DERMA SCIENCES INC
Form 10QSB
May 14, 2002

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, 2002
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, 2002	Class: Common Stock, par value $.01 per share Shares Outstanding: 3,707,109

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DERMA SCIENCES, INC.

Consolidated Balance Sheets

ASSETS	March 31, 2002 (Unaudited)	December 31, 2001
Current Assets		
Cash and cash equivalents	$ 577,581	$ 524,783
Restricted cash	565,000	-
Accounts receivable, net	946,024	914,458
Inventories, net	1,567,478	1,787,247
Prepaid expenses and other current assets	158,997	54,661
Total current assets	3,815,080	3,281,149
Property and equipment, net	187,074	169,708
Goodwill and other intangibles, net	1,264,433	1,268,827
Other assets	154,392	-
Total Assets	$ 5,420,979	$ 4,719,684
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	$ 484,494	$ 551,428
Accrued expenses	246,262	392,649
Convertible bonds	-	475,000
Other current liabilities	565,000	-
Total current liabilities	1,295,756	1,419,077
Total Liabilities	1,295,756	1,419,077
Shareholders' Equity		
Common stock, $.01 par value, 30,000,000 shares authorized; issued and outstanding: 2,407,109 shares in 2002 and 2001	24,071	24,071
Convertible preferred stock, $.01 par value; 11,750,000 shares authorized; issued and outstanding: 3,150,409 shares in 2002; 1,960,009 shares in 2001 (liquidation preferences of $5,860,240 at March 31, 2002)	31,504	19,600
Additional paid-in capital	14,736,379	13,987,882
Accumulated deficit	(10,666,731)	(10,730,946)
Total Shareholders' Equity	4,125,223	3,300,607
Total Liabilities and Shareholders' Equity	$ 5,420,979	$ 4,719,684

See accompanying notes.

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DERMA SCIENCES, INC.

Consolidated Statement of Operations (Unaudited)

	Three months ended March 31, 2002	2001
Net sales	$2,114,491	$2,371,058
Cost of sales	949,954	1,281,779
Gross Profit	1,164,537	1,089,279
Operating expenses	985,521	1,031,979
Interest expense	124,375	49,022
Other income, net	(9,574)	(911)
Total Expenses	1,100,322	1,080,090
Income before provision for income taxes	64,215	9,189
Provision for income taxes	-	-
Net Income	$ 64,215	$ 9,189
Income per common share - basic	$ 0.03	$ 0.00
Income per common share - diluted	$ 0.01	$ 0.00
Shares used in computing income per common share - basic	2,407,109	2,279,871
Shares used in computing income per common share - diluted	5,843,397	4,351,918

See accompanying notes.

DERMA SCIENCES, INC.

Consolidated Statement of Cash Flows (Unaudited)

	Three months ended March 31, 2002	2001
Operating Activities		
Net income	$ 64,215	$ 9,189
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	16,615	19,352
Amortization	4,394	30,918
Non-cash financing costs	127,700	40,000
Provision for bad debts	20,000	25,163
Provision for rebates	(15,000)	333
Provision for inventory obsolescence	9,000	20,609
Changes in operating assets and liabilities		
Restricted cash	(565,000)	50,771
Accounts receivable	(36,566)	326,953
Inventories	210,769	(90,031)
Prepaid expenses and other current assets	(109,336)	(87,955)
Other assets	(111,892)	-
Accounts payable	(66,934)	(65,449)

Accrued expenses	(26,187)	(127,883)
Other current liabilities	565,000	-
Net cash provided by operating activities	86,778	151,970
Investing Activities		
Purchases of property and equipment	(33,980)	(20,151)
Net cash used in investing activities	(33,980)	(20,151)
Financing Activities		
Net change in bank line of credit	-	(50,771)
Net cash used in financing activities	-	(50,771)
Net increase in cash and cash equivalents	52,798	81,048
Cash and cash equivalents		
Beginning of period	524,783	424,165
End of period	$ 577,581	$ 505,213
Supplemental cash flow information		
Conversion of bonds payable and accrued interest to preferred stock	$595,200	-
Common stock and warrants issued for debt conversion/extension	$120,200	$160,000
Bond conversion reset provision charge to paid-in capital	$45,000	-

See accompanying notes.

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DERMA SCIENCES, INC.

