SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

(Mark One)

[X] Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2000 or

[ ] 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)	(I.R.S. Employer Identification Number)
123 Saginaw Drive, Redwood City, California	94063
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (650) 366-2626

Securities registered pursuant to Section 12 (b) of the Act: None

Securities registered pursuant to Section 12 (g) of the Act:
Common Stock ($.01 par value)

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 [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (ss.229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

The aggregate market value of the voting stock of the registrant held by non-affiliates of the registrant as of February 28, 2001, was $27,718,756. (1)

As of February 28, 2001, 20,206,065 shares of registrant's Common Stock, $.01 par value, were outstanding.

(1)Excludes 6,346,687 shares held by directors, officers and shareholders whose ownership exceeds 5% of the outstanding shares at February 28, 2001. Exclusion of such shares should not be construed as indicating that the holders thereof possess the power, directly or indirectly, to direct the management or policies of the registrant, or that such person is controlled by or under common control with the registrant.

DOCUMENTS INCORPORATED BY REFERENCE

Document	Form 10-K Part

TABLE OF CONTENTS

PART I

ITEM 1. Business

ITEM 2. Properties

ITEM 3. Legal Proceedings

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

PART II

ITEM 5. Market for the Registrant's Common Equity and Related Shareholder Matters

ITEM 6. Selected Financial Data

ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

ITEM 7A. Quantitative and Qualitative Disclosure About Market Risk

ITEM 8. Financial Statements and Supplementary Data

ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

PART III

ITEM 10. Directors and Executive Officers of the Registrant

ITEM 11. Executive Compensation

ITEM 12. Security Ownership of Certain Beneficial Owners and Management

ITEM 13. Certain Relationships and Related Transactions

PART IV

ITEM 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

Signatures

PART I

Item 1. BUSINESS

INTRODUCTION-FORWARD LOOKING STATEMENTS

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 factors described below under the headings "APS Technology", "Products", "Manufacturing", "Marketing", "Government Regulation", "Patents and Trade Secrets" and "Competition". In addition, such risks and uncertainties also include the matters discussed under Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 below.

THE COMPANY

Advanced Polymer Systems, Inc. and subsidiaries ("APS" or the "Company") is using its patented delivery systems and other proprietary technologies to enhance the safety and effectiveness of prescription products. It has under development patented new drug delivery systems including bioerodible polymers for injectable, implantable and oral drug delivery. Additionally, the company has commercialized its Microsponge(R) system technology in topical products in the market place today. APS holds 102 issued U.S. and foreign patents on its technology and has over 21 other patent applications pending.

The Company, founded in February 1983 as a California corporation under the name AMCO Polymerics, Inc., changed its name to Advanced Polymer Systems, Inc. in 1984 and was reincorporated in Delaware in 1987.

Until July 2000, the Company engaged in the manufacturing, marketing and selling of a variety of cosmeceutical and toiletry products to cosmetic companies. In July 2000, the Company sold its cosmeceutical and toiletry product lines, together with certain technology rights to topical pharmaceuticals to R.P. Scherer, a subsidiary of Cardinal Health. The Company received $25 million at closing, and could receive up to an additional $26.5 million over the next three years if certain performance milestones are met.

The major focus for the Company is the development of its families of bioerodible polymers. Such polymers are of increasing interest within the pharmaceutical community for use in both drug delivery applications and as devices. APS has made substantial progress in developing bioerodible polymers that represent a significant improvement over existing drug delivery systems. The major point of difference is that the APS polymers have been specifically designed as drug delivery devices and for this reason they are very versatile. The Company has demonstrated that erosion times can be varied from days to months and that mechanical properties can be adjusted to produce materials ranging from semi-solid at room temperature to hard. In addition, the synthesis is reproducible, can be easily scaled up and the polymer is stable at room temperature, provided it is stored under anhydrous conditions. In previous studies, the polymer was observed to erode to completion and, once the drug was released, no polymer remained.

The Company's current areas of focus for the use of its bioerodible technologies are in pain management, orthopedic applications and delivery of therapeutic proteins, peptides and DNA. The Company is also developing bioerodible polymer systems that have the potential to carry anti-cancer drugs preferentially to solid tumors. Such a targeted delivery would make possible high drug concentration in a tumor without excessive concentration in normal tissue, thus greatly decreasing the serious side effects of cancer chemotherapy.

Ethical topical products in the marketplace utilize the Company's Microsponge(R) Systems as reservoirs releasing active ingredients over an extended period of time. The resulting benefits include extended efficacy and reduced skin irritation.

In February 1997, the Company received FDA marketing clearance for the first ethical pharmaceutical product based on its patented Microsponge technology, Retin-A(R) Micro(TM), which has been licensed to Ortho-McNeil Pharmaceutical Corporation, a member of the Johnson & Johnson family of companies. This product was launched in March 1997. The Company has also licensed to Dermik, an Aventis company, a Microsponge-based formulation incorporating 5-

fluorouracil for the treatment of actinic keratoses, a pre-cancerous skin condition. The New Drug Application ("NDA") was approved in the fourth quarter of 2000 and the product was launched in the first quarter of 2001 under the brand name Carac(TM). This new product has a number of advantages over existing topical therapies, including less irritation with shorter duration of therapy and reduced dosage frequency.

Additionally, the Company is utilizing its patented Microsponge systems in the development of oral delivery systems for improved bioavailability. There are many drugs that have a very low rate of solubilization and whose efficacy could be substantially improved if their rate of solubilization and hence bioavailability could be increased. The Company is still in early research and development stages, but has successfully concluded significant in vitro and preliminary in vivo studies which indicate that a Microsponge system enhances the rate of dissolution of poorly water-soluble drugs.

Also in development are modified Microsponge systems that are able to deliver drugs to the colon. This could provide much better treatment of a number of diseases including ulcerative colitis and chronic constipation. A feasibility study in humans has demonstrated that the APS system is capable of bypassing degradation in the stomach and small intestine and releasing drugs throughout the length of the colon.

APS TECHNOLOGY
- --------------

The Company has made a significant investment in the development of bioerodible drug delivery systems. Specifically, the Company has developed three families of polymers, each with unique attributes. The first family is known collectively as poly(ortho esters) under the trademark Biochronomer(TM); polymers in the second family are known collectively as block copolymers of poly(ortho esters) and poly(ethylene glycol) under the trade name Erodomer(TM); and polymers in the third family are known collectively as polyacetals. The first two polymer families are covered by US 5,968,543, issued October 19, 1999 and US 5,939,453, issued August 17, 1999. Both are broad composition of matter patents. A number of other patents have been filed.

Work at the Company with bioerodible polymers used as drug delivery vehicles is in early stages of development. Toxicology studies are nearing completion, scaled up synthesis and GMP manufacturing procedures are completed, and pre-clinical studies are in progress.

Current product development work takes full advantage of the versatility of these materials, and is exemplified by forms that are injectable semi-solids into which drugs can be incorporated by a simple mixing procedure, as well as solid devices that can be fabricated at temperatures low enough to allow the incorporation of materials such as proteins that require mild fabrication conditions.

The Company is also developing water-soluble polymers with the intent to maximize the concentration of anti-cancer agents in solid tumors and to minimize their concentration in healthy tissue. Two such approaches are currently under development. In one approach, drugs are chemically attached to a water-soluble polyacetal. The resulting compound is injected intravenously where it accumulates in the tumor and releases the chemically attached drug. In the second approach, micelles formed from block copolymers of poly(ortho esters) and poly(ethylene glycol) are used to entrap hydrophobic drugs. The micelles are then injected intravenously and carry the entrapped drug to the solid tumor. The latter approach has the benefit of not chemically altering the drug.

The Company is also developing biodegradable devices based on poly(ortho esters). Because both mechanical properties and erosion rates can be controlled, these polymers are emerging as promising materials for the construction of orthopedic devices for soft and hard tissue fixation, as devices useful in cardiovascular applications such as stent coatings and in the development of scaffolding materials used in tissue engineering. In all of these applications, the ability to also deliver drugs is a distinct advantage.

The Company's Microsponge technology is a highly crosslinked copolymer system that is completely inert, thus allowing a wide range of fabrication methods. It is currently used as a topical delivery system for prescription drugs and has potential for oral delivery applications. Its success as a topical delivery system for drugs that can cause a high degree of irritation is based on the incorporation of Microsponge systems into an ointment in which the drug being delivered has only limited solubility. In these systems, the Microsponge system acts as a reservoir to replenish the drug dissolved in the ointment as it penetrates the skin.

In oral applications, the Microsponge system has been shown to increase the

rate of solubilization of poorly water-soluble drugs by entrapping such drugs in the Microsponge system's pores. Because these pores are very small, the drug is in effect reduced to microscopic particles and the significantly increased surface area thus greatly increases the rate of solubilization. An added benefit is that the time it takes the Microsponge system to traverse the small and large intestine is significantly increased thus maximizing the amount of drug that is absorbed.

In another oral application, the Microsponge system is incorporated into a matrix that is designed to disintegrate only in the colon by taking advantage of the unique environment found in the colon. Using human subjects the Company has demonstrated that this system performs as designed and preliminary evidence shows that drug is released from this delivery system as it traverses the entire length of the colon.

PRODUCTS
- --------

APS' efforts in pharmaceutical markets include additional applications using the Company's technology which are under development, as noted below.

Ethical Pharmaceuticals
- -----------------------

APS defines ethical pharmaceutical products as prescription products which are promoted primarily through the medical profession. The Company is developing several pharmaceutical products which will require marketing clearance from the FDA before they can be sold in the United States. The Company believes that the benefits offered by its delivery systems will create valuable product differentiation and improvements in this large and profitable market. Results from various clinical studies reaffirm that this technology offers the potential to reduce drug side effects, maintain or improve therapeutic efficacy and potentially increase patient compliance with a less frequent treatment regimen.

The following ethical dermatological products have been developed and commercialized:

Tretinoin Acne Medication. In February 1997, the Company received FDA approval for Microsponge-entrapped tretinoin for improved acne treatment. Tretinoin has been marketed in the U.S. by Ortho Dermatological, a Johnson & Johnson ("J&J") subsidiary, under the brand name RETIN-A(R) since 1971. It has proven to be a highly effective topical acne medication. However, skin irritation among sensitive individuals can limit patient compliance with the prescribed therapy. The Company believes its patent-protected approach to drug delivery reduces the potentially irritating side effects of tretinoin. Ortho Dermatological began marketing this product in March 1997 under the brand name Retin-A(R) Micro (TM). The company receives royalty income based on the sales of this product over the life of the applicable patents.

During 1999, Ortho also filed an NDA in Canada for this formulation and completed Phase III clinical trials in Europe in preparation for a European Union filing. Additionally, Ortho completed Phase III clinical trials in the U.S.A. on a second Retin-A Micro formulation and is preparing an NDA filing for the product.

5-Fluorouracil. In the fourth quarter of 2000, Dermik Laboratories, an Aventis company, received marketing clearance for an NDA for an APS-developed formulation containing Microsponge-entrapped 5-fluorouracil (5-FU) for the treatment of actinic keratoses. This product was launched under the trade name Carac(TM) in the first quarter of 2001. The Company receives royalty income based on the sales of this product over the life of the applicable patents. The Company also expanded its agreement with Dermik to include two additional indications in return for milestone payments and royalties upon successful development.

Other Product Applications
- --------------------------

While not the principal focus of APS development efforts, other products could benefit from the value-added application of the Company's polymer technology. To date, the Company has applied its technology to its analytical standards business.

Analytical Standards. APS initially developed microspheres (precursors to the Microsponge system) for use as a testing standard for gauging the purity of municipal drinking water. Marketed by APS nationwide, these microspheres are suspended in pure water to form an accurate, stable, reproducible turbidity standard for the calibration of turbidimeters used to test water purity.

The Company has also developed standards for industrial use for the

calibration of spectrophotometers and colorimeters.

MARKETING

A key part of APS' business strategy is to ally the Company with pharmaceutical partners. The Company has therefore negotiated agreements covering Microsponge delivery systems and the marketing of formulated products. The Company is now engaged in several feasibility studies relating to its bioerodible polymer systems.

