

SECURITIES AND EXCHANGE COMMISSION  
 Washington, D.C. 20549

Quarterly Report Under Section 13 or 15(d)  
 of the Securities Exchange Act of 1934  
 For the quarterly period ended March 31, 1997

Transition Report Pursuant to Section 13 or 15(d)  
 of the Securities Exchange Act of 1934

For the transition period from to

Commission file Number 0-16109

ADVANCED POLYMER SYSTEMS, INC.  
 -----

(Exact name of registrant as specified in its charter)

Delaware  
 -----

94-2875566  
 -----

(State or other jurisdiction of  
 incorporation or organization)

(IRS Employer  
 Identification No.)

3696 Haven Avenue, Redwood City, CA 94063  
 -----

(Address of principal executive offices)

(415) 366-2626  
 -----

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes            X            No

At April 30, 1997 the number of outstanding shares of the Company's common stock, par value \$.01, was 18,418,492.

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ADVANCED POLYMER SYSTEMS, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Unaudited)

	March 31, 1997	December 31, 1996
	-----	-----
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 5,436,700	\$ 5,394,509
Marketable securities	1,596,617	--
Trade accounts receivable, net	2,092,257	1,666,148
Inventory	2,707,728	2,085,073
Prepaid expenses and other	354,688	328,028
Receivable from/and assets held for sale	731,306	2,181,004
	-----	-----
Total current assets	12,919,296	11,654,762
Property and equipment, net	4,642,670	4,681,292
Deferred loan costs, net	551,142	616,958
Prepaid license fees	145,034	165,752
Intangible assets, including goodwill, net	1,209,261	1,265,801
Other assets	153,780	59,603
	-----	-----
	\$ 19,621,183	\$ 18,444,168
	=====	=====
<b>LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 809,029	\$ 1,543,143
Accrued expenses	1,924,428	1,456,512
Accrued melanin purchase commitments	1,800,000	1,800,000
Accounts payable, Johnson & Johnson	359,872	814,509
Deferred revenues	2,225,000	750,000
Current portion - long-term debt	1,825,371	1,490,779
	-----	-----
Total current liabilities	8,943,700	7,854,943
Long-term debt	4,958,070	5,578,849
	-----	-----
Total liabilities	13,901,770	13,433,792
	-----	-----
Shareholders' equity:		
Common stock and common stock warrants	76,881,495	76,591,381
Accumulated deficit	(71,162,082)	(71,581,005)
	-----	-----
Total shareholders' equity	5,719,413	5,010,376
	-----	-----
	\$ 19,621,183	\$ 18,444,168
	=====	=====

See accompanying notes.

ADVANCED POLYMER SYSTEMS, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited)

	3 Months Ended March 31, 1997 -----	3 Months Ended March 31, 1996 -----
Microsponge product and technology revenues	\$ 3,547,132	\$ 1,448,745
Sales of consumer products	--	3,704,727
Milestone payment	1,500,000	--
	-----	-----
Total revenues	5,047,132	5,153,472
Cost of sales	1,491,515	3,304,806
Operating expenses:		
Research & development	932,474	889,956
Selling, marketing & advertising	1,173,812	2,037,568
General & administration	843,294	670,021
	-----	-----
Total operating expenses	2,949,580	3,597,545
	-----	-----
Operating income (loss)	606,037	(1,748,879)
Interest income	79,300	38,956
Interest expense	(271,392)	(299,078)
Other income (expense)	4,978	(10,296)
	-----	-----
Net income (loss)	\$ 418,923	(\$ 2,019,297)
	=====	=====
Net income (loss) per common share	\$ 0.02	(\$ 0.12)
	=====	=====
Number of shares used in computing per share amounts (the 1997 and 1996 number of shares include 1,286,824 and 0 shares, respectively, relating to common stock equivalents)	19,692,958	17,354,858
	=====	=====

See accompanying notes.

