

IGI INC  
Form 10QSB  
August 14, 2006

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

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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 June 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

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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 August 7, 2006 was 12,887,444.

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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 June 30, |          | Six months ended June 30, |          |
|--|-----------------------------|----------|---------------------------|----------|
|  | 2006                        | 2005     | 2006                      | 2005     |
| Revenues:                                    |                             |          |                           |          |
| Product sales, net                           | \$ 490                      | \$ 593   | \$ 856                    | \$1,092  |
| R&D Revenues                                 | 133                         | -        | 163                       | 6        |
| Licensing and royalty income                 | 194                         | 232      | 379                       | 502      |
| Total revenues                               | 817                         | 825      | 1,398                     | 1,600    |
| Cost and expenses:                           |                             |          |                           |          |
| Cost of sales                                | 444                         | 354      | 711                       | 767      |
| Selling, general and administrative expenses | 442                         | 362      | 900                       | 673      |
| Product development and research expenses    | 271                         | 265      | 561                       | 500      |
| Operating (loss)                             | (340)                       | (156)    | (774)                     | (340)    |
| Loss on impairment of investment securities  | -                           | (77)     | -                         | (77)     |
| Interest (expense) income                    | (28)                        | 2        | (70)                      | 5        |
| Other income                                 | -                           | 32       | 24                        | 32       |
| Loss before benefit for income taxes         | (368)                       | (199)    | (820)                     | (380)    |
| Benefit for income taxes                     | -                           | 8        | -                         | 6        |
| Net loss                                     | \$(368)                     | \$(191)  | \$ (820)                  | \$ (374) |
| Basic and Diluted Loss Per Share             |                             |          |                           |          |
| Net loss per share                           | \$ (.03)                    | \$ (.02) | \$ (.06)                  | \$ (.03) |

|  |            |            |            |            |
|--|------------|------------|------------|------------|
| Weighted Average of Common Stock and<br>Common Stock Equivalents Outstanding |            |            |            |            |
| Basic and diluted  | 12,781,255 | 11,859,984 | 12,705,984 | 11,771,247 |

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)

|   | June 30,<br>2006 | December 31,<br>2005* |
|---|------------------|-----------------------|
|   | (unaudited)      |                       |
| <b>ASSETS</b>   |                  |                       |
| Current assets:   |                  |                       |
| Cash and cash equivalents   | \$ 24            | \$ 365                |
| Restricted cash   | 50               | 50                    |
| Accounts receivable, less allowance for doubtful<br>accounts of \$7 in 2006 and \$ 30 in 2005 | 421              | 268                   |
| Licensing and royalty income receivable   | 77               | 147                   |
| Inventories   | 614              | 261                   |
| Prepaid expenses and other current assets   | 96               | 83                    |
|   | <hr/>            | <hr/>                 |
| Total current assets  | 1,282            | 1,174                 |
| Property, plant and equipment, net  | 2,370            | 2,909                 |
| Assets held for sale  | 388              | -                     |
| License fee, net  | 950              | 1,000                 |
| Other assets  | 78               | 52                    |
|   | <hr/>            | <hr/>                 |
| Total assets  | \$ 5,068         | \$ 5,135              |
|   | <hr/>            | <hr/>                 |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                  |                       |
| Current liabilities:  |                  |                       |
| Accounts payable  | \$ 833           | \$ 350                |
| Accrued expenses  | 191              | 220                   |
| Note payable - related party  | 1,090            | 1,015                 |
| Deferred income   | 95               | 90                    |
|   | <hr/>            | <hr/>                 |
| Total current liabilities   | 2,209            | 1,675                 |
| Deferred income   | 68               | 102                   |
|   | <hr/>            | <hr/>                 |
| Total liabilities   | 2,277            | 1,777                 |
|   | <hr/>            | <hr/>                 |
| Stockholders' equity:   |                  |                       |

|  |          |          |
|--|----------|----------|
| Common stock \$.01 par value, 50,000,000 shares<br>authorized; 14,799,852 and 14,484,519 shares<br>issued in 2006 and 2005, respectively | 148      | 145      |
| Additional paid-in capital   | 25,323   | 25,073   |
| Accumulated deficit  | (21,285) | (20,465) |
| Less treasury stock, 1,965,740 shares at cost  | (1,395)  | (1,395)  |
|  | <hr/>    | <hr/>    |
| Total stockholders' equity   | 2,791    | 3,358    |
|  | <hr/>    | <hr/>    |
| Total liabilities and stockholders' equity   | \$ 5,068 | \$ 5,135 |
|  | <hr/>    | <hr/>    |