In general, APS grants limited marketing exclusivity in defined markets for defined periods to its partners. However, after development is completed and a partner commercializes a formulated product utilizing the Company's delivery systems, APS can exert only limited influence over the manner and extent of the client's marketing efforts.

The Company's key relationships are set forth below:

Johnson & Johnson Inc. In May 1992, APS and Ortho-McNeil Pharmaceutical Corporation ("Ortho"), a subsidiary of J&J, entered into a development and license agreement related to tretinoin-based products incorporating APS' Microsponge technology. As part of the agreement, certain license fees and milestone payments were paid by Ortho to APS. The license fees provided Ortho with exclusive distribution or license rights for all Ortho tretinoin products utilizing the APS Microsponge system. Ortho's exclusivity will continue as long as annual minimum royalty payments are made, governed by the life of the applicable patents owned by the Company.

In February 1997, APS received FDA marketing clearance for the first product covered by this agreement, Microsponge-entrapped tretinoin. This product has been marketed by Ortho Dermatological since March 1997 as Retin-A(R) Micro (TM). APS received a payment of $3,000,000 from Ortho upon receipt of the FDA approval, of which half is a milestone payment which was recognized as revenue and half as prepaid royalties which was recorded as deferred revenues.

Dermik. In March 1992, APS and Dermik, a subsidiary of Aventis Pharmaceuticals, formerly known as Rhone-Poulenc Rorer, restructured their 1989 joint venture agreement. Under the new terms, Aventis received 705,041 shares of APS stock. Furthermore, Aventis agreed to continue funding the exploration and development of certain dermatological applications of APS' technology in exchange for exclusive marketing rights. Product applications include a 5-FU treatment for actinic keratoses, pre-cancerous skin lesions. In the fourth quarter of 1999, Dermik filed an NDA for this product and expanded its agreement with APS to cover two additional applications, in return for milestone payments and royalties upon successful development. In the fourth quarter of 2000 Dermik received FDA marketing clearance for the product which was launched under the trade name Carac(TM) in the first quarter of 2001. Dermik's exclusivity will continue as long as annual minimum royalty payments are made, governed by the life of the applicable patents owned by the Company.

GOVERNMENT REGULATION

Ethical Products

In order to clinically test, produce and sell products for human therapeutic use, mandatory procedures and safety evaluations established by the FDA and comparable agencies in foreign countries must be followed. The procedure for seeking and obtaining the required governmental clearances for a new therapeutic product includes pre-clinical animal testing to determine safety and efficacy, followed by human clinical testing. This can take many years and require substantial expenditures. In the case of third party agreements, APS expects that its corporate partner will partially fund the testing and the approval process with guidance from APS. The Company intends to seek the necessary regulatory approvals for its proprietary products as they are developed.

PATENTS AND TRADE SECRETS

As part of the Company's strategy to protect its current products and to provide a foundation for future products, APS has filed a number of United States patent applications on inventions relating to specific products, product groups, and processing technology. The Company also has filed foreign patent applications on its polymer technology with the European Union, Japan, Australia, South Africa, Canada, Korea and Taiwan. The Company has a total of 10 issued U.S. patents and an additional 92 issued foreign patents. Currently, the Company has over 21 pending patent applications

worldwide.

Although the Company believes the bases for these patents and patent applications are sound, they are untested, and there is no assurance that they will not be successfully challenged. There can be no assurance that any patent previously issued will be of commercial value, or that any patent applications will result in issued patents of commercial value, or that APS' technology will not be held to infringe patents held by others.

APS relies on unpatented trade secrets and know-how to protect certain aspects of its production technologies. APS' employees, consultants, advisors and corporate partners have entered into confidentiality agreements with the Company. These agreements, however, may not necessarily provide meaningful protection for the Company's trade secrets or proprietary know-how in the event of unauthorized use or disclosure. In addition, others may obtain access to, or independently develop, these trade secrets or know-how.

COMPETITION
- -----------

In the development of bioerodible poly(ortho esters) for implantation applications, there is competition from a number of other bioerodible systems, especially polymers based on lactic and glycolic acid and to a lesser extent, polyanhydrides. The Company believes that its proprietary bioerodible Biochronomer(TM) polymers have a number of important advantages. Among these are ease of synthesis, ability to control within wide limits both erosion times and mechanical properties and the simultaneous drug delivery and erosion process, resulting in complete polymer disappearance when all the drug has been delivered.

The attribute of the second family of bioerodible polymers, the block copolymers of poly(ortho esters) and poly(ethylene glycols) is that a hydrophobic (water-hating) bioerodible segment can be connected to a water-soluble segment. There are other such polymers, but the Company believes that its proprietary material is superior because the hydrophobic poly(ortho ester) segment can greatly increase the efficiency of drug entrapment making transport to tumors much more effective.

The third family of bioerodible polymers, the water-soluble polyacetals with chemically bound drugs for transport to tumors also competes with alternate polymer systems. However, the Company believes that its proprietary polymer system is superior because it is degradable and can be easily eliminated from the body.

Microsponge polymers, by virtue of their highly porous structure, are versatile delivery systems for topical and oral applications.

In topical applications, there is competition from many transdermal systems currently in the marketplace, or in development, as well as other microparticulate systems such as liposomes, microcapsules and microspheres. However, in topical applications, Microsponge systems are particularly versatile because the active agent can be entrapped within the pores of the Microsponge polymer and the release rate of the active agent can be controlled by changes in the composition of the vehicle that contains the Microsponge polymer. This is not the case with transdermal delivery systems or with liposomes, microcapsules and microspheres that require a complete change in composition to achieve desired delivery rates.

For oral applications, there are a number of systems that deliver active agents directly to the colon. However, many such systems are based on transit time through the gastrointestinal tract and it is well known that such transit times are variable so that delivery to the colon cannot be reproducibly achieved. There are also systems under development that rely, as do the Microsponge systems, on the unique environment of the colon to trigger release. However, such competing systems are based on materials that are not approved for human use, while the Microsponge colonic delivery system is based on approved materials with the exception of Microsponge polymers for which extensive toxicological data are available.

The use of Microsponge polymers to achieve enhanced dissolution rates of poorly water-soluble drugs competes with many approaches that reduce the solid drug to very small particles. However, preliminary indications of using the Microsponge polymer approach to enhance dissolution rates indicate that a much greater reduction in particle size is possible and that agglomeration, common with many competing systems, may not be a problem.

HUMAN RESOURCES
- ---------------

As of February 28, 2001, the Company had 27 full-time employees, 5 of whom hold PhDs. There were 12 employees engaged in research and development and quality control, 8 in production and sales activities and 7 working in

finance, marketing, human resources and administration.

The Company considers its relations with employees to be satisfactory. None of the Company's employees is covered by a collective bargaining agreement.

Item 2. PROPERTIES

The Company leases 26,067 square feet of laboratory, office and warehouse space in Redwood City, California. The annual rent expense for the Redwood City facility is approximately $587,000.

The Company occupied a production facility and warehouse in Lafayette, Louisiana which was sold to R.P. Scherer in July 2000. The construction of the facility in 1986 was financed primarily by 15-year, tax-exempt industrial development bonds. In 1995, the Company extinguished the bond liability through an "insubstance defeasance" transaction by placing U.S. government securities in an irrevocable trust to fund all future interest and principal payments.

The Company's existing research and development and administrative facilities are not yet being used at full capacity and management believes that such facilities are adequate and suitable for its current and anticipated needs.

Item 3. LEGAL PROCEEDINGS

In February 2000, Douglas Kligman and Albert Kligman filed a complaint against the Company in the U.S. District Court for the Eastern District of Pennsylvania. The complaint alleges that the plaintiffs entered into a partnership with the Company to pursue development and sales of a product developed by the plantiffs. The complaint states various claims, dissolution of partnership, implied-in-law contract and other claims. The complaint alleges damages in excess of $75,000, but otherwise makes no specific damage claim.

The Company has denied liability and is vigorously defending the claims, basing its defense on the assertion that its rights to the product are governed by a binding license agreement that was executed in November 1995 and amended in September 1996.

The Company expects that the outcome of this legal proceeding will not have a material adverse effect on the consolidated financial statements.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED SHAREHOLDER MATTERS

Shares of the Company's common stock trade on the Nasdaq National Market, under the symbol APOS. As of February 28, 2001, there were 487 holders of record of the Company's common stock.

The Company has never paid cash dividends and does not anticipate paying cash dividends in the foreseeable future. The following table sets forth for the fiscal periods indicated, the range of high and low sales prices for the Company's common stock on the NASDAQ National Market System.

2000	High	Low	1999	High	Low
First Quarter	6 1/2	3 11/32	First Quarter	5 5/8	4 1/8
Second Quarter	5 1/4	3 1/4	Second Quarter	7 1/4	4 1/8
Third Quarter	4 1/8	2 1/8	Third Quarter	7 1/8	3 7/8
Fourth Quarter	3 9/16	1 3/4	Fourth Quarter	4 3/4	2 3/4

Item 6. SELECTED FINANCIAL DATA
(in thousands, except per share data)

For the Years Ended and as of December 31,	2000	1999	1998	1997	1996
Statements of Operations Data					
Product revenues	$ 1,163	1,210	1,131	1,273	1,325
Royalties	2,081	2,025	1,724	1,150	--
Consumer products	--	--	--	--	10,468
License, R&D and option fees	122	1,462	219	1,500	--
Cost of sales	496	532	321	676	6,958
Research and development, net	3,713	2,471	2,371	2,354	1,875
Selling, marketing and advertising	594	496	385	595	6,450
General and administrative	2,869	2,946	2,165	2,797	2,589
Loss from continuing operations	(3,758)	(2,138)	(2,746)	(3,252)	(7,005)
Income (loss) from discontinued operations	1,163	4,510	5,271	1,444	(3,376)
Gain on disposition of discontinued operations	11,147	--	--	--	--
Net income (loss)	8,552	2,372	2,525	(1,808)	(10,381)
Basic (loss) income per common share:					
Loss from continuing operations	$ (0.19)	(0.11)	(0.14)	(0.17)	(0.39)
Net income (loss)	$ 0.42	0.12	0.13	(0.10)	(0.58)
Diluted (loss) income per common share:					
Loss from continuing operations	$ (0.19)	(0.11)	(0.14)	(0.17)	(0.39)
Net income (loss)	$ 0.42	0.12	0.12	(0.10)	(0.58)
Weighted average common shares outstanding - basic	20,179	20,079	19,854	18,779	17,987
Weighted average common shares outstanding - diluted	20,213	20,252	20,381	19,815	19,494
Balance Sheet Data					
Working capital	$20,087	13,192	2,456	3,372	2,371
Total assets	26,996	19,296	17,582	18,052	13,441
Long-term debt, excluding current portion	--	2,409	--	3,055	5,579
Shareholders' equity	21,159	12,036	9,036	4,113	7

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (DOLLAR AMOUNTS ARE ROUNDED TO NEAREST THOUSAND)

The following tables summarize highlights from the statements of operations expressed as a percentage change from the prior year and as a percentage of product revenues.

STATEMENTS OF OPERATIONS HIGHLIGHTS (in thousands)

	For the Years Ended December 31,			Annual % Change	
	2000	1999	1998	00/99	99/98
Product revenues	$ 1,163	1,210	1,131	(4%)	7%
Royalties	2,081	2,025	1,724	3%	17%
License, R&D and option fees	122	1,462	219	(92%)	568%
Total revenues	3,366	4,697	3,074	(28%)	53%
Cost of sales	496	532	321	(7%)	66%
Research and development, net	3,713	2,471	2,371	50%	4%
Selling and marketing	594	496	385	20%	29%
General and administrative	2,869	2,946	2,165	(3%)	36%

	2000	1999	1998
Expenses expressed as a percentage of total revenues:			
Cost of sales	15%	11%	10%
Research and development, net	110%	53%	77%
Selling and marketing	18%	11%	13%
General and administrative	85%	63%	70%

Results of Operations for the years ended December 31, 2000 and 1999
- ----------

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 the Company's Securities and Exchange Commission filings.

