

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

Quarterly Report Under Section 13 or 15(d)
of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2004

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

A.P. PHARMA, 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.)

123 Saginaw Drive, Redwood City, CA 94063

(Address of principal executive offices)

(650) 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 No
--- ---

Indicate by check mark whether the registrant is an accelerated
filer (as defined in Rule 12b-2 of the Act).

Yes No

At April 30, 2004, the number of outstanding shares of the Company's
common stock, par value \$.01, was 20,744,735.

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements:

A.P. PHARMA, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS (in thousands)

	March 31, 2004	December 31, 2003
	(Unaudited)	(Note 1)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 2,400	\$ 97
Marketable securities	5,344	9,387
Accounts receivable, net	1,466	1,340
Prepaid expenses and other	421	434
	-----	-----
Total current assets	9,631	11,258
Property and equipment, net	1,349	1,430
Other long-term assets	287	467
	-----	-----
Total assets	\$ 11,267	\$ 13,155
	=====	=====
LIABILITIES & STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,201	\$ 476
Accrued expenses	1,052	1,173
Accrued disposition costs	76	53
Deferred revenue	190	190
	-----	-----
Total current liabilities	2,519	1,892
	-----	-----
Stockholders' equity:		
Common stock	86,936	86,844
Accumulated deficit	(78,197)	(75,598)
Accumulated other comprehensive income	9	17
	-----	-----
Total stockholders' equity	8,748	11,263
	-----	-----
Total liabilities and stockholders' equity	\$ 11,267	\$ 13,155
	=====	=====

See accompanying notes to condensed consolidated financial statements.

A.P. PHARMA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(in thousands except per share amounts)

	Three Months Ended March 31,	
	2004	2003
	-----	-----
Royalties	\$ 1,154	\$ 1,032
Contract revenues	26	74
	-----	-----
Total revenues	1,180	1,106
Operating expenses:		
Research & development	3,035	2,202
General & administrative	724	778
	-----	-----
Total operating expenses	3,759	2,980
	-----	-----
Operating loss	(2,579)	(1,874)
Interest income, net	31	77
Other income (expense), net	(2)	(1)
	-----	-----
Loss from continuing operations	(2,550)	(1,798)
Loss from discontinued operations	(50)	(54)
Gain on disposition of discontinued operations	1	1,886
	-----	-----
Net income (loss)	\$(2,599)	\$ 34
	=====	=====
Basic earnings (loss) per share:		
Loss from continuing operations	\$ (0.12)	\$ (0.09)
	=====	=====
Net income (loss)	\$ (0.13)	\$ *
	=====	=====
Diluted earnings (loss) per share:		
Loss from continuing operations	\$ (0.12)	\$ (0.09)
	=====	=====
Net income (loss)	\$ (0.13)	\$ *
	=====	=====
Weighted average common shares outstanding-basic	20,653	20,475
	=====	=====
Weighted average common shares outstanding-diluted	20,653	20,516
	=====	=====

* Less than \$0.01 per share.

See accompanying notes to condensed consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)(in thousands)

except for share amounts)

	Three Months Ended March 31,	
	2004	2003
Cash flows from operating activities:		
Net income (loss)	\$(2,599)	\$ 34
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Loss from discontinued operations	50	54
Gain on disposition of discontinued operations	(1)	(1,886)
Gain on sale of marketable securities	(2)	--
Depreciation and amortization	92	117
Recovery of doubtful accounts and note receivable	--	(8)
Stock and stock option compensation awards to non-employees	6	28
Amortization of premium/discount and accretion of marketable securities	(43)	(23)
Loss on retirements of property and equipment	6	8
Changes in operating assets and liabilities:		
Accounts receivable	(145)	(46)
Prepaid expenses and other current assets	13	73
Other long-term assets	180	(292)
Accounts payable	725	(86)
Accrued expenses	(121)	447
Net cash used in continuing operating activities	(1,839)	(1,580)
Net cash used in discontinued operations	(26)	(211)
Cash flows from investing activities:		
Proceeds from disposition of discontinued operations	19	2,149
Purchases of property and equipment	(18)	(26)
Purchases of marketable securities	(1,295)	(2,836)
Maturities of marketable securities	5,376	2,854
Net cash provided by investing activities	4,082	2,141
Cash flows from financing activities:		
Proceeds from the exercise of stock options	86	--
Net cash proceeds provided by financing activities	86	--
Net increase in cash and cash equivalents	2,303	350
Cash and cash equivalents, beginning of the period	97	3,282
Cash and cash equivalents, end of the period	\$ 2,400	\$ 3,632

See accompanying notes to condensed consolidated financial statements.

A.P. PHARMA, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2004 and 2003 (UNAUDITED)

(1) Basis of Presentation

A.P. Pharma, Inc. ("APP", the "Company", "we", "our", or "us") is developing patented polymer-based delivery systems to enhance the safety and effectiveness of pharmaceutical compounds. Projects are currently conducted under feasibility and development arrangements with pharmaceutical and biotechnology companies. New products and technologies under development include bioerodible polymers for injectable and implantable drug delivery.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments of a normal recurring nature considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004. The condensed consolidated balance sheet as of December 31, 2003 has been derived from the audited financial statements as of that date. For further information, refer to the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2003.

The condensed consolidated financial statements include the financial statements of the Company and its subsidiary, APS Analytical Standards, Inc through the date of sale (February 13, 2003). All significant intercompany balances and transactions have been eliminated in consolidation.