Notes To Consolidated Financial Statements

1. Organization and Summary of Significant Accounting Policies

Derma Sciences, Inc. and its subsidiary (the Company) is a full line provider of advanced 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 and select international markets.

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, 2002, are not necessarily indicative of the results that may be expected for the year ending December 31,

2002. For further information, refer to the financial statements and footnotes thereto for the year ended December 31, 2001, 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 subsidiary Sunshine Products, Inc. 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.

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.

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, convertible preferred stock and convertible bonds in the weighted average number of common shares outstanding for a period, if dilutive.

Inventories Inventories consist primarily of raw materials, packaging materials 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.

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 Goodwill relates to the acquisition of Sunshine Products, Inc. in 1998. The Company does not believe that the goodwill is impaired. However, an impairment charge would be recognized if the Company expected that the present value of future earnings from Sunshine Products, Inc. did not exceed the unamortized goodwill.

On January 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 141 (SFAS No. 141), Business Combinations and Statement of Financial Accounting Standards No. 142 (SFAS No. 142), Goodwill and Other Intangible Assets. SFAS No. 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting. SFAS No. 142 requires that goodwill and intangible assets deemed to have indefinite lives no longer be amortized but be subject to an annual impairment test. Other intangible assets will continue to be amortized over their useful lives. Application of the nonamortization provisions of SFAS No. 142 for the three months ended March 31, 2001 would have resulted in an increase in net income of approximately $26,500. The Company will perform the first of the required impairment tests of goodwill as of January 1, 2002 and has not yet determined what the effect of this test will be on the earnings and financial position of the Company.

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.

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

2. Accounts Receivable

Accounts Receivable comprise the following:

	March 31, 2002	December 31, 2001
Trade accounts receivable	$1,074,319	$1,051,283
Less: Allowance for doubtful accounts	(58,658)	(50,000)
Allowance for trade rebates	(85,000)	(100,000)
Net trade receivables	930,661	901,283
Other receivables	15,363	13,175
Total receivables	$ 946,024	$ 914,458

3. Inventories

Inventories comprise the following:

	March 31, 2002	December 31, 2001
Finished goods	$1,320,293	$1,617,449
Packaging materials	255,227	268,001
Raw materials	96,661	96,797
Gross inventory	1,672,181	1,982,247
Reserve for obsolescence	(104,703)	(195,000)
Net inventory	$1,567,478	$1,787,247

4. Property and Equipment

Property and equipment comprise the following:

	March 31, 2002	December 31, 2001
Machinery and equipment	$ 380,288	$ 360,188
Furniture and fixtures	682,216	668,336
Gross property and equipment	1,062,504	1,028,524
Less: Accumulated depreciation	(875,430)	(858,816)
Net property and equipment	$ 187,074	$ 169,708

5. Goodwill, Patents and Trademarks

Goodwill, patents and trademarks comprise the following:

	March 31, 2002	December 31, 2001
Goodwill	$1,497,364	$1,497,364
Less: Accumulated amortization	(386,397)	(386,397)
Net goodwill	1,110,967	1,110,967
Patents and trademarks	451,417	451,417
Less: Accumulated amortization	(297,951)	(293,557)
Net patents and trademarks	153,466	157,860
Net goodwill, patents and trademarks	$1,264,433	$1,268,827

Amortization of goodwill was discontinued effective January 1, 2002 in accordance with SFAS No. 142. Goodwill amortization expense was $26,500 in the first quarter of 2001.

6. Bank Line of Credit

The Company previously had a $1,000,000 bank line of credit facility fully secured with cash deposited with the bank. On November 5, 2001, the Company paid off its outstanding loan balance and did not renew the line of credit facility. At March 31, 2001, $589,229 of the line of credit facility was outstanding.

7. 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 warrants.

Further, 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.

As of January 5, 2001, bondholders owning an aggregate of $475,000 of the Company s Series C and Series D Convertible Bonds extended the maturity date of their bonds from January 7, 2001 to January 7, 2002. In consideration for this maturity postponement, the Company accorded the bondholders the following: (1) 57,000 shares of the Company s Common Stock with registration rights, (2) reduction in the per unit conversion rate of the Series C and Series D Convertible Bonds remaining outstanding from $0.75 to $0.50, (3) increase in the ratio of preferred stock to warrants comprising the units from one share of preferred stock and one warrant to one share of preferred stock and one and one tenth warrants, and (4) reduction of the exercise price of the warrants from $0.85 per share to $0.57 per share. The $160,000 value of the foregoing was recorded as bond discount and amortized to interest expense over the one-year bond maturity extension.