The Company's revenues are derived principally from product sales, license fees, royalties and R&D fees. Under strategic alliance arrangements entered into with certain corporations, APS can receive non-refundable upfront fees, future milestone payments and royalties based on third party product sales. Until July 25, 2000, the Company manufactured and sold Microsponge(R) and Polytrap(R) delivery systems for use by customers in a variety of personal care and cosmetic products. On July 25, 2000, the Company completed the sale of certain technology rights for topical pharmaceuticals and its cosmeceutical product lines and other assets to R.P. Scherer Corporation, a subsidiary of Cardinal Health, Inc.

Royalties for 2000 increased by 3% to $2,081,000 from $2,025,000 in the prior year. This increase related to increased sales of Retin-A(R) Micro(TM) by Ortho Dermatological, a Johnson and Johnson company. Product revenues for 2000 relating to sales of analytical standards decreased by 4% or $47,000 to $1,163,000 from $1,210,000 in the prior year. License, R&D and option fees of $122,000 decreased by $1,340,000 from $1,462,000 in the prior year due mainly to the absence of revenues from the sale of a proprietary product line in the prior year.

Gross profit on sales of analytical standards increased from 56% to 57% due mainly to lower production labor costs resulting from staff turnover.

Research and development expense for 2000 increased by $1,242,000 or 50% over the prior year to $3,713,000 due mainly to the initiation of preliminary toxicology studies on the Company's bioerodible Biochronomer(TM) delivery systems.

Selling and marketing expense for 2000 increased by $98,000 or 20% over the prior year to $594,000 due mainly to higher commission expense on sales of analytical standards and higher overhead allocation compared with the prior year.

General and administrative expense decreased by 3% or $77,000 from the prior year to $2,869,000 due mainly to reduced travel expenses and outside services.

Interest income for 2000 increased by $616,000 or 307% over the prior year to $817,000 due mainly to the receipt of $25 million in July 2000 as proceeds from the sale of the Company's cosmeceutical and toiletries product lines to R.P. Scherer Corporation. Interest expense for 2000 decreased by $291,000 or 50% to $294,000 due to the repayment of all outstanding debt on the receipt of the $25 million from R.P. Scherer.

Income from discontinued operations represents the net contribution attributable to the cosmeceutical and toiletries product lines which were sold to R.P. Scherer Corporation in July 2000. For the year 2000, the net contribution totaled $1,163,000, being the contribution earned in the seven months prior to the closing of the sale transaction in July 2000, compared with $4,510,000 in the full twelve months of the prior year. This decrease was also due to unabsorbed overhead at the manufacturing facility in Louisiana, resulting from a planned reduction in inventory levels and a shift in sales mix from toiletries to cosmeceutical products which require less Microsponge entrapment.

Results of Operations for the years ended December 31, 1999 and 1998
- ----------

Royalties for 1999 increased by 17% or $301,000 to $2,025,000 due mainly to increased sales of Retin-A Micro by Ortho Dermatological, a Johnson and Johnson company. Product revenues from sales of analytical standards increased by 7% or $78,000 to $1,210,000 due mainly to increased sales of calibration equipment compared to the prior year. License, R&D and option fees increased by $1,243,000 to $1,462,000 over the prior year due to revenues from the one-time sale of a proprietary product line in 1999.

Gross profit on sales of analytical standards for 1999 decreased from 72% in

1998 to 56% due mainly to sales mix, as revenues included higher sales of low margin equipment.

Research and development expense, net, for 1999 increased by 4% or $100,000 to $2,471,000 due mainly to increased headcount and overhead allocation resulting from the Company's relocation to new offices and laboratories in 1999.

Selling and marketing expense increased by 29% or $111,000 to $496,000 due to increased overhead allocation resulting from the Company's relocation to new offices in 1999.

General and administrative expense in 1999 increased by 36% or $781,000 to $2,946,000 due mainly to increased professional, directors and investor relations fees.

Interest expense in 1999 decreased by 27% or $220,000 to $585,000 due mainly to scheduled principal repayments during the year. Interest income for 1999 decreased by 18% or $45,000 to $201,000 due to lower average cash balances during the year.

Capital Resources and Liquidity
- ------------------------------

Total assets as of December 31, 2000 were $26,996,000 compared with $19,297,000 at December 31, 1999. Working capital increased to $20,087,000 from $13,192,000 for the same period and cash, cash equivalents and marketable securities increased to $22,523,000 from $3,705,000. For the year ended December 31, 2000, the Company's operating activities used $3,116,000 of cash compared to $842,000 in the prior year. The Company invested approximately $3,713,000 in product research and development.

Accounts receivable, net of allowances, decreased to $491,000 at December 31, 2000 from $3,580,000 at December 31, 1999 due primarily to the sale of the Company's cosmeceutical product lines in July 2000.

Capital expenditures for the year ended December 31, 1999 totaled $179,000 compared to $176,000 in the prior year.

Purchases of marketable securities of $18,854,000 were made using the proceeds from the sale of its cosmeceutical and toiletries product lines and certain technology rights to topical pharmaceuticals to R.P. Scherer, Inc. for $25 million in July 2000. These proceeds were also used to repay the Company's outstanding debt in full.

In the current year, the Company has also financed its operations, including technology and product research and development, from the sale of Microsponge and Polytrap delivery systems and analytical standard products, payments received under licensing agreements, and interest earned on short-term investments.

The Company's existing cash and cash equivalents, marketable securities, collections of trade accounts receivable, together with interest income and other revenue-producing activities including royalties, license and option fees and R&D fees, 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 Standards
- ------------------------

In June 1998, the Financial Accounting Standards Board (FASB) issued SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities" which is effective for all fiscal quarters of fiscal years beginning after June 15, 1999. In June 1999, the FASB issued SFAS No. 137, which defers the implementation of SFAS 133 to be effective for all fiscal quarters of fiscal years beginning after June 15, 2000. SFAS 133 establishes accounting and reporting standards for derivative instruments and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. SFAS 133 generally provides for matching the timing of gain or loss recognition on the hedging instrument with the recognition of (a) the changes in the fair value of the hedged asset or liability that are attributed to the hedged risk or (b) the earnings effect of hedged forecasted transactions. The Company anticipates that adoption of this statement will not have a material effect on the consolidated financial statements.

In March 2000, the FASB issued FASB Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation-an interpretation of APB Opinion No. 25 (FIN 44). This opinion provides guidance on the accounting for certain stock option transactions and subsequent amendments to stock

option transactions. FIN 44 was effective July 1, 2000, but certain conclusions cover specific events that occur after either December 15, 1998 or January 12, 2000. The adoption of FIN 44 did not have a material impact on the Company's financial position or results of operations.

In December 1999, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 101, Revenue Recognition (SAB 101), which provides guidance on the recognition, presentation and disclosure of revenue in financial statements filed with the SEC. Subsequently, the SEC released SAB 101B, which delayed the implementation date of SAB 101 for registrants with fiscal years beginning between December 16, 1999 and March 15, 2000 until the fourth quarter of 2000. The implementation of the provisions of SAB 101 did not have a material impact on the financial position or results of operations of the Company.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The Company's exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio. APS does not use derivative financial instruments in our investment portfolio. The Company manages its interest rate risk by maintaining an investment portfolio primarily consisting of debt instruments of high credit quality and relatively short average maturities. The Company also manages its interest rate risk by maintaining sufficient cash and cash equivalent balance such that it is typically able to hold its investments to maturity. At December 31, 2000, the Company's cash equivalents, and marketable securities include corporate and other debt securities of $22,285,662. Notwithstanding its efforts to manage interest rate risks, there can be no assurances that it will be adequately protected against the risks associated with interest rate fluctuations.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Advanced Polymer Systems, Inc.
Consolidated Balance Sheets

	December 31, 2000	December 31, 1999
Assets		
Current Assets:		
Cash and cash equivalents	$ 6,493,336	3,705,194
Marketable securities	16,029,320	--
Accounts receivable less allowance for doubtful accounts of $223,235 and $27,301 at December 31, 2000 and 1999, respectively	490,578	3,580,026
Receivables for royalties, license fees and R&D fees	1,200,554	1,492,634
Inventory	71,079	60,650
Advances to officers and employees	34,018	84,632
Prepaid expenses and other	730,964	319,206
Assets held for sale	--	7,721,958
Total current assets	25,049,849	16,964,300
Property and equipment, net	1,795,313	1,990,309
Other long-term assets	151,000	342,047
Total Assets	$ 26,996,162	19,296,656
Liabilities and Shareholders' Equity		
Current Liabilities:		
Accounts payable	$ 329,305	1,029,534
Accrued expenses	1,499,552	1,263,186
Accrued disposition costs	2,488,242	--
Income taxes payable	255,358	13,480
Current portion - long-term debt	--	891,111
Deferred revenue	390,201	575,000
Total current liabilities	4,962,658	3,772,311
Deferred revenue - long-term	874,250	1,079,644
Long-term debt	--	2,408,933
Total Liabilities	5,836,908	7,260,888
Commitments and Contingencies (Notes 4 and 9)		
Shareholders' Equity:		
Preferred stock, authorized 2,500,000 shares; none issued or outstanding at December 31, 2000 and 1999	--	--
Common stock, $.01 par value, authorized 50,000,000 shares; issued and outstanding 20,206,064 and 20,119,042 at December 31, 2000 and 1999, respectively	202,061	201,190
Deferred compensation	(79,890)	(299,578)
Additional paid-in capital	85,901,145	85,629,340
Accumulated deficit	(64,942,829)	(73,495,184)
Accumulated other comprehensive income	78,767	--
Total Shareholders' Equity	21,159,254	12,035,768
Total Liabilities and Shareholders' Equity	$ 26,996,162	19,296,656

See accompanying notes to consolidated financial statements.

Advanced Polymer Systems, Inc.
Consolidated Statements of Operations

	Years Ended December 31,		
	2000	1999	1998
Revenues			
Product revenues	$ 1,162,537	1,209,914	1,131,582
Royalties	2,081,025	2,024,817	1,724,055
License, R&D and option fees	122,297	1,461,842	218,600
Total revenues	3,365,859	4,696,573	3,074,237
Expenses			
Cost of sales	496,439	532,470	321,116
Research and development, net	3,713,089	2,471,144	2,370,871
Selling and marketing	594,226	496,054	384,704
General and administrative	2,868,935	2,945,594	2,164,870
Operating loss	(4,306,830)	(1,748,689)	(2,167,324)
Interest expense	(294,374)	(585,313)	(805,364)
Interest income	816,864	200,650	246,260
Other income (expense), net	26,224	(4,157)	(19,252)
Loss from continuing operations	(3,758,116)	(2,137,509)	(2,745,680)
Income from discontinued operations	1,162,984	4,509,896	5,270,721
Gain on disposition of discontinued operations, net of taxes	11,147,487	--	--
Net income	$ 8,552,355	2,372,387	2,525,041
Basic (loss) income per common share:			
Loss from continuing operations	$ (0.19)	(0.11)	(0.14)
Net income	$ 0.42	0.12	0.13
Diluted (loss) income per common share:			
Loss from continuing operations	$ (0.19)	(0.11)	(0.14)
Net income	$ 0.42	0.12	0.12
Weighted average common shares outstanding - basic	20,179,280	20,078,912	19,854,103
Weighted average common shares outstanding - diluted	20,213,095	20,252,381	20,380,832

See accompanying notes to consolidated financial statements.

