DERMA SCIENCES INC
Form 10QSB
May 15, 2003

U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-QSB

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

For Quarter Ended	March 31, 2003
Commission File Number	1-31070

Derma Sciences, Inc.

(Exact name of small business issuer as specified in its charter)

Pennsylvania	**23-2328753**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

214 Carnegie Center, Suite 100
Princeton, New Jersey 08540
(609) 514-4744
(Address including zip code and telephone number, of principal executive offices)

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

State the number of shares of each of the issuer's classes of common equity, as of the latest practicable date.

Date: March 31, 2003 | Class: Common Stock, par value $.01 per share
Shares Outstanding: 4,631,276

DERMA SCIENCES, INC.

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Forward Looking Statements

This document includes certain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on management's current expectations and are subject to uncertainty and changes in circumstances. Actual results may differ materially from these expectations due to changes in political, economic, business, competitive, market and regulatory factors.

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Part I - Financial Information

Item 1. FINANCIAL STATEMENTS

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DERMA SCIENCES, INC.

Consolidated Balance Sheets

	March 31, 2003 (Unaudited)	December 31 2002
ASSETS		
Current Assets		
Cash and cash equivalents	$ 471,426	$ 1,496,357
Accounts receivable, net	2,091,430	1,975,993
Inventories	3,017,866	2,875,755
Prepaid expenses and other current assets	445,485	281,066
Total current assets	6,026,207	6,629,171
Property and equipment, net	1,034,317	987,891
Goodwill	1,110,967	1,110,967
Patents and trademarks, net	136,152	140,378
Other assets, net	158,366	220,177
Total Assets	$ 8,466,009	$ 9,088,584
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Line of credit	$ 1,221,092	$ 1,962,627
Current maturities of long-term debt	160,512	173,493
Accounts payable	873,242	692,259
Accrued expenses and other current liabilities	266,325	445,791
Total current liabilities	2,521,171	3,274,170
Long-term debt	867,284	845,455
Total Liabilities	3,388,455	4,119,625
Shareholders' Equity		
Common stock, $.01 par value, 30,000,000 shares authorized; issued and outstanding: 4,631,276 shares	46,313	46,313
Convertible preferred stock, $.01 par value; 11,750,000 shares		

authorized; issued and outstanding: 2,526,242 shares (liquidation preference of $4,460,237)	25,262	25,262
Additional paid-in capital	15,583,056	15,588,698
Accumulated other comprehensive income (loss)	84,431	(21,736
Accumulated deficit	(10,661,508)	(10,669,578
Total Shareholders' Equity	5,077,554	4,968,959
Total Liabilities and Shareholders' Equity	$ 8,466,009	$ 9,088,584

See accompanying notes.

DERMA SCIENCES, INC.

Consolidated Statement of Operations (Unaudited)

	Three months ended March 31, 2003	2002
Net sales	$ 4,216,239	$ 2,140,457
Cost of sales	2,689,229	975,920
Gross Profit	1,527,010	1,164,537
Operating expenses	1,455,097	985,521
Interest expense, net	113,439	124,375
Other income, net	(49,596)	(9,574)
Total Expenses	1,518,940	1,100,322
Income before provision for income taxes	8,070	64,215
Provision for income taxes	-	-
Net Income	$ 8,070	$ 64,215
Income per common share - basic	$ 0.00	$ 0.03
Income per common share - diluted	$ 0.00	$ 0.01
Shares used in computing income per common share - basic	4,631,276	2,407,109
Shares used in computing income per common share - diluted	7,174,116	5,843,397

See accompanying notes.

DERMA SCIENCES, INC.

Consolidated Statement of Cash Flows (Unaudited)

	Three months ended March 31, 2003	200
Operating Activities		
Net income	$ 8,070	$ 64,2
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation	37,206	16,6
Amortization	74,072	4,3
Deferred financing costs	7,500	127,7
Provision for bad debts and rebates	5,176	5,0
Provision for inventory obsolescence	12,000	9,0
Loss on disposal of fixed assets	2,132	-
Changes in operating assets and liabilities		
Restricted cash	-	(565,0
Accounts receivable	(31,709)	(36,5
Inventories	(41,184)	210,7
Prepaid expenses and other current assets	(129,439)	(221,2
Other assets	(6,893)	-
Accounts payable	165,185	(66,9
Accrued expenses and other current liabilities	(192,548)	538,8
Net cash (used in) provided by operating activities	(90,432)	86,7
Investing Activities		
Purchases of property and equipment	(26,572)	(33,9
Net cash used in investing activities	(26,572)	(33,9
Financing Activities		
Net change in bank line of credit	(817,548)	-
Deferred financing costs	(19,757)	-
Long-term debt repayments	(65,929)	-
Stock issuance costs	(5,642)	-
Net cash (used in) financing activities	(908,876)	-
Effect of exchange rate changes on cash	949	-
Net (decrease) increase in cash and cash equivalents	(1,024,931)	52,7
Cash and cash equivalents		
Beginning of period	1,496,357	524,7
End of period	$ 471,426	$ 577,5
Supplemental cash flow information		
Conversion of bonds payable and accrued interest to preferred stock	$ -	$595,2
Common stock and warrants issued for debt conversion/extension	$ -	$120,2
Bond conversion reset provision charge to paid-in capital	$ -	$45,0

See accompanying notes.

DERMA SCIENCES, INC.