8. Shareholders Equity

Preferred Stock

There are 272,503 shares of Series A Convertible Preferred Stock (Series A Preferred) outstanding. The Series A Preferred 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 and maintains voting rights identical to the Common Stock on all other matters.

There are 554,171 shares of Series B Convertible Preferred Stock (Series B Preferred) outstanding. The Series B Preferred 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 and maintains voting rights identical to the Common Stock on all other matters.

There are 1,119,055 shares of Series C Convertible Preferred Stock (Series C Preferred) outstanding. The Series C Preferred is convertible into Common Stock on a one-for-one basis, bears no dividend, maintains a liquidation preference averaging $0.72 per share, votes as a class on matters affecting the Series C Preferred 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 (Series D Preferred) outstanding. The Series D Preferred 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 and maintains voting rights identical to the Common Stock on all other matters.

Stock Purchase Warrants

At March 31, 2002, the Company had warrants outstanding to purchase the Company s common stock as outlined below:

Series	Number of Warrants	Exercise Price	Expiration Date
B	666,673	$6.75	June 15, 2002
E	2,200,009	$0.85	July 18, 2005
F	1,309,441	$0.57	January 6, 2007

Other Equity Transactions

The Company initiated in January 2002 a private offering of 2,000,000 shares of its common stock at a price of $0.50 per share. The proceeds will be used to fund an acquisition or other strategic initiatives of the Company approved by the purchasers. In the event the proceeds are not so utilized by July 31, 2002, each purchaser has the option to rescind his/its purchase of common stock and receive all consideration paid therefor. This right of rescission must be exercised, if at all, prior to August 31, 2002.

At March 31, 2002 the Company had concluded subscription agreements with its president, together with 15 other individuals and institutional investors, for the sale of 1,300,000 shares of common stock for a total investment of $650,000 from the above private placement. At March 31, 2002, subscriptions totaling $565,000 had been funded. This $565,000 has been recorded as Restricted Cash and Other Current Liabilities on the balance sheet as of March 31, 2002 and will be so recorded until the rescission rights relative to this investment lapse.

The shares issued subject to the right of rescission have not been reported as outstanding or considered in the earnings per share calculation as they are deemed to be temporary equity.

In February 2001, a total of 229,169 shares of Series B, C and D Preferred Stock were converted into 229,169 shares of Common Stock. In January 2001, 57,000 shares of Common Stock were issued as consideration for extending the maturity date of the Convertible Bonds.

9. Income Taxes

No provision for income taxes has been made in the first quarter 2002, given the Company's available net operating loss carry forwards.

At December 31, 2001, the Company has net operating loss carryforwards of approximately $6,800,000 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 $6,800,000 that expire in years 2004 through 2010. During 1998 the Company had a change in control as defined by the Internal Revenue Code Section 382. Consequently, certain limitations may apply to the timing and amount of the utilization of such net operating loss carryforwards.

10. 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 dressings, ointments and sprays designed to treat chronic 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.

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 wound care and wound closure-fastener products is primarily outsourced. 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, 2002 and 2001 are as follows:

Three Months Ended March 31, 2002

	Wound Care	Wound Closure-Fasteners	Skin Care	Other Costs	Total Company
Net sales	$750,079	$767,770	$596,642	---	$2,114,491
Gross profit	571,514	392,943	200,080	---	1,164,537
Total expenses	---	---	---	($1,100,322)	(1,100,322)
Net income					$ 64,215

Three Months Ended March 31, 2001

	Wound Care	Wound Closure-Fasteners	Skin Care	Other Costs	Total Company
Net sales	$675,786	$766,325	$928,947	---	$2,371,058
Gross profit	529,426	394,313	165,540	---	1,089,279
Total expenses	---	---	---	($1,080,090)	(1,080,090)

Net income	$ 9,189
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With the exception of goodwill associated with the acquisition of Sunshine Products, Inc. (attributable to the skin care operations segment), the Company s property, equipment and intangible assets support each of the Company s operating segments in approximately equal measure. Accordingly, the Company does not classify its assets by operating segments.

International sales were $169,000 in 2002 and $115,000 in 2001. Wound closure-fastener sales represent the majority of international sales.

