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, 2002

[ ] 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, 2002, the number of outstanding shares of the Company's common stock, par value $.01, was 20,450,186.

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements (unaudited) (in thousands):

A.P. PHARMA, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS (IN THOUSANDS)

	September 30, 2002 (Unaudited)	December 31, 2001 (1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 6,556	$ 3,618
Marketable securities	8,568	15,876
Trade accounts receivable, net	323	338
Receivables for royalties and contract revenues	1,055	1,130
Inventory	66	61
Prepaid expenses and other	412	601
Total current assets	16,980	21,624
Property and equipment, net	1,736	1,668
Other long-term assets	197	215
Total assets	$ 18,913	$ 23,507
LIABILITIES & SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 244	$ 347
Accrued expenses	1,246	1,409
Accrued disposition costs	750	1,479
Deferred revenue	265	315
Total current liabilities	2,505	3,550
Deferred revenue - long-term	761	785
Shareholders' equity:		
Common stock	86,567	86,391
Accumulated deficit	(71,007)	(67,456)
Accumulated other comprehensive income	87	237
Total shareholders' equity	15,647	19,172
Total liabilities and shareholders' equity	$ 18,913	$ 23,507

(1) Information derived from audited financial statements included in the Company's Form 10-K for the year ended December 31, 2001.
See accompanying notes.

A.P. PHARMA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED) (IN THOUSANDS, EXCEPT PER SHARE DATA)

	Three Months Ended		Nine Months Ended	
	September 30, 2002	September 30, 2001	September 30, 2002	September 30, 2001
Royalties	$ 935	$ 722	$ 2,768	$ 2,066
Contract revenues	106	4	192	35
Product revenues	302	243	869	839
Total revenues	1,343	969	3,829	2,940
Costs and expenses:				
Cost of product revenues	109	87	331	294
Research & development	1,874	1,988	5,243	4,910
Selling & marketing	108	106	352	345
General & administration	696	720	2,225	2,159
Operating loss	(1,444)	(1,932)	(4,322)	(4,768)
Interest income	127	237	491	861
Other (expense) income net	55	(12)	70	65
Loss from continuing operations	(1,262)	(1,707)	(3,761)	(3,842)
Income from discontinued operations	--	198	--	15
Gain on disposition of discontinued operations, net of taxes	210	3,000	210	3,000
Net income (loss)	$(1,052)	$ 1,491	$(3,551)	$ (827)
Basic income (loss) per common share:				
Loss from continuing operations	$(0.06)	$(0.08)	$(0.18)	$(0.19)
Net income (loss)	$(0.05)	$ 0.07	$(0.17)	$(0.04)
Diluted income (loss) per common share				
Loss from continuing operations	$(0.06)	$(0.08)	$(0.18)	$(0.19)
Net income (loss)	$(0.05)	$ 0.07	$(0.17)	$(0.04)
Weighted average common shares outstanding-basic	20,417	20,278	20,393	20,259
Weighted average common shares outstanding-diluted	20,417	20,301	20,393	20,259

See accompanying notes.

A.P. PHARMA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) (IN THOUSANDS)

	For the nine months ended September 30,	
	2002	2001
Cash flows from operating activities:		
Net loss	$(3,551)	$ (827)
Adjustments to reconcile net loss to net cash used in operating activities:		
Gain on sale of discontinued operations	(210)	(3,000)
Gain on sale of marketable securities	(81)	(89)
Provision for doubtful accounts and note receivable relating to the discontinued operation	68	197
Depreciation and amortization	337	296
Amortization of deferred revenue	(75)	(10)
Stock and stock option compensation awards to non-employees	92	137
Restricted stock awards	33	80
Amortization of premium/discount and accretion of marketable securities	11	150
Loss on retirements of fixed assets	2	4
Changes in operating assets and liabilities:		
Accounts receivable	(18)	104
Receivables for royalties and contract revenues	75	129
Inventory	(5)	(13)
Prepaid expenses and other	154	(5)
Other long-term assets	18	--
Accounts payable	(103)	324
Accrued expenses	(163)	(354)
Income taxes payable relating to the discontinued operations	--	(255)
Cash used in discontinued operations	(519)	(139)

See accompanying notes.