Critical Accounting Policies

We believe there have been no significant changes in our critical accounting policies during the three months ended March 31, 2004 compared to those previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2003 filed with the SEC on March 26, 2004.

Use of Estimates

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in our financial statements and accompanying notes. Estimates were made relating to useful lives of fixed assets, valuation allowances, impairment of assets and accruals. Actual results could differ materially from those estimates.

Revenue Recognition

Our revenue arrangements with multiple deliverables are divided into separate units of accounting if certain criteria are met, including whether the delivered item has stand-alone value to the customer and whether there is objective and reliable evidence of the fair value of the undelivered items. The consideration we receive is allocated among the separate units based on their respective fair values, and the applicable revenue recognition criteria are considered separately for each of the separate units. Advance payments received in excess of

amounts earned are classified as deferred revenue until earned.

* Royalties

Royalties from licenses are based on third-party sales of licensed products or technologies and recorded as earned in accordance with contract terms when third-party results can be reliably determined and collectibility is reasonably assured.

Generally, contractually required minimum royalties are recorded ratably throughout the contractual period. Royalties in excess of minimum royalties are recognized as earned when the related product is shipped to the end customer by our licensees based on information provided to us by our licensees.

* License Fees

We have licensing agreements that generally provide for periodic minimum payments, royalties, and/or non-refundable license fees. These licensing agreements typically require a non-refundable license fee and allow our partners to sell our proprietary products in a defined field or territory for a defined period. The license agreements provide for APP to earn future revenue through royalty payments. These non-refundable license fees are initially reported as deferred revenues and recognized as revenues over the estimated life of the product to which they relate as we have continuing involvement with licensees until the related product is discontinued or the related patents expire, whichever is earlier. Revenue recognized from deferred license fees is classified as license fees in the accompanying consolidated statements of operations. License fees received in connection with arrangements where we have no continuing involvement are recognized as license fees when the amounts are received or when collectibility is assured, whichever is earlier. No such fees were recorded during the three months ended March 31, 2004.

A milestone payment is a payment made by a third party or corporate partner to us upon the achievement of a predetermined milestone as defined in a legally binding contract. Milestone payments are recognized as license fees when the milestone event has occurred and we have completed all milestone related services such that the milestone payment is currently due and is non-refundable. No such fees were recorded during the three months ended March 31, 2004.

* Contract Revenues

Contract revenues also relate to research and development arrangements that generally provide for the company to invoice research and development fees based on full-time equivalent hours for each project. Revenues from these arrangements are recognized as the related development costs are incurred. These revenues approximate the costs incurred.

Cash Equivalents and Short-term Investments

We consider all short-term investments in debt securities which have original maturities of less than three months at date of purchase to be cash equivalents. Investments which have original maturities longer than three months are classified as marketable securities in the accompanying balance sheets.

Accrued Disposition Costs

Costs relating to disposal of discontinued operations are reported as accrued disposition costs in the accompanying balance sheets. Accrued disposition costs include severance costs and gross profit guarantees.

Concentrations of Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk consist primarily of cash equivalents, short-term investments and trade accounts receivable. We invest excess cash in a variety of high grade

short-term, interest-bearing securities. This diversification of risk is consistent with our policy to ensure safety of principal and to maintain liquidity.

Approximately 79% of the receivables were concentrated with two customers in the pharmaceutical industry as of March 31, 2004. To reduce credit risk, we perform ongoing credit evaluations of our customers' financial conditions. We do not generally require collateral for customers with accounts receivable balances.

Segment and Geographic Information

Our operations are confined to a single business segment, the design and commercialization of polymer technologies for pharmaceutical and other applications. Substantially all of our revenues are derived from domestic customers.

Stock-Based Compensation

We have elected to account for stock-based compensation related to employees using the intrinsic value method. Accordingly, except for stock options issued to non-employees and restricted stock awards to employees and directors, no compensation cost has been recognized for our stock option plans and stock purchase plan. Compensation related to options granted to non-employees is periodically remeasured as earned.

In accordance with FAS No. 123, "Accounting for Stock-Based Compensation," as amended by FAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure," we have provided, below, the pro forma disclosures of the effect on net income (loss) and net earnings (loss) per share as if FAS No. 123 had been applied in measuring compensation expense for all periods presented.

	Three Months Ended March 31,	
	2004	2003
	(In thousands, except per share amounts)	
Net earnings (loss), as reported	\$(2,599)	\$ 34
Deduct:		
Stock-based employee compensation expense determined under FAS 123	(104)	(132)
Pro forma net loss	\$(2,703)	\$ (98)
Basic earnings (loss) per share as reported	\$ (0.13)	\$ *
Basic pro forma loss per share	\$ (0.13)	\$ **
Diluted earnings (loss) per share as reported	\$ (0.13)	\$ *
Diluted pro forma loss per share	\$ (0.13)	\$ **

* Less than \$0.01 per share.