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

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

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

|   | Six months ended June 30, |         |
|---|---------------------------|---------|
|   | 2006                      | 2005    |
|   | <hr/>                     | <hr/>   |
| Cash flows from operating activities:                                   |                           |         |
| Net loss  | \$(820)                   | \$(374) |
| Reconciliation of net loss to net cash used in<br>operating activities: |                           |         |
| Depreciation and amortization   | 157                       | 149     |
| Bad debt expense  | 1                         | -       |
| Loss on impairment of investment securities                             | -                         | 77      |
| Recognition of deferred income  | (53)                      | (84)    |
| Amortization of license fee   | 50                        | -       |
| Stock option compensation expense                                       | -                         | 2       |
| Changes in operating assets and liabilities:                            |                           |         |
| Accounts receivable   | (154)                     | (89)    |
| Inventories   | (353)                     | (181)   |
| Licensing and royalty income receivable                                 | 70                        | 4       |
| Prepaid expenses and other assets                                       | (45)                      | (128)   |
| Accounts payable and accrued expenses                                   | 529                       | 151     |
| Deferred income   | 24                        | 50      |
|   | <hr/>                     | <hr/>   |
| Net cash used in operating activities                                   | (594)                     | (423)   |
|   | <hr/>                     | <hr/>   |
| Cash flows from investing activities:                                   |                           |         |

|  |       |        |
|--|-------|--------|
| Capital expenditures                           | -     | (68)   |
|  | <hr/> | <hr/>  |
| Cash flows from financing activities:          |       |        |
| Proceeds from exercise of common stock options | 253   | 325    |
|  | <hr/> | <hr/>  |
| Net decrease in cash and cash equivalents      | (341) | (166)  |
| Cash and equivalents at beginning of period    | 365   | 380    |
|  | <hr/> | <hr/>  |
| Cash and equivalents at end of period          | \$ 24 | \$ 214 |
|  | <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 \$24,000 at June 30, 2006 and cash from operations. The Company sustained net losses of \$820,000 and \$374,000 for the six months ended June 30, 2006 and 2005, respectively, and had a working capital deficiency of \$927,000 at June 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 and is terminable by either party on or after August 17, 2006 if the contingency is not met by such date. Upon the earlier of the closing of the sale-leaseback transaction or September 30, 2006, the Company must repay the \$1,000,000 loan provided to the Company by Frank Gerardi, its Chief Executive Officer, together with accrued interest. Accrued interest as of June 30, 2006 was approximately \$90,000. 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 2006 through new business arrangements may be sufficient to provide the capital needed to fund the Company through the end of August 2007. The Company received a \$30,000 refundable deposit in the first quarter of 2006 relating to the sale-leaseback transaction. 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.

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 began distribution via an Internet website, [www.miaj.com](http://www.miaj.com), at the end of the second quarter and are currently seeking other avenues of distribution for the product line as well.

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 UltraCem 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.

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 June 30, 2006. In the third quarter of 2006, this reporting segment, the Metal Plating Division, will be classified as discontinued operations. 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 represents less than a 1% ownership interest in UCT.

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

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. 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 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







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 \$80,000 remains accrued as of June 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.

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

7. 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 over the ten year period. The Company recorded amortization of \$50,000 related to this agreement for the six months ended June 30, 2006.

