of product sales relates to the sale of a product with a negative gross margin in 2005.

As a percentage of total revenues, selling, general and administrative expenses were 67% of revenues in the third quarter of 2006 compared to 52% for the third quarter of 2005. The increase in expenses was a result of sales & marketing expenses of \$40,000 for our new product line, Miaj™. The remaining increase in expenses related to higher legal fees in 2006.

Litigation settlement costs in 2005 were related to a lawsuit between the Company and Ted's Taxidermy (among others), in which the Company paid a \$70,000 settlement to Ted's Taxidermy and a \$30,000 settlement to Brunozzi Transfer Company to indemnify them for fines related to the Company's hazardous waste removal DEP case.

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IGI, INC. AND SUBSIDIARIES

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

Interest Expense (Income) (in thousands):

| | 2006 | 2005 | \$ Change | % Change |
|-------------------|-------|-------|-----------|----------|
| Interest Expense | \$ 30 | \$ - | \$30 | 100% |
| Interest (Income) | \$(1) | \$(3) | \$ -2 | -66% |

Interest expense was related to the short term notes payable to Univest Management EPSP, controlled by Frank Gerardi, CEO and President of IGI.

Net loss (in thousands):

| | 2006 | 2005 | \$ Change | % Change |
|---|---------|---------|-----------|----------|
| Loss from continuing operations | \$(472) | \$(511) | \$ -39 | -8% |
| Net loss per share from continuing operations | (.04) | (.04) | - | -% |
| Loss from discontinued operations | \$ (38) | \$(104) | \$ -66 | -63% |
| Net loss per share from discontinued operations | - | (.04) | -.04 | -100% |

The decrease in loss from continuing operations related to the decrease in costs of goods sold and the absence of litigation fees in the three months ended September 30, 2006.

The decrease in loss from discontinued operations was a result of operations ceasing as of July 10, 2006.

Nine months ended September 30, 2006 compared to September 30, 2005

Revenues (in thousands):

| | 2006 | 2005 | \$ Change | % Change |
|-----------------|---------|---------|-----------|----------|
| Product Sales | \$1,393 | \$1,655 | \$-262 | -16% |
| R&D Revenues | 164 | - | 164 | 100% |
| Royalty Revenue | 499 | 674 | -175 | -26% |
| Total Revenues | \$2,056 | \$2,329 | \$-273 | -12% |

The decrease in product sales relates to no product sales being recorded for Estee Lauder in the nine months ended September 30, 2006 compared to \$457,000 being recorded in the nine months ended September 30, 2005 offset by higher product sales to Vetoquinol USA of \$200,000. The R&D revenues relate to fees paid to the Company by Genesis Pharmaceutical for product development services in connection with their new product line to be launched in 2007 as well as \$1,000 of R&D revenue from Complexions, a new customer for the Company. The decrease in royalty revenue was related to a decline in royalties from J&J of \$117,000 and Genesis pharmaceuticals of \$78,000 in 2006 offset slightly by an increase of \$25,000 from Estee Lauder.

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IGI, INC. AND SUBSIDIARIES

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

Costs and expenses (in thousands):

| | 2006 | 2005 | \$ Change | % Change |
|-------------------------------------|---------|---------|-----------|----------|
| Cost of sales | \$1,092 | \$1,143 | \$ -51 | -4% |
| Selling, general and administrative | 1,324 | 1,016 | 308 | 30% |
| Litigation Settlement Costs | - | 100 | -100 | -100% |
| Product development and research | 814 | 730 | 84 | 12% |
| Totals costs and expenses | \$3,230 | \$2,989 | \$ 241 | 8% |

As a percentage of product sales, cost of sales was 78% for the nine months ended September 30, 2006 and 70% for the nine months ended September 30, 2005. The slight increase in cost of sales as a percentage of product sales relates to the higher overhead and lower absorption of costs in 2006.

As a percentage of total revenues, selling, general and administrative expenses were 64% of revenues for the nine months ended September 30, 2006 compared to 48% for the nine months ended 2005. The increase in expenses was a result of a higher cost of shareholder reports in 2006 of \$30,000, higher sales & marketing expenses of \$130,000

relating to our new product line, Miaj™, higher salary expense in the finance department as a result of an additional support person being added in July of 2005 which amounted to \$25,000, a reallocation of the business insurance expense to the finance department of \$21,000 and higher professional fees of \$63,000 plus other small increases in miscellaneous expenses.