Advanced Polymer Systems, Inc.
Consolidated Statements of Shareholders' Equity and Comprehensive Income

For the Years Ended December 31, 2000, 1999 and 1998

	Common Stock Shares	Common Stock Amount	Deferred Compensation	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Shareholders' Equity
Balance, December 31, 1997	19,464,821	$194,648	--	$82,310,746	$(78,392,612)	--	$ 4,112,782
Options exercised	79,598	796	--	413,072	--	--	413,868
Fair value of stock options issued to non-employees	--	--	--	42,200	--	--	42,200
Restricted stock awards	100,000	1,000	(599,151)	599,151	--	--	1,000
Amortization of restricted stock	--	--	99,857	--	--	--	99,857
Common stock issued to employees under the Employee Stock Purchase Plan	38,614	386	--	190,249	--	--	190,635
Warrants exercised	310,278	3,103	--	1,647,576	--	--	1,650,679
Net income	--	--	--	--	2,525,041	--	2,525,041
Balance, December 31, 1998	19,993,311	$199,933	$(499,294)	$85,202,994	$(75,867,571)	--	$ 9,036,062
Options exercised	3,719	37	--	19,489	--	--	19,526
Fair value of stock issued to non-employees	8,506	85	--	37,415	--	--	37,500
Amortization of restricted stock	--	--	199,716	--	--	--	199,716
Common stock issued to employees under the Employee Stock Purchase Plan	43,506	435	--	160,142	--	--	160,577
Warrants exercised	70,000	700	--	209,300	--	--	210,000
Warrants expired	--	--	--	--	--	--	--
Net income	--	--	--	--	2,372,387	--	2,372,387
Balance, December 31, 1999	20,119,042	$201,190	$(299,578)	$85,629,340	$(73,495,184)	--	$12,035,768
Comprehensive income:							
Net income	--	--	--	--	8,552,355	--	8,552,355
Net unrealized holding gain on marketable securities	--	--	--	--	--	78,767	78,767
Comprehensive income							8,631,122
Fair value of stock issued to non-employees	10,197	102	--	40,398	--	--	40,500
Amortization of restricted stock	--	--	219,688	--	--	--	219,688
Common stock issued to employees under the Employee Stock Purchase Plan	36,825	369	--	111,807	--	--	112,176
Warrants exercised	40,000	400	--	119,600	--	--	120,000
Balance, December 31, 2000	20,206,064	$202,061	$ (79,890)	$85,901,145	$(64,942,829)	$ 78,767	$21,159,254

See accompanying notes to consolidated financial statements.

Advanced Polymer Systems, Inc.
Consolidated Statements of Cash Flows
- ----------

	For the Years Ended December 31,		
	2000	1999	1998
Cash flows from operating activities:			
Net income	$ 8,552,355	2,372,387	2,525,041
Adjustments to reconcile net income to net cash used in operating activities:			
Gain on disposition of discontinued operations	(11,147,487)	--	--
Depreciation and amortization	374,962	379,978	378,480
Provision for doubtful accounts	206,968	7,891	38,830
Amortization of deferred revenue	(390,193)	(131,211)	(306,014)
Stock compensation awards to non-employees	40,500	37,500	42,200
Restricted stock awards	179,745	199,716	100,857
Amortization of premium/discount and accretion of marketable securities	(101,531)	--	--
Changes in operating assets and liabilities:			
Accounts receivable	2,882,480	(1,055,390)	(283,060)
Receivables for royalties, license fees and R&D fees	292,080	804,218	(1,196,484)
Inventory	(10,429)	(1,627)	35
Advances to officers and employees	50,614	254,315	(242,241)
Prepaid expenses and other	(411,758)	96,933	(162,596)
Other long-term assets	191,047	(166,680)	71,288
Accounts payable	(700,229)	205,899	(288,452)
Accrued expenses	236,366	(318,203)	(1,775,012)
Accrued disposition costs	(2,946,589)	--	--
Income taxes payable	(208,622)	13,480	--
Accrued settlement liability	--	(1,300,000)	(500,000)
Net cash (used in) provided by continuing activities	(2,909,721)	1,399,206	(1,597,128)
Cash used in discontinued operations	(206,281)	(2,241,348)	(1,142,699)
Net cash used in operating activities	(3,116,002)	(842,142)	(2,739,827)
Cash flows from investing activities:			
Proceeds from disposition of discontinued operations	25,000,000	--	--
Purchases of property and equipment	(178,966)	(175,524)	(1,575,814)
Purchases of marketable securities	(18,854,008)	--	--
Maturities of marketable securities	3,004,986	--	--
Net cash provided by (used in) investing activities	8,972,012	(175,524)	(1,575,814)
Cash flows from financing activities:			
Repayment of long-term debt	(3,300,044)	(3,755,416)	(2,523,389)
Proceeds from long-term debt and warrants issued	--	4,000,000	--
Proceeds from the exercise of common stock options and warrants	120,000	229,526	2,064,547
Proceeds from issuance of shares under the Employee Stock Purchase Plan	112,176	160,577	190,635
Net cash provided by (used in) financing activities	(3,067,868)	634,687	(268,207)
Net increase (decrease) in cash and cash equivalents	2,788,142	(382,979)	(4,583,848)
Cash and cash equivalents at the beginning of the year	3,705,194	4,088,173	8,672,021
Cash and cash equivalents at the end of the year	$ 6,493,336	3,705,194	4,088,173
Cash paid in interest	$ 244,243	478,375	559,664
Cash paid in taxes	$ 244,044	51,500	39,621

	==========	=========	=========

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2000, 1999 AND 1998

Note 1 Business

Advanced Polymer Systems, Inc. ("APS" or the "Company") develops, manufactures and sells patented delivery systems to enhance the safety and effectivenes of prescription products. Projects are currently conducted under development and licensing arrangements with pharmaceutical companies. New products and technologies under development include bioerodible polymers for injectable and implantable drug delivery, and certain oral applications.

On July 25, 2000, the Company completed the sale of certain technology rights for topical pharmaceuticals and its cosmeceutical product lines and other assets ("cosmeceutical and toiletry business") to R.P. Scherer Corporation, a subsidiary of Cardinal Health, Inc. The Company received $25 million up-front and could receive up to an additional $26.5 million over the next three years relating to the performance milestones of the cosmeceutical and toiletry business (Note 12).

Note 2 Summary of Significant Accounting Policies

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

Cash Equivalents and Marketable Securities

For purposes of the Consolidated Statements of Cash Flows and Consolidated Balance Sheets, the Company considers all short-term investments that have original maturities of less than three months to be cash equivalents. Investments with original maturities longer than three months are classified as marketable securitites. Short-term investments consist primarily of commercial paper, bankers acceptances, master notes, repurchase agreements and corporate debt securities. The Company has classified all its investments in certain debt and equity securities as "available-for-sale".

Financial Instruments

The carrying value of financial instruments, including marketable securities and accounts receivable, approximate fair value. Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash equivalents, short-term investments and trade accounts receivable. The Company invests 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 maintain liquidity.

The Company's investments are recorded at fair value with unrealized holding gains and losses reported as a separate component of shareholders' equity.

Inventory

Inventory is stated at the lower of cost or market value, utilizing the average cost method.

Assets Held for Sale

On July 25, 2000, the Company completed the sale of certain technology rights for topical pharmaceuticals and its cosmeceutical product lines and other assets ("cosmeceutical and toiletry business") to R.P. Scherer Corporation, a subsidiary of Cardinal Health, Inc. The Company received $25 million up-front and could receive up to an additional $26.5 million over the next three years relating to the performance milestones of the cosmeceutical and toiletry business (Note 12).

All assets and liabilities relating to the cosmeceutical and toiletry business are reported in the accompanying condensed Consolidated Balance Sheet as of December 31, 1999 as "Net assets held for sale" and consist of the following:

	December 31, 1999
Inventory	$ 4,524,347
Prepaid expenses	59,763
Property, plant & equipment, net	6,040,767
Other intangible assets	1,259,020
Other long-term assets	44,203
Deferred revenue - short-term	(620,396)
Deferred revenue - long-term	(3,585,746)
	$ 7,721,958

Property and Equipment

Property and equipment are carried at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets as follows: equipment and machinery, 5 to 10 years; furniture and fixtures, 5 years; and leasehold improvements, over the shorter of the respective lease terms or the respective useful lives of the leasehold improvements.

Long-Lived Assets, Including Goodwill and Other Intangibles

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" as circumstances dictate, the Company evaluates whether changes have occurred that would require revision of the remaining estimated lives of recorded long-lived assets, including goodwill, or render those assets not recoverable. Recoverability of assets to be held and used is determined by comparing the undiscounted net cash flows of long-lived assets to their respective carrying values. If such assets are considered to be impaired, the amount of impairment to be recognized is measured based on the projected discounted cash flows using an appropriate discount rate.

Stock-Based Compensation

The Company follows the provisions of SFAS No. 123 "Accounting for Stock Based Compensation" and has elected to account for stock-based compensation related to employees using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations. Accordingly, except for stock options issued to non-employees and restricted stock awards to employees, no compensation cost has been recognized for the Company's fixed stock option plans and stock purchase plan.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and related notes to financial statements. Changes in such estimates may affect amounts in future periods.

Revenue Recognition

Product revenues are recorded upon shipment of products.

The Company has licensing agreements that generally provide for the Company to receive periodic minimum payments, royalties, and/or non-refundable license fees. These licensing agreements typically require a non-refundable license fee and allow partners to sell the Company's proprietary products in a defined field or territory for a defined period. The license agreements provide for APS to earn future revenue through royalty payments. The license fees are non-refundable even if the agreements are terminated before their term. These amounts are reported as deferred revenues and amortized over the estimated life of the product to which they relate. Amortization of license fees are classified as License, R&D and Option Fees in the accompanying consolidated statements of operations.

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 the Company's licensees based on information received by the Company from its

licensees.

A milestone payment is a payment made by a third party or corporate partner to the Company upon the achievement of a predetermined milestone as defined in a legally binding contract. Milestone payments are recognized as revenue when the milestone event has occurred and the Company has completed all milestone related services such that the milestone payment is currently due and is non-refundable. In 1999, the Company earned milestone payments from Dermik upon the acceptance for filing by the FDA of the New Drug Application ("NDA") for 5-Fluorouracil.

Deferred Revenue
- ----------------

Non-refundable license fees received by the Company are reported as deferred revenues and amortized over the estimated life of the product to which they relate.

Prepaid royalties paid to APS by Ortho-McNeil Pharmaceutical Corporation ("Ortho"), a subsidiary of Johnson & Johnson Inc. ("J&J"), as part of the retinoid licensing agreement are also reported as deferred revenue. In accordance with the licensing agreement, 25% of the royalties earned by APS are applied against the deferred revenues after certain annual minimum royalty payments are met.

Earnings (Loss) Per Share
- -------------------------

SFAS No. 128 requires the Company to report both basic earnings per share, which is computed by dividing net income by the weighted-average number of common shares outstanding, and diluted earnings per share, which is computed by dividing net income by the total of weighted-average number of common shares outstanding and dilutive potential common shares outstanding.

Concentrations of Credit Risk
- -----------------------------

Financial instruments which potentially expose the Company to concentrations of credit risk, as defined by SFAS No. 105, consist primarily of trade accounts receivable and receivables from royalties, license fees and R&D fees. Approximately 79% and 57% of the recorded trade receivables and receivables from royalties, license fees and R&D fees were concentrated with five and four customers in the pharmaceutical, cosmetic and personal care industries as of December 31, 2000 and 1999, respectively. Approximately 62%, 67% and 63% of the recorded net sales were concentrated with one, three and one customers for the years ended December 31, 2000, 1999 and 1998, respectively. To reduce credit risk, the Company performs ongoing credit evaluations of its customers' financial conditions. The Company does not generally require collateral.

Segment and Geographic Information
- ----------------------------------

SFAS No. 131 "Disclosures about Segments of an Enterprise and Related Information," requires an enterprise to report segment information based on how management internally evaluates the operating performance of its business units (segments). The Company's operations are confined to a single business segment, the design and commercialization of polymer technologies for pharmacetuical and other applications.

Royalty revenues from one domestic customer amounted to approximately 62% of total revenues for the year ended December 31, 2000. Revenues from three domestic customers amounted to 43%, 13% and 11% for the year ended December 31, 1999. Revenues from one domestic customer amounted to approximately 63% for the year ended December 31, 1998.

Reclassifications
- -----------------

Certain reclassifications have been made to the prior year financial statements to conform with the presentation in 2000.

Note 3 Related Party Transactions

The Company has entered into agreements with Large Scale Biology Corp.("LSB Corp.") formerly known as Biosource Technologies, Inc. of which Toby Rosenblatt, a member of the Company's Board of Directors, is a stockholder and a former director. Agreements between APS and LSB were made prior to 1998 and have been settled and closed in 1999. All agreements between APS and LSB Corp. were considered and approved by a vote of the disinterested directors (Note 4).

Note 4 Legal Proceedings

In November, 1997 LSB Corp. filed a complaint against the Company in the San Mateo Superior Court. LSB Corp. claimed damages from the Company on the grounds that the Company had failed to pay certain minimum amounts allegedly due under a contract for the supply of melanin.