Notes To Consolidated Financial Statements

1. Organization and Summary of Significant Accounting Policies

Derma Sciences, Inc. and its subsidiaries (the Company) are full line providers of wound care, wound closure-fasteners and skin care products. The Company markets its products principally through independent distributors servicing the long-term care, home health and acute care markets in the United States, Canada and other select international markets. The Company s principal manufacturing and distribution facilities are located in St. Louis, Missouri and Toronto, Canada. The Company also has a manufacturing facility in Nantong, China.

Basis of Presentation

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

The accompanying unaudited 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-QSB and Item 310(b) of Regulation S-B. 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 (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three month period ended March 31, 2003, are not necessarily indicative of the results that may be expected for the year ending December 31, 2003. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended December 31, 2002, included in Form 10-KSB filed with the Securities and Exchange Commission.

Summary of Significant Accounting Policies:

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.

Use of Estimates In conformity with accounting principles generally accepted in the United States, the preparation of 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.

Foreign Currency Translation Assets and liabilities are translated using the exchange rates in effect at the balance sheet date, while income and expenses are translated using average rates. Translation adjustments are reported as a component of shareholders equity in accumulated other comprehensive income (loss).

Cash and Cash Equivalents The Company considers cash and cash equivalents as amounts on hand, on deposit in financial institutions and highly liquid investments purchased with an original maturity of three months or less.

Allowance for Doubtful Accounts The Company provides an allowance for doubtful accounts for estimated losses resulting from the inability of customers to make required payments. The allowance is determined by analyzing historical data and trends. Past due or delinquency status is based on contractual terms. Charges for doubtful accounts are recorded in operating expenses.

Inventories Inventories consist primarily of raw materials, packaging materials, work in process and finished goods valued at the lower of cost or market. Cost is determined on the basis of the first-in, first-out method.

Property and Equipment Property and equipment are stated at cost and are depreciated principally by the straight-line method over the estimated useful lives of the assets ranging from three to ten years. Leasehold improvements are depreciated over the lesser of their useful lives or the remaining lease term.

Patents and Trademarks Patents and trademarks are stated on the basis of cost and are amortized over 12 to 17 years on a straight-line basis.

Goodwill On January 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 142 (SFAS No. 142), Goodwill and Other Intangible Assets. SFAS No. 142 requires that goodwill is deemed to have an indefinite life and is no longer to be amortized but is subject to an annual impairment test.

Stock Based Compensation The Company grants stock options to employees with an exercise price equal to the fair value of the shares at the date of grant. The Company accounts for stock option grants in accordance with APB Option No. 25, Accounting for Stock Issued to Employees , and, accordingly recognizes no compensation expense for the stock option grants.

Pro forma information regarding net income (loss) and earnings (loss) per share is required by SFAS No. 123, which also requires that the information be determined as if the Company has accounted for its stock options granted under the fair value method of that Statement. For purposes of pro forma disclosures, the estimated fair value of stock options is amortized to expense over the options vesting period. Therefore, future pro forma compensation expense may be greater as additional options are granted. The Company s pro forma information follows:

	Quarter Ended March 31,	
	2003	2002
Net income - as reported	$ 8,070	$ 64,215
Pro forma compensation expense	(81,247)	(20,794)
Pro forma net (loss) income	$(73,177)	$ 43,421
Income (loss) per common share - basic		
As reported	$0.00	$0.03
Pro forma	$(0.02)	$0.02
Income (loss) per common share - diluted		
As reported	$0.00	$0.01
Pro forma	$(0.02)	$0.01

Revenue Recognition The Company operates in three segments: wound care, wound closure-fasteners and skin care. Sales are recorded when product is shipped and title passes to customers. Gross sales are adjusted for cash discounts, Medicaid rebates and trade rebates to derive net sales. Freight costs to ship product to customers are recorded as a component of cost of sales. Freight costs billed to and reimbursed by customers are recorded as a component of revenue.

Advertising and Promotion Costs Advertising and promotion costs are expensed in the period incurred.

Net Income Per Share Net income per common share basic is computed by dividing net income by the weighted average number of common shares outstanding for the period. Net income per common share diluted reflects the potential dilution of earnings by including other common stock equivalents, including stock options, warrants and convertible preferred stock in the weighted average number of common shares outstanding for a period, if dilutive.

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2. Dumex Medical Inc. Acquisition

On August 26, 2002, the Company acquired substantially all the assets of Dumex Medical Inc., a leading manufacturer and distributor of wound care and related medical devices to the Canadian market. The acquisition was effected by the Company s wholly owned Canadian subsidiary, Dumex Medical Canada Inc. The results of operations of Dumex Medical Canada Inc. have been included in the Company s consolidated financial statements since the acquisition date.

3. Accounts Receivable

Accounts receivable include the following:

	March 31, 2003	December 31, 2002
Trade accounts receivable	$2,202,092	$1,943,674
Less: Allowance for doubtful accounts	(35,000)	(40,000)
Allowance for trade rebates	(96,000)	(96,000)
Net trade receivables	2,071,092	1,807,674
Other receivables	20,338	168,319
Total receivables	$2,091,430	$1,975,993

4. Inventories

Inventories include the following:

	March 31, 2003	December 31, 2002
Finished goods	$2,168,458	$2,111,546
Work in process	109,612	91,788
Packaging materials	350,015	287,903
Raw materials	389,781	384,518
Total inventory	$3,017,866	$2,875,755

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5. Property and Equipment

Property and equipment include the following:

	March 31, 2003	December 31, 2002
Machinery and equipment	$1,121,950	$1,043,383
Furniture and fixtures	169,730	165,858
Leasehold improvements	43,759	40,714
Gross property and equipment	1,335,439	1,249,955
Less: Accumulated depreciation	(301,122)	(262,064)
Net property and equipment	$1,034,317	$ 987,891

6. Goodwill

Goodwill of $1,110,967 relates to the 1998 acquisition of Sunshine Products, Inc. Effective January 1, 2002, in accordance with SFAS No. 142, the Company discontinued the amortization of goodwill and conducted the first of the required annual tests of goodwill impairment. An impairment charge would be recognized if the fair value of Sunshine Products, Inc. s goodwill is less than its carrying value. The results of the initial and subsequent tests which the Company completed in the fourth quarter, 2002 indicate that the goodwill carrying value is not impaired.