Litigation settlement costs in 2005 were related to a lawsuit between the Company and Ted's Taxidermy (among others), in which the Company paid a \$70,000 settlement to Ted's Taxidermy and a \$30,000 settlement to Brunozzi Transfer Company to indemnify them for fines related to the Company's hazardous waste removal DEP case.

Interest Expense (Income) (in thousands):

| | 2006 | 2005 | \$ Change | % Change |
|------------------|-------|-------|-----------|----------|
| Interest Expense | \$105 | \$ - | \$105 | 100% |
| Interest Income | \$ | \$(8) | \$ -2 | -25% |
| | (6) | | | |

Interest expense was related to the short term notes payable to Univest Management EPSP, controlled by Frank Gerardi, CEO and President of IGI.

Net loss (in thousands):

| | 2006 | 2005 | \$ Change | % Change |
|---|-----------|---------|-----------|----------|
| Loss from continuing operations | \$(1,273) | \$(717) | \$ 556 | 78% |
| Net loss per share from continuing operations | (.10) | (.06) | .04 | 66% |
| Loss from discontinued operations | \$ (58) | \$(272) | \$-214 | -79% |
| Net loss per share from discontinued operations | (.00) | (.02) | .02 | 100% |

The increase in net loss related to the decrease in revenues and higher selling, general and administration costs for the nine months ended September 30, 2006.

The decrease in loss from discontinued operations was a result of operations ceasing as of July 10, 2006.

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IGI, INC. AND SUBSIDIARIES

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

Liquidity and Capital Resources

The Company's operating activities used \$784,000 of cash during the nine months ended September 30, 2006 compared to \$793,000 used in the comparable period of 2005. This use of cash is substantially related to the net loss for the Company.

The Company investing activities used no cash in the nine months ended September 30, 2006 compared to proceeds of \$269,000 in investing activities in the nine months ended September 30, 2005. The proceeds are related to the sale of investment securities in 2005 offset by funds used for capital expenditures.

The Company's financing activities provided \$440,000 of cash in the nine months ended September 30, 2006 compared to \$340,000 provided by financing activities in the nine months ended September 30, 2005. The cash provided in 2005 and 2006 represents proceeds from the exercise of stock options, warrants and the private placement of stock.

The Company's principal sources of liquidity are cash and cash equivalents of approximately \$21,000 at September 30, 2006 and cash from operations. The Company sustained net losses of \$1,331,000 and \$989,000 for the nine months ended September 30, 2006 and 2005, respectively, and had a working capital deficiency of \$777,000 at September 30, 2006. The accompanying consolidated financial statements have been prepared on the going concern basis which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business over a reasonable length of time. The Company's recurring operating losses and working capital deficiency raise substantial doubt about the Company's ability to continue as a going concern. The consolidated financial statements do not include any adjustments that might result from the outcome of this going concern uncertainty.

Currently, the Company's cash from operations are not sufficient to maintain operations or provide financing for the Company's future growth and business plan. In order to generate the working capital needed, the Company has signed an agreement of sale for a sale-leaseback of our corporate building for \$1,600,000, to be accounted for as a financing transaction and a sale of a vacant parcel of land adjacent to our building for \$225,000. The closing of the sale-leaseback transaction is subject to a contingency which currently has not been met and therefore is terminable by either party on or after October 16, 2006. The Company received a \$30,000 refundable deposit in the first quarter of 2006 relating to the sale-leaseback transaction. Upon the earlier of the closing of the sale-leaseback transaction or December 31, 2006, the Company must repay the \$1,000,000 loan provided to the Company by an affiliate of Frank Gerardi, its Chief Executive Officer, together with accrued interest, which loan is secured by the property which is subject to the sale-leaseback and at the same time must repay a \$100,000 loan to Pharmachem, Inc. which was extended to the Company in October 2006 and which is also secured by such property. As of September 30, 2006, accrued interest on the Gerardi loan was approximately \$120,000. If the sale-leaseback transaction does not materialize, the Company will be forced to seek alternative funding, of which there can be no assurance. If consummated, this transaction if accompanied by an increase in product sales that the Company hopes to achieve during the rest of 2006 and 2007 through new business arrangements may be sufficient to provide the capital needed to fund the Company through the end of November 2007. The Company's ability to continue as a going concern is ultimately dependent on its ability to increase sales to a level that will allow it to operate profitably and sustain positive operating cash flows.

