

DERMA SCIENCES, INC.  
Form 10-Q  
August 12, 2013

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

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**FORM 10-Q**

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2013

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 1-31070

**Derma Sciences, Inc.**

(Exact name of registrant as specified in its charter)

Delaware

23-2328753

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(State or other jurisdiction of Incorporation) (IRS employer identification number)

214 Carnegie Center, Suite 300

Princeton, NJ 08540

(Address of principal executive offices)

(609) 514-4744

(Issuer's telephone number)

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

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Date: August 12, 2013 Class: Common Stock, par value \$.01 per share  
Shares Outstanding: 17,264,198

PART I – FINANCIAL INFORMATION

**DERMA SCIENCES, INC.**

**FORM 10-Q**

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**Part I – Financial Information****Item 1. Financial Statements.**

## DERMA SCIENCES, INC. AND SUBSIDIARIES

**Consolidated Balance Sheets (Unaudited)**

<b>ASSETS</b>	<b>June 30, 2013</b>	<b>December 31, 2012</b>
Current Assets		
Cash and cash equivalents	\$21,402,603	\$41,616,657
Short-term investments	16,472,000	3,730,000
Accounts receivable, net	7,425,109	7,085,713
Inventories	14,051,601	13,670,588
Prepaid expenses and other current assets	3,068,825	3,209,031
Total current assets	62,420,138	69,311,989
Long-term investments	1,494,000	498,000
Equipment and improvements, net	2,986,501	3,304,852
Identifiable intangible assets, net	15,781,556	17,128,883
Goodwill	13,457,693	13,457,693
Other assets	138,858	141,213
Total Assets	\$96,278,746	\$103,842,630
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities		
Accounts payable	\$4,817,561	\$3,993,687
Accrued expenses and other current liabilities	4,058,851	4,132,934
Total current liabilities	8,876,412	8,126,621
Long-term liabilities	274,661	268,517
Deferred tax liability	1,744,792	1,736,299
Total Liabilities	10,895,865	10,131,437
Commitments and contingencies (Note 8)		
Stockholders' Equity		
Convertible preferred stock, \$.01 par value; shares authorized 1,468,750; issued and outstanding 73,332 at June 30, 2013 and December 31, 2012 (liquidation preference of \$3,222,368 at June 30, 2013)	733	733
	172,412	165,247

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Common stock, \$.01 par value; shares authorized 35,000,000; issued and outstanding 17,241,248 at June 30, 2013 and 16,524,723 at December 31, 2012		
Additional paid-in capital	137,636,158	132,163,083
Accumulated other comprehensive income – cumulative translation adjustments	1,369,788	1,588,888
Accumulated deficit	(53,796,210 )	(40,206,758 )
Total Stockholders' Equity	85,382,881	93,711,193
Total Liabilities and Stockholders' Equity	\$96,278,746	\$103,842,630

See accompanying consolidated notes.

**DERMA SCIENCES, INC. AND SUBSIDIARIES****Consolidated Statements of Comprehensive Loss (Unaudited)**

	<b>Three Months Ended</b>	
	<b>June 30,</b>	
	<b>2013</b>	<b>2012</b>
<b>Net Sales</b>	\$ 18,148,061	\$ 17,609,799
Cost of sales	11,473,900	11,411,224
<b>Gross Profit</b>	6,674,161	6,198,575
<b>Operating Expenses</b>		
Selling, general and administrative	10,823,370	9,229,184
Research and development	3,242,599	1,515,329
Total operating expenses	14,065,969	10,744,513
Operating loss	(7,391,808 )	(4,545,938 )
Other (income) expense, net:		
Interest income	(8,030 )	(5,771 )
Other (income) expense, net	(8,703 )	56,069
Total other (income) expense, net	(16,733 )	50,298
Loss before income taxes	(7,375,075 )	(4,596,236 )
Income tax benefit	(30,402 )	(1,804,187 )
<b>Net Loss</b>	(7,344,673 )	(2,792,049 )
<b>Other Comprehensive Loss</b>		
Foreign currency translation adjustment	(169,419 )	(86,510 )
<b>Comprehensive Loss</b>	\$(7,514,092 )	\$(2,878,559 )
Net loss per common share – basic and diluted	\$(0.43 )	\$(0.23 )
Shares used in computing net loss per common share – basic and diluted	17,068,854	12,243,156

See accompanying consolidated notes.



**DERMA SCIENCES, INC. AND SUBSIDIARIES****Consolidated Statements of Comprehensive Loss (Unaudited)**

	<b>Six Months Ended June</b>	
	<b>30,</b>	
	<b>2013</b>	<b>2012</b>
<b>Net Sales</b>	\$36,937,807	\$32,887,165
Cost of sales	23,559,181	21,812,430
<b>Gross Profit</b>	13,378,626	11,074,735
<b>Operating Expenses</b>		
Selling, general and administrative	20,676,455	15,588,274
Research and development	6,235,765	2,630,027
Total operating expenses	26,912,220	18,218,301
Operating loss	(13,533,594)	(7,143,566)
Other expense (income), net:		
Interest income	(14,052 )	(10,850 )
Other expense, net	86,124	1,185
Total other expense (income), net	72,072	(9,665 )
Loss before income taxes	(13,605,666)	(7,133,901)
Income tax benefit	(16,214 )	(1,802,951)
<b>Net Loss</b>	(13,589,452)	(5,330,950)
<b>Other Comprehensive Loss</b>		
Foreign currency translation adjustment	(219,100 )	(7,170 )
<b>Comprehensive Loss</b>	\$(13,808,552)	\$(5,338,120)
Net loss per common share – basic and diluted	\$(0.81 )	\$(0.46 )
Shares used in computing net loss per common share – basic and diluted	16,832,578	11,660,609

See accompanying consolidated notes.