A.P. PHARMA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) (IN THOUSANDS)

	For the nine months ended September 30,	
	2002	2001
Net cash used in operating activities	(3,935)	(3,271)
Cash flows from investing activities:		
Purchases of property and equipment	(407)	(179)
Purchase of intangibles	--	(14,407)
Purchases of marketable securities	(9,076)	--
Maturities and sales of marketable securities	16,304	13,963
Net cash provided by investing activities	6,821	(623)
Cash flows from financing activities:		
Proceeds from issuance of shares under the Employee Stock Purchase Plan	52	28
Net cash provided by financing activities	52	28
Net (decrease) increase in cash and cash equivalents	2,938	(3,866)
Cash and cash equivalents, beginning of the period	3,618	6,493
Cash and cash equivalents, end of the period	$ 6,556	$ 2,627

See accompanying notes.

A.P. PHARMA, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2002 AND 2001 (UNAUDITED)

(1) Basis of Presentation

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

In the opinion of management, the accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments of a normal recurring nature considered necessary for a fair presentation have been included. Operating results for the three and nine month periods ended September 30, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002. The condensed consolidated balance sheet as of December 31, 2001 has been derived from the audited financial statements as of that date. For further information, refer to the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2001.

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.

Reclassification

Certain reclassifications have been made to the prior period financial statements to conform with the presentation in 2002. Such reclassifications have not impacted previously reported revenues, operating loss, or net income (loss).

Critical Accounting Policies

Use of Estimates

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

Revenue Recognition

Product revenues relate to the Company's sales of water standards for the calibration of turbidimeters used to test water purity and are recorded upon shipment of products when four basic criteria are met: 1) persuasive evidence of an arrangement exists, 2) delivery has occurred or services have been rendered, 3) the fee is fixed and determinable, and 4)

collectibility is reasonably assured. Determination of criteria 3 and 4 are based on management's judgments regarding the fixed nature of the fees charged for products delivered and the collectibility of those fees. Should changes in conditions cause management to determine these criteria are not met for certain future transactions, revenues recognized for any reporting period could be adversely affected.

The Company's licensing agreements generally provide for the Company to receive periodic minimum payments, royalties, milestone payments 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 APP to earn future revenue through royalty payments. These non-refundable license fees are initially reported as deferred revenues and recognized as contract revenues over the estimated life of the product to which they relate as long as the Company has continuing involvement with licensees and until the related product is discontinued. Revenue recognized from deferred license fees is classified as contract revenue in the accompanying consolidated statements of operations. License fees received in connection with arrangements where the Company has no continuing involvement are recognized as revenue when the amounts are received or when collectibility is assured, whichever is earlier. No such fees were recorded in the third quarter of 2002.

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 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. No such payments were received during the nine months ended September 30, 2002.

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

Cash Equivalents and Short-term Investments
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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.

Accrued Disposition Costs
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Costs relating to disposal of discontinued operations are reported as accrued disposition costs in the accompanying balance sheets. Accrued disposition costs include severance costs and indemnification claims related to inventory and gross profit guarantees, all of which are payable over the next year.

Concentrations of Credit Risk
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Financial instruments which potentially expose the Company to concentrations of credit risk consist primarily of trade accounts receivable and receivables from royalties, license fees and research and development fees. Approximately 62% of the recorded trade receivables and receivables from royalties and contract revenues were concentrated with two customers in the pharmaceutical, cosmetic and personal care industries as of

September 20, 2002.

Segment and Geographic Information
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The Company's operations are confined to a single business segment, the design and commercialization of polymer technologies for pharmaceutical and other applications.

Substantially all of our revenues are derived from domestic customers.

Recent Accounting Pronouncements
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In July 2001, the FASB issued FAS 141, "Business Combinations" (FAS 141). FAS 141 supersedes APB 16, "Business Combinations," and FAS 38, "Accounting for Preacquisition Contingencies of Purchased Enterprises." FAS 141 requires the purchase method of accounting for all business combinations initiated after June 30, 2001 and eliminates the pooling-of-interests method. FAS 141 also includes guidance on the initial recognition and measurement of goodwill and other intangible assets arising from business combinations completed after June 30, 2001. Adoption of this statement on January 1, 2002 did not have a material effect on the Company's financial condition or results of operations.

