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

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

For the quarterly period ended September 30, 2001

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

For the transition period from -------- to --------

Commission file Number 0-16109

A.P. PHARMA, INC.
(Exact name of registrant as specified in its charter)

Delaware	94-2875566
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

123 Saginaw Drive, Redwood City, CA 94063
(Address of principal executive offices)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes X No

At October 31, 2001, the number of outstanding shares of the Company's common stock, par value $.01, was 20,302,763.

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements (unaudited):

A.P. PHARMA, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	September 30, 2001	December 31, 2000
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,627,477	$ 6,493,336
Marketable securities	16,619,456	16,029,320
Receivables for royalties and other	2,631,066	706,242
Trade accounts receivable, net	217,332	490,578
Inventory	83,864	71,079
Advances to employees	--	34,018
Prepaid expenses and other	770,085	1,225,276
Total current assets	22,949,280	25,049,849
Property and equipment, net	1,674,051	1,795,313
Other long-term assets	151,000	151,000
Total assets	$ 24,774,331	$ 26,996,162
LIABILITIES & SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 653,330	$ 329,305
Accrued expenses	2,083,154	3,987,794
Taxes payable	--	255,358
Deferred revenue	404,906	390,201
Total current liabilities	3,141,390	4,962,658
Deferred revenue - long-term	849,318	874,250
Total liabilities	3,990,708	5,836,908
Shareholders' equity:		
Common stock and common stock warrants	86,268,341	86,023,316
Accumulated deficit	(65,770,196)	(64,942,829)
Accumulated other comprehensive income	285,478	78,767
Total shareholders' equity	20,783,623	21,159,254
Total liabilities and shareholders' equity	$ 24,774,331	$ 26,996,162

See accompanying notes.

A.P. PHARMA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30, 2001	September 30, 2000	September 30, 2001	September 30, 2000
Royalties	$ 725,794	$ 605,392	$ 2,100,194	$ 1,594,634
Product revenues	242,833	281,170	839,385	891,215
Total revenues	968,627	886,562	2,939,579	2,485,849
Expenses:				
Cost of sales	87,341	116,627	293,980	304,121
Research & development	1,987,474	790,295	4,909,676	2,194,810
Selling & marketing	106,391	149,517	344,799	426,321
General & administration	719,776	722,116	2,158,947	2,113,568
Operating loss	(1,932,355)	(891,993)	(4,767,823)	(2,552,971)
Interest income	237,802	302,192	860,889	421,243
Interest expense	--	(66,208)	--	(294,247)
Other (expense) income net	(12,393)	(1,992)	65,154	4,523
Loss before taxes	(1,706,946)	(658,001)	(3,841,780)	(2,421,452)
Taxes	--	--	--	--
Loss from continuing operations	(1,706,946)	(658,001)	(3,841,780)	(2,421,452)
Income from discontinued operations	198,187	30,980	14,413	1,381,046
Gain on disposition of discontinued operations, net of taxes	3,000,000	11,184,793	3,000,000	11,184,793
Net income (loss)	$ 1,491,241	$10,557,772	$ (827,367)	$10,144,387
Basic income (loss) per common share:				
Loss from continuing operations	$ (0.08)	$ (0.03)	$ (0.19)	$ (0.12)
Net income (loss)	$ 0.07	$ 0.52	$ (0.04)	$ 0.50
Diluted income (loss) per common share				
Loss from continuing operations	$ (0.08)	$ (0.03)	$ (0.19)	$ (0.12)
Net income (loss)	$ 0.07	$ 0.52	$ (0.04)	$ 0.50
Weighted average common shares outstanding-basic	20,278,474	20,190,181	20,258,996	20,170,351
Weighted average common shares outstanding-diluted	20,301,240	20,194,157	20,258,996	20,194,017

See accompanying notes.

A.P. PHARMA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	For the nine months ended September 30, 2001	For the nine months ended September 30, 2000
Net cash used in operating activities	$ (4,294,427)	$ (1,588,649)
Cash flows from investing activities:		
Purchases of property and equipment	(178,617)	(141,678)
Purchase of intangibles	--	(100,000)
Purchases of marketable securities	(14,407,155)	(13,866,677)
Maturities and sales of marketable securities	13,962,706	--
Net cash used in investing activities	(623,066)	(14,108,355)
Cash flows from financing activities:		
Proceeds from disposal of discontinued operations	1,023,000	25,000,000
Proceeds from the exercise of common stock options and warrants	--	120,000
Proceeds from issuance of shares under the Employee Stock Purchase Plan	28,634	75,595
Repayment of debt	--	(3,300,044)
Net cash provided by financing activities	1,051,634	21,895,551
Net (decrease) increase in cash and cash equivalents	(3,865,859)	6,198,547
Cash and cash equivalents, beginning of the period	6,493,336	3,705,194
Cash and cash equivalents, end of the period	$ 2,627,477	$ 9,903,741
Cash paid for interest	$ --	$ 250,025
Non-cash investing activities:		
Changes in unrealized appreciation of marketable securities	$ 206,711	$ 7,234

See accompanying notes.