In December 1998, the Company reached a settlement agreement with LSB Corp. for a net amount of $1,300,000, which consisted of a $1,500,000 settlement of LSB Corp. claims and a $200,000 settlement of the Company's cross claims. The Company's consolidated financial statemements for the period ended December 31, 1998 included a favorable decrease in accrued settlement liability of $500,000 resulting from the settlement agreement. The settlement liability was paid to LSB Corp. in cash in 1999.

In February 2000, Douglas Kligman and Albert Kligman filed a complaint against the Company in the U.S. District Court for the Eastern District of Pennsylvania. The complaint alleges that the plaintiffs entered into a partnership with the Company to pursue development and sales of a product developed by the plantiffs. The complaint states various claims, dissolution of partnership, implied-in-law contract and other claims. The complaint alleges damages in excess of $75,000, but otherwise makes no specific damage claim.

The Company has denied liability and is vigorously defending the claims, basing its defense on the assertion that its rights to the product are governed by a binding license agreement that was executed in November 1995 and amended in September 1996.

The Company expects that the outcome of this legal proceeding will not have a material adverse effect on the consolidated financial statements.

Note 5 Cash Equivalents and Marketable Securities

At December 31, 2000 and 1999, the amortized cost and estimated market value of investments in debt securities are set forth in the tables below:

	December 31, 2000			
	Cost	Unrealized Gains	Unrealized Losses	Estimated Marked Value
Available-for-Sale:				
Corporate debt securities	$ 7,997,117	52,813	--	8,049,930
Other debt securities	14,209,778	26,424	(470)	14,235,732
Totals	$22,206,895	79,237	(470)	22,285,662

	December 31, 1999	
	Cost	Estimated Market Value
Available-for-Sale:		
Corporate debt securities	$2,518,000	2,518,000
Other debt securities	102,660	102,660
Totals	$2,620,660	2,620,660

The table below summarizes fair value disclosures at December 31:

	2000		1999	
	Cost	Fair Value	Cost	Fair Value
Cash Equivalents	$ 6,343,300	6,256,342	2,620,660	2,620,660
Marketable Securities	15,863,595	16,029,320	--	--
Totals	$22,206,895	22,285,662	2,620,660	2,620,660

The cost and estimated fair value of available-for-sale debt securities as of December 31, 2000, by contractual maturity, consisted of the following:

	Cost	Estimated Market Value
Available-for-Sale:		
Due in one year or less	$14,208,875	14,213,292
Due after one year through two years	7,998,020	8,072,370
Totals	$22,206,895	22,285,662

Note 6 Inventory

The major components of inventory are as follows:

	December 31,	
	2000	1999
Raw materials	$43,387	27,267
Finished goods	27,692	33,383
Total inventory	$71,079	60,650

Note 7 Property and Equipment

Property and equipment consist of the following:

	December 31,	
	2000	1999
Leasehold improvements	$ 1,358,320	1,380,779
Furniture and equipment	3,206,744	3,238,521
Total property and equipment	4,565,064	4,619,300
Accumulated depreciation and amortization	(2,769,751)	(2,628,991)
Property and equipment, net	$ 1,795,313	1,990,309

Depreciation expense amounted to $374,962, $379,978 and $378,480 for the years ended December 31, 2000, 1999, and 1998, respectively.

Note 8 Long-Term Debt

Long-term debt consists of the following:

	December 31,	
	2000	1999
Term loan, principal and interest due in equal monthly installments commencing March 1999 through February 2003, secured by certain real and personal property and a portion of the Company's accounts receivable	$ --	3,300,044
Total	--	3,300,044
Less current portion	--	891,111
Long-term debt	$ --	2,408,933

In March 1999, the Company obtained a $4,000,000 term loan with a fixed interest rate of 13.87%. The loan was secured by the assets of the Company's manufacturing facility in Louisiana and a portion of the Company's accounts

receivable. Principal and interest payments were due in equal monthly installments over a period of forty-eight months commencing March 1999. The term loan was obtained mainly to refinance scheduled debt payments made in the first quarter of 1999.

In July 2000, the Company extinguished the debt as repayment of the debt was necessary in order to release liens on the assets sold as part of the cosmeceutical and toiletry business (Note 12).

All costs incurred in obtaining the financing arrangement were capitalized as deferred loan costs, and were amortized over the life of the loans using the interest method. Interest paid in 2000, 1999 and 1998 totalled $244,243, $478,375 and $559,664, respectively.

Note 9 Commitments

Lease Commitments: Total rental expense for property and equipment was $586,991, $803,140 and $853,653 for 2000, 1999 and 1998, respectively.

The Company's future minimum lease payments under noncancellable operating leases for facilities as of December 31, 2000, are as follows:

Years Ending December 31,	Minimum Payments
2001	$ 659,423
2002	659,495
2003	675,135
2004	573,474
2005 and thereafter	--
	$2,567,527

Note 10 Shareholders' Equity

Shareholders Rights Plan: On August 19, 1996, the Board of Directors approved a Shareholders Rights Plan under which shareholders of record on September 3, 1996 received a dividend of one Preferred Stock purchase right ("Rights") for each share of common stock outstanding. The Rights were not exercisable until 10 business days after a person or group acquired 20% or more of the outstanding shares of common stock or announced a tender offer which could have resulted in a person or group beneficially owning 20% or more of the outstanding shares of common stock (an "Acquisition") of the Company. The Board of Directors approved an increase in threshold to 30% in December 1997. Each Right, should it become exercisable, will entitle the holder (other than acquirer) to purchase company stock at a discount. The Board of Directors may terminate the Rights plan or, under certain circumstances, redeem the rights.

In the event of an Acquisition without the approval of the Board, each Right will entitle the registered holder, other than an acquirer and certain related parties, to buy at the Right's then current exercise price a number of shares of common stock with a market value equal to twice the exercise price.

In addition, if at the time when there was a 30% shareholder, the Company were to be acquired by merger, shareholders with unexercised Rights could purchase common stock of the acquirer with a value of twice the exercise price of the Rights.

The Board may redeem the Rights for $0.01 per Right at any time prior to Acquisition. Unless earlier redeemed, the Rights will expire on August 19, 2006.

Stock-Based Compensation Plans: The Company has two types of stock-based compensation plans, a stock purchase plan and stock option plans.

In 1997, the stockholders approved the Company's 1997 Employee Stock Purchase Plan (the "Plan"). Under the 1997 Employee Stock Purchase Plan, the Company is authorized to issue up to 400,000 shares of common stock to its employees, nearly all of whom are eligible to participate. Under the terms of the Plan, employees can elect to have up to a maximum of 10 percent of their base earnings withheld to purchase the Company's common stock. The purchase price of the stock is 85 percent of the lower of the closing prices for the Company's common stock on: (i) the first trading day in the enrollment period, as defined in the Plan, in which the purchase is made, or (ii) the purchase date. The length of the enrollment period may not exceed a maximum of 24 months. Enrollment dates are the first business day of May and November provided that the first enrollment date was April 30, 1997. Approximately 54 percent of eligible employees participated in the Plan in 2000. Under the Plan, the Company issued 36,825 shares in 2000, 43,506

shares in 1999 and 38,614 shares in 1998. The weighted average fair value of purchase rights granted during 2000, 1999 and 1998 were $1.90, $3.05 and $1.65, respectively. The weighted average exercise price of the purchase rights exercised during 2000, 1999 and 1998 were $3.05, $3.69 and $3.83, respectively. As of December 31, 2000, the Company had 266,510 shares reserved for issuance under the stock purchase plan.

The Company has various stock option plans for employees, officers, directors and consultants. The options are granted at fair market value and expire no later than ten years from the date of grant. The options are exercisable in accordance with vesting schedules that generally provide for them to be fully exercisable four years after the date of grant. Any shares that are issuable upon exercise of options granted under the 1992 Stock Option Plan that expire or become unexercisable for any reason without having been exercised in full are available for future grant and issuance under the same stock option plan.

The following table summarizes option activity for 2000, 1999 and 1998:

	2000		1999		1998	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	3,660,048	$6.30	3,567,183	$6.32	2,947,755	$6.63
Granted	507,000	3.12	125,047	5.69	777,000	5.18
Exercised	--	--	(3,719)	5.25	(79,598)	5.20
Expired or Cancelled	(256,871)	6.56	(28,463)	6.81	(77,974)	7.83
Outstanding at end of year	3,910,177	5.87	3,660,048	6.30	3,567,183	6.32
Options exercisable at year end	3,224,583	6.33	3,013,164	6.46	2,698,960	6.44
Shares available for future grant at year end	176,056		196,185		293,269	
Weighted-average fair value of options granted during the year		$1.70		$3.00		$2.45

The following table summarizes information about fixed stock options outstanding at December 31, 2000:

	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
Range of Exercise Prices	Number Outstanding 12/31/00	Weighted Average Remaining Contractual Life	Weighted Average Remaining Exercise Price	Number Exercisable at 12/31/00	Weighted Average Remaining Exercise Price
$2.50-$4.19	1,061,508	6.8 years	$ 3.62	470,673	$ 4.02
$4.41-$5.44	1,120,602	4.2	5.18	1,120,602	5.18
$5.56-$7.38	1,016,812	5.8	6.52	923,583	6.55
$7.75-$11.13	711,255	3.1	9.38	709,725	9.38
$2.50-$11.13	3,910,177	5.1	$ 5.87	3,224,583	$ 6.33

The Company has adopted the disclosure only provisions of SFAS No. 123 "Accounting for Stock-Based Compensation." Accordingly, except for stock options issued to non-employees and restricted stock awards to employees, no compensation cost has been recognized for the various fixed stock option plans and stock purchase plan. The compensation cost that has been charged against income for the stock options issued to non-employees and restricted stock awards to employees was $179,745, $199,716 and $142,057 for 2000, 1999

and 1998, respectively. Had compensation cost for the Company's stock-based compensation plans been determined consistent with the fair value method provisions of SFAS No. 123, the Company's net income (loss) and income (loss) per common share would have changed to the pro-forma amounts indicated below:

	2000	1999	1998
Loss from continuing operations - as reported	$(3,758,116)	(2,137,509)	(2,745,680)
Loss from continuing operations - pro-forma	(5,050,654)	(3,436,184)	(4,475,635)
Basic (loss) income per common share - as reported			
Loss from continuing operations	(0.19)	(0.11)	(0.14)
Net income	0.42	0.12	0.13
Basic (loss) income per common share - pro-forma			
Loss from continuing operations	(0.25)	(0.17)	(0.23)
Net income	0.36	0.05	0.04
Diluted (loss) income per common share - as reported			
Loss from continuing operations	(0.19)	(0.11)	(0.14)
Net income	0.42	0.12	0.12
Diluted (loss) income per common share - pro-forma			
Loss from continuing operations	(0.25)	(0.17)	(0.23)
Net income	0.36	0.05	0.04

For stock options, the fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants in 2000, 1999 and 1998, respectively: dividend yield of zero for all years; annualized volatility of 58 percent, 52 percent and 48 percent; risk-free interest rates of 4.8 percent, 6.6 percent and 4.7 percent; and expected life of five years for all the stock option plans.

For the stock purchase plan, the fair value of each award is also estimated using the Black-Scholes option pricing model. For purchase rights granted in 2000, the multiple option approach with the following assumptions were used for expected terms of six, twelve, eighteen and twenty-four months: risk free interest rate of 6.4 percent; volatility of 58 percent; and dividend yield of zero. The purchase rights granted in 1999 were valued using the following assumptions for expected terms of six, twelve, eighteen and twenty-four months: risk-free interest rate of 4.6 percent; volatility of 55 percent; and dividend yield of zero. The purchase rights granted in 1998 were valued using the following assumptions for expected terms of six, twelve, eighteen and twenty-four months, respectively: risk-free interest rate of 5.1 percent; volatility of 54 percent; and dividend yield of zero.