In July 2001, the FASB issued FAS 142, "Goodwill and Other Intangible Assets" (FAS 142). FAS 142 supersedes APB 17, "Intangible Assets," and requires the discontinuance of goodwill amortization. In addition, FAS 142 includes provisions regarding the reclassification of certain existing recognized intangibles as goodwill, reassessment of the useful lives of existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill and the testing for impairment of existing goodwill and other intangibles out of previously reported goodwill and other intangibles. FAS 142 is required to be applied for fiscal years beginning after December 15, 2001, with certain early adoption permitted. Adoption of this statement on January 1, 2002 did not have a material effect on the Company's financial condition or results of operations.

In August 2001, the FASB issued FAS 143, "Accounting for Asset Retirement Obligations" (FAS 143). FAS 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated retirement costs. Adoption of this statement on January 1, 2002 did not have a material effect on the Company's financial condition or results of operations.

In October 2001, the FASB issued FAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (FAS 144), which supersedes FAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" (FAS 121). FAS 144 addresses financial accounting and reporting for the impairment of long-lived assets and for long-lived assets to be disposed of. However, FAS 144 retains the fundamental provisions of FAS 121 for: 1) recognition and measurement of the impairment of long-lived assets to be held and used; and 2) measurement of long-lived assets to be disposed of by sale. FAS 144 is effective for fiscal years beginning after December 15, 2001. Adoption of this statement on January 1, 2002 did not have a material effect on the Company's financial condition or results of operations.

In June 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards, "Accounting for Costs Associated with Exit or Disposal Activities" (FAS 146)." FAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue (EITF) No. 94-3 " Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)" (EITF 94-3). FAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred, not at the date of an entity's commitment to an exit plan, as required under EITF 94-3. The provisions of FAS 146 are effective for exit or disposal activities initiated after December 31, 2002,

with earlier application encouraged. The Company is currently analyzing the effect, if any, the adoption of this standard will have on the financial condition or results of operations.

(2) Net Loss Per Share Information

The Company reports both basic earnings (loss) per share, which is computed by dividing net income (loss) by the weighted-average number of common shares outstanding, and diluted earnings per share, which is computed by dividing net income (loss) by the total of weighted-average number of common shares outstanding and dilutive potential common shares outstanding. Because the Company is in a net loss position for the three and nine months ended September 30, 2002 diluted earnings per share excludes the effects of options, warrants and convertible securities which are antidilutive.

(3) Comprehensive Loss

Comprehensive loss for the three and nine months ended September 30, 2002 and 2001 consists of the following (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2002	September 30, 2001	September 30, 2002	September 30, 2001
Net income (loss)	$(1,052)	$ 1,491	$(3,551)	$ (827)
Unrealized holding gains arising during the period	(20)	141	(150)	207
Comprehensive income (loss)	$(1,072)	$ 1,632	$(3,701)	$ (620)

(4) Inventory

The major components of inventory are as follows (in thousands):

	September 30, 2002	December 31, 2001
Raw materials	$ 33	$ 28
Finished goods	33	33
Total inventory	$ 66	$ 61

(5) 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 further earnout amounts for the subsequent three years up to a maximum of $26.5 million, the amounts of which are dependent on the performance of the business sold. During the first two years of the earnout period, the Company received an aggregate of $3.8 million. The earnout is calculated based on gross profit earned by the

business sold over a three-year period. The terms of the agreement with RP Scherer provide for an earnout of 20% to 60% of gross profit of the business sold over a threshold which increases each year. Each earnout year has a different minimum level of gross profit that should be achieved before any earnout income can be received. In addition to the minimum gross profit levels, each earnout period has three additional gross profit hurdles that correspond to a specific earnout percentage up to a maximum of 60%. Earnout hurdles for the third and final year are higher than the first two years. The cosmeceutical and toiletry business is reported as a discontinued operation for all periods presented in the accompanying Condensed Consolidated Statements of Operations.