There have been no material changes to the Company's contractual commitments as reflected in the 2005 10-KSB Annual Report other than those disclosed in this Form 10-QSB.

Off Balance Sheet Arrangements

The Company does not have any off balance sheet arrangements as of the date of this report.

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IGI, INC. AND SUBSIDIARIES

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

Factors Which May Affect Future Results

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

Intense Competition in Consumer Products Business

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

Dependence on a Limited Number of Customers

The Company depends on a limited number of customers for a large portion of our sales and the loss of one or more of these customers could have a significant impact on our revenues.

Effect of Rapidly Changing Technologies

The Company expects to sublicense its technologies to third parties, which would manufacture and market products incorporating the technologies. However, if its competitors develop new and improved technologies that are superior to the Company's technologies, its technologies could be less acceptable in the marketplace and therefore the Company's planned technology sublicensing could be materially adversely affected.

Insufficient cash to support operations

The Company currently is not generating sufficient cash to fund operations. There can be no assurance that the Company will have the ability to acquire the necessary cash to successfully continue operations.

Sarbanes Oxley 404 Implementation

The Company is faced with the task of implementing Sarbanes Oxley 404 ("SOX 404"). The Company may not have the proper resources to successfully implement SOX 404.

Licensing Agreement with Universal Chemical Technologies, Inc

In February 2004, the Company signed a license agreement with UCT to utilize their patented technology for an electroless nickel boride metal finishing process. This venture required \$913,000, of which \$308,000 related to building improvements and \$605,000 related to the purchase of equipment, to set up the operations at our facility. The Company has an exclusive license within a 150 mile radius of its facility for commercial and military applications. The Company has ceased operations of this division due to potential new customers of the consumer division not being comfortable with the metal finishing division being housed in the same facility as our Consumer

Products division. The equipment relating to the finishing division is classified as held for sale as of September 30, 2006. The Company recorded an impairment charge of \$175,000 on the plating line equipment in the fourth quarter of 2005 to record the equipment of this division at what management believed was its fair market value.

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IGI, INC. AND SUBSIDIARIES

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

On July 10, 2006 the Company and the Board of Directors decided to discontinue the operations for the Metal Plating division and sell the related equipment to a third party. In accordance with Statement of Financial Standards No.144, "Accounting for the Impairment of Disposal of Long-Lived Assets" ("FAS 144"), the related assets have been classified as held for sale at the lower of its carrying amount or fair value less cost to sell on the Balance Sheet at September 30, 2006. This reporting segment, the Metal Plating Division, is classified as discontinued operations for all periods presented. Management recorded an additional impairment expense of \$38,000 on the equipment in the third quarter of 2006 to record the value of the equipment at the estimated fair value less cost to sell. In November 2006, the Company received a letter of interest from UCT to buy the equipment from the Company for a price of \$350,000. Because the Company owes UCT \$89,000, the Company will only receive \$261,000 if such transaction is consummated, of which there can be no assurance. They intend to remove the equipment from our facility at their expense and relocate it to a new facility. They anticipate the transaction to be completed by March 31, 2007. Frank Gerardi, the Company's Chairman and Chief Executive Officer, 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.

American Stock Exchange (AMEX) Continuing Listing Standards

On June 12, 2006, the Company was notified by AMEX that it was below certain of the Exchange's continuing listing standards. Specifically, the Company was required to reflect income from continuing operations and/or net income in one of its four most recent fiscal years and a minimum of \$4,000,000 in stockholders' equity to remain listed of the exchange. The Company had net income from continuing operations in its 2002 fiscal year, but had net losses and losses from continuing operations in each of its 2003, 2004, and 2005 fiscal years. The Company's stockholders' equity at June 30, 2006 was \$2.89 million.