8. 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. One warrant to purchase 26,666 shares was granted in the first quarter of 2006. A total of four warrants to purchase 106,664 shares were granted through June 30, 2006 (the other three warrants were issued in 2005). The warrants expire two years from the date of issue. In July of 2006, Frank Gerardi and Steve Morris, an IGI Director, exercised their warrant.

9. 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 September 30, 2006 or when a sale leaseback of the land and building closes, with 30% interest per annum through February 1, 2006 and 12% interest per annum thereafter. The note is collateralized by a mortgage on real property owned by the Company. The Company accrued \$90,000 of interest related to this note for the six months ended June 30, 2006. The note amount at June 30, 2006 includes all accrued interest since inception.

10. Segment Information

The Company presents segment information in accordance with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," which established reporting and disclosure standards for an enterprise's

operating segments. Operating segments are defined as components of an enterprise for which separate financial information is available and regularly reviewed by the Company's senior management.

The Company has two reportable segments: Consumer Products and Metal Plating Division. Products and services from each of the segments serve different markets and use different channels of distribution. The Consumer Products Division is the core segment of the Company's business. The Metal Plating Division is currently not operating at our main facility and on July 10, 2006 the Company decided to discontinue operations for this division and sell the related equipment. In accordance with FAS 144, the assets related to this division are classified as held for sale on the Balance Sheet at June 30, 2006 (see Note 2 above).

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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 six months ended June 30, 2006 and June 30, 2005 appear below:

| Three months ended June 30, 2006 | Plating | Consumer Products | Total   |
|----------------------------------|---------|-------------------|---------|
| Revenue from external customers  | \$ -    | \$ 817            | \$ 817  |
| Depreciation and amortization    | (11)    | (66)              | (77)    |
| Segment losses                   | (11)    | (357)             | (368)   |
| Segment fixed assets             | 388     | 2,370             | 2,758   |
| Expenditures for segment assets  | -       | -                 | -       |
| <br>                             |         |                   |         |
| Three months ended June 30, 2005 | Plating | Consumer Products | Total   |
| Revenue from external customers  | \$ 2    | \$ 823            | \$ 825  |
| Depreciation and amortization    | (21)    | (62)              | (83)    |
| Segment losses                   | (89)    | (102)             | (191)   |
| Segment fixed assets             | 516     | 2,692             | 3,208   |
| Expenditures for segment assets  | 4       | -                 | 4       |
| <br>                             |         |                   |         |
| Six months ended June 30, 2006   | Plating | Consumer Products | Total   |
| Revenue from external customers  | \$ -    | \$1,398           | \$1,398 |
| Depreciation and amortization    | (22)    | (135)             | (157)   |
| Segment losses                   | (31)    | (789)             | (820)   |
| Segment fixed assets             | 388     | 2,370             | 2,758   |
| Expenditures for segment assets  | -       | -                 | -       |
| <br>                             |         |                   |         |
| Six months ended June 30, 2005   | Plating | Consumer Products | Total   |
| Revenue from external customers  | \$ 2    | \$1,598           | \$1,600 |
| Depreciation and amortization    | (21)    | (128)             | (149)   |

|                                 |       |       |       |
|---------------------------------|-------|-------|-------|
| Segment losses                  | (170) | (204) | (374) |
| Segment fixed assets            | 516   | 2,692 | 3,208 |
| Expenditures for segment assets | 68    | -     | 68    |

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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 OperationsThree months ended June 30, 2006 compared to June 30, 2005Revenues (in thousands):

|                 | 2006 | 2005 | \$ Change | % Change |
|-----------------|------|------|-----------|----------|
| Product Sales   | 490  | 593  | -103      | -17%     |
| R&D Revenues    | 133  | -    | 133       | 100%     |
| Royalty Revenue | 194  | 232  | -38       | -16%     |
| Total Revenues  | 817  | 825  | -8        | -1%      |

The decrease in product sales is due to no product sales being recorded for Estee Lauder in the three months ended June 30, 2006 compared to \$214,000 in the three months ended June 30, 2005 offset by higher product sales to Albrian International of \$124,000 in the three months ended June 30, 2006. 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 the fourth quarter of 2006. The decrease in royalty revenue was related to a decline in royalties from J&J in 2006.