7. Patents and Trademarks

Patents and trademarks include the following:

	March 31, 2003	December 31, 2002
Patents and trademarks	$ 444,067	$ 444,067
Less: Accumulated amortization	(307,915)	(303,689)
Net patents and trademarks	$ 136,152	$ 140,378

8. Other Assets

Other assets include the following:

	March 31, 2003	December 31, 2002
Deferred financing costs	$ 82,367	$ 162,314
Deposits	53,305	57,863
Other	22,694	-
Total other assets	$ 158,366	$ 220,177

Other relates to legal and consulting expenses associated with a proposed acquisition. These deferred costs will be expensed if the transaction is not completed.

9. Short Term Borrowings

Short term borrowings include the following:

	March 31, 2003	December 31, 2002
Canadian line of credit	1,221,092	$ 962,627
U.S. line of credit	-	1,000,000
Total short term borrowings	$1,221,092	$1,962,627

Canadian Line of Credit

Effective August 26, 2002, in connection with the acquisition of Dumex Medical Inc., the Company entered into a sixteen month revolving credit facility agreement (the Dumex Agreement) for a maximum principal amount of $1,700,000 with a Canadian bank. At March 31, 2003 and December 31, 2002, advances of $1,221,092 and $962,627, respectively, have been drawn against the facility.

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The Company s wholly owned Canadian subsidiary, Dumex Medical Canada Inc., may request advances under the Dumex Agreement up to the value of seventy-five percent (75%) of its eligible receivables (as defined) and fifty percent (50%) of eligible inventory (as defined) up to a maximum of $645,000. Interest on outstanding advances is payable monthly at the prime rate (as defined) plus 1.0%, or 5.75% for advances outstanding at March 31, 2003. Outstanding advances are secured by all tangible and intangible assets of Dumex Medical Canada Inc. In addition, the Canadian bank has a second lien security interest in the assets of the Company s U.S. operations. The Company has also guaranteed payment of amounts due under the Dumex Agreement.

Over the term of the Dumex Agreement, the Company has agreed to comply with a number of financial covenants governing minimum working capital, current ratios, tangible net worth, interest coverage, total indebtedness to tangible net worth and total indebtedness to adjusted pre-tax earnings. These covenants are measured at the end of each month. Additional covenants governing permitted indebtedness, liens, payments of dividends and protection of collateral are included in the Dumex Agreement. In the event of a margin deficiency (as defined) or covenant violation, the Company is required to advance up to an additional $340,000 of working capital to Dumex Medical Canada Inc. in order to correct the deficiency. This additional working capital may be repaid to the Company 45 days after the margin deficiency or covenant violation has been cured upon the condition that such repayment not result in a margin deficiency, covenant violation or any other event of default.

U.S. Line of Credit

In March, 2003 the Company entered into a new one year line of credit agreement (subject to annual renewal) with a U.S. lender (the Agreement) for a maximum principal amount of $2,000,000. No funds have been drawn against the line to date. Estimated maximum potential advances under the Agreement on the date of signing were $1,250,000, less any outstanding standby letters of credit. Advances will be utilized to fund strategic initiatives and for general working capital purposes. The Company terminated its prior U.S. line of credit on February 28, 2003 by repaying the $1,000,000 outstanding indebtedness and paying a $50,000 early termination fee. In addition, the Company charged $66,342 to interest expense for deferred financing costs associated with the prior U.S. line of credit.

The Company may request advances under the Agreement up to the value of 80% of eligible U.S. receivables (as defined) and 50% of eligible U.S. inventory (as defined), excluding work-in-process inventory. Interest on outstanding advances is payable monthly in arrears at the one month LIBOR rate (as published in The Wall Street Journal), plus 3.0%, or 4.3% on the date of signing. In addition, the Company will pay an annual line fee of $20,000. This line fee and any one-time lender or legal costs associated with securing the line of credit will be deferred and amortized to interest expense over the line term of one year.

Outstanding advances are secured by all tangible and intangible assets of the Company s U.S. operations. Over the term of the Agreement, the Company has agreed to maintain its fixed charge ratio (as defined) at not less than 1.25:1.0 as measured quarterly on a twelve month trailing basis. Additional covenants governing permitted indebtedness, changes in entity status, purchase of securities and protection of collateral are included in the Agreement.

As security for indebtedness of the Company s subsidiary, Dumex Medical Canada Inc., the Company has accorded a Canadian bank its guarantee of payment together with a second lien security interest in the Company s assets located in the U.S. In connection with the Agreement and in return for a standby letter of credit in the amount of $200,000 against the new line of credit, the Canadian bank has agreed not to exercise its rights under its second lien security interest and guarantee against the Company s U.S. assets without the U.S. lender s approval. The standby letter of credit serves to reduce the Company s potential borrowing capacity under the Agreement by $200,000.