Income from discontinued operations represents changes in estimates relating to the discontinued operations and consists of the following:

	For the nine months ended	
	September 30, 2002	September 30, 2001
Change in estimate for professional fees	$ (8)	$(168)
Change in estimate for Kligman lawsuit settlement	--	138
Provision for doubtful accounts and note receivable	(68)	(180)
Change in estimate for guarantees	25	(50)
Change in estimate of provision for income taxes and tax refunds	51	275
Total change in estimate	$ --	$ 15

Basic and diluted loss per common share from discontinued operations excluding the gain on sale of the cosmeceutical product lines was $0.00 for the three and nine months ended September 30, 2002. Basic and diluted income per share from discontinued operations was $0.01 and $0.00 for the three and nine months ended September 30, 2001, respectively.

As of September 30, 2002, net assets relating to the discontinued operation include trade receivables of $195,000, a note receivable of $453,000 and a provision for doubtful accounts and note receivable of $486,000. Liabilities related to the discontinued operation in the amount of $750,000 include severance costs and accruals for indemnification claims related to inventory and gross profit guarantees. These liabilities are reported as accrued disposition costs in the accompanying balance sheets.

Cash used in discontinued operations primarily relates to payments of severance costs to former employees who were terminated as a result of the sale of the cosmeceutical and toiletry business. A total of 56 positions, primarily in the manufacturing, marketing and research and development departments and associated general and administrative staff, were eliminated as a result of the sale. During the year ended December 31, 2000, the Company recorded severance charges related to salaries and benefits in gain on disposition of discontinued operations. The total amount of severance-related charges was approximately $3,685,000, of which approximately $3,478,000 has been paid to date, including $62,000 in the current quarter. Approximately $207,000 remains accrued as of September 30, 2002. The accrued severance of approximately $207,000 is expected to be paid by July 31, 2003.

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

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

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

CRITICAL ACCOUNTING POLICIES

Revenue Recognition

Product revenues relate to the Company's sales of water standards for the calibration of turbidimeters used to test water purity and are recorded upon shipment of products when four basic criteria are met: 1) persuasive evidence of an arrangement exists, 2) delivery has occurred or services have been rendered, 3) the fee is fixed and determinable, and 4) collectibility is reasonably assured. Determination of criteria 3 and 4 are based on management's judgments regarding the fixed nature of the fees charged for products delivered and the collectibility of those fees. Should changes in conditions cause management to determine these criteria are not met for certain future transactions, revenue recognized for any reporting period could be adversely affected.

The Company's has licensing agreements that generally provide for the Company to receive periodic minimum payments, royalties, milestone payments 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 APP to earn future revenue through royalty payments. These non-refundable license fees are initially reported as deferred revenues and recognized as revenues over the estimated life of the product to which they relate as the Company has continuing involvement with licensees until the related product is discontinued. Revenue recognized from deferred license fees is classified as contract revenues in the accompanying condensed consolidated statements of operations. License fees received in connection with arrangements where the Company has no continuing involvement are recognized as revenue when the amounts are received or when collectibility is assured, whichever is earlier. No such fees were recorded in the third quarter of 2002.

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 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. No such payments were received during the nine months ended September 30, 2002.

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

Results of Operations for the Three Months Ended September 30, 2002 and 2001

The Company's revenues are derived principally from royalties from third party sales of topical prescription products, license fees, contract revenues and product sales of water standards. 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.

Royalties for the third quarter of 2002 increased by 30% or $213,000 to $935,000 from $722,000 in the corresponding quarter of the prior year. This increase was due primarily to increased sales of Retin-A Micro(R), a prescription acne treatment which is marketed and distributed by Ortho Neutrogena, following the launch of a low dose product line extension in July 2002, and increased sales of Carac(TM)for the treatment of actinic keratoses, which is marketed and distributed by Dermik Laboratories, an Aventis Company.

Contract revenues for the three months ended September 30, 2002 were $106,000 compared with $4,000 in the corresponding period of the prior year, due to the initiation of more collaborative research and development arrangements.

Product revenues for the third quarter of 2002 relating to sales of analytical standards products increased by $59,000 or 24% to $302,000 from $243,000 in the third quarter of the prior year.

Gross profit margin on sales of analytical standards for the third quarter of 2002 was essentially flat compared with the corresponding quarter of the prior year.