Costs and expenses (in thousands):

|                                     | 2006  | 2005 | \$ Change | % Change |
|-------------------------------------|-------|------|-----------|----------|
| Cost of sales                       | 444   | 354  | 90        | 25%      |
| Selling, general and administrative | 442   | 362  | 80        | 22%      |
| Product development and research    | 271   | 265  | 6         | 2%       |
| Totals costs and expenses           | 1,157 | 981  | 176       | 18%      |

As a percentage of product sales, cost of sales was 91% for the quarter ended June 30, 2006 and 60% for the quarter ended June 30, 2005. The 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 55% of revenues in the second quarter of 2006 compared to 44% for the second quarter of 2005. The increase in expenses was a result of a higher cost of shareholder reports in the second quarter of 2006 of \$23,000 relating to the annual report and proxy statement and higher sales & marketing expenses of \$28,000 relating to our new product line, Miaj™.

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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  | 2    | 2    | 0         | -        |

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 |
|--------------------|------|------|-----------|----------|
| Net loss           | -368 | -191 | 177       | 93%      |
| Net loss per share | -.03 | -.02 | .02       | 50%      |

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

##### Six months ended June 30, 2006 compared to June 30, 2005

##### Revenues (in thousands):

|                 | 2006 | 2005  | \$ Change | % Change |
|-----------------|------|-------|-----------|----------|
| Product Sales   | 856  | 1,092 | -236      | -22%     |
| R&D Revenues    | 163  | 6     | 157       | 2600%    |
| Royalty Revenue | 379  | 502   | -123      | -25      |

|                |       |       |      |      |
|----------------|-------|-------|------|------|
| Total Revenues | 1,398 | 1,600 | -202 | -13% |
|----------------|-------|-------|------|------|

The decrease in product sales is due to no product sales being recorded for Estee Lauder in the six months ended June 30, 2006 compared to \$386,000 being recorded in the six months ended June 30, 2005 and a decrease in sales to Chattem in 2006 of \$29,000 offset by higher product sales to Albrian International of \$164,000, for the six months ended June 30, 2006. 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 the fourth quarter of 2006. The decrease in royalty revenue was related to a decline in royalties from J&J in 2006.

Costs and expenses (in thousands):

|                                     | 2006  | 2005  | \$ Change | % Change |
|-------------------------------------|-------|-------|-----------|----------|
| Cost of sales                       | 711   | 767   | -56       | -7%      |
| Selling, general and administrative | 900   | 673   | 227       | 34%      |
| Product development and research    | 561   | 500   | 61        | 12%      |
| Totals costs and expenses           | 2,172 | 1,940 | 232       | 12%      |

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IGI, INC. AND SUBSIDIARIES

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

As a percentage of product sales, cost of sales was 83% for the six months ended June 30, 2006 and 70% for the six months ended June 30, 2005. The 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 63% of revenues for the six months ended June 30, 2006 compared to 42% for the six 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 \$60,000 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 \$68,000.

Interest Expense (Income) (in thousands):

|                  | 2006 | 2005 | \$ Change | % Change |
|------------------|------|------|-----------|----------|
| Interest Expense | -75  | -    | 75        | -100%    |
| Interest Income  | 5    | 5    | -         | -        |

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 |
|--------------------|------|------|-----------|----------|
| Net loss           | -820 | -374 | 446       | 119%     |
| Net loss per share | -.06 | -.03 | -.03      | 100%     |

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

## Liquidity and Capital Resources

The Company's operating activities used \$594,000 of cash during the six months ended June 30, 2006 compared to \$423,000 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 six months ended June 30, 2006 compared to \$68,000 used in investing activities in the first three months of 2005. The money used represents capital expenditures to purchase machinery and equipment related to the electroless nickel boride finishing operations in 2005.

The Company's financing activities provided \$253,000 of cash in the six months ended June 30, 2006 compared to \$325,000 provided by financing activities in the six months ended June 30, 2005. The cash provided in 2005 and 2006 represents proceeds from the exercise of stock options.