10. Convertible Bonds

Effective January 7, 2002, bondholders of all the Company s issued and outstanding series C and D convertible bonds converted the entirety of the $475,000 principal and $120,200 accrued interest into units at a rate of one unit for each $0.50 of principal and interest converted. Each unit consists of one share of series C or series D preferred stock and one and one tenth warrants to purchase one share of common stock at a per share exercise price of $0.57 (Series F Warrants). Each share of preferred stock is convertible into common stock on a one-for-one basis. Principal and accrued interest under the bonds totaling $595,200 were converted into 1,190,400 shares of convertible preferred stock and 1,309,441 series F warrants.

If prior to July, 2003, the Company offers for sale its common stock at a price per share below $0.50 or its warrants at a per share exercise price of less than $0.57, then the Company has agreed to: (1) issue to the bondholders such additional shares of preferred stock and warrants as, when added to the preferred stock and warrants previously issued, equal the shares of preferred stock and warrants that would have been issued using the lower common stock price as the conversion rate, and (2) lower the per share exercise price of the Series F Warrants to the lower per share exercise price.

In connection with the conversion, the Company recognized an imputed non-cash interest charge of $165,200. A charge of $45,000 was taken to account for the value of the reset concession granted to the bondholders. This charge is being amortized over the eighteen-month term of the reset concession. A charge of $120,200 was taken immediately to account for the conversion terms associated with the accrued interest.

11. Long-Term Debt

Long-term debt includes the following:

	March 31, 2003	December 31, 2002
Canadian term loan	$1,022,619	$ 987,576
Capital lease obligations	5,177	31,372
Total debt	$1,027,796	$1,018,948
Less: current maturities	160,512	173,493
Long-term debt	$ 867,284	$ 845,455

Effective August 26, 2002, in connection with the acquisition of substantially all the assets of Dumex Medical Inc., the Company entered into a five-year term loan agreement with a Canadian Bank. The loan is repayable in monthly payments consisting of principal and interest commencing October 1, 2002. Interest on the outstanding principal balance is payable monthly at the bank s prime rate (as defined) plus 1.25%, or 6.0% at March 31, 2003. The term loan is secured by all tangible and intangible assets of Dumex Medical Canada Inc. and subject to the same financial covenants applicable to the operating line of credit (Note 9).

12. Shareholders Equity

Preferred Stock

There are 150,003 shares of series A convertible preferred stock outstanding. The series A preferred stock is convertible into common stock on a one-for-one basis, bears no dividend, maintains a liquidation preference of $4.00 per share, votes as a class on matters affecting the series A preferred stock and maintains voting rights identical to the common stock on all other matters.

There are 452,504 shares of series B convertible preferred stock outstanding. The series B preferred stock is convertible into common stock on a one-for-one basis, bears no dividend, maintains a liquidation preference of $6.00 per share, votes as a class on matters affecting the series B preferred stock and maintains voting rights identical to the common stock on all other matters.

There are 719,055 shares of series C convertible preferred stock outstanding. The series C preferred stock is convertible into common stock on a one-for-one basis, bears no dividend, maintains a liquidation preference averaging $0.71 per share, votes as a class on matters affecting the series C preferred stock and maintains voting rights identical to the common stock on all other matters.

There are 1,204,680 shares of series D convertible preferred stock outstanding. The series D preferred stock is convertible into common stock on a one-for-one basis, bears no dividend, maintains a liquidation preference averaging $0.53 per share, votes as a class on matters affecting the series D preferred stock and maintains voting rights identical to the common stock on all other matters.

Stock Purchase Warrants

At March 31, 2003, the Company had warrants outstanding to purchase the Company s common stock as outlined below:

Series	Number of Warrants	Exercise Price	Expiration Date
E	2,200,009	$0.85	July 18, 2005
F	1,309,441	$0.57	January 6, 2007

The Company s 666,673 series B warrants with an exercise price of $6.75 per share expired on June 15, 2002. In connection with the conversion of the Company series C and D convertible bonds on January 7, 2002 described in Note 10, 1,309,441 series F warrants were issued.

Other Equity Transactions

The Company initiated in January 2002 a private offering of 4,000,000 shares of its common stock at a price of $0.50 per share. Offering proceeds are being used to fund strategic initiatives and for general working capital purposes. Through March 31, 2003, 1,600,000 shares of common stock have been issued pursuant to the offering and offering proceeds of $747,678, net of $52,322 in offering expenses, have been received.

In May 2002, a total of 624,167 shares of series A, B and C preferred stock were converted into 624,167 shares of common stock.

13. Comprehensive Income

The Company s total comprehensive income was as follows:

	Quarter Ended March 31, 2003	2002
Net income - as reported	$ 8,070	$ 64,215
Other comprehensive income:		
Foreign currency translation adjustment	106,167	-
Comprehensive income	$114,237	$ 64,215

14. Promissory Note

On January 9, 2003 the Company loaned $50,000 to a supplier pursuant to a secured promissory note. The stated maturity date of the note is December 31, 2003. The note may be prepaid without penalty, bears interest at the annual rate of 5% and is secured by the tangible and intangible property of the supplier. The funds advanced are to be used by the supplier for general working capital purposes in the ordinary course of business. The promissory note is included in prepaid and other current assets on the balance sheet of March 31, 2003.

15. Income taxes

No provision for income taxes has been made in either the first quarter 2003 and 2002 given the Company s available net operating loss carryforwards.

At December 31, 2002, the Company has net operating loss carryforwards of approximately $7,000,000 for federal income tax purposes that begin to expire in years 2012 through 2020. For state income tax purposes, the Company has net operating loss carryforwards of approximately $7,000,000 that expire in years 2004 through 2010. As of December 31, 2002, the Company has foreign net operating loss carryforwards of approximately $182,000 which begin to expire in 2009. Based on transactions occurring in periods prior to 2001, the Company may have had a change in control as defined in Internal Revenue Code Section 382. Consequently, certain limitations may apply to the timing and amount of the utilization of the federal operating loss carryforwards.