** Less than \$(0.01) per share.

Fair values of awards granted under the stock option plans and employee stock purchase plan were estimated at grant or purchase dates using Black-Scholes option pricing model. For pro forma disclosure, the estimated fair value of the options is amortized to expense over the vesting period of the options using the straight line method. The multiple option approach is used to value the purchase rights granted under the employee

stock purchase plan. We used the following assumptions:

	Three Months Ended March 31,	
	2004	2003
Expected life in years (from vesting date):		
Stock options	5	5
Employee stock purchase plan	1.5 - 2	1.5 - 2
Discount rate:		
Stock options	2.8%	3.8%
Employee stock purchase plan	1.47 - 1.82	1.7 - 3.2
Volatility		
Stock options	65%	102%
Employee stock purchase plan	65% - 68%	68% - 69%
Expected dividend yield	0%	0%

Reclassifications

Certain immaterial amounts in the prior year financial statements have been reclassified to conform with the current year presentation.

(2) Earnings (Loss) Per Share Information

Basic earnings (loss) per share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding. Diluted earnings (loss) per share is computed by dividing net income (loss) by the total of weighted-average number of common shares outstanding and dilutive potential common shares outstanding.

The following table sets forth the computation of our basic and diluted earnings (loss) per share (in thousands, except per share amounts):

	Three Months Ended March 31,	
	2004	2003
Loss from continuing operations	\$ (2,550)	\$ (1,798)
Net income (loss)	(2,599)	34
Shares calculation:		
Weighted average shares outstanding - basic	20,653	20,475
Effect of dilutive securities: Stock options, employee stock purchase plan and stock to be issued to directors	--	41
Weighted average shares outstanding - diluted	20,653	20,516
Basic earnings (loss) per share:		
Loss from continuing operations	\$ (0.12)	\$ (0.09)
Net income (loss)	\$ (0.13)	\$ *
Diluted earnings (loss) per share:		
Loss from continuing operations	\$ (0.12)	\$ (0.09)
Net income (loss)	\$ (0.13)	\$ *

* Less than \$0.01 per share.

The following stock options were outstanding during the periods presented, but were not included in the computation of diluted earnings (loss) per share since inclusion of these potentially dilutive securities would have been anti-dilutive for the periods presented (in thousands, except exercise prices):

	Three Months Ended March 31,	
	2004	2003
Number outstanding	2,197	2,929
Range of exercise prices	\$1.00 - \$10.25	\$1.01 - \$10.25

(3) Comprehensive Income (Loss)

Comprehensive income (loss) for the three months ended March 31, 2004 and March 31, 2003 consists of the following (in thousands):

	Three Months Ended March 31,	
	2004	2003
Net income (loss)	\$(2,599)	\$ 34
Unrealized losses on available-for-sale securities	(8)	(8)
Comprehensive income (loss)	<u>\$(2,607)</u>	<u>\$ 26</u>

(4) Commitments

In March 2004 we renegotiated the lease for our facilities. The following is our operating lease commitment as of March 31, 2004.

Twelve Months Ending March 31,	Minimum Payments
2005	\$ 316
2006	444
2007	453
2008	463
2009	475
Thereafter	995
Total	<u>\$3,146</u>

(5) Discontinued Operations

We completed the sale of certain assets of our Analytical Standards division as well as certain technology rights for our topical pharmaceutical and cosmeceutical product lines and other assets ("cosmeceutical and toiletry business") in February 2003 and July 2000, respectively.

The Analytical Standards division and cosmeceutical and toiletry business are reported as discontinued operations for all periods presented in the accompanying Condensed Consolidated Statements of Operations.

Loss from discontinued operations represents the income (loss) attributable to our Analytical Standards division that was sold to GFS Chemicals on February 13, 2003, and changes in estimates for our cosmeceutical and toiletry business that was sold to RP Scherer on July 25, 2000, as follows (in thousands):

	For the Three Months Ended March 31,	
	2004	2003

Analytical Standards Division		

Income from Analytical Standards division	\$ --	\$ 9
	----	----
	--	9
Cosmeceutical and Toiletry Business		

Recovery of doubtful accounts receivable	--	4
Change in estimates for gross profit guarantees	(50)	(67)
	-----	----
	(50)	(63)
	-----	----
Total loss from discontinued operations	\$ (50)	\$(54)
	=====	====

Basic and diluted loss per common share from discontinued operations excluding the gain on sale of the Analytical Standards and cosmeceutical product lines were less than (\$0.01) per share for the three months ended March 31, 2004 and 2003, respectively.

Gain on disposition of discontinued operations in the accompanying Consolidated Statement of Operations for the three months ended March 31, 2003 represents the gain on the sale of certain assets of our Analytical Standards division in February 2003.

As of March 31, 2004, net assets relating to the discontinued operations include trade receivables of \$119,000. Liabilities related to the discontinued operation in the amount of \$76,000 include severance costs and accruals for gross profit guarantees. These liabilities are reported as accrued disposition costs in the accompanying consolidated balance sheets.

Cash used in discontinued operations primarily relates to payments of severance costs to former employees who were terminated as a result of the sale of the Analytical Standards division.

Analytical Standards Division

On February 13, 2003, we completed the sale of our Analytical Standards division to GFS Chemicals, Inc. ("GFS"), a privately held company based in Columbus, Ohio. In this transaction, we received \$2.1 million on closing and are entitled to receive royalties on sales of Analytical Standards products for a period of five years at rates ranging from 5% to 15%. The net present value of the guaranteed minimum royalties is included in the gain on disposition of discontinued operations. Royalties in excess of the guaranteed minimum royalties are included in the gain on disposition of discontinued operations when they are realized in accordance with our revenue recognition policy. We recorded additional royalties of \$20,000 as income for the 3 months ended March 31, 2004.