Research and development expense for the third quarter of 2002 decreased by $114,000 to $1,874,000 due mainly to postponed spending on Phase II clinical studies, offset by increased headcount and related expenses as the Company undertook a variety of new product development activities. In July 2002, the Company submitted to the Food and Drug Administration (FDA) the protocol for a Phase II clinical study for the Company's first product candidate, APF112, for the treatment of post-surgical pain. In August 2002, the Company withdrew the proposed protocol for a Phase II clinical study for APF112 in response to FDA concerns regarding observed irritation in preclinical studies. This mild to moderate irritation lasted beyond the planned 24 - 36 hours of pain relief following administration into the knee joint. A comprehensive proposal on the scope of animal studies required for the resumption of human clinical studies has been submitted to the FDA and the Company anticipates meeting with FDA officials during the fourth quarter of 2002. The delay caused by the withdrawal of the Phase II protocol will defer a portion of the anticipated increase in research and development spending until 2003, assuming that the Company is successful in gaining FDA clearance to proceed with the study. Additional costs will be incurred in the near-term to conduct animal studies as part of the Company's plan to resume human clinical testing. These additional costs are not expected to be material. If the Company is successful in gaining FDA clearance to proceed with the protocol, the delay in the commencement of a Phase II clinical study could result in a delay in the filing of a New Drug Application (NDA) for APF112, and hence could result in a delay in the product candidate's marketing clearance and initiation of revenue streams. If the Company is not successful in gaining FDA clearance to proceed with the protocol, there will be a delay in the development of the Company's first product candidate while reformulation work is carried out prior to clinical trials.

Selling and marketing expense for the third quarter of 2002 increased by $2,000 or 2% to $108,000. Selling and marketing expense is expected to remain essentially unchanged for fiscal 2002 as compared with fiscal 2001.

General and administrative expense for the third quarter of 2002

decreased by $24,000 or 3% from $720,000 to $696,000. General and administrative expense is expected to increase only moderately for fiscal 2002 as compared with fiscal 2001, primarily due to increased investor relations activities.

Interest income for the third quarter of 2002 decreased by $110,000 or 46% to $127,000 from $237,000 due to lower interest rates earned on lower average cash balances.

The gain on disposal of discontinued operations of $210,000 represents the second year earnout payment from the sale of the cosmeceutical and toiletries business to RP Scherer in July 2000. This compares with an earnout payment of $3,000,000 reported in the third quarter of the prior year. The decrease of $2,790,000 is principally due to lower sales of the divested product lines and resulting lower gross profit. Under the agreement, the Company can receive up to $26.5 million over the first three years of the earnout period, based on the gross profit of the business sold.

Income from discontinued operations in the prior year included a reserve of $400,000 relating to a note receivable arising from the Company's sale of certain proprietary rights to a consumer product in 1999. As payments on the note were not received on a timely basis, a reserve was recorded against the remaining outstanding balance on the note. This was partially offset by the recovery from a customer of $220,000 for which the Company had previously recorded a reserve.

Results of Operations for the Nine Months Ended September 30, 2002 and 2001

Royalties for the nine months ended September 30, 2002 of $2,768,000 increased by $702,000 or 34% over the corresponding period of the prior year. This increase was due primarily to increased sales of Carac(TM) by Dermik Laboratories, an Aventis company, and the launch of a new product line extension of Retin-A Micro(R) by Ortho Neutrogena, a Johnson & Johnson company.

Contract revenues for the nine months ended September 30, 2002 were $192,000 compared with $35,000 in the corresponding period of the prior year, due to the initiation of more collaborative research and development arrangements.

Product revenues for the nine months ended September 30, 2002 increased by $30,000 or 4% to $869,000 due to increased sales of analytical standards.