16. Operating Segments

The Company consists of three operating segments: wound care, wound closure-fasteners and skin care. Products in the wound care segment consist of basic and advanced dressings, ointments and sprays designed to treat wounds. Wound closure-fasteners products include wound closure strips, nasal tube fasteners, a variety of catheter fasteners and net dressings. The skin care segment consists of bath sponges, antibacterial skin cleansers, hair and body soaps, lotions and moisturizers designed to enable customers to implement and maintain successful skin care/hygiene programs. As of August 26, 2002, Dumex Medical Canada Inc. s operating results have been included in the wound care segment.

Products in all three operating segments are marketed to long-term care facilities, hospitals, physicians, clinics, home health care agencies and other healthcare institutions. The manufacture of advanced wound care and wound closure-fastener products is primarily outsourced. Basic wound care and skin care products are manufactured in-house with the exception of the bath sponge line. Internally, the segments are managed at the gross profit level. The aggregation or allocation of other costs by segment is not practical.

Segment sales and gross profit for the three months ended March 31, 2003 and 2002 are as follows:

	Three Months Ended March 31, 2003				
	Wound Care	Wound Closure-Fasteners	Skin Care	Other Costs	Tota Compa
Net sales	$2,810,985	$845,256	$559,998	-	$4,216,
Gross profit	965,121	394,434	167,455	-	1,527,
Total expenses	-	-	-	$(1,518,940)	(1,518,
Net income					$ 8,
Net long-lived assets	$970,946	-	$1,274,758	$35,732	$2,281,

	Three Months Ended March 31, 2003				
	Wound Care	Wound Closure-Fasteners	Skin Care	Other Costs	Tota Compa
Net sales	$751,377	$771,250	$617,830	-	$2,140,
Gross profit	571,514	392,943	200,080	-	1,164,
Total expenses	-	-	-	$(1,100,322)	(1,100,
Net income					$ 64,
Net long-lived assets	$161,068	$459	$1,225,165	$64,815	$1,451,

Long-lived assets consist of property and equipment, patents and trademarks and goodwill. Wound care long-lived assets consist principally of Dumex Medical Canada Inc. property and equipment in the first quarter 2003 and patents and trademarks in the first quarter 2003 and 2002. Wound closure and fastener products are for the most part outsourced, and accordingly, are not appreciably supported internally by long-lived assets. Skin care long-lived assets consist of goodwill associated with the acquisition of Sunshine Products, Inc. and associated property and equipment.

International sales (excluding Canada) were $217,925 and $162,000 in the first quarter of 2003 and 2002, respectively. Wound closure-fastener sales represent the majority of international sales.

17. Subsequent Event

Subsequent to March 31, 2003, the Company sold 820,000 additional shares of its common stock at a price of $0.50 per share and received gross proceeds of $410,000, pursuant to the private offering discussed in Note 12. The proceeds will be used for general working capital purposes and to fund strategic initiatives.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Quarter Ended March 31, 2003 Compared to Quarter Ended March 31, 2002.

Results of Operations

Net sales increased $2,075,782, or 97.0%, to $4,216,239 in the first quarter 2003 from $2,140,457 in the first quarter 2002. Gross profit increased $362,473, or 31.1%, to $1,527,010 in the first quarter 2003, from $1,164,537 in the first quarter 2002. Gross profit margins decreased to 36.2% in the first quarter 2003 from 54.4% in the first quarter 2002. Operating expenses increased $469,576, or 47.6%, in the first quarter 2003 to $1,455,097 from $985,521 in the first quarter 2002. Interest expense decreased $10,936 in the first quarter 2003 to $113,439 from $124,375 in the first quarter 2002. Other income increased $40,022 in the first quarter 2003 to $49,596 from $9,574 in the first quarter 2002. Net income of $8,070 and $64,215 was generated in the first quarters of 2003 and 2002, respectively.

The following table highlights the impact on first quarter 2003 operating results of the August 26, 2002 acquisition by the Company s subsidiary, Dumex Medical Canada, Inc., of substantially all of the assets of Dumex Medical Inc.

	Quarter Ended March 31, 2003			Quarter March 31
	Consolidated	Dumex	Derma	(Derma
Net sales	$4,216,239	$2,079,712	$2,136,527	$2,140,
Gross profit	1,527,010	432,650	1,094,360	1,164,
Operating expenses	1,455,097	454,264	1,000,833	985,
Interest expense, net	113,439	32,788	80,651	124,
Other income, net	(49,596)	(10,570)	(39,026)	(9,
Total expenses	1,518,940	476,482	1,042,458	1,100,
Income (loss) before income taxes	8,070	(43,832)	51,902	64,
Provision for taxes	-	-	-	-
Net income (loss)	$ 8,070	$ (43,832)	$ 51,902	$ 64,

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Derma Business Overview

Excluding the Dumex acquisition, first quarter 2003 net sales were essentially flat at $2,136,527 versus $2,140,457 in the first quarter 2002. The Derma business net sales were lower in both the wound and skin care segments primarily due to lower sales volume and competitive pricing pressure. The wound closure-fastener segment experienced a 9.6% increase in sales due to stronger Percu Stay catheter fasteners sales, partially offset by lower sales of other wound closure-fastener products.