As a result of the sale of the Analytical Standards division, we recorded severance charges of \$210,000 for the year ended December 31, 2003 as a partial offset to the gain on disposition of the Analytical Standards division. In the three

months ended March 31, 2004 a reduction to the estimated severance charges of \$19,000 was recorded. Approximately \$184,000 of these severance charges has been paid through March 31, 2004.

Cosmeceutical and Toiletry Business

On July 25, 2000, we completed the sale of certain technology rights for our topical pharmaceuticals and cosmeceutical product lines and other assets ("cosmeceutical and toiletry business") to RP Scherer Corporation, a subsidiary of Cardinal Health, Inc. We received \$25 million at closing and were entitled to receive further earnout amounts for the subsequent three years up to a maximum of \$26.5 million, the amounts of which were dependent on the performance of the business sold. During the first two years of the earnout period, we received an aggregate of \$3.8 million. No earnout income was received or reported for the third and final earnout year.

Under the terms of the agreement with RP Scherer, we guaranteed a minimum gross profit percentage on RP Scherer's combined sales of products to Ortho Neutrogena and Dermik ("Gross Profit Guaranty"). The guaranty period commenced on July 1, 2000 and ends on the earlier of July 1, 2010 or the end of two consecutive guaranty periods where the combined gross profit on sales to Ortho and Dermik equals or exceeds the guaranteed gross profit. Payments for the Gross Profit Guaranty aggregated \$404,000 for the first three guaranty years. We expect the annual Gross Profit Guaranty payments to range from approximately \$100,000 to \$150,000 for the remainder of the guaranty period. As there is no minimum amount of Gross Profit Guaranty due, no accrual for the guaranty is estimable for future years.

(6) Subsequent Events

On May 5, 2004, we announced our filing of a shelf registration statement with the Securities and Exchange Commission covering up to \$15,000,000 of our common stock. The specific terms of this offering under the shelf registration will be established at the time of such offering.

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

and Results of Operations (all dollar amounts rounded to the

nearest thousand)

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 development, 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 our Securities and Exchange Commission filings.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in our financial statements and accompanying notes. On an ongoing basis, we evaluate our estimates including those related to the useful lives of fixed assets, valuation allowances, impairment of assets, accrued clinical and preclinical expenses and contingencies. Actual results could differ materially from those estimates.

We believe there have been no significant changes in our critical accounting policies during the three months ended March 31, 2004 as compared to what was previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2003 filed with the SEC on March 26, 2004. For a description of our critical accounting policies, please refer to our 2003 Annual Report on Form 10-K.

On March 31, 2003, the Financial Accounting Standards Board ("FASB") issued an exposure draft of proposed statement titled Share-Based Payment, that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The proposed statement would eliminate the ability to account for share-based compensation transactions using APB Opinion No. 25, Accounting for Stock Issued to Employees, and generally would require instead that such transactions be accounted for using a fair-value-based method. We currently apply the recognition and measurement principles of APB Opinion No. 25. Under this opinion, no stock-based employee compensation expense is charged for options that were granted at an exercise price that was equal to the market value of the underlying common stock on the date of grant. Pro forma information regarding net income and earnings per share is required to be disclosed in the footnotes to our financial statements by Statement of Financial Accounting Standards ("SFAS") No. 123, as amended by SFAS No. 148, as if we had accounted for our employee stock options under the fair value method to that statement. The FASB will invite public comment regarding its proposed statement before issuing a final pronouncement, which is expected later this year. As the proposed statement currently stands, it would become effective with our fiscal quarter ended March 31, 2005. We monitor progress at the FASB and other developments with respect to the general issue of stock-based incentive compensation. In the future, should we expense the value of stock-based incentive compensation, either out of choice or due to new requirements issued by the FASB, and/or decide to alter our current employee compensation programs to provide other benefits in place of incentive stock options, we may have to recognize substantially more compensation expense. This may have an adverse impact on our results of operations.

Results of Operations for the Three Months Ended March 31, 2004 and

2003

Our revenues are derived principally from royalties and contract revenues. Under strategic alliance arrangements entered into with certain corporations, we can receive non-refundable upfront fees,

milestone payments and royalties based on third party product sales.

Royalties for the first quarter of 2004 increased by \$122,000 to \$1,154,000 from \$1,032,000 in the corresponding quarter of the prior year. This increase was due mainly to increased sales of Retin-A Micro(R). We expect royalty revenue to continue to increase in 2004.

Contract revenues decreased by \$48,000 from \$74,000 to \$26,000 as a result of fewer collaborative research and development arrangements. Additionally, our feasibility studies frequently experience a period of inactivity while initial results are being evaluated by our collaborators.

Research and development expense for the first quarter of 2004 increased by \$833,000 from \$2,202,000 to \$3,035,000 due mainly to the cost of Phase 2 clinical trials of APF112 for the treatment of post-surgical pain as well as preclinical studies of APF530 for the treatment of chemotherapy-induced nausea and vomiting. We expect research and development expense to continue at this level during the second quarter of 2004 while we are conducting human clinical trials for our two product candidates, APF112 and APF530.

General and administrative expense for the first quarter of 2004 decreased by \$54,000 from \$778,000 to \$724,000 due to decreased investor relations, rent and depreciation costs, netted with an increase in consultant and professional fees. We expect general and administrative expense to remain essentially flat through the end of the year.