Research and development expense increased by $333,000 or 7% to $5,243,000 due mainly to increased headcount and related expenses offset by deferred expenditures on the Company's first product candidate, APF112, for the treatment of post-surgical pain. In August 2002, the Company withdrew the proposed protocol for a Phase II clinical study for APF112 in response to FDA concerns regarding observed irritation in preclinical studies. This mild to moderate irritation lasted beyond the planned 24 - 36 hours of pain relief following administration into the knee joint. A comprehensive proposal on the scope of animal studies required for the resumption of human clinical studies has been submitted to the FDA and the Company anticipates meeting with FDA officials during the fourth quarter of 2002. The delay caused by the withdrawal of the Phase II protocol will defer a portion of the anticipated increase in research and development spending until 2003, assuming that the Company is successful in gaining FDA clearance to proceed with the study. Additional costs will be incurred in the near-term to conduct animal studies as part of the Company's plan to resume human clinical testing. These additional costs are not expected to be material. If the Company is successful in gaining FDA clearance to proceed with the protocol, the delay in the commencement of a Phase II clinical study could result in a delay in the filing of a New Drug Application (NDA) for APF112, and hence could result in a delay in the product candidate's marketing clearance and initiation of revenue streams. If the Company is not successful in gaining FDA clearance to proceed with the protocol, there will be a delay in the development of the Company's first product candidate while reformulation work is carried out prior to clinical trials.

Selling and marketing expense for the nine months ended September 30, 2002 of $352,000 increased by $7,000 or 2% from $345,000 in the corresponding period of the prior year. Selling and marketing

expense is expected to remain essentially unchanged for fiscal 2002 as compared to fiscal 2001.

General and administrative expense for the first nine months of 2002 increased by $66,000 or 3% to $2,225,000 due mainly to increased investor relations activities and the addition of the business development function in May 2001. General and administrative expense is expected to increase moderately in 2002, primarily due to increased investor relations activities.

Interest income for the first nine months of 2002 decreased by $370,000 or 43% to $491,000 due to lower interest rates earned on lower average cash balances.

The gain on disposal of discontinued operations of $210,000 represents the second year earnout payment from the sale of the cosmeceutical and toiletries business to RP Scherer in July 2000. This compares with an earnout payment of $3,000,000 reported in the third quarter of the prior year. The decrease of $2,790,000 is principally due to lower sales of the divested product lines and resulting lower gross profit. Under the agreement, the Company can receive up to $26.5 million over the first three years of the earnout period, based on the gross profit of the business sold.

Income from discontinued operations in the prior year included a reserve of $400,000 relating to a note receivable arising from the Company's sale of certain proprietary rights to a consumer product in 1999. As payments on the note were not received on a timely basis, a reserve was recorded against the remaining outstanding balance on the note. This was partially offset by the recovery from a customer of $220,000 for which the Company had previously recorded a reserve.

Capital Resources and Liquidity
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Total assets as of September 30, 2002 were $18,913,000 compared with $23,507,000 at December 31, 2001. Cash, cash equivalents and marketable securities decreased by $4,370,000 to $15,124,000 at September 30, 2002 from $19,494,000 at December 31, 2001.

Net cash used in operating activities for the nine months ended September 30, 2002 and 2001 was $3,935,000 and $3,271,000, respectively. The increase in net cash used in operating activities was due principally to a lower earnout payment from the sale of the cosmeceutical and toiletries business to RP Scherer compared with the prior year.

Cash provided by investing activities for the nine months ended September 30, 2002 was $6,821,000 compared with cash used in investing activities of $623,000 for the comparable period of the prior year. The increase is due to maturities and sales of marketable securities.

The Company has financed its operations, including technology and product research and development, from royalties on sales of Retin-A Micro and Carac, proceeds from the sale of the cosmeceutical and toiletry business to RP Scherer, the sales of analytical standard products, interest earned on short-term investments and research and development fees received from corporate collaborators.

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 research and development fees, are expected to be sufficient to meet the Company's cash needs for at least two years, assuming no changes to business plans.

The Company's future capital requirements will depend on numerous factors including, among others, royalties from sales of products by third party licensees; the Company's ability to enter into collaborative research and development and licensing agreements; progress of product candidates in preclinical and clinical trials; investment in new research and development programs; time required to gain regulatory approvals; resources that the Company devotes to self-funded products; the Company's ability to obtain and retain funding from third parties under collaborative agreements; and the costs of defending or prosecuting any patent opposition or litigation necessary to protect the Company's proprietary technology.

New Accounting Standards
- ------------------------

In July 2001, the FASB issued FAS 141, "Business Combinations" (FAS 141). FAS 141 supersedes APB 16, "Business Combinations," and FAS 38, "Accounting for Preacquisition Contingencies of Purchased Enterprises." FAS 141 requires the purchase method of accounting for all business combinations initiated after June 30, 2001 and eliminates the pooling-of-interests method. FAS 141 also includes guidance on the initial recognition and measurement of goodwill and other intangible assets arising from business combinations completed after June 30, 2001. Adoption of this statement on January 1, 2002 did not have a material effect on the Company's financial condition or results of operations.