The Derma business gross profit in the first quarter of 2003 decreased $70,177, or 6.0%, to $1,094,360 versus $1,164,537 in the first quarter 2002. This decrease is attributable to decreases in profitability in the wound care line due to pricing pressures and the skin care line due to lower volumes and competitive pricing pressures, partially offset by a modest gross profit increase in the wound closure-fastener segment.

The Derma business total expenses in the first quarter of 2003 decreased $57,864, or 5.3%, to $1,042,458 from $1,100,322 in the first quarter of 2002. The first quarter of 2003 was favorably impacted by receipt from the Internal Revenue Service of $32,553 and the reversal of a $65,000 accrued liability relative to the settlement of a prior year civil tax penalty and lower interest expense of $43,724, largely offset by a one-time $50,000 U.S. line of credit early termination fee and a $66,342 write-off of deferred financing interest costs associated with the U.S. line of credit. Net income for the Derma business in the first quarter 2003 decreased 19.2% to $51,902 from $64,215 in the first quarter 2002.

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Dumex Business Overview

The Dumex business acquired on August 26, 2002, generated first quarter 2003 net sales of $2,079,712. Net sales were slightly lower than plan in local currency, but benefited approximately 4% in translation due to a stronger than anticipated Canadian to U.S. dollar exchange rate. All areas of the Dumex wound care business performed well in the first quarter of 2003 versus plan.

Gross profit of $432,650 and gross profit percentage of 20.8% in the first quarter met expectations. Gross profit benefited from favorable material prices which were partially offset by higher than anticipated freight and utility costs and unfavorable foreign exchange.

First quarter 2003 operating expenses of $454,264 were 11% higher than plan due primarily to higher general and administrative costs for fringe benefits and accounting fees, along with higher selling related expenses and unfavorable foreign exchange. The higher sales and marketing expenses are consistent with the plan to expand resources in this area.

The Dumex business had a first quarter net loss of $43,832 versus the plan to essentially break-even. This unfavorability to plan was primarily due to the higher operating expenses discussed above.

Sales Overview

The Company s sales are derived from its wound care, wound closure-fasteners and skin care product lines. Wound care sales consist mainly of Dermagran ointment and spray, hydrophilic wound dressings and the Dumex product line. Wound closure-fasteners sales consist primarily of wound closure strips and catheter fasteners. Skin care sales consist of bath sponges, body washes, shampoos, incontinent care products, skin conditioners, disinfectants and deodorizers.

Gross sales are adjusted for trade rebates, cash discounts and Medicaid rebates to derive net sales. Gross to net sales adjustments comprise the following:

	Quarter Ended March 31,	
	2003	2002
Gross Sales	$4,454,232	$2,326,867
Trade rebates	(190,081)	(124,372)
Cash discounts	(34,605)	(43,413)
Medicaid rebates	(13,307)	(18,625)
Net Sales	$4,216,239	$2,140,457

Gross sales increased $2,127,365, or 91.4%, from the same quarter of the prior year due to inclusion of Dumex sales for the entire first quarter of 2003, along with higher wound closure-fastener sales, slightly offset by lower skin care sales. Gross to net sales adjustments relate primarily to the Derma business and are not significantly impacted by Dumex activity. Trade rebates were higher due to more aggressive pricing and a higher percentage of bid related business. Cash discounts decreased on a quarter-to-quarter basis principally due to a reduction in the Derma cash discount rate to general industry terms for several customers, effective January 1, 2003.

The following table presents net sales by product line expressed in dollars and percentage change:

Product Line	Quarter Ended March 31, 2003	2002	Variance	
Wound care	$2,810,985	$ 751,377	$2,059,608	274.1%
Wound closure-fasteners	845,256	771,250	74,006	9.6%
Skin care	559,998	617,830	(57,832)	(9.4)%
Total	$4,216,239	$2,140,457	$2,075,782	97.0%

Net sales increased $2,075,782, or 97.0%, in the first quarter 2003 versus the first quarter 2002. Wound care net sales increased due to the acquisition of Dumex in August 2002. Excluding Dumex net sales, quarter-to-quarter wound care net sales decreased $20,104, or 2.7%, largely due to competitive pricing pressures. Wound closure-fasteners sales increased $74,006, or 9.6%, due principally to an increase in sales of Percu-Stay catheter fasteners. Net sales of skin care products were down $57,832, or 9.4%, from the same quarter of the prior year due to increased competition.

Net Sales, Cost of Sales and Gross Profit

The Company s net sales, cost of sales, gross profit and gross profit margins for the first quarter of 2003 and 2002 are outlined in the table below:

	Quarter Ended March 31, 2003		2002		Variance	
Net sales	$4,216,239	100.0%	$2,140,457	100.0%	$2,075,782	97.0%
Cost of sales	2,689,229	63.8%	975,920	45.6%	1,713,309	175.6%
Gross profit	$1,527,010	36.2%	$1,164,537	54.4%	$ 362,473	31.1%

Gross profit increased 31.1% in the first quarter of 2003 to $1,527,010 from $1,164,537 in the first quarter of 2002 due to higher sales volume arising from the Dumex acquisition. Excluding Dumex sales, the first quarter 2003 gross profit was lower than the first quarter 2002 gross profit as a result of pricing pressures in the wound care business, lower sales volumes in the skin care business and increased sales of lower margin international sales in the wound care and wound closure-fasteners businesses.