ADVANCED POLYMER SYSTEMS, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
for the three months ended March 31, 1997 and 1996  
(Unaudited)

	March 31, 1997	March 31, 1996
Cash flows from operating activities:		
Net income (loss)	\$ 418,923	(\$2,019,297)
Adjustments to reconcile net income (loss) to net cash provided from (used in) operating activities:		
Depreciation and amortization	251,947	353,135
Change in allowance for doubtful accounts	--	(1,308)
Provision for deferred compensation	45,000	--
Changes in operating assets and liabilities:		
Trade accounts receivable	(426,109)	(1,699,365)
Inventory	(622,655)	1,282,946
Prepaid expenses and other	(26,660)	103,650
Deferred loan costs	65,816	16,961
Other assets	(94,177)	68,875
Accounts payable and accrued expenses	(750,835)	(1,827,610)
Deferred revenue	1,475,000	--
	336,250	(3,722,013)
Net cash provided from (used in) operating activities	336,250	(3,722,013)
Cash flows from investing activities:		
Purchases of fixed assets	(136,067)	(61,225)
Purchase of marketable securities	(1,596,617)	(512,513)
Maturities and sales of marketable securities	--	506,396
Proceeds from assets held for sale	1,449,698	--
	(282,986)	(67,342)
Net cash used in investing activities	(282,986)	(67,342)
Cash flows from financing activities:		
Proceeds from the exercise of common stock options	275,114	730,309
Proceeds from note payable	--	500,000
Proceeds from long-term debt and warrants	--	150,000
Repayment of long-term debt	(286,187)	(192,389)
Proceeds from private placement, net of offering costs	--	2,976,044
	(11,073)	4,163,964
Net cash (used in) provided from financing activities	(11,073)	4,163,964
Net increase in cash and cash equivalents	42,191	374,609
Cash and cash equivalents, beginning of the period	5,394,509	5,172,809
Cash and cash equivalents, end of the period	\$ 5,436,700	\$ 5,547,418

Supplemental disclosure of non-cash financing transactions:

During the first quarter of 1996, the Company acquired all rights to the Polytrap technology from Dow Corning Corporation in exchange for shares of Common Stock valued at \$1,200,000.

During the first quarter of 1996, the Company paid Biosource for the 1995 purchase commitment totalling \$600,000 by issuing 94,000 shares of Common Stock.

See accompanying notes.

ADVANCED POLYMER SYSTEMS, INC.  
Notes to Condensed Consolidated Financial Statements  
March 31, 1997 and 1996  
(Unaudited)

(1) Basis of Presentation

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, necessary to present fairly the financial position of Advanced Polymer Systems, Inc. and subsidiaries ("the Company" or "APS") as of March 31, 1997 and the results of their operations and their cash flows for the three months ended March 31, 1997 and 1996.

These condensed consolidated statements should be read in conjunction with the Company's audited consolidated financial statements for the years ended December 31, 1996, 1995 and 1994.

The condensed consolidated financial statements include the financial statements of the Company and its subsidiaries, Premier, Inc. ("Premier"), Advanced Consumer Products, Inc., and APS Analytical Standards, Inc. All significant intercompany balances and transactions have been eliminated in consolidation.

Effective January 1997, as part of the Company's long-term strategic plan to move away from the direct marketing of consumer products, APS licensed its consumer products to Lander Company. The Company is no longer generating revenues from sales of these products, but is receiving revenues from royalties on product sales and the supply of Microsponge(R) systems incorporated into various products. Prior year results include the sales of consumer products and related selling, marketing and distribution expenses.

The Company considers all short-term investments which have original maturities of less than three months to be cash equivalents. Investments which have original maturities longer than three months are classified as marketable securities in the accompanying balance sheets.

Certain reclassifications have been made to the prior year financial statements to conform with the presentation in 1997.

(2) Common Shares Outstanding and per Share Information

Common stock outstanding as of March 31, 1997 is as follows:

	Number of Shares -----
Common stock outstanding as of December 31, 1996	18,359,744
Options exercised after December 31, 1996	58,748
	-----
Total shares	18,418,492 =====

In 1996, the number of shares used in calculating earnings per share was the weighted average number of shares of common stock outstanding. Common stock equivalents were not considered since they were antidilutive. In 1997, the number of shares used in calculating earnings per share included the effect of common stock equivalents.