Interest income for the first quarter of 2004 decreased by \$46,000 to \$31,000 from \$77,000 due to lower interest rates earned on lower average cash balances.

Loss from discontinued operations represents the net contribution (loss) attributable to the Analytical Standards division which was sold to GFS Chemicals, Inc. in February 2003 and the cosmeceutical and toiletries product lines which were sold to RP Scherer Corporation in July 2000. Net loss from discontinued operations totaled \$50,000 for the three months ended March 31, 2004, compared with a net loss of \$54,000 in the three months ended March 31, 2003.

Gain on disposition of discontinued operations of \$1,886,000 for the three months ended March 31, 2003 relates to the sale of the Analytical Standards division on February 13, 2003 to GFS Chemicals, Inc., a private company based in Columbus, Ohio. We received \$2,149,000 million in cash on the closing date and are entitled to receive royalties on sales varying from 5% to 15% for five years following the closing, with guaranteed minimum annual royalty payments.

Capital Resources and Liquidity

- - - - -

Cash, cash equivalents and marketable securities decreased by \$1,740,000 to \$7,744,000 at March 31, 2004 from \$9,484,000 at December 31, 2003 due to cash used in operating activities.

Net cash used in continuing operating activities for the three months ended March 31, 2004 and 2003 was \$1,839,000 and \$1,580,000, respectively. The increase in net cash used in operating activities was mainly due to increased clinical and preclinical study costs.

Net cash provided by investing activities for the three months ended March 31, 2004 and 2003 was \$4,082,000 and \$2,141,000, respectively. The increase in the cash provided by investing activities was primarily due to the maturities of \$5,376,000 of marketable securities, partially offset by the purchases of \$1,295,000 of marketable securities. The proceeds received from disposition of discontinued operations received in the three months ended March 31, 2004 of \$19,000 relates to the royalties in excess of the guaranteed minimum royalties received from GFS Chemicals compared to \$2,149,000 for the three months ended March 31, 2003 which relates to the proceeds received following the sale of our Analytical Standards division.

We have funded our operations, including technology and product research and development, primarily through royalties received on sales of Retin-A Micro and Carac, income from collaborative research and development fees, the proceeds received from the sales of our Analytical Standards division and our cosmeceutical and toiletry

business, and interest earned on short-term investments. Unless we agree on appropriate terms with a collaborator or partner, our existing cash and cash equivalents, marketable securities, collections of accounts receivable, together with interest income and other revenue-producing activities including royalties, license and option fees and research and development fees, may not be sufficient to meet our cash needs for the next year at the current planned expenditure levels. We will seek additional financing within this timeline through debt or equity financing, the sale of certain assets and technology rights, collaborative arrangements with prospective partners or other arrangements.

On May 5, 2004, we announced our filing of a shelf registration statement with the Securities and Exchange Commission which covered up to \$15,000,000 of our common stock. If we decide to seek financing through this shelf offering, the specific terms will be established at that time.

Our future capital requirements will depend on numerous factors including, among others, royalties from sales of products of third party licensees; our ability to enter into collaborative research and development and licensing agreements; progress of product candidates in preclinical and clinical trials; investment in new research and development programs; time required to gain regulatory approvals; resources that we devote to self-funded products; potential acquisitions of technology, product candidates or businesses; and the costs of defending or prosecuting any patent opposition or litigation necessary to protect our proprietary technology.

We may be unable to raise sufficient additional capital when we need it or to raise capital on favorable terms. The sale of equity or convertible debt securities in the future may be dilutive to our stockholders, and debt-financing arrangements may require us to pledge certain assets and enter into covenants that could restrict certain business activities or our ability to incur further indebtedness and may contain other terms that are not favorable to us or our stockholders. If we are unable to obtain adequate funds on reasonable terms, we may be required to curtail operations significantly or to obtain funds by entering into financing, supply or collaboration agreements on unattractive terms.

In March 2004 we renegotiated the lease for our facilities. The following is a summary of fixed payments related to certain contractual obligations as of March 31, 2004 (in thousands):

	Total	Less than 1 year	2 to 3 years	4 to 5 years	More than 5 years
	-----	-----	-----	-----	-----
Operating Leases	\$3,146	\$316	\$897	\$938	\$995
	-----	---	---	---	---
Total	\$3,146	\$316	\$897	\$938	\$995
	=====	===	===	===	===

ITEM 3. Quantitative and Qualitative Disclosure about Market Risk

Since December 31, 2003, there have been no material changes in the Company's market risk exposure.

ITEM 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures: We carried out an evaluation, under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operations of our disclosure controls and procedures pursuant to Rule 13a-15(e) and 15(d)-15(e) of the Exchange Act. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that as of March 31, 2004, the end of period covered by this report, our disclosure controls and procedures were effective at the reasonable assurance level to alert them in a timely manner to material information relating to the Company required to be included

in our Exchange Act filings.

(b) Changes in internal controls: During the quarter ended March 31, 2004, there have been no significant changes in our internal control over financial reporting that materially affected, or are reasonable likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

On October 22, 2003, Tristrata Technology, Inc. (Tristrata) filed an amended complaint joining A.P. Pharma, Inc. and other companies as defendants in Tristrata's action first filed July 12, 2002 against Cardinal Health, Inc. and others in the Federal District Court of Delaware. Tristrata's complaint alleges infringement of patents pertaining to alpha-hydroxy acids used in cosmetics. A.P. Pharma answered Tristrata's amended complaint on December 22, 2003. A.P. Pharma is vigorously defending this action.