A.P. PHARMA, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2001 AND 2000 (UNAUDITED)

(1) Basis of Presentation

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the financial position of A.P. Pharma, Inc. and subsidiaries ("the Company" or "APP") as of September 30, 2001 and the results of their operations and cash flows for the three and nine months ended September 30, 2001 and 2000.

These condensed consolidated statements should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2000 included in the Company's Annual Report on Form 10-K.

The condensed consolidated financial statements include the financial statements of the Company and its subsidiary, APS Analytical Standards, Inc. All significant intercompany balances and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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.

The Company considers all short-term investments in debt securities which have original maturities of less than three months at date of purchase to be cash equivalents. Investments which have original maturities longer than three months are classified as marketable securities in the accompanying balance sheets. The Company has classified all its investments in certain debt and equity securities as "available-for-sale".

Certain reclassifications have been made to the prior period financial statements to conform with the presentation in 2001.

(2) Common Shares Outstanding and Earnings Per Share Information

Common stock outstanding as of September 30, 2001 is as follows:

	Number of Shares
Common stock outstanding as of December 31, 2000	20,206,064
Shares issued to Directors after December 31, 2000	60,590
Shares issued under the Employee Stock Purchase Plan	11,820
Total shares	20,278,474

(3) Revenue Recognition

Licensing agreements that generally provide for the Company to receive periodic minimum payments, royalties, and/or non-refundable license fees typically allow customers to develop, use or sell the Company's proprietary products in a specific field or territory. The license agreements provide for APP to earn future revenue through royalty payments. The license fees are non-refundable even if the agreements are terminated before their term. These license fees are amortized on a straightline basis over the appropriate period.

(4) Comprehensive Loss

Comprehensive loss for the three and nine months ended September 30, 2001 and 2000 consists of the following:

	Three Months Ended		Nine Months Ended	
	September 30, 2001	September 30, 2000	September 30, 2001	September 30, 2000
Net income (loss)	$ 1,491,241	$10,557,772	$ (827,367)	$10,144,387
Unrealized holding gains arising during the period	140,808	7,234	206,711	7,234
Comprehensive income (loss)	$ 1,632,049	$10,565,006	$ (620,656)	$10,151,621

(5) Inventory

The major components of inventory are as follows:

	September 30, 2001	December 31, 2000
Raw materials	$45,092	$43,387
Finished goods	38,772	27,692
Total inventory	$83,864	$71,079

(6) 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 RP Scherer Corporation, a subsidiary of Cardinal Health, Inc. The Company received $25 million on closing and is entitled to receive additional amounts over the three years following the sale relating to the achievement of 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.

Due to the attainment of certain performance milestones by the cosmeceutical product lines, an additional $3.6 million in earnout income was achieved in accordance with the sale agreement. After reserves for certain indemnification claims allowable under the sale agreement, the accompanying condensed consolidated financial statements include an additional $3,000,000 of net gain on disposition of discontinued operations.

Basic and diluted income per common share from discontinued operations excluding the gain on sale of the cosmeceutical product lines was $0.01 and $0.00 for the three and nine months ended September 30, 2001, respectively.

Basic and diluted income per common share from discontinued operations excluding the gain on sale of the cosmeceutical product lines was $0.00 and $0.07 for the three and nine months ended September 30, 2000, respectively.

(7) 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 alleged that the plaintiffs entered into a partnership with the Company to pursue development and sales of a product developed by the plaintiffs. The complaint stated various claims, dissolution of partnership, implied-in-law contract and other claims.