(3) New Accounting Standard

In February 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 128, "Earnings per Share" (SFAS 128), which will be effective for financial statements for periods ending after December 15, 1997, including interim periods, and establishes standards for computing and presenting earnings per share. Earlier application is not permitted. In its consolidated financial statements for the year ending December 31, 1997, the Company will make the required disclosures of basic and diluted earnings per share. All prior period earnings per share data will be restated by the Company upon adoption of SFAS 128.

(4) Milestone Payment

In February 1997, upon receipt of marketing clearance from the Food and Drug Administration ("FDA") to market Retin-A(R) Micro(TM) (tretinoin gel) 0.1% - microsphere for the treatment of acne, APS received \$3,000,000 from Ortho McNeil Pharmaceutical Corporation, a subsidiary of Johnson & Johnson. One half of the amount received was a milestone payment which was recognized as revenues in the first quarter of 1997 and the other half was prepaid royalties which was recorded as deferred revenue.

(5) Inventory

The major components of inventory are as follows:

	March 31, 1997 -----	December 31, 1996 -----
Raw materials and work-in-process	\$ 668,257	\$ 604,852
Finished goods	2,039,471	1,480,221
	-----	-----
Total inventory	\$ 2,707,728 =====	\$ 2,085,073 =====

Item 2.

Management's Discussion and Analysis of Financial Condition  
and Results of Operations  
(all dollar amounts rounded to the nearest thousand)

Results of Operations for the Three Months Ended March 31, 1997 and 1996

Except for statements of historical fact, the statements herein are forward-looking and are subject to a number of risks and uncertainties that could cause actual results to differ materially from the statements made. These include, among others, uncertainty associated with timely approval, launch and acceptance of new products, establishment of new corporate alliances, progress in research and development programs and other risks described below or identified from time to time in the Company's Securities and Exchange Commission filings.

The Company's revenues are derived principally from product sales, license fees and royalties. The Company is currently manufacturing and selling Microsponge(R) delivery systems for use by customers in almost 100 different personal care and cosmetic products. Under strategic alliance arrangements entered into with certain multinational corporations, APS generally receives an initial cash infusion, future milestone payments, royalties based on third party product sales and revenues from the supply of Microsponge systems.

These strategic alliances are intended to provide the Company with the marketing expertise and/or financial strength of other companies. In this respect, the Company's periodic financial results are dependent upon the degree of success of current collaborations and the Company's ability to negotiate acceptable collaborative agreements in the future.

Revenues for the three months ended March 31, 1997 were \$5,047,000 compared to \$5,153,000 in the corresponding quarter of the prior year. Microsponge product and technology revenues were \$3,547,000 in the first quarter of 1997 compared to \$1,449,000, an increase of \$2,098,000 or 145% over the first quarter of the prior year. This was due primarily to increased shipments of Microsponge systems to manufacturers of personal care and cosmeceutical products, and up-front technology revenues received from corporate partners.

The current quarter included a milestone payment of \$1,500,000 from Ortho McNeil Pharmaceutical Corporation ("Ortho"), a subsidiary of Johnson & Johnson, upon the Company's receipt of marketing clearance for Retin-A(R) Micro(TM) from the Food and Drug Administration (FDA). Retin-A Micro was launched in March 1997.

The first quarter of 1997 did not include revenues from sales of consumer products which were licensed to



the Lander Company effective January 1, 1997. Sales of consumer products in the year-ago quarter were \$3,705,000 which consisted of sales of products subsequently licensed to the Lander Company and sales of sun care products.

Gross profit on product revenues for the quarter was \$1,256,000 or 46% of product revenues compared to \$1,799,000 or 35% in the year-ago period reflecting increased manufacturing volume and sales of higher margin products, primarily proprietary cosmeceuticals.