On July 17, 2006, the Company submitted a plan of compliance to AMEX. AMEX had 45 days to review the plan and notify the Company whether they will accept the plan or if the Company will be subject to delisting procedures.

On September 1, 2006, the Exchange notified the Company that it has completed its review of IGI's plan of compliance and supporting documentation and has determined that, in accordance with Section 1009 of the Company Guide, the Plan makes a reasonable demonstration of the Company's ability to regain compliance with the continued listing standards by the end of the Plan period and therefore its listing is being continued pursuant to an extension. The targeted completion date to regain compliance with the continued listing standards is December 12, 2007. Failure to regain compliance with the continued listing standards by the end of the extension period could result in the Company being delisted from the American Stock Exchange.

The Company has also been notified by the American Stock Exchange ("Amex") that the Company has more shares outstanding than the Amex has recorded as listed. Under Section 301 of the Amex Company Guide, the Company may not issue unlisted shares. The Amex has asked the Company to investigate the situation. The Company believes that at least some of the shares in question were in fact listed. Because of management changes the Company has had difficulty in locating the listing applications for such shares. The Company intends to discuss with the Amex the appropriate resolution to the situation. Failure to satisfactorily resolve this issue with Amex could result in the Company being delisted from the American Stock Exchange.

Critical Accounting Policies

Revenue Recognition

The Company recognizes revenue from its product sales, product research and development, and license agreements in accordance with SEC Staff Accounting Bulletin No. 104, "Revenue Recognition." Under these guidelines, revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred or services rendered, the price is fixed or determinable and payment is reasonably assured.

Sales, net of appropriate cash discounts, product returns, and sales reserves are recorded upon shipment of products. Revenues earned under research contracts or sublicensing and supply agreements are either recognized when the related contract provisions are met, or, if under such contracts or agreements the Company has continuing obligations, the revenue is initially deferred and then recognized over the life of the agreement or at such time that the obligations are completed. Beginning in the first quarter of 2006, in accordance with Amendment No.2 to our Manufacturing and Supply Agreement with Genesis Pharmaceutical ("Genesis"), the Company recognized \$30,000 of R&D revenues for product development for Genesis in the first quarter 2006 and \$133,000 in the second quarter 2006. The revenue recognized was for development completed on nine new products for Genesis. The Company recognized \$1,000 of R & D revenues in the third quarter 2006 from a new Company.

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IGI, INC. AND SUBSIDIARIES

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

Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes". FIN 48 is an interpretation of FASB Statement No. 109 "Accounting for Income Taxes" and must be adopted by the Company no later than January 1, 2007. FIN 48 prescribes a comprehensive model for recognizing, measuring, presenting, and disclosing in the financial statements uncertain tax positions that the Company has taken or expects to take in its tax returns. We are currently evaluating the impact of adopting FIN 48 on our financial statements. We do not anticipate that the adoption of this statement will have a material effect on our financial position or results of operations.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 provides guidance on how to evaluate prior period financial statement misstatements for purposes of assessing their materiality in the current period. Correcting prior year financial statements for immaterial misstatements would not require amending previously filings; rather such corrections may be made in subsequent filings. The cumulative effect of initially applying SAB 108, if any, can be recorded as an adjustment to opening retained earnings. SAB 108 does not change the SEC staff's previous positions regarding qualitative considerations in assessing the materiality of misstatements. SAB 108 is effective for the Company beginning in the fourth quarter of this fiscal year and management does not currently anticipate any adjustments to opening retained earnings resulting from the application of SAB 108.

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements" ("FAS 157"). FAS 157 establishes a common definition of fair value to be used when the Company is required to use a fair value measure for recognition or disclosure purposes under GAAP. FAS 157 is effective for the Company beginning in 2008. The Company is currently evaluating the impact the adoption of FAS 157 will have on its consolidated financial statements.

Market Risk

Market risk represents the risk of loss that may impact the financial position, results of operations, or cash flow of the Company due to adverse changes in market prices and interest rates.

The Company does not use derivative instruments. Changes in interest rates are not expected to have an adverse effect on the Company's financial condition or results of operations.

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IGI, INC. AND SUBSIDIARIES

ITEM 3. Controls and Procedures

Evaluation of Disclosure Controls and Procedures.