On September 28, 2001, the U.S. District Court for the Eastern District of Pennsylvania granted a summary judgment in favor of A.P. Pharma, Inc.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (all dollar amounts rounded to the nearest thousand)

Results of Operations for the Three Months Ended September 30, 2001 and 2000

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

The Company's revenues are derived principally from royalties, license fees, R&D fees and product sales. Under strategic alliance arrangements entered into with certain corporations, APP can receive non-refundable upfront fees, future milestone payments and royalties based on third party product sales. On July 25, 2000, the Company completed the sale of certain technology rights for topical pharmaceuticals and its cosmeceutical product lines and associated assets to RP Scherer Corporation, a subsidiary of Cardinal Health, Inc.

Royalties for the third quarter of 2001 increased by 20% to $726,000 from $605,000 in the corresponding quarter of the prior year. This increase was primarily due to royalties earned following the launch of Carac(TM), a topical prescription treatment for actinic keratoses which was launched in April, 2001 by the Company's marketing partner, Dermik Laboratories, an Aventis Company.

Product revenues relating to sales of analytical standards decreased by 14% to 243,000 from $281,000 in the corresponding quarter of the prior year.

Gross profit on sales of analytical standards increased from 59% to 64% due mainly to sales mix as the year-ago quarter included higher sales of low-margin instruments.

Research and development expense for the third quarter of 2001 totaled $1,987,000, an increase of $1,197,000 or 151% over the corresponding quarter of the prior year. The increase is mainly due to the completion of pre-clinical trials associated with the Company's bioerodible Biochronomer(TM) system in preparation for the filing of an Investigational New Drug Application (IND) for a treatment for post-surgical pain.

Selling and marketing expense relating to analytical standards for the third quarter of 2001 decreased by 29% to $106,000 from $150,000 in the corresponding quarter of the prior year due mainly to lower overhead allocations.

General and administrative expense for the quarter ended September 30, 2001 of $720,000, was essentially flat with the reported $722,000 in the corresponding quarter of the prior year.

Interest income for the third quarter of 2001 decreased by $64,000 to $238,000 due mainly to lower interest rates compared with the corresponding quarter of the prior year.

Interest expense for the quarter ended September 30, 2001 decreased to $0 from $66,000 in the corresponding quarter of the prior year due to the repayment of all outstanding debt on the receipt of the payment of $25 million from RP Scherer in the corresponding quarter of the prior year.

Income from discontinued operations represents the net contribution associated with the cosmeceutical product lines which were sold to RP Scherer in July 2000. The gain on disposition in the current quarter includes net earnout income of $3.0 million from the sale of the Company's cosmeceutical product lines in the prior year, which represents additional earnout income of $3.6 million less reserves for certain indemnification claims allowable under the sale agreement. The earnout income is the first of three contractual annual payments, the amounts of which are dependent on the performance of the cosmeceutical business which was sold.

Results of Operations for the Nine Months Ended September 30, 2001 and 2000

Royalties for the nine months ended September 30, 2001 totaled $2,100,000 representing an increase of $505,000 or 32% over the corresponding period of the prior year. This increase was primarily due to royalties earned following the launch of Carac(TM), a topical prescription treatment for actinic keratoses which was launched by the Company's marketing partner, Dermik Laboratories, an Aventis company. Product revenues from sales of analytical standards totaled $839,000, a decrease of $52,000 or 6% over the corresponding period of the prior year.

As a percentage of sales, gross profit on product revenues for the nine months ended September 30, 2001 of $545,000 represented 65% of product revenues compared with 66% in the corresponding period of the prior year.

Research and development expense for the nine months ended September 30, 2001 totaled $4,910,000, an increase of $2,715,000 or 124% over the corresponding period of the prior year. This increase was due to ongoing development of the Company's bioerodible Biochronomer(TM) system including the scale-up and GMP manufacturing of the polymer and the completion of pre-clinical studies in preparation for an IND filing this year for a treatment for post-surgical pain.

Selling and marketing expense for the nine months ended September 30, 2001 decreased by $82,000 or 19% from the corresponding period of the prior year, mainly due to lower overhead allocation.

General and administrative expense for the nine months ended September 30, 2001 increased by $45,000 or 2% over the corresponding period of the prior year mainly due to increased investor relations expenses.

Interest income for the nine months ended September 30, 2001 totaled $861,000, an increase of $440,000 or 104% over the corresponding period of the prior year. This increase is due mainly to interest earned from the receipt of $25 million received in July 2000 as proceeds from the sale of the company's cosmeceutical product lines to RP Scherer Corporation. Interest expense for the nine months ended September 30, 2001 was $0, a decrease of $294,000 from the same period of the prior year due to the repayment of all outstanding debt following the receipt of $25 million from RP Scherer.