Operating expenses decreased by \$648,000 or 18%. Research and development expense increased by \$43,000 or 5% to \$932,000. Selling, marketing and advertising expense decreased by \$864,000 or 42% to \$1,174,000. This was primarily due to the fact that the Company licensed its consumer products to Lander Company effective January 1, 1997, thus avoiding the advertising expenditure and variable selling expenses such as commission and freight associated with promoting and distributing consumer products. This decrease is expected to continue. General and administrative expense increased by \$173,000 or 26% due primarily to higher professional fees.

Operating income of \$606,000 represented an improvement of \$2,355,000 over the prior year's first quarter loss of \$1,749,000. This was due primarily to the milestone payment received from Ortho, up-front technology revenues, improved margins on product sales and a significant reduction in operating expenses.

Interest income of \$79,000 for the first quarter of 1997 was higher than the prior year by \$40,000 due mainly to higher cash and investment balances. Interest expense for the quarter of \$271,000 was lower than the year-ago quarter by \$28,000 due mainly to principal repayments.

The net income for the period was \$419,000 compared to a net loss of \$2,019,000 in the corresponding period of the prior year.

#### Capital Resources and Liquidity

Total assets as of March 31, 1997 were \$19,621,000 compared with \$18,444,000 at December 31, 1996, and working capital increased to \$3,976,000 from \$3,800,000. In the same period, cash, cash equivalents and marketable securities increased to \$7,033,000 from \$5,395,000. During the first quarter, Company operations provided \$336,000 of cash. The Company invested approximately \$932,000 in product research and development and \$1,174,000 in selling and marketing the Company's products and technologies.

The Company has financed its operations, including product research and development, from amounts raised in debt and equity financings, the sale of consumer products,

Microsponge delivery systems and analytical standard products; payments received under licensing agreements; and interest earned on short-term investments.

In the first quarter of 1997, upon receipt of approval from the FDA to market Retin-A Micro (tretinoin gel) microsphere for the treatment of acne, APS received \$3,000,000 from Ortho McNeil Pharmaceutical of which one half was a milestone payment which was recognized as revenue in the first quarter of 1997 and half was prepaid royalties which was recorded as deferred revenue.

The Company's existing cash, cash equivalents and marketable securities, collections of trade accounts receivable, together with interest income and other revenue producing activities including licensing fees and milestone payments, are expected to be sufficient to meet the Company's working capital requirements for the foreseeable future, assuming no changes to existing business plans.

#### New Accounting Standard

In February 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 128, "Earnings per Share" (SFAS 128), which will be effective for financial statements for periods ending after December 15, 1997, including interim periods, and establishes standards for computing and presenting earnings per share. Earlier application is not permitted. In its consolidated financial statements for the year ending December 31, 1997, the Company will make the required disclosures of basic and diluted earnings per share. All prior period earnings per share data will be restated by the Company upon adoption of SFAS 128.

PART II.

Item 1. Legal Proceedings

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits: 27 Financial Data Schedules

(b) Reports on Form 8-K: None

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.

ADVANCED POLYMER SYSTEMS, INC.

Date: May 14, 1997  
-----

By: /s/ John J. Meakem, Jr.  
-----

John J. Meakem, Jr.  
Chairman, President and  
Chief Executive Officer

Date: May 14, 1997  
-----

By: /s/ Michael O'Connell  
-----

Michael O'Connell  
Executive Vice President,  
Chief Administrative Officer and  
Chief Financial Officer

EXHIBIT INDEX

Form 10-Q

ADVANCED POLYMER SYSTEMS, INC.

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-Financial Data Schedules.

3-MOS

	DEC-31-1997	
	JAN-01-1997	
	MAR-31-1997	
		5,436,700
		1,596,617
		2,092,257
		40,888
		2,707,728
	12,919,296	
		13,558,040
		8,915,370
	19,621,183	
8,943,700		
		4,958,070
	0	
		0
		184,185
		5,535,228
19,621,183		
		2,455,132
	5,047,132	
		1,491,515
		1,491,515
	2,949,580	
		0
	271,392	
		418,923
		0
418,923		
		0
		0
		0
		418,923
		0.02
		0.02