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Vice President of Finance, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-14 as of the end of the period covered by this Report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic Securities and Exchange Commission filings. No significant changes were made in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

Changes in Internal Control over Financial Reporting.

There was no change in the Company's internal control over financial reporting that occurred during the period covered by this quarterly report on Form 10-QSB that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Control Systems.

The Company's management cannot assure that its disclosure controls and procedures or its internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and breakdowns can occur because of simple errors or mistakes. Additionally, controls can be circumvented by the individual acts of some person or by collusion of two or more people. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. Accordingly, the Company's disclosure controls and procedures are designed to provide reasonable, not absolute, assurance that the objectives of its disclosure control system are met and, as set forth above.

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IGI, INC. AND SUBSIDIARIES
PART II
OTHER INFORMATION

ITEM 1. Legal Proceedings

Other Matters

On April 6, 2000, officials of the New Jersey Department of Environmental Protection ("DEP") inspected the Company's storage site in Buena, New Jersey, and issued Notices of Violation ("NOV's") relating to the storage of waste materials in a number of trailers at the site. The Company established a disposal and cleanup schedule and completed the removal of materials from the site. In March 2006, the Company received a judge's decision of a fine in the amount of \$35,000 in respect to the NOV's the Company received from the DEP. Due to the criminal settlement that was reached between the Company and the DEP in 2002, the Company had a credit of \$40,000 to be used against any fines determined as a result of the civil matter, therefore, the Company did not have to pay any money to the DEP for the settlement amount. As a result, the balance accrued for the NOV was reversed and is reflected in other income in the amount of \$24,000 for the nine month period ended September 30, 2006. The Company was notified in June 2006 that the DEP has appealed the judge's decision and the decision is pending before an appellate court.

On March 2, 2001, the Company discovered the presence of environmental contamination resulting from an unknown heating oil leak at its Companion Pet Products manufacturing site. The remediation was completed by September 30, 2003. The Company has spent approximately \$540,000 to date on the cleanup and associated costs and \$50,000 remains accrued as of September 30, 2006. There will be periodic monitoring performed, which is projected to span over the next three years. The estimated cost of the monitoring is included in the accrual.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

On July 1, July 12, and September 28, 2006, three investors, each exercised warrants to purchase 26,666 shares of the Company's common stock at \$.90 per share. The Company issued the Common Stock in reliance upon the exemption from registration provided by Section 4(2) of the Securities Act of 1933, as amended and/or Regulation D promulgated under the Securities Act of 1933. The Company used the funds resulting from such exercise for working capital.

ITEM 3. Defaults Upon Senior Securities

None.

ITEM 4. Submission of Matters to a Vote of Security Holders

None.

ITEM 5. Other Information

The Company has also been notified by the American Stock Exchange ("Amex") that the Company has more shares outstanding than the Amex has recorded as listed. Under Section 301 of the Amex Company Guide, the Company may not issue unlisted shares. The Amex has asked the Company to investigate the situation. The Company believes that at least some of the shares in question were in fact listed. Because of management changes the Company has had difficulty in locating the listing applications for such shares. The Company intends to discuss with the Amex the appropriate resolution to the situation. Failure to satisfactorily resolve this issue with Amex could result in the Company being delisted from the American Stock Exchange.

ITEM 6. Exhibits

- 10.1 Letter Agreement, dated July 21, 2006 between IGI, Inc. and Univest Management EPSP, c/o Frank Gerardi, Trustee. (incorporated by reference from Exhibit 10.1/99.1) to 8-K filed on July 27, 2006.
- 31.1 Certification of the Chairman and Chief Executive Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Vice President of Finance Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of the Chairman and Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as enacted under Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the Vice President of Finance pursuant to 18 U.S.C. Section 1350, as enacted under Section 906 of the Sarbanes-Oxley Act of 2002.

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IGI, INC. AND SUBSIDIARIES

SIGNATURES

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

IGI, Inc.
(Registrant)

Date: November 14, 2006

By:

/s/ Frank Gerardi

Frank Gerardi
Chairman and Chief Executive Officer

Date: November 14, 2006

By:

/s/ Carlene Lloyd

Carlene Lloyd
Vice President, Finance

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