In July 2001, the FASB issued FAS 142, "Goodwill and Other Intangible Assets" (FAS 142). FAS 142 supersedes APB 17, "Intangible Assets," and requires the discontinuance of goodwill amortization. In addition, FAS 142 includes provisions regarding the reclassification of certain existing recognized intangibles as goodwill, reassessment of the useful lives of existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill and the testing for impairment of existing goodwill and other intangibles out of previously reported goodwill and other intangibles. FAS 142 is required to be applied for fiscal years beginning after December 15, 2001, with certain early adoption permitted. Adoption of this statement on January 1, 2002 did not have a material effect on the Company's financial condition or results of operations.

In August 2001, the FASB issued FAS 143, "Accounting for Asset Retirement Obligations" (FAS 143). FAS 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated retirement costs. Adoption of this statement on January 1, 2002 did not have a material effect on the Company's financial condition or results of operations.

In October 2001, the FASB issued FAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (FAS 144), which supersedes FAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" (FAS 121). FAS 144 addresses financial accounting and reporting for the impairment of long-lived assets and for long-lived assets to be disposed of. However, FAS 144 retains the fundamental provisions of FAS 121 for: 1) recognition and measurement of the impairment of long-lived assets to be held and used; and 2) measurement of long-lived assets to be disposed of by sale. FAS 144 is effective for fiscal years beginning after December 15, 2001. Adoption of this statement on January 1, 2002 did not have a material effect on the Company's financial condition or results of operations.

In June 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards, "Accounting for Costs Associated with Exit or Disposal Activities" (FAS 146). FAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue (EITF) No. 94-3 " Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)" (EITF 94-3). FAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred, not at the date of an entity's commitment to an exit plan, as required under EITF 94-3. The provisions of FAS 146 are effective for exit or disposal activities initiated after December 31, 2002, with earlier application encouraged. The Company is currently analyzing the effect, if any, the adoption of this standard will have on the financial condition or results of operations.

ITEM 3. Quantitative and Qualitative Disclosure about Market Risk

Since December 31, 2001, there have been no material changes in the Company's market risk exposure.

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures: The Company's

Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-14(c) and 15d-14(c)) within 90 days before the filing date of this quarterly report, have concluded that the Company's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company was made known to them particularly during the period in which this Form 10-Q was being prepared.

Changes in Internal Controls: There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, nor were there any significant deficiencies or material weaknesses in the Company's internal controls. Accordingly, no corrective actions were required or undertaken.

We intend to review and evaluate the design and effectiveness of our disclosure controls and procedures on an ongoing basis and to improve our controls and procedures over time and to correct any deficiencies that we may discover in the future. Our goal is to ensure that our senior management has timely access to all material financial and non-financial information concerning our business. Wile we believe the present design of our disclosure controls and procedures is effective to achieve our goal, future events affecting our business may cause us to significantly modify our disclosure controls and procedures.

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 14, 2002 By: /S/ Michael O'Connell

Michael O'Connell
President and Chief
Executive Officer

Date: November 14, 2002 By: /S/ Gordon Sangster

Gordon Sangster
Chief Financial Officer

CERTIFICATIONS

Certifications:

I, Michael O'Connell, certify that:

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

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

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

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the

registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ Michael O'Connell
- ---------------------
Michael O'Connell
President and Chief Executive Officer

Certifications:

I, Gordon Sangster, certify that:

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

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

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

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b. any fraud, whether or not material, that involves

management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ Gordon Sangster
- ------------------
Gordon Sangster
Chief Financial Officer

EXHIBIT INDEX

99.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Exhibit 99.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of A.P. Pharma, Inc. (the "Company") on Form 10-Q for the period ending September 30, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Michael O'Connell, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Michael O'Connell
Michael O'Connell,
Chief Executive Officer

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of A.P. Pharma, Inc. (the "Company") on Form 10-Q for the period ending September 30, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Gordon Sangster, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Gordon Sangster
Gordon Sangster,
Chief Financial Officer