11. Deferred Costs

The Company deferred $115,000 of costs during the first quarter 2002 relating to the potential acquisition of a business, debt financing costs associated with securing a collateralized line of credit and equity issuance costs associated with a private placement offering. These costs are included in Other Assets on the balance sheet at March 31, 2002. Through April 30, 2002, additional costs of $60,000 have been deferred. These deferred costs will be expensed if the transactions are not completed.

12. Subsequent Events

On April 30, 2002, the Company entered into a three year revolving credit facility agreement (the Agreement) for a maximum principal amount of $2,500,000. Advances may be drawn, repaid and redrawn, from time to time as permitted under the Agreement. The Company may request advances under the Agreement up to the value of eighty-five percent (85%) of eligible receivables (as defined) and fifty percent (50%) of eligible finished goods inventory (as defined). Interest on outstanding advances is payable monthly in arrears at the rate of prime plus 2.5% per annum, but not less than 7.5% per annum. The Company will pay a monthly collateral management fee at the rate of 1.5% per annum upon the daily average amount of advances outstanding each month. In addition, the Company will pay a monthly unused line fee at the rate of 0.6% per annum upon the difference between the daily average amount of advances outstanding and $2,500,000. Outstanding advances are secured by all existing and

after-acquired tangible and intangible assets of the company. At April 30, 2002, maximum potential advances under the Agreement are estimated to be in the range of $1.2 to $1.4 million. Advances will be utilized to fund strategic initiatives and general working capital requirements. Lender and legal fees of approximately $75,000 ($55,000 at March 31, 2002) will be deferred and amortized to interest expense over the three-year term of the Agreement.

Over the term of the Agreement, the Company has agreed to comply with the following covenants as measured at the end of each month for the average of the three most recent calendar months: (a) the Company will maintain a positive EBITDA (earnings before interest, taxes, depreciation and amortization), and (b) the fixed charge ratio (EBITDA divided by the sum of debt service, capital expenditures, income taxes and dividends) shall not be less that 1.2:1.0. Additional covenants governing permitted indebtedness, liens, payments of dividends and protection of collateral are included in the Agreement.

The Company may terminate the Agreement at any time by paying off all outstanding indebtedness and any other payments due lender. Early termination fees of $50,000 or $25,000 are payable if termination occurs before April 30, 2003 or April 30, 2004, respectively. There is no fee for termination of the Agreement after April 30, 2004.

DERMA SCIENCES, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

QUARTER ENDED MARCH 31, 2002 COMPARED TO QUARTER ENDED MARCH 31, 2001.

Results of Operations

Net sales decreased $256,567, or 10.8%, to $2,114,491 in the first quarter 2002 from $2,371,058 in the first quarter 2001. Gross profit increased $75,258, or 6.9%, to $1,164,537 in the first quarter 2002 from $1,089,279 in the first quarter 2001. Gross Profit margins increased to 55.1% in the first quarter 2002 from 45.9% in the first quarter 2001. Operating expenses decreased $46,458, or 4.5%, in the first quarter 2002 to $985,521 from $1,031,979 in the first quarter 2001. Interest expense increased $75,353 in the first quarter 2002 to $124,375 from $49,022 in the first quarter 2001. Net income of $64,215 was generated in the first quarter of 2002 versus net income of $9,189 in the first quarter of 2001.

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 and hydrophilic wound dressings. 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,	
	2002	2001
Gross Sales	$2,300,901	$2,683,647
Trade rebates	(124,372)	(239,911)
Cash discounts	(43,413)	(53,928)
Medicaid rebates	(18,625)	(18,750)
Net Sales	$2,114,491	$2,371,058

Gross sales were down $382,746, or 14.3%, quarter to quarter reflecting lower skin care sales associated principally with the loss of the Beverly supply agreement. Trade rebates were down significantly due to the reduction in rebate intensive Beverly skin care sales and discontinuation of a wound care related incentive rebate agreement in November 2001. Cash discounts are down due to the lower sales base and efforts undertaken by the Company to improve adherence to terms.