At this early stage of the proceedings we cannot state the amount, if any, which might be recovered by Tristrata from A.P. Pharma. In our opinion, this litigation should not have a material effect on our results of operations or financial condition.

ITEM 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit 10-Y Amendment to lease agreement dated March 29, 2004.

Exhibit 31.1 Certification of Chief Executive Officer pursuant to Rules 13A-15(e) Promulgated under the Securities Exchange Act of 1934 as amended.

Exhibit 31.2 Certification of Chief Financial Officer pursuant to Rules 13A-15(e) Promulgated under the Securities Exchange Act of 1934 as amended.

Exhibit 32 Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K

On March 12, 2004, the Company furnished a press release current report on Form 8-K reporting the earnings for the fourth quarter of 2003.

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.

A.P. PHARMA, INC.

Date: May 14, 2004

By: /S/ Michael O'Connell

Michael O'Connell
President and Chief
Executive Officer

Date: May 14, 2004

By: /S/ Gordon Sangster

Gordon Sangster
Chief Financial Officer

AMENDMENT TO LEASE AGREEMENT

This Amendment to Lease ("Amendment") is entered into, and dated for reference purposes, as of March 29, 2004 (the "Execution Date") by and between METROPOLITAN LIFE INSURANCE COMPANY, a New York corporation ("Metropolitan"), as Landlord ("Landlord"), and A.P. PHARMA, INC., a Delaware corporation, ("A.P. Pharma"), which was formerly named Advanced Polymer Systems, a Delaware corporation), as Tenant ("Tenant"), with reference to the following facts ("Recitals"):

A. Metropolitan and A.P. Pharma are parties to that certain written Lease, dated as of November 7, 1997, for Premises comprising part of the Building, which current street address of the Premises remains 123 Saginaw Drive, Redwood City, California 94063, all as more particularly described in such Lease (the "Existing Lease").

B. Tenant and Landlord desire to provide for a modification and extension of the Term, new rental rate applicable thereto and such other modifications and amendments of the Existing Lease as more particularly set forth below.

NOW, THEREFORE, in consideration of the foregoing, and of the mutual covenants set forth herein and of other good and valuable consideration, the receipt and adequacy of which are hereby acknowledged, the parties hereto agree as follows:

Section 1. Scope of Amendment; Defined Terms; Tenant Name Change.

(a) Except as expressly provided in this Amendment, the Existing Lease shall remain in full force and effect. Should any inconsistency arise between this Amendment and the Existing Lease as to the specific matters which are the subject of this Amendment, the terms and conditions of this Amendment shall control. The term "Lease" as used herein and in the Existing Lease shall refer to the Existing Lease as modified by this Amendment. All capitalized terms used in this Amendment and not defined herein shall have the meanings set forth in the Existing Lease unless the context clearly requires otherwise.

(b) Tenant represents, warrants and agrees that: (i) it has amended its Articles of Incorporation to change its name from Advanced Polymer Systems to A.P. Pharma, Inc., which is its name as of the Execution Date; (ii) Tenant's legal entity remains the same and was not otherwise changed; (iii) A.P. Pharma is the Tenant under the Existing Lease, is bound by all obligations of the Tenant under the Existing Lease and holds all right, title and interest of the Tenant under the Existing Lease; (iv) Tenant's Federal Employer Identification Number has not changed and remains 94-2875566. Tenant's obligations with respect to the representations, warranties and agreements under this Section survive the expiration or sooner termination of the Term of this Lease.

Section 2. Modification and Extension of Term. Landlord and Tenant acknowledge and agree that, before giving effect to this Amendment, pursuant to the Existing Lease, the Expiration Date of the Term of the Existing Lease is November 14, 2004. Notwithstanding any provision of the Existing Lease to the contrary, the Existing Lease is hereby amended to provide that the Expiration Date of the Term of the Existing Lease shall be March 31, 2004 instead of November 14, 2004, and then this Lease shall continue for a term (the "Extended Term") beginning on April 1, 2004 (the "Extended Term Commencement Date") and expiring on March 31, 2011 (hereafter, the "Expiration Date" with respect to the Extended Term), unless sooner terminated pursuant to the terms of the Lease.

Provided however, in the event that this Amendment is not executed by both Tenant and Landlord on or before April 1, 2004, then the Extended Term Commencement Date shall instead be the day after the date on which both Tenant and Landlord have executed this Amendment, the Expiration Date of the Term of the Existing Lease shall instead be the date of such execution, and the Expiration Date of the Extended Term shall remain March 31, 2011. Landlord and Tenant acknowledge and agree that this Amendment provides all rights and obligations of the parties with respect to extension of the current Term, whether or not in accordance with any other provisions, if any, of the Existing Lease regarding renewal or extension, and any such provisions, options or rights for renewal or extension provided in the Existing Lease are hereby deleted as of the Execution Date,

and without limiting the generality of the foregoing, the Option to Extend in the Rider of the Existing Lease is hereby deleted.