Note 11 Earnings Per Share

The following table sets forth the computation of the Company's basic and diluted loss per share:

	2000	1999	1998
Loss from continuing operations	$(3,758,116)	(2,137,509)	(2,745,680)
Net income	8,552,355	2,372,387	2,525,041
Shares calculation (denominator):			
Weighted average shares outstanding - basic	20,179,280	20,078,912	19,854,103
Effect of dilutive securities:			
Stock options, employee stock purchase plan and stock to be issued to directors	32,712	125,762	381,518
Warrants	1,103	47,707	145,211

Weighted average shares outstanding - diluted	20,213,095	20,252,381	20,380,832
Basic (loss) income per common share:			
Loss from continuing operations	$ (0.19)	(0.11)	(0.14)
Net income	$ 0.42	0.12	0.13
Diluted (loss) income per common share:			
Loss from continuing operations	$ (0.19)	(0.11)	(0.14)
Net income	$ 0.42	0.12	0.12

The following options with expiration dates ranging from February 19, 2001 to June 16, 2009 were outstanding during the periods presented, but were not included in the computation of diluted earnings per share since the exercise prices of the options were greater than the average market price of the common shares:

	2000	1999	1998
Number outstanding	3,571,590	2,816,970	1,362,432
Range of exercise prices	$3.88 - $15.00	$5.00 - $15.00	$6.81 - $15.00

Note 12 Discontinued Operations

On July 25, 2000, the Company completed the sale of certain technology rights for topical pharmaceuticals and its cosmeceutical product lines and other assets ("cosmeceutical and toiletry business") to R.P. Scherer Corporation, a subsidiary of Cardinal Health, Inc. The Company received $25 million up-front and could receive up to an additional $26.5 million over the next three years relating to the performance milestones of the cosmeceutical and toiletry business. In accordance with Accounting Principles Board Opinion No. 30 "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," the cosmeceutical and toiletry business is reported as a discontinued operation for all periods presented in the accompanying Condensed Consolidated Statements of Operations (Note 2).

"Gain on disposal of discontinued operations" in the accompanying Consolidated Statement of Operations for the year ended December 31, 2000 is reported net of a provision for income taxes of $450,000.

The following table sets forth the Company's basic and diluted income per common share from discontinued operations excluding the gain on sale for the years ended December 31, 2000, 1999 and 1998:

	For the years ended December 31,		
	2000	1999	1998
Basic income per common share from discontinued operations	$0.06	$0.22	$0.27
Diluted income per common share from discontinued operations	$0.06	$0.22	$0.26

Note 13 Defined Contribution Plan

The Company sponsors a defined contribution plan covering substantially all of its employees. In the past three calendar years, the Company made matching contributions equal to 50% of each participant's contribution during the plan year up to a maximum amount equal to the lesser of 3% of each participant's annual compensation or $5,100, $4,800 and $4,800 for the 2000, 1999 and 1998 calendar years, respectively. The Company may also contribute additional discretionary amounts as it may determine. For the years ended

December 31, 2000, 1999 and 1998, the Company contributed to the plan approximately $106,000, $122,000 and $124,000, respectively. No discretionary contributions have been made to the plan since its inception.

Note 14 Income Taxes

Income tax expense for the year ended December 31, 2000 consisted of:

	Current	Deferred	Total
Federal	$304,500	--	$304,500
State	145,500	--	145,500
	450,000	--	450,000

A reconciliation of the federal statutory rate of 35% (34% in 1999 and 1998) to the Company's effective tax rate is as follows:

	December 31,		
	2000	1999	1998
U.S. statutory rate (benefit)	35.00%	34.00%	34.00%
State taxes, net of federal income tax benefit	--	--	--
Net losses without benefits	--	--	--
Alternative minimum tax	--	--	--
Utilization of temporary differences for which no benefit was previously recognized	(34.58)	(32.22)	(33.47)
Nondeductible expenses	(0.42)	(1.78)	(0.53)
Total tax expense (benefit)	--%	--%	--%

At December 31, 2000, the Company had net federal operating loss carryforwards of approximately $61,444,000 for income tax reporting purposes and California operating loss carryforwards of approximately $1,480,000. The federal net operating losses expire beginning in 2004 through the year 2019. The California net operating loss carryforwards expire beginning in 2001 through the year 2002. A California net operating loss carryforward from 1995 in the approximate amount of $911,000 expired on December 31, 2000. The Company also has federal alternative minimum tax credit carryforwards of approximately $237,000, which can be carried forward indefinitely.

The Company also has research and experimental tax credits aggregating approximately $1,673,000 and $1,193,000 for federal and California purposes, respectively. The federal credit carryforwards expire beginning in 2001 through the year 2011. The California credits carry over indefinitely until utilized.

There are also California credit carryforwards for qualified manufacturing and research and development equipment of approximately $33,000; these credits expire beginning in 2004 through the year 2008.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities as of December 31, 2000 and 1999 are presented below:

	2000	1999
Deferred tax assets:		
Deferred research expenditures	$ 214,800	441,000
Accruals and reserves not currently deductible for tax purposes	461,500	253,000
Net operating loss carryforwards	22,240,200	24,728,000
Credit carryforwards	3,144,700	2,745,000
Other	2,900	320,000
Gross deferred tax assets	26,064,100	28,487,000
Less valuation allowance	(26,010,500)	(26,615,000)
Total deferred tax assets	53,600	1,872,000
Deferred tax liabilities:		
Property and equipment	(53,600)	(1,872,000)
Total deferred tax liabilities	(53,600)	(1,872,000)

Net deferred tax assets (liabilities)	$ --	--

The net change in the valuation allowance for the year ended December 31, 2000 was a decrease of approximately $604,500. The net change in the valuation allowance for the years ended December 31, 1999 and 1998 was a decrease of approximately $3,312,000 and $1,595,000, respectively. Management believes that sufficient uncertainty exists regarding the realizability of these items and, accordingly, a valuation allowance is required.

Gross deferred tax assets as of December 31, 2000 include approximately $2,848,000 relating to the exercise of stock options, for which any related tax benefits will be credited to equity when realized.

Note 15 Ortho-McNeil Pharmaceutical Corporation

In May 1992, APS entered into development, and licensing and investment agreements with Ortho-McNeil Pharmaceutical Corporation ("Ortho") for the development of retinoid products. The first product is a Microsponge system entrapment of tretinoin (trans-retinoic acid or "t-RA"), a prescription acne drug for which FDA approval was received in February 1997. A second product licensed to Ortho is a Microsponge entrapment of a retinoid to be used for the treatment of photodamaged skin.

In February 1995, APS received $750,000 in prepaid royalties and an additional $750,000 as a milestone payment on the submission to the FDA of its New Drug Application for the tretinoin prescription acne treatment. The milestone payment was recognized as revenue upon receipt. The prepaid royalties of $750,000 were recorded as deferred revenues. In February 1997, upon receipt of approval from the FDA to market Retin-A(R) Micro (tretinoin gel) microsphere for the treatment of acne, APS received $3,000,000 from Ortho of which one half was a milestone payment which was recognized as revenue in 1997 and half was prepaid royalties which were recorded as deferred revenues. As of December 31, 2000, $1,014,000 was the balance remaining in deferred revenues. Ortho pays APS a royalty on product sales subject to certain minimums. Should these minimums not be achieved, Ortho would lose its exclusivity and APS would regain marketing rights to the retinoid products.

Note 16 Historical Quarterly Results of Operations (Unaudited)

The following table presents summarized historical quarterly results of operations for each of the fiscal quarters in the Company's fiscal years ended December 31, 2000 and 1999. These quarterly results are unaudited, but, in the opinion of management, have been prepared on the same basis as the Company's audited financial information and include all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the information set forth therein.

HISTORICAL QUARTERLY RESULTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

Year Ended December 31, 2000	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Total revenue	$ 730	869	887	880
Cost of sales	56	132	117	192
Operating expenses	1,322	1,751	1,662	2,441
Interest income	65	54	302	396
Loss from continuing operations	(738)	(1,026)	(658)	(1,336)
Net income (loss)	220	(634)	10,558	(1,592)
Basic (loss) income per common share:				
Loss from continuing operations	(0.04)	(0.05)	(0.03)	(0.07)
Net income (loss)	0.01	(0.03)	0.52	(0.08)
Diluted (loss) income per common share:				
Loss from continuing operations	(0.04)	(0.05)	(0.03)	(0.07)
Net income (loss)	0.01	(0.03)	0.52	(0.08)

Year Ended December 31, 1999	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Total revenue	$1,451	1,334	961	951
Cost of sales	131	131	147	124
Operating expenses	1,436	1,442	1,494	1,540
Interest income	34	47	52	67
Loss from continuing operations	(227)	(354)	(779)	(777)
Net income (loss)	524	519	610	720
Basic (loss) income per common share:				
Loss from continuing operations	(0.01)	(0.01)	(0.04)	(0.04)
Net income	0.03	0.03	0.03	0.04
Diluted (loss) income per common share:				
Loss from continuing operations	(0.01)	(0.01)	(0.04)	(0.04)
Net income (loss)	0.03	0.03	0.03	0.04

Independent Auditors' Report

The Board of Directors and Shareholders
Advanced Polymer Systems, Inc.:

We have audited the accompanying consolidated balance sheets of Advanced Polymer Systems, Inc. and subsidiaries as of December 31, 2000 and 1999, and the related consolidated statements of operations, shareholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2000. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and the financial statement schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Advanced Polymer Systems, Inc. and subsidiaries as of December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America.

/s/KPMG LLP

Mountain View, California
February 16, 2001

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

Part III

Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

APS incorporates by reference the information set forth under the captions "Nomination and Election of Directors" and "Executive Compensation" of the Company's Proxy Statement (the "Proxy Statement") for the annual meeting of shareholders to be held on May 9, 2001.

Item 11. EXECUTIVE COMPENSATION

APS incorporates by reference the information set forth under the caption "Executive Compensation" of the Proxy Statement.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The Company incorporates by reference the information set forth under the caption "Beneficial Stock Ownership" of the Proxy Statement.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The Company incorporates by reference the information set forth under the caption "Certain Transactions" of the Proxy Statement.

Part IV

Item 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) 1. Financial Statements
The financial statements and supplementary data set forth in Part II of the 10-K Annual Report are incorporated herein by reference.

2. Financial Statement Schedules
Schedule II Valuation Accounts
All other schedules have been omitted because the information is not required or is not so material as to require submission of the schedule, or because the information is included in the financial statements or the notes thereto.

3. Exhibits
2.1-Copy of Asset Purchase Agreement between Registrant and R.P. Scherer South, Inc. dated June 21, 2000 (7)
3-A-Copy of Registrant's Certificate of Incorporation. (1)
3-B-Copy of Registrant's Bylaws. (1)
10-C-Registrant's 1992 Stock Plan dated August 11, 1992. (2)*
10-D-Registrant's 1997 Employee Stock Purchase Plan dated March 5, 1997 (5)*
10-E-Lease Agreement between Registrant and Metropolitan Life Insurance Company for lease of Registrant's executive offices in Redwood City dated as of November 17, 1997. (6)
10-N-Agreement with Johnson & Johnson dated April 14, 1992. (3)
10-X-Registrant's Non-Qualified Plan
21-Proxy Statement for the Annual Meeting of Shareholders. (4)
23-Consent of Independent Auditors.

(b) Reports on Form 8-K
None.

(c) Exhibits
The Company hereby files as part of this Form 10-K the exhibits listed in Item 14(a)3 as set forth above.

(d) Financial Statement Schedules
See Item 14(a)2 of this Form 10-K.

---

(1)Filed as an Exhibit with corresponding Exhibit No. to Registrant's Registration Statement on Form S-1 (Registration No. 33-15429) and incorporated herein by reference.
(2)Filed as Exhibit No. 28.1 to Registrant's Registration Statement on Form S-8 (Registration No. 33-50640), and incorporated herein by reference.
(3)Filed as an Exhibit with corresponding Exhibit No. to Registrant's Annual Report on Form 10-K for the year ended December 31, 1992, and incorporated herein by reference.
(4)To be filed supplementally.
(5)Filed an Exhibit No. 99.1 to Registrant's Registration Statement on Form S-8 (Registration No. 333-35151), and incorporated herein by reference.
(6)Filed as an Exhibit with corresponding Exhibit No. to Registrant's Annual Report on Form 10-K for the year ended December 31, 1997, and incorporated herein by reference.
(7)Filed as an Exhibit with corresponding Exhibit No. to Registrant's Form 8-K dated July 25, 2000, and incorporated herein by reference.