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

Quarter Ended March 31,

Product Line	2002	2001	Variance	
Wound care	$ 750,079	$ 675,786	$ 74,293	11.0%
Wound closure-fasteners	767,770	766,325	1,445	0.2%
Skin care	596,642	928,947	(332,305)	(35.8)%
Total	$2,114,491	$2,371,058	($256,567)	(10.8)%

Skin care sales decreased principally due to the loss of the Beverly supply agreement effective May 31, 2001. Market pressure in a competitive marketplace also contributed. Sales of the Company s new bath sponge included in this product line were $13,323. The increase in wound care sales was largely attributable to increases in sales of impregnated gauze dressings. These sales were depressed in the first quarter 2001 due to backorders. In addition, first quarter 2002 wound care sales benefited from discontinuation of an incentive rebate agreement with a major customer in November 2001. Overall, wound closure-fastener sales were flat. Suture strips experienced growth due to new business associated with a private label agreement entered into in the second half of 2001. Catheter fasteners exhibited good growth in the first quarter. Offsetting these gains were lower Percu-Stay sales due to supply interruptions from the product s supplier.

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 2002 and 2001 are outlined in the table below:

	Quarter Ended March 31,					
	2002		2001		Variance	
Net sales	$2,114,491	100.0%	$2,371,058	100.0%	($256,567)	(10.8%)
Cost of sales	949,954	44.9%	1,281,779	54.1%	331,825	25.9%
Gross profit	$1,164,537	55.1%	$1,089,279	45.9%	$ 75,258	6.9%

Gross profit and profit margins increased in the first quarter 2002 versus the first quarter 2001 due principally to favorable sales mix. Higher margined wound care sales increased to 36% of quarterly sales in 2002 versus 29% in 2001. Conversely, lower margined skin care sales decreased to 29% of quarterly sales in 2002 from 39% in 2001. Skin care line margins improved significantly in 2002 due to cost reduction initiatives implemented in response to the loss of the Beverly business in 2001 and the reclassification of certain overhead costs previously charged to cost of sales to operating expense in 2002.

Operating Expenses

A summary of selling, marketing and general administrative expenses for the first quarter 2002 and 2001 are outlined in the table below.

Quarter Ended March 31,		
2002	2001	Variance

Selling	$348,703	$ 380,645	($31,942)	(8.4%)
Marketing	64,574	63,794	780	1.2%
General administrative	572,244	587,540	(15,296)	(2.6%)
Total	$985,521	$1,031,979	($46,458)	(4.5%)

Selling expenses are down quarter to quarter due to the elimination of a sales administration position in April 2001 and lower commission expense associated with the reorganization of the manufacturer representative network early in the first quarter 2002. Marketing costs were essentially flat quarter to quarter. In 2002, marketing spending was directed in support of higher advertising and promotion efforts, while clinical support activities were reduced versus the prior year. The decrease in general administrative expense reflects discontinuation of goodwill amortization of $26,500 coupled with lower other general administrative spending due to cost containment initiatives partially offset by higher compensation and benefit costs for existing personnel.

Interest Expense, net

Interest expense, net increased $75,353 to $124,375 in the first quarter 2002 from $49,022 in the first quarter 2001. The increase is attributable to an imputed non-cash interest charge of $127,700 associated with the conversion of the Company s Series C and D bonds and accrued interest outstanding in January 2002. This increase was partially offset by the non-recurrence of $40,000 of non-cash interest expense associated with amortizing the consideration granted in January 2001 to extend the maturity date of the outstanding Series C and D convertible bonds, a significant reduction in convertible bond interest expense associated with the conversion in early January 2002 and elimination of line of credit interest expense due to payoff of the line in November 2001.

Provision for Income Taxes

No provision for income taxes has been provided in the first quarter of 2002 and 2001 given available net operating loss carry forwards.

Net Income

The Company generated net income of $64,215, or $0.03 per share (basic) and $0.01 per share (diluted), in the first quarter 2002 compared to net income of $9,189, or $0.00 per share (basic) and $0.00 per share (diluted) in the first quarter 2001. Non-cash imputed interest costs of $127,700 and $40,000 were included in first quarter 2002 and 2001 net income, respectively. In addition, first quarter 2001 net income includes $26,500 of goodwill amortization expense.

Liquidity and Capital Resources

Operating results for the first quarter 2002 versus the corresponding period last year are positive. Sales, while softer than expected, are comparable with the last two quarters. Operating expenses remain in line with revenues and cash flow is positive.