Section 3. Base Annual Rent. Notwithstanding any provision of the Existing Lease to the contrary, Tenant and Landlord agree that Basic Annual Rent and Monthly Installments thereof due and payable (in the manner required under the Lease for Monthly Installments of Basic Annual Rent) by Tenant for the Extended Term shall be as set forth follows:

(a) For the Extended Term, Item 3 of the Basic Lease Provisions and Paragraph 2(a) of the Existing Lease are hereby amended to provide that the Initial Basic Annual Rent applicable to the first year of the Extended Term shall be Four Hundred Twenty-two Thousand Two Hundred Eighty-five and 40/100 Dollars (\$422,285.40) (i.e., \$16.20 NNN per square foot of Rentable Area annually).

(b) For the Extended Term, Item 4 of the Basic Lease Provisions and Paragraph 2(a) of the Existing Lease are hereby amended to provide that the Initial Monthly Rental Installments applicable to the first year of the Extended Term shall be Thirty-five Thousand One Hundred Ninety and 45/100 (\$35,190.45) per month (i.e., \$1.35 NNN per square foot of Rentable Area per month).

(c) For the Extended Term, Item 5 of the Basic Lease Provisions and Paragraph 2(a) of the Existing Lease are hereby amended to provide that the Rent Adjustment Date(s) are the respective anniversaries of the Extended Term Commencement Date set forth in the table below with corresponding new Basic Annual Rent and Monthly Rental Installments effective until the next Rent Adjustment Date:

Rent Adjustment Date	Basic Annual Rent NNN	Monthly Rental Installment NNN	Monthly Rate/RSF NNN
1st Anniversary	\$434,797.56	\$36,233.13	\$1.39
2nd Anniversary	\$447,309.72	\$37,275.81	\$1.43
3rd Anniversary	\$462,949.92	\$38,579.16	\$1.48
4th Anniversary	\$475,462.08	\$39,621.84	\$1.52
5th Anniversary	\$491,102.28	\$40,925.19	\$1.57
6th Anniversary	\$503,614.44	\$41,967.87	\$1.61

Section 4. Project & Tenant's Project Share. Notwithstanding any provision of the Existing Lease to the contrary, including without limitation, Paragraphs 1(a) and 3(a), and Item 6 of the Basic Lease Provisions, Phase III ceased to be part of the Project, and as of the Execution Date, the Project consists of Phase I and Phase II with a total of 301,824 rentable square feet, and Tenant's Project Share is agreed to be 8.64%.

Section 5. Condition of Premises. Notwithstanding any provision of the Existing Lease to the contrary, Tenant acknowledges and agrees that: (1) Tenant has been in occupancy of the Premises since 1997; (2) Tenant has investigated the condition of the Premises to the extent Tenant desires to do so; (3) Tenant is leasing the Premises in its "As Is" condition; (4) no representation regarding the condition of the Premises has been made by or on behalf of Landlord; (5) in connection with this Amendment, Landlord has no obligation to remodel or to make any repairs, alterations or improvements in connection with this Amendment, or to provide Tenant any allowance therefor; and (5) all alterations, additions or improvements in connection with this Amendment or hereafter shall be in accordance with Paragraph 7 of the Existing Lease and Tenant shall pay a fee to Landlord ("Construction Administration Fee") in connection with Landlord's review of plans and specifications and monitoring construction performed by Tenant, which shall not exceed two percent (2%) of the contract amount for the design and construction.

Section 6. Rights & Responsibilities of Landlord Re Certain HVAC Units. Notwithstanding any provision of the Existing Lease to the contrary, including, without limitation, Sections 6(a) and (b), and Section 3(c)(18), if and to the extent that replacement of the Original HVAC Units (defined below) or components thereof is necessary and would constitute a capital expenditure, Landlord (rather than Tenant) shall cause such replacement to be made and Tenant shall pay 100% of the portion of the amortized cost of such

capital expenditures allocable to the remainder of the Extended Term, calculated using an amortization period equal to the useful life of the HVAC unit or component, as applicable, together with a return on capital at the rate of ten percent (10%) per annum. For purposes hereof, "Original HVAC Units" shall mean those HVAC units owned by Landlord which exclusively serve the Premises and which were in place when the Premises was originally delivered to Tenant.

Section 7. Amendment & Reduction of the Security Deposit. Provided that (a) all Rent due and owing under the Lease (as modified by this Amendment) has been paid in full; and (b) Tenant is not, on the Extended Term Commencement Date, in default under the Existing Lease beyond any applicable notice and grace period; then: (i) the cash Security Deposit required under Paragraph 4 of the Lease and Item 10 of the Basic Lease Provisions shall be reduced from One Hundred Fifty Thousand Dollars (\$150,000.00) to Seventy-five Thousand Dollars (\$75,000.00) and Landlord shall apply the unapplied outstanding balance of the Security Deposit then held by Landlord in excess of the reduced amount as a credit against the next payments of Rent due and owing under the Lease on and after the Extended Term Commencement Date.

Section 8. Change of Address for Copies of Notices to Landlord. The current addresses for notices to be sent to Landlord pursuant to Paragraph 23 of the Existing Lease are modified as follows:

Metropolitan Life Insurance Company
c/o Seaport Centre Property Manager
701 Chesapeake Drive
Redwood City, California 94063
Attention: Property Manager

with copies to the following:

Metropolitan Life Insurance Company
400 South El Camino Real, Suite 800
San Mateo, CA 94402
Attention: EIM Manager, Real Estate Investments

and

Metropolitan Life Insurance Company
400 South El Camino Real, Suite 800
San Mateo, CA 94402
Attention: Associate General Counsel

Section 9. Time of Essence. Without limiting the generality of any other provision of the Existing Lease, time is of the essence to each and every term and condition of this Amendment.