Income from discontinued operations for the nine months ended September 30, 2001 totaled $14,000 compared with $1,381,000 in the corresponding period of the prior year and represents the net contribution associated with the cosmeceutical product lines which were sold to RP Scherer in July 2000. The current period also included net earnout income of $3.0 million from the sale of the Company's cosmeceutical product lines in the prior year, which represents additional earnout income of $3.6 million less reserves for certain indemnification claims allowable under the sale agreement. The earnout income is the first of three contractual annual payments, the amounts of which are dependent on the performance of the cosmeceutical product lines which were sold.

Capital Resources and Liquidity

Total assets as of September 30, 2001 were $24,774,000 compared with $26,996,000 at December 31, 2000. Working capital decreased to $19,808,000 from $20,087,000. Cash, cash equivalents and marketable securities decreased to $19,247,000 from $22,523,000 at December 31, 2000. During the first nine months of 2001, the Company's operating activities used $4,294,000 compared with $1,589,000 in the corresponding period of the prior year.

Trade accounts receivable decreased to $217,000 at September 30, 2001 from $491,000 at December 31, 2000 due primarily to collections of receivables relating to discontinued operations.

Receivables for royalties and other increased to $2,631,000 from $706,000 at December 31, 2000 due mainly to a receivable relating to a portion of the earnout from the sale of discontinued operations.

Capital expenditures for the nine months ended September 30, 2001 totaled $179,000, an increase of $37,000 from the corresponding period of the prior year.

The Company has financed its operations, including technology and product research and development, from the proceeds of the sale of its cosmeceutical product lines and certain technology rights to topical pharmaceuticals to RP Scherer, Inc. for $25 million in July 2000, the sale of analytical standard products, payments received under licensing agreements, and interest earned on short-term investments.

Cash is being expended with regard to development and pre-clinical trials associated with the Company's bioerodible Biochronomer System for implantable and injectable pharmaceutical applications. 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 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 July 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141 "Business Combinations" and SFAS No. 142 "Goodwill and Other Intangible Assets."

SFAS No. 141 addresses the accounting for and reporting of business combinations and requires that all business combinations be accounted for using the purchase method of accounting for acquisitions and eliminates the use of the pooling method. This Statement applies to all business combinations initiated after June 30, 2001. The Company adopted this statement as of July 1, 2001.

SFAS No. 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets. This Statement changes the accounting for goodwill from an amortization method to an impairment-only method. The amortization of goodwill, including goodwill recorded in past business combinations will cease upon adoption of the Statement, which will begin with the Company's fiscal year beginning January 1, 2002. However, goodwill and intangible assets acquired after June 30, 2001 will be subject to immediate adoption of the Statement. The Company does not expect that the adoption of SFAS No. 142 will have a material effect on its consolidated financial statements. If in a future period the Company determines that goodwill or another intangible asset is impaired, the impairment could have a material impact on earnings for that period.

In June 2001, the FASB issued SFAS 143, "Accounting for Asset Retirement Obligations." SFAS 143 requires liability recognition for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The Company is required to adopt the provisions of SFAS 143 effective January 1, 2003, with earlier application encouraged. The Company believes that the adoption of this standard will not have a material effect on its financial statements.

In August 2001, the FASB issued SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS 144 supercedes SFAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of," in that it removes goodwill from its impairment scope and allows for different approaches in cash flow estimation. However, SFAS 144 retains the fundamental provisions of SFAS 121 for (a) recognition and measurement of the impairment of long-lived assets to be held and used and (b) measurement of long-lived assets to be disposed of. SFAS 144 also supercedes the business segment concept in APB 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," in that it permits presentation of a component of an entity, whether classified as held for sale or disposed of, as a discontinued operation.

However, SFAS 144 retains the requirement of APB Opinion No. 30 to report discontinued operations separately from continuing operations. The Company is required to adopt the provisions of SFAS 144 effective January 1, 2002, with earlier application encouraged. The Company believes that the implementation of this standard will not have a material effect on the Company's results of operations and financial position.

ITEM 3. Quantitative and Qualitative Disclosure about Market Risk

Since December 31, 2000, there have been no material changes in the Company's market risk exposure.

PART II. OTHER INFORMATION

SIGNATURES

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

A.P. PHARMA, INC.

Date: November 13, 2001 By: /S/ Michael O'Connell

Michael O'Connell
President and Chief
Executive Officer

Date: November 13, 2001 By: /S/ Gordon Sangster

Gordon Sangster
Chief Financial Officer