The first quarter 2003 and 2002 gross profit percentages were 36.2% and 54.4%, respectively. The decrease in the 2003 first quarter to 2002 first quarter gross profit percentage is primarily attributable to the inclusion of lower margin Dumex product sales and a decline in the gross profit margin of the Derma business on a stand-alone basis of 3.2% from 54.4% in 2002 to 51.2% in 2003. The Derma business gross profit margin decline was attributable to pricing pressures in the wound care line and pricing and volume pressures in the skin care line. The Dumex business on a stand-alone basis generated a 20.8% gross profit which met first quarter 2003 expectations.

Operating Expenses

Operating expenses increased $469,576, or 47.6%, to $1,455,097 in the first quarter of 2003 from $985,521 in the first quarter of 2002. A summary of selling, marketing and general and administrative expenses for the first quarter 2003 and 2002 are outlined in the table below.

	Quarter Ended March 31, 2003	2002	Variance	
Selling	$ 403,090	$348,703	$ 54,387	15.6%
Marketing	46,732	64,574	(17,842)	(27.6%)
General administrative	1,005,275	572,244	433,031	75.7%

Total	$1,455,097	$985,521	$469,576	47.6%

Selling expenses increased from the same quarter of the prior year due principally to incremental Dumex selling expenses of $92,247, partially offset by a decrease in Derma business selling expenses of $37,860. The decrease in Derma business selling expenses is attributable to lower compensation and commissions as the sales department implements a reorganization. Marketing expenses, which relate primarily to the Derma business, decreased due primarily to a delay in promotional activities and sales literature expenses. General and administrative expenses increased from the same quarter of the prior year as a result of incremental Dumex expenses, along with the Derma business incurring higher compensation, accounting, insurance, consulting and public relations expenses, partially offset by lower bad debt and regulatory expenses.

Excluding Dumex related operating expenses of $454,264 operating expenses increased $15,312, or 1.6%, to $1,000,833 versus $985,521 on a quarter-to-quarter basis.

Interest Expense, net

Interest expense, net decreased $10,936 to $113,439 in the first quarter 2003 from $124,375 in the first quarter 2002. The decrease is attributable to the non-recurrence of an imputed non-cash interest charge of $122,700 associated with the conversion of the Company s Series C and D bonds and accrued interest outstanding in January 2002, which was largely offset by the February 28, 2003 termination of the Company s existing U.S. line of credit facility resulting in the write-off of $66,342 of deferred financing costs, Dumex interest expense of $32,835 related to its line of credit and long-term indebtedness, and $19,662 of interest incurred on the U.S. line of credit prior to its termination.

Other Income

Other income, net increased $40,022 to $49,596 in the first quarter of 2003 from $9,574 in the first quarter of 2002. The increase is attributable to the settlement of an Internal Revenue Service civil tax penalty resulting in the return of credits applied against the penalty of $23,553 and the reversal of a $65,000 accrued liability allocated to the IRS civil tax penalty and sale and/or conversion of previously reserved, discontinued and slow-moving inventory of $31,200, partially offset by the payment of a $50,000 fee associated with the early termination of the Company s U.S. line of credit on February 28, 2003 and miscellaneous expenses of approximately $20,000.

Provision for Income Taxes

Given available net operating loss carry forwards, no provision for income taxes has been made in the first quarter of 2003 and 2002.

Net Income

The Company generated net income of $8,070, or $0.00 per share (basic) and $0.00 per share (diluted), in the first quarter 2003 compared to net income of $64,215, or $0.03 per share (basic) and $0.01 per share (diluted), in the first quarter 2002.

Liquidity and Capital Resources

Sales in the first quarter of 2003 increased over the first quarter of 2002 due to the inclusion of Dumex sales in 2003. Excluding Dumex sales, on a quarter-to-quarter basis, 2003 Derma business sales were essentially flat. On a quarter-to-quarter basis, the gross profit increased due to the inclusion of Dumex sales, but the gross profit percentage declined due to the inclusion of lower margin Dumex products and competitive pressures in the Derma business. Operating expenses continued to be closely monitored. Net income of $8,070 for the first quarter of 2003 was consistent with plan expectations.

At March 31, 2003, and December 31, 2002, the Company had cash and cash equivalents of $471,426 and $1,496,357, respectively. For the first quarter ended March 31, 2003, there was a $1,024,931 decrease in cash and cash equivalents, principally attributable to cash used in financing and operating activities of $908,876 and $90,432, respectively. In the first quarter, the Company terminated and repaid its $1,000,000 U.S. line of credit and entered into a new, more cost effective U.S. line of credit. Cash used in operating activities primarily related to the pre-payment of operating expenses that will be amortized over the balance of 2003, a $50,000 interest bearing promissory note to a supplier of one of the Company s products to be used for working capital purposes, reversal of a $65,000 accrued liability no longer required due to resolution of an Internal Revenue Service civil tax penalty and payment of a $64,000 obligation to the former owner of Dumex Medical Inc. Cash provided from operating activities primarily relates to the timing of accounts payable obligations and the write-off of deferred financing costs associated with the terminated U.S. line of credit. Working capital increased $150,035 at March 31, 2003 to $3,505,036 from $3,355,001 at December 31, 2002.

In connection with the Dumex acquisition, the Company entered into a sixteen month $1,700,000 revolving credit facility expiring December 31, 2003 to fund day-to-day operations. Maximum potential advances under the agreement at March 31, 2003 were $1,470,000. Advances outstanding against the credit facility were $1,221,092 at March 31, 2003, leaving an additional $248,908 available for borrowing.

In March 2003 the Company entered into a new one year line of credit agreement (subject to annual renewal) with a U.S. lender (the Agreement) for a maximum principal amount of $2,000,000. No funds have been drawn against the line to date. Estimated maximum potential advances under the Agreement on the date of signing were $1,250,000, less any outstanding standby letters of credit. Advances will be utilized to fund strategic initiatives and for general working capital purposes.