Section 10. Brokers. Tenant represents that no broker, agent or person has represented, dealt with or had discussions with it in connection with this Amendment transaction other than Tom Driscoll and Jon Mackey of Cornish & Carey Commercial ("Tenant's Broker") and that no broker, agent or person except Tenant's Broker has brought about this Amendment transaction. Tenant hereby indemnifies and agrees to protect, defend and hold Landlord harmless from and against all claims, losses, damages, liability, costs and expenses (including, without limitation, attorneys' fees and expenses) by any broker, agent or other person (except Landlord's Broker) claiming a commission or other form of compensation by virtue of alleged representation of, or dealings or discussions with, Tenant with respect to the transaction contemplated by this Amendment, except for a commission payable to Tenant's Broker to the extent provided for in a separate written agreement between Tenant's Broker and Landlord's Broker (defined below). The term "Landlord's Broker" shall mean Howard Dallmar and Roderick Shepard of Cornish & Carey Commercial, and Tenant shall not be responsible for payment of any commission to Landlord's Broker. The provisions of this Section shall survive the expiration or earlier termination of the Amendment or the Lease. Landlord hereby agrees to pay such commission, if any, to which Landlord's Broker is entitled in connection with the subject matter of this Amendment pursuant to Landlord's separate written agreement with Landlord's Broker, and agrees that Tenant is not obligated to pay or fund any amount to Landlord's Broker. The provisions of this Section shall survive the expiration or earlier termination of the Amendment or the Lease.

Section 11. Attorneys' Fees. Each party to this Amendment shall bear its own attorneys' fees and costs incurred in connection with the discussions preceding, negotiations for and documentation

of this Amendment. In the event any party brings any suit or other proceeding with respect to the subject matter or enforcement of this Amendment or the Lease, the prevailing party (as determined by the court, agency or other authority before which such suit or proceeding is commenced) shall, in addition to such other relief as may be awarded, be entitled to recover attorneys' fees, expenses and costs of investigation as actually incurred, including court costs, expert witness fees, costs and expenses of investigation, and all attorneys' fees, costs and expenses in any such suit or proceeding (including in any action or participation in or in connection with any case or proceeding under the Bankruptcy Code, 11 United States Code Sections 101 et seq., or any successor statutes, in establishing or enforcing the right to indemnification, in appellate proceedings, or in connection with the enforcement or collection of any judgment obtained in any such suit or proceeding).

Section 12. Effect of Headings. The titles or headings of the various parts or sections hereof are intended solely for convenience and are not intended and shall not be deemed to or in any way be used to modify, explain or place any construction upon any of the provisions of this Amendment.

Section 13. Entire Agreement; Amendment. This Amendment taken together with the Existing Lease, together with all exhibits, schedules, riders and addenda to each, constitutes the full and complete agreement and understanding between the parties hereto and shall supersede all prior communications, representations, understandings or agreements, if any, whether oral or written, concerning the subject matter contained in this Amendment and the Existing Lease, as so amended, and no provision of the Lease as so amended may be modified, amended, waived or discharged, in whole or in part, except by a written instrument executed by all of the parties hereto.

Section 14. Authority. Each person executing this Amendment represents and warrants that he or she is duly authorized and empowered to execute it, and does so as the act of and on behalf of the party indicated below.

Section 15. Counterparts. This Amendment may be executed in duplicates or counterparts, or both, and such duplicates or counterparts together shall constitute but one original of the Amendment. The parties contemplate that they may be executing counterparts of this Amendment transmitted by facsimile and agree and intend that a signature by facsimile machine shall bind the party so signing with the same effect as though the signature were an original signature. Each duplicate and counterpart shall be equally admissible in evidence, and each original shall fully bind each party who has executed it.

IN WITNESS WHEREOF, the parties hereto have executed this Amendment as of the date first set forth above.

TENANT: A.P. PHARMA, INC.,
a Delaware corporation

By: /S/ Gordon Sangster

Print Name: Gordon Sangster

Title: Chief Financial Officer

LANDLORD: METROPOLITAN LIFE INSURANCE COMPANY,
a New York corporation

By: /S/ Jon R. Redman

Print Name: Jon R. Redman

Title: Director

SECTION 302 CERTIFICATIONS

Certifications:

I, Michael O'Connell, certify that:

1. I have reviewed this quarterly report on Form 10-Q of A.P. Pharma, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonable likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors:

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial report which could reasonable likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 14, 2004

/s/ Michael O'Connell

Michael O'Connell
President and Chief Executive Officer

SECTION 302 CERTIFICATIONS

Certifications:

I, Gordon Sangster, certify that:

1. I have reviewed this quarterly report on Form 10-Q of A.P. Pharma, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonable likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors:

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial report which could reasonable likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 14, 2004

/s/ Gordon Sangster

Gordon Sangster
Chief Financial Officer

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED

PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of A.P. Pharma, Inc. (the "Company") on Form 10-Q for the period ending March 31, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Michael O'Connell, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Michael O'Connell

Michael O'Connell,
Chief Executive Officer

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED

PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of A.P. Pharma, Inc. (the "Company") on Form 10-Q for the period ending March 31, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Gordon Sangster, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Gordon Sangster

Gordon Sangster,
Chief Financial Officer