* Management Contract or Compensatory plans.

SIGNATURES

Pursuant to the requirement of Section 13 or 15 (d) 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.

By: /s/Michael O'Connell

Michael O'Connell
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons in the capacities and on the dates indicated.

Signature	Title	Date
/S/ Michael O'Connell Michael O'Connell	President and Chief Executive Officer	March 23, 2001
/S/ Gordon Sangster Gordon Sangster	Chief Financial Officer	March 23, 2001
/S/ Paul Goddard Paul Goddard	Chairman of the Board of Directors	March 23, 2001
/S/ Stephen Drury Stephen Drury	Director	March 23, 2001
/S/ Carl Ehmann Carl Ehmann	Director	March 23, 2001
/S/ Jorge Heller Jorge Heller	Director	March 23, 2001
/S/ Peter Riepenhausen Peter Riepenhausen	Director	March 23, 2001
/S/ Toby Rosenblatt Toby Rosenblatt	Director	March 23, 2001
/S/ Richard Spizzirri Richard Spizzirri	Director	March 23, 2001
/S/ Gregory H. Turnbull Gregory H. Turnbull	Director	March 23, 2001
/S/ C. Anthony Wainwright C. Anthony Wainwright	Director	March 23, 2001
/S/ Dennis Winger Dennis Winger	Director	March 23, 2001

Schedule II

Valuation Accounts

	Beginning Balance	Additions Charged to Expense	Deductions	Ending Balance
December 31, 1998				
Accounts receivable, allowance for doubtful accounts	57,454	38,830	--	96,284
December 31, 1999				
Accounts receivable, allowance for doubtful accounts	96,284	7,891	76,874	27,301
December 31, 2000				
Accounts receivable, allowance for doubtful accounts	27,301	206,968	11,034	223,235

CONSENT OF INDEPENDENT AUDITORS

The Board of Directors and Shareholders
Advanced Polymer Systems, Inc.:

We consent to incorporation by reference in the Registration Statements (Nos. 33-18942, 33-21829, 33-29084, 33-50640, 333-06841, 333-35151 and 333-60585) on Forms S-8 of Advanced Polymer Systems, Inc. and in the Registration Statements (Nos. 33-47399, 33-51326, 33-67936, 33-82562, 33-88972, 333-00759, 333-042527 and 333-69815) on Forms S-3 of Advanced Polymer Systems, Inc. of our report dated February 16, 2001, relating to the consolidated balance sheets of Advanced Polymer Systems, Inc. and subsidiaries as of December 31, 2000 and 1999, and the related consolidated statements of operations, shareholders' equity and comprehensive income and cash flows for each of the years in the three-year period ended December 31, 2000, which report appears in the December 31, 2000 annual report on Form 10-K of Advanced Polymer Systems, Inc.

/s/KPMG LLP

Mountain View, California
March 23, 2001

EXHIBIT INDEX
Form 10-K Annual Report

2.1-Copy of Asset Purchase Agreement between Registrant and R.P. Scherer South, Inc. dated June 21, 2000. (7)
3-A-Copy of Registrant's Certificate of Incorporation. (1)
3-B-Copy of Registrant's Bylaws. (1)
10-C-Registrant's 1992 Stock Plan dated August 11, 1992. (2)*
10-D-Registrant's 1997 Employee Stock Purchase Plan dated March 5, 1997 (5)*
10-E-Lease Agreement between Registrant and Metropolitan Life Insurance Company for lease of Registrant's executive offices in Redwood City dated as of November 17, 1997. (6)
10-N-Agreement with Johnson & Johnson dated April 14, 1992. (3)
10-X-Registrant's Non-Qualified Stock Plan
21-Proxy Statement for the Annual Meeting of Shareholders. (4)
23-Consent of Independent Auditors.

---

(1)Filed as an Exhibit with corresponding Exhibit No. to Registrant's Registration Statement on Form S-1 (Registration No. 33-15429) and incorporated herein by reference.
(2)Filed as Exhibit No. 28.1 to Registrant's Registration Statement on Form S-8 (Registration No. 33- 50640), and incorporated herein by reference.
(3)Filed as an Exhibit with corresponding Exhibit No. to Registrant's Annual Report on Form 10-K for the year ended December 31, 1992, and incorporated herein by reference.
(4)To be filed supplementally.
(5)Filed an Exhibit No. 99.1 to Registrant's Registration Statement on Form S-8 (Registration No. 333-35151), and incorporated herein by reference.
(6)Filed as an Exhibit with corresponding Exhibit No. to Registrant's Annual Report on Form 10-K for the year ended December 31, 1997, and incorporated herein by reference.
(7)Filed as an Exhibit with corresponding Exhibit No. to Registrant's Form 8-K dated July 25, 2000, and incorporated herein by reference.

* Management Contract or Compensatory plans.

ADANCED POLYMER SYSTEMS, INC.
NON-QUALIFIED STOCK PLAN

SECTION 1. PURPOSE; DEFINITIONS.

a. Purpose. The purposes of the Plan are:

(i) to provide to certain persons who are not employees of the Company a material inducement to become executives of, or consultants to, Advance Polymer Systems, Inc., a Delaware corporation, its subsidiaries or affiliates by providing an opportunity to acquire stock in the Company; and

(ii) to encourage selected employees, excluding officers and directors, to improve operations and increase profits of the Company.

b. Definitions. For purposes of the Plan, the following terms have the following meanings:

(i) "Award" means any award under the Plan, including any Option, Restricted Stock or Stock Purchase Right Award.

(ii) "Award Agreement" means, with respect to each Award, the signed written agreement between the Company and the Plan participant setting forth the terms and conditions of the Award.

(iii) "Board" means the Board of Directors of the Company.

(iv) "Change in Control" has the meaning set forth in Section 8(a).

(v) "Code" means the Internal Revenue Code of 1986, as amended from time to time, and any successor statute.

(vi) "Commission" means the Securities and Exchange Commission and any successor agency.

(vii) "Committee" means the Committee referred to in Section 2, or the Board in its capacity as administrator of the Plan in accordance with Section 2.

(viii) "Company" means Advanced Polymer Systems, Inc., a Delaware corporation.

(ix) "Disability" means permanent and total disability as determined by the Committee for purposes of the Plan.

(x) "Non-Employee Director" has the meaning set forth in Rule 16b-3 under the Exchange Act, and any successor definition adopted by the Commission.

(xi) "Exchange Act" means the Securities Exchange Act of 1934, as amended from time to time, and any successor statute.

(xii) "Fair Market Value" means as of any given date (a) if the Stock is listed on any established stock exchange or a national market system, the closing sales price for the Stock or the closing bid if no sales were reported, as quoted on such system or exchange, as reported in the Wall Street Journal; or (b) in the absence of an established market for the Stock, the fair market value of the Stock as determined by the Committee in good faith.

(xiii) "Non-Qualified Stock Option" means an Option that is not an Incentive Stock Option, within the meaning of Section 422 of the Code.

(xiv) "Option" means an option granted under Section 5.

(xv) "Plan" means this Advanced Polymer Systems, Inc. Non-Qualified Stock Plan, as amended from time to time.

(xvi) "Restricted Stock" means an Award of Stock subject to restrictions, as more fully described in Section 6.

(xvii) "Restriction Period" means the period determined by the Committee under Section 6(b).

(xviii) "Rule 16b-3" means Rule 16b-3 under Section 16(b) of the Exchange Act, as amended from time to time, and any successor rule.

(xix) "Stock" means the Common Stock of the Company, and any successor security.

(xx) "Stock Purchase Right" means an Award granted under Section 7.

(xxi) "Subsidiary" has the meaning set forth in Section 424 of the Code.

(xxii) "Tax Date" means the date defined in Section 9(f).

(xxiii) "Termination" means, for purposes of the Plan, with respect to a participant, that the participant has ceased to be, for any reason, employed by, or a consultant to, the Company, a subsidiary or an affiliate; provided, that for purposes of this definition, unless otherwise determined by the President of the Company, in his sole discretion, Termination shall not include a change in status from an employee of, to a consultant to, the Company or any subsidiary or affiliate, or vice versa.

SECTION 2. ADMINISTRATION.

a. Committee. The Plan shall be administered by the Board or, upon delegation by the Board, by a committee of Non-Employee Directors appointed by the Board. In connection with the administration of the Plan, the Committee shall have the powers possessed by the Board. The Committee may act only by a majority of its members, except that the Committee may from time to time select another committee or one or more other persons to be responsible for any matters for which Non-Employee Director are not required pursuant to Rule 16b-3. The Board at any time may abolish the Committee and revest in the Board the administration of the Plan.

b. Authority. The Committee shall grant Awards only to persons who (i) are not at the time of the Award employees of the Company for the purpose of providing a material inducement to such persons to become employees of or consultants to the Company or (ii) are employees, but not officers and directors of the Company. In particular and without limitation, the Committee, subject to the terms of the Plan, shall:

(i) select the persons to whom Awards may be granted;

(ii) determine whether and to what extent Awards are to be granted under the Plan;

(iii) determine the number of shares to be covered by each Award granted under the Plan;

(iv) determine the terms and conditions of any Award granted under the Plan and any related loans to be made by the Company, based upon factors determined by the Committee; and

(v) determine to what extent and under what circumstances any Award payments may be deferred by a participant.

c. Committee Determinations Binding. The Committee may adopt, alter and repeal administrative rules, guidelines and practices governing the Plan as it from time to time shall deem advisable, may interpret the terms and provisions of the Plan, any Award and any Award Agreement and may otherwise supervise the administration of the Plan. Any determination made by the Committee pursuant to the provisions of the Plan with respect to any Award shall be made in its sole discretion at the time of the grant of the Award or, unless in contravention of any express term of the Plan or Award, at any later time. All decisions made by the Committee under the Plan shall be binding on all persons, including the Company and Plan participants.

SECTION 3. STOCK SUBJECT TO PLAN.

a. Number of Shares. The total number of shares of Stock reserved and available for issuance pursuant to Awards under this Plan shall be 250,000 shares. Such shares may consist, in whole or in part, of authorized and unissued shares or treasury shares or shares reacquired in private transactions or open market purchases, but all shares issued under the Plan, regardless of source shall be counted against the 250,000 share limitation. If any Option terminates or expires without being exercised in full or if any shares of Stock subject to an Award are forfeited, or if an Award otherwise terminates without issuance in full being made to the participant in the form of Stock, the shares not issued under such Option or Award shall again be available for issuance in connection with Awards. Any Award under this Plan shall be governed by the terms of the Plan and any applicable Award Agreement.

b. Adjustments. In the event of any merger, reorganization, consolidation, recapitalization, stock dividend, stock split or other change in corporate structure affecting the Stock, such substitution or adjustments shall be made in the aggregate number of shares of Stock reserved for issuance under the Plan, in the number and exercise price of shares subject to outstanding Options, and in the number of shares subject to other outstanding Awards, as may be determined to be appropriate by the Committee, in its sole discretion; provided, however, that the number of shares subject to any Award shall

always be a whole number.

SECTION 4. ELIGIBILITY.

Awards may be granted only to persons (i) not employed by the Company at the time of the Award and who the Company wishes to attract as an officer or other employee of, or consultant to, the Company, its subsidiaries and affiliates as a material inducement to accepting employment or consultancy with the Company or (ii) who are employees of the Company but are not officers or directors of the Company at the time of the Award.

SECTION 5. STOCK OPTIONS.

a. Type. Any Option granted under the Plan shall be in such form as the Committee may from time to time approve; provided, that only Non-Qualified Stock Options may be granted under the Plan.

b. Terms and Conditions. Options granted under the Plan shall be subject to the following terms and conditions:

(i) Option Term. The term of each Option shall be fixed by the Committee, but no Option shall be exercisable more than ten (10) years after the date the Option is granted.

(ii) Grant Date. The Company may grant Options under the Plan at any time and from time to time before the Plan terminates. The Committee shall specify the date of grant or, if it fails to, the date of grant shall be the date the intended optionee is first treated as an employee or consultant for payroll purposes.