As security for indebtedness of the Company s subsidiary, Dumex Medical Canada Inc., the Company has accorded a Canadian bank its guarantee of payment together with a second lien security interest in the Company s assets located in the U.S. In connection with the Agreement and in return for a standby letter of credit in the amount of $200,000 against the new line of credit, the Canadian bank has agreed not to exercise its rights under its second lien security interest and guarantee against the Company s U.S. assets without the U.S. lender s approval. The standby letter of credit serves to reduce the Company s potential borrowing capacity under the Agreement by $200,000.

The Company initiated in January 2002, a private offering of 4,000,000 shares of its common stock at a price of $0.50 per share. Through March 31, 2003, the Company had sold 1,600,000 shares and received proceeds of $747,678, net of $52,322 in offering expenses. As of May 12, 2003, an additional 820,000 shares were sold for which the Company received gross proceeds of $410,000.

For 2003, the Company seeks to increase sales and profits by, among other initiatives, launching sale of the Dumex product line in the U.S., driving organic growth of its core product lines both in the U.S. and Canada and integrating the Dumex business more fully into Derma. Steps are planned to minimize year-to-year product cost increases and improve overall supply chain efficiency and cost effectiveness. Plans are also in place to invest in upgrading sales and marketing resources. Operating expenses will continue to be properly balanced with revenues.

Among the potential sources of capital the Company expects to utilize to finance its growth plans in 2003 are anticipated improved profitability, anticipated additional stock sale proceeds and prudent utilization of available lines of credit.

Strategically, the Company s plan is to stay focused on its base business while considering external opportunities to leverage its core capabilities for growth.

The Common Stock of the Company is traded on the OTC Bulletin Board under the symbol DSCI.OB. The Common Stock is also traded on the Boston and Pacific Stock Exchanges under the symbol DMS. The Company has paid no cash dividends in respect of its Common Stock and does not intend to pay cash dividends in the near future.

Critical Accounting Policies

The preparation of the financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts in the financial statements and the accompanying notes. Actual results could differ from those estimates. We believe the following accounting policies are the most critical to the Company.

Revenue Recognition and Allowance for Trade Rebates

Revenue is recognized when product is shipped and title passes to the customer. Sales are adjusted for cash discounts, Medicaid rebates and trade rebates to derive net sales. The Company establishes an allowance for trade and Medicaid rebates based on past experience. If the estimate of trade and Medicaid rebates is not sufficient to cover actual rebates, additional allowances may be required.

Inventory

The Company writes down the value of inventory by the estimate of the difference between the cost of the inventory and its net realizable value. The estimate takes into account projected sales of the inventory on hand and the age of the inventory in stock. If actual future demand or market conditions are less favorable than those projected by management, additional inventory write-downs may be required. The provision for the write-down of inventory is recorded in cost of sales.

Goodwill Impairment

At March 31, 2003, the Company s skin care segment had $1,110,967 of goodwill. The Company tests goodwill for impairment on a periodic basis. The process of evaluating the potential impairment of goodwill is highly subjective and requires significant judgments at many points during the analysis. In estimating the fair value of the skin care segment with recognized goodwill, the Company makes estimates and judgments about the future cash flows of this segment. The Company s cash flow forecasts are based on assumptions that are consistent with the plans and estimates used to manage the underlying business. In addition, the Company makes certain judgments about allocating shared assets to the balance sheet for this segment. Changes in these estimates would cause the skin care segment to be valued differently in the future.

Item 3. CONTROLS AND PROCEDURES

The Company s management, including the Chief Executive Officer and Chief Financial Officer, have conducted an evaluation of the effectiveness of disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based on the evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures are effective in ensuring that all material information required to be filed in this quarterly report has been made known to them in a timely fashion. There have been no significant changes in internal controls, or in factors that could significantly affect internal controls, subsequent to the date the Chief Executive Officer and Chief Financial Officer completed their evaluation.

Part II - Other Information

Item 1. Legal Proceedings

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits. All exhibits required by Item 601 of Regulation S-B and required hereunder, as filed with the Securities and Exchange Commission in Form 10-KSB on March 31, 2003, are incorporated herein by reference.

Exhibit	Description
99.1	Certification of Principal Executive Officer pursuant to U.S.C. Section 1350 regarding Form 10-QSB for the quarter ended March 31, 2003
99.2	Certification of Principal Financial Officer pursuant to U.S.C. Section 1350 regarding Form 10-QSB for the quarter ended March 31, 2003

(b) Reports on Form 8-K. Form 8-K was filed on February 14, 2003 relative to the Registrant's termination of its credit facility with Capital Source Finance, LLC.

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

DERMA SCIENCES, INC.

By: /s/ John E. Yetter
John E. Yetter, CPA
Chief Financial Officer

Dated: May 15, 2003

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Certification of Principal Executive Officer
Pursuant to Section 302 of the
Sarbanes-Oxley Act of 2002

I, Edward J. Quilty, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Derma Sciences, 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 or not 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.

Dated: May 15, 2003

/s/ Edward J. Quilty
Edward J. Quilty
Chairman, President and Chief Executive Officer
(Principal Executive Officer)

Certification of Principal Financial Officer
Pursuant to Section 302 of the
Sarbanes-Oxley Act of 2002

I, John E. Yetter, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Derma Sciences, 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 or not 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.

Dated: May 15, 2003

/s/ John E. Yetter
John E. Yetter
Vice President and Chief Financial Officer
(Principal Financial Officer)