The Company's principal sources of liquidity are cash and cash equivalents of approximately \$24,000 at June 30, 2006 and cash from operations. The Company sustained net losses of \$820,000 and \$374,000 for the six months ended June 30, 2006 and 2005, respectively, and had a working capital deficiency of \$927,000 at June 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.

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## IGI, INC. AND SUBSIDIARIES

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

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 and is terminable by either party on or after August 17, 2006 if the contingency is not met by such date. Upon the earlier of the closing of the sale-leaseback transaction or September 30, 2006, the Company must repay the \$1,000,000 loan provided to the Company by Frank Gerardi, its Chief Executive Officer, together with accrued interest, which accrued interest, as of June 30, 2006 was approximately \$90,000. 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 2006 through new business arrangements may be sufficient to provide the capital needed to fund the Company through the end of August 2007. The Company received a \$30,000 refundable deposit in the first quarter of 2006 relating to the sale-leaseback transaction. 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.

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.

#### 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.

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#### IGI, INC. AND SUBSIDIARIES

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

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 June 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 believes is its fair market value.

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 June 30, 2006. In the third quarter of 2006, this reporting segment, the Metal Plating Division, will be classified as discontinued operations. 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 represents less than a 1% ownership interest in UCT.

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 \$2.79 million.

On July 17, 2006, the Company submitted a plan of compliance to AMEX. AMEX has 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. If the plan is accepted, the Company may be able to continue its listing during the plan period of up to 18 months, during which time it will be subject to periodic review to determine whether it is making progress consistent with the plan.

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.

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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.

#### 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 ("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 of a fine in the amount of \$35,000 in respect to the NOVs 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 six month period ended June 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 \$80,000 remains accrued as of June 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

None.

ITEM 3. Defaults Upon Senior Securities

None.

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

The following is a report of the voting results of the Company's annual shareholders meeting held on May 24, 2006.

The proposal to elect four directors, as described in the Company's proxy statement for its annual meeting of shareholders held on May 24, 2006, was approved. The directors were elected until the next annual meeting of shareholders or until their successors are duly elected and qualified. The tabulation was as follows:

| Director           | Votes For  | Withhold Authority |
|--------------------|------------|--------------------|
| Frank Gerardi      | 11,265,305 | 156,300            |
| Stephen Morris     | 10,974,981 | 446,624            |
| Terrence O'Donnell | 10,898,756 | 522,849            |
| Rajiv Mathur       | 10,928,872 | 492,733            |

The proposal to approve the adoption of an amendment to increase the number of shares by 200,000 as authorized and available under the Company's 1999 Director Stock Option Plan was approved. The tabulation was as follows:

Votes For: 5,820,085      Votes Against: 589,256  
 Votes Abstain: 18,826      Broker Non-Votes: 4,993,483

The proposal to approve the adoption of an amendment to increase the number of shares by 500,000 as authorized and available under the Company's 1999 Stock Incentive Plan, and to ensure compliance with Section 409A of the Internal Revenue Code was approved. The tabulation was as follows:

Votes For: 5,722,347      Votes Against: 688,894  
 Votes Abstain: 16,926      Broker Non-Votes: 4,993,483

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IGI, INC. AND SUBSIDIARIES  
 PART II  
 OTHER INFORMATION

The proposal to approve the adoption of an amendment to increase the number of shares by 200,000 as authorized and available under the Company's 1998 Directors Stock Plan was approved. The tabulation was as follows:

Votes For: 5,784,085      Votes Against: 627,206  
 Votes Abstain: 16,876      Broker Non-Votes: 4,993,483

ITEM 5. Other Information

None.

ITEM 6. Exhibits

- 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: August 14, 2006

By:

/s/ Frank Gerardi

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Frank Gerardi  
Chairman and Chief Executive Officer

Date: August 14, 2006

By:

/s/ Carlene Lloyd

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Carlene Lloyd  
Vice President, Finance

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