(iii) Exercise Price. The exercise price per share of Stock purchasable under an Option shall be equal to at least 85% of the Fair Market Value on the date of grant.

(iv) Exercisability. Subject to the other provisions of the Plan, an Option shall be exercisable in its entirety at grant or at such times and in such amounts as are specified in the Award Agreement evidencing the Option. Except to the extent otherwise provided in the Award Agreement, in the event of Termination prior to the Option being exercisable in full, any such unexercisable portion shall expire as of such Termination. The Committee, in its absolute discretion, at any time may waive any limitations respecting the time at which an Option first becomes exercisable in whole or in part.

(v) Method of Exercise; Payment. To the extent the right to purchase shares has accrued, Options may be exercised, in whole or in part, from time to time, by written notice from the optionee to the Company stating the number of shares being purchased, accompanied by payment of the exercise price for the shares.

SECTION 6. RESTRICTED STOCK.

a. Price. The Committee may grant to a participant Restricted Stock. The grantee shall pay the par value per share as consideration therefor.

b. Restrictions. Subject to the provisions of the Plan and the Award Agreement, during the Restriction Period set by the Committee, commencing with and not exceeding ten (10) years from the date of such Award, the participant shall not be permitted to sell, assign, transfer, pledge or otherwise encumber shares of Restricted Stock. Within these limits, the Committee may provide for the lapse of such restrictions in installments and may accelerate or waive such restrictions, in whole or in part, based on service, performance or such other factors or criteria as the Committee may determine.

c. Dividends. Unless otherwise determined by the Committee, with respect to dividends on shares of Restricted Stock, dividends payable in cash shall be automatically reinvested in additional Restricted Stock, and dividends payable in Stock shall be paid in the form of Restricted Stock.

d. Termination. Except to the extent otherwise provided in the Award Agreement and pursuant to Section 6(b), in the event of a Termination during the Restriction Period, all shares still subject to restriction shall be forfeited by the participant.

SECTION 7. STOCK PURCHASE RIGHTS.

a. Price. The Committee may grant Stock Purchase Rights which shall enable the recipients to purchase Stock at a price equal to not less than 85% of its Fair Market Value on the date of grant.

b. Exercisability. Stock Purchase Rights shall be exercisable for a period determined by the Committee not exceeding 30 days from the date of the grant.

SECTION 8. CHANGE IN CONTROL.

a. Definition of "Change in Control". For purposes of Section 8(b), a "Change in Control" means the occurrence of any one of the following:

(i) Any "person", as such term is used in Sections 13(d) and 14(d) of the Exchange Act (other than the Company, a subsidiary, an affiliate, or a Company employee benefit plan, including any trustee of such plan acting as trustee) is or becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing 51% or more of the combined voting power of the Company's then outstanding securities; or

(ii) the dissolution or liquidation (partial or total) of the Company or a sale of assets involving 51% or more of the assets of the Company, any merger or reorganization of the Company, whether or not another entity is the survivor, in a transaction pursuant to which the holders, as a group, of all of the shares of the Company outstanding prior to the transaction hold, as a group, less than 51% of the shares of the Company outstanding after the transaction, or any other event which the Board determines, in its discretion, would materially alter the structure of the Company or its ownership.

b. Impact of Event. In the event of a "Change in Control" as defined in Section 8(a), acceleration provisions no more favorable to participants than the following shall apply:

(i) Any Options outstanding as of the date such Change in Control is determined to have occurred and not then exercisable and vested shall become fully exercisable and vested; and

(ii) The restrictions and limitations applicable to any Restricted Stock and Stock Purchase Rights shall lapse, and such Restricted Stock shall become fully vested.

SECTION 9. GENERAL PROVISIONS.

a. Award Grants. Any Award may be granted either alone or in addition to other Awards granted under the Plan. Subject to the terms and restrictions set forth elsewhere in the Plan, the Committee shall determine the consideration, if any, payable by the participant for any Award and, in addition to those set forth in the Plan, any other terms and conditions of the Awards. The Committee may condition the grant or payment of any Award upon the attainment of specified performance goals or such other factors or criteria, including vesting based on continued employment or consulting, as the Committee shall determine. Performance objectives may vary from participant to participant and among groups of participants and shall be based upon such Company, subsidiary, group or division factors or criteria as the Committee may deem appropriate, including, but not limited to, earnings per share or return on equity. The other provisions of Awards also need not be the same with respect to each recipient.

b. Award Agreement. As soon as practicable after the date of an Award grant, the Company and the participant shall enter into a written Award Agreement identifying the date of grant, and specifying the terms and conditions of the Award. Options are not exercisable until after execution of the Award agreement by the Company and the Plan participant, but a delay in execution of the agreement shall not affect the validity of an Option grant.

c. Certificates. All certificates for shares of Stock or other securities delivered under the Plan shall be subject to such stock transfer orders, legends and other restrictions as the Committee may deem advisable under the rules, regulations and other requirements of the Commission, any market in which the Stock is then traded and any applicable federal, state or foreign securities law.

d. Termination. Unless otherwise provided in the applicable Award Agreement or by the Committee, in the event of Termination for any reason other than death, retirement or Disability, Awards held at the date of Termination (and only to the extent then exercisable or payable, as the case may be) may be exercised in whole or in part at any time within three (3) months after the date of Termination, or such lesser period specified in the Award Agreement (but in no event after the expiration date of the Award), but not thereafter. If Termination is due to retirement or to death or Disability, Awards held at the date of Termination (and only to the extent then exercisable or payable, as the case may be) may be exercised in whole or in part by the participant in the case of retirement or Disability, by the participant's guardian or legal representative or by the person to whom the Award is transferred by will or the laws of descent and distribution, at any time within two (2) years from the date of Termination or any lesser period

specified in the Award Agreement (but in no event after the expiration of the Award).

e. Delivery of Purchase Price. If and only to the extent authorized by the Committee, participants may make all or any portion of any payment due to the Company

(i) with respect to the consideration payable for an Award,

(ii) upon exercise of an Award, or

(iii) with respect to federal, state, local or foreign tax payable in connection with an Award, by delivery of (x) cash, (y) check, or (z) any property other than cash (including a promissory note of the participant or shares of Stock or securities) so long as, if applicable, such property constitutes valid consideration for the Stock under, and otherwise complies with, applicable law. No promissory note under the Plan shall have a term (including extensions) of more than five years or shall be of a principal amount exceeding 90% of the purchase price paid by the borrower.

f. Tax Withholding. Any shares or other securities so withheld or tendered will be valued by the Committee as of the date they are withheld or tendered; provided, however, that Stock shall be valued at Fair Market Value on such date. The value of the shares withheld or tendered may not exceed the required federal, state, local and foreign withholding tax obligations as computed by the Company. Unless the Committee permits otherwise, the participant shall pay to the Company in cash, promptly when the amount of such obligations becomes determinable (the "Tax Date"), all applicable federal, state, local and foreign withholding taxes that the Committee in its discretion determines to result (i) from the lapse of restrictions imposed upon an Award, (ii) upon exercise of an Award, or (iii) from a transfer or other disposition of shares acquired upon exercise or payment of an Award, or otherwise related to the Award or the shares acquired in connection with an Award.

A participant who has received an Award or payment under an Award may, to the extent, if any, authorized by the Committee in its discretion, make an election to (x) deliver to the Company a promissory note of the participant on the terms set forth in Section 9(e), or (y) tender any such securities to the Company to pay the amount of tax that the Committee in its discretion determines to be required to be withheld by the Company subject to any limitations imposed by Section 16(b) of the Exchange Act or other applicable law.

g. No Transferability. Unless otherwise provided for in the applicable Award Agreement or by the Committee, no Award shall be assignable or otherwise transferable by the participant other than by will or by the laws of descent and distribution, and during the life of a participant, an Award shall be exercisable, and any elections with respect to an Award may be made, only by the participant or participant's guardian or legal representative.

h. Adjustment of Awards; Waivers. The Committee may adjust the performance goals and measurements applicable to Awards (i) to take into account changes in law and accounting and tax rules, (ii) to make such adjustments as the Committee deems necessary or appropriate to reflect the inclusion or exclusion of the impact of extraordinary or unusual items, events or circumstances in order to avoid windfalls or hardships, and (iii) to make such adjustments as the Committee deems necessary or appropriate to reflect any material changes in business conditions. In the event of hardship or other special circumstances of a participant and otherwise in its discretion, the Committee may waive in whole or in part any or all restrictions, conditions, vesting, or forfeiture with respect to any Award granted to such participant.

i. Non Competition. The Committee may condition its discretionary waiver of a forfeiture, the acceleration of vesting at the time of Termination of a participant holding any unexercised or unearned Award, the waiver of restrictions on any Award, or the extension of the expiration period to a period not longer than that provided by the Plan upon such participant's agreement (and compliance with such agreement) to (i) not engage in any business or activity competitive with any business or activity conducted by the Company and (ii) be available for consultations at the request of the Company's management, all on such terms and conditions (including conditions in addition to clauses (i) and (ii)) as the Committee may determine.

j. Dividends. The reinvestment of dividends in additional Stock or Restricted Stock at the time of any dividend payment pursuant to Section 6(c) shall only be permissible if sufficient shares of Stock are available under Section 3 for such reinvestment (taking into account then outstanding Awards).

k. Regulatory Compliance. Each Award under the Plan shall be subject to the condition that, if at any time the Committee shall determine that (i) the

listing, registration or qualification of the shares of Stock upon any securities exchange or for trading in any securities market or under any state or federal law, (ii) the consent or approval of any government or regulatory body or (iii) an agreement by the participant with respect thereto, is necessary or desirable, then such Award shall not be consummated in whole or in part unless such listing, registration, qualification, consent, approval or agreement shall have been effected or obtained free of any conditions not acceptable to the Committee.

l. Rights as Shareholder. Unless the Plan or the Committee expressly specifies otherwise, an optionee shall have no rights as a shareholder with respect to any shares covered by an Award until the stock certificates representing the shares are actually delivered to the optionee. Subject to Sections 3(b) and 6(c), no adjustment shall be made for dividends or other rights for which the record date is prior to the date the certificates are delivered.

m. Beneficiary Designation. The Committee, in its discretion, may establish procedures for a participant to designate a beneficiary to whom any amounts payable in the event of the participant's death are to be paid.

n. Additional Plans. Nothing contained in the Plan shall prevent the Company, a subsidiary or an affiliate from adopting other or additional compensation arrangements for its employees and consultants.

o. No Employment Rights. The adoption of the Plan shall not confer upon any employee any right to continued employment nor shall it interfere in any way with the right of the Company, a subsidiary or an affiliate to terminate the employment of any employee at any time.

p. Rule 16b-3. Notwithstanding any provision of the Plan, the Plan shall always be administered, and Awards shall always be granted and exercised, in such a manner as to conform to the provisions of Rule 16b-3.

q. Governing Law. The Plan and all Awards shall be governed by and construed in accordance with the laws of the State of California.

r. Use of Proceeds. All cash proceeds to the Company under the Plan shall constitute general funds of the Company.

s. Unfunded Status of Plan. The Plan shall constitute an "unfunded" plan for incentive and deferred compensation. The Committee may authorize the creation of trusts or arrangements to meet the obligations created under the Plan to deliver Stock or make payments; provided, however, that unless the Committee otherwise determines, the existence of such trusts or other arrangements shall be consistent with the "unfunded" status of the Plan.

t. Assumption by Successor. The obligations of the Company under the Plan and under any outstanding Award may be assumed by any successor corporation, which for purposes of the Plan shall be included within the meaning of "Company".

SECTION 10. AMENDMENTS AND TERMINATION.

The Board may amend, alter or discontinue the Plan or any Award, but no amendment, alteration or discontinuance shall be made which would impair the rights of a participant under an outstanding Award without the participant's consent.

SECTION 11. EFFECTIVE DATE OF PLAN.

The Plan shall be effective on the date it is adopted by the Board.

SECTION 12. TERM OF PLAN.

No Award shall be granted on or after October 24, 2010, but Awards granted prior to October 24, 2010 may extend beyond that date.

Plan approved by the Board of Directors on October 24, 2000.