**DERMA SCIENCES, INC. AND SUBSIDIARIES****Consolidated Statements of Cash Flows (Unaudited)**

	Six Months Ended June 30,	
	2013	2012
<b>Operating Activities</b>		
Net loss	\$(13,589,452)	\$(5,330,950 )
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation of equipment and improvements	467,400	516,209
Amortization of intangible assets	1,447,327	667,540
Provision (recovery) for bad debts	14,000	(2,923 )
(Recovery) allowance for sales adjustments	(16,805 )	12,080
Provision for inventory obsolescence	73,781	84,060
Loss on disposal of equipment	--	25,653
Deferred rent expense	16,945	(15,459 )
Stock based compensation	2,806,137	1,251,322
Deferred income taxes	74,639	(1,829,470 )
Changes in operating assets and liabilities:		
Accounts receivable	(349,151 )	340,591
Inventories	(732,687 )	(3,711,502 )
Prepaid expenses and other current assets	83,236	1,305,474
Other assets	(431 )	(46,799 )
Accounts payable	871,362	(224,045 )
Accrued expenses and other current liabilities	30,839	(211,360 )
Net cash used in operating activities	(8,802,860 )	(7,169,579 )
<b>Investing Activities</b>		
Investment in acquired business, net of cash acquired	--	(14,382,578)
Purchase of investments	(16,475,000)	(1,990,000 )
Proceeds from sale of investments	2,737,000	2,240,000
Purchase of equipment and improvements	(282,574 )	(409,944 )
Proceeds from sale of equipment	--	43,000
Purchase of identifiable intangible assets	(100,000 )	--
Net cash used in investing activities	(14,120,574)	(14,499,522)
<b>Financing Activities</b>		
Proceeds from sale of common stock, net of costs	--	17,855,922
Proceeds from exercise of stock options and warrants, net of costs	2,750,549	329,878
Payment of withholding taxes related to employee stock compensation	(76,446 )	(68,190 )
Net cash provided by financing activities	2,674,103	18,117,610
Effect of exchange rate changes on cash and cash equivalents	35,277	40,867
Net decrease in cash and cash equivalents	(20,214,054)	(3,510,624 )
Cash and cash equivalents		
Beginning of period	41,616,657	17,110,350
End of period	\$21,402,603	\$13,599,726

Supplemental disclosures of cash flow information:

Cash paid during the year for:

Interest	\$717	\$943
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See accompanying consolidated notes.

## **DERMA SCIENCES, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements (Unaudited)

### **1. Organization and Summary of Significant Accounting Policies**

Derma Sciences, Inc. and its subsidiaries (the “Company”) is a medical technology company focused on three segments of the wound care marketplace: advanced wound care, traditional wound care and pharmaceutical wound care products. The Company has one drug candidate that initiated its Phase 3 study during the first quarter of 2013. The Company markets its products principally through direct sales representatives in the United States (“U.S.”), Canada and the United Kingdom (“U.K.”), and through independent distributors within other select international markets. The Company’s U.S. distribution facilities are located in St. Louis, Missouri and Houston, Texas. The Company utilizes third party distributors for distribution in Canada, Europe and the Far East. The Company also has manufacturing facilities in Toronto, Canada and Nantong, China.

#### **Basis of Presentation**

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the U.S. for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the six months ended June 30, 2013, are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. Information included in the consolidated balance sheet as of December 31, 2012 has been derived from the consolidated financial statements and footnotes thereto for the year ended December 31, 2012, included in the Annual Report on Form 10-K previously filed with the Securities and Exchange Commission. For further information refer to the Annual Report on Form 10-K.

**Principles of Consolidation** – The consolidated financial statements include the accounts of Derma Sciences, Inc. and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

**Use of Estimates** – The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Although these estimates are based on knowledge of current events and actions which may be undertaken in the future, actual results may ultimately differ from these estimates. Estimates and assumptions are required in the determination of sales deductions for trade rebates, sales incentives, discounts and allowances. Significant estimates and assumptions are also required in determining the appropriateness of amortization periods for identifiable intangible assets, the potential impairment of goodwill and the valuation of inventory.

**Revenue Recognition** – Sales are recorded when product is shipped or title passes to customers and collectability is reasonably assured. Gross sales are adjusted for cash discounts, returns and allowances, trade rebates, distribution fees (in Canada) and other sales deductions in the same period that the related sales are recorded. Freight costs billed to and reimbursed by customers are recorded as a component of revenue. Freight costs to ship product to customers are recorded as a component of cost of sales.

**Net Loss per Share** – Net loss per common share – basic is computed by dividing net loss by the weighted average number of common shares outstanding for the period. Net loss per common share – diluted reflects the potential dilution of earnings by including the effects of the assumed exercise, conversion or issuance of potentially issuable shares of common stock (“potentially dilutive securities”), including those attributable to stock options, warrants, convertible preferred stock and restricted stock units in the weighted average number of common shares outstanding for a period, if dilutive. The effects of the assumed exercise of warrants and stock options are determined using the treasury stock method. Potentially dilutive securities have not been included in the computation of diluted loss per share for the three and six months ended June 30, 2013 and 2012 as the effect would be anti-dilutive.

**DERMA SCIENCES, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements (Unaudited)

Potentially dilutive shares excluded as a result of the effects being anti-dilutive are as follows:

	Three and Six Months Ended June 30, <b>2013</b> 2012	
Dilutive shares:		
Convertible preferred stock	73,332	73,332
Additional stock issuable related to conversion of preferred stock	73,566	-
Restricted share units		