At March 31, 2002 and 2001, the Company had unrestricted cash and cash equivalents of $577,581 and $505,213, respectively. Cash of $86,778 was provided by operations in the first quarter of 2002. Working capital improved $927,934 at March 31, 2002 to $2,519,324 from $1,591,390 at March 31, 2001. The improvement in working capital is principally attributable to the $595,200 conversion of the Company s Series C and D bonds and accrued interest in January 2002 and a significant reduction in accounts payable reflecting the Company s improving cash flow.

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 $.057 (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 warrants.

Further, if prior to July, 2003 the Company offers for sale its common stock at a price per share below $.050 or its warrants with 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 imputed non-cash interest charges of $165,200. A charge of $45,000 was taken to account for the value of the reset concession granted the bondholders. This charge is being amortized over the eighteen-month term of the reset provision. A charge of $120,200 was taken immediately to account for the beneficial reduction in conversion terms associated with the accrued interest.

The Company initiated in January 2002 a private offering of 2,000,000 shares of its common stock at a price of $0.50 per share. The proceeds will be used to fund an acquisition or other strategic initiatives of the Company approved by the purchasers. In the event the proceeds are not so utilized by July 31, 2002, each purchaser has the option to rescind his/its purchase of common stock and receive all consideration paid therefor. This right of rescission must be exercised, if at all, prior to August 31, 2002.

At March 31, 2002 the Company had concluded subscription agreements with its president, together with 15 other individuals and institutional investors, for the sale of 1,300,000 shares of common stock for a total investment of $650,000 from the above private placement. At March 31, 2002, subscriptions totaling $565,000 had been funded. This $565,000 has been recorded as Restricted Cash and Other Current Liabilities on the balance sheet as of March 31, 2002 and will be so recorded until the rescission rights relative to this investment lapse.

During the first quarter 2002, the Company deferred charges of $115,000 related to the ongoing evaluation of strategic initiatives, securing debt financing and private placement issuance costs. These costs are included in Other Assets on the balance sheet. Through April 30, 2002 additional costs of $60,000 have been deferred. These deferred costs will be expensed if the transactions are not completed as planned.

On April 30, 2002, the Company entered into a three year revolving credit facility agreement (the Agreement) for a maximum principal amount of $2,500,000. The Company may request advances under the Agreement up to the value of eighty-five percent (85%) of eligible receivables and fifty percent (50%) of eligible finished goods inventory (as defined). Interest on outstanding advances is payable at the rate of prime plus 2.5% per annum, but not less than 7.5% per annum. Additional fees include a collateral management fee of 1.5% per annum on average outstanding advances and an unused line fee of 0.6% per annum. At current prime interest rates and Company borrowing capacity, the overall effective interest rate is anticipated to be approximately 9.5% per annum. Outstanding advances are secured by all existing and after-acquired tangible and intangible assets of the Company.

At April 30, 2002, maximum potential advances under the Agreement are estimated to be in the range of $1.2 to 1.4 million. Advances will be utilized to fund strategic initiatives and general working capital requirements.

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.

Prospectively, the Company expects to build on the momentum created in 2001 in a competitive market place. Modest sales and profitability growth are projected in 2002. Sales are projected to grow based upon identified new customers, new products and expanded sales and marketing efforts. Steps are planned to better control product costs and minimize year-to-year cost increases. Operating expenses will continue to be properly balanced with revenues. Cash flow is projected to improve in concert with the Company s operating performance.

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

Forward Looking Statements

Statements that are not historical facts, including statements about the Company s confidence, strategies, expectations about new or existing products, technologies, opportunities, market demand or acceptance of new or existing products are forward-looking statements that involve risks and uncertainties. These uncertainties include, but are not limited to, product demand and market acceptance risk, impact of competitive products and prices,

product development, commercialization or technological delays or difficulties, and trade, legal, social, financial and economic risks.

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.

Reserve for Obsolete Inventory

The Company establishes a reserve for obsolete inventory based on quantities of the inventory on hand, expected future sales and inventory expiration dates. If the estimated reserve for obsolete inventory is not sufficient to cover actual obsolete inventory, additions to the reserve may be required.

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 April 1, 2002, are incorporated herein by reference.

(b) Reports on Form 8-K. Forms 8-K were filed on March 5, 2002 relative to the Registrant s private placement of securities and on March 7, 2002 relative to the conversion into equity of the Registrant s Series C and Series D Convertible Bonds.

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 14, 2002