

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-K

- Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013
- Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _____ to _____

Commission file number: 1-31070

DERMA SCIENCES, INC.
(Name of Issuer in Its Charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

23-2328753

(I.R.S. Employer
Identification No.)

214 Carnegie Center, Suite 300, Princeton, New Jersey

(Address of principal executive offices)

08540

(Zip code)

Registrant's telephone number: (609) 514-4744

Securities registered under Section 12(b) of the Exchange Act:

Title of each class	Name of each exchange on which registered
Common Stock, \$.01 par value	The NASDAQ Stock Market LLC

Securities registered under Section 12(g) of the Exchange Act:

None.

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

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

Yes No

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files).

Yes No

Indicate by checkmark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).
Yes No

The aggregate market value of the common equity stock held by non-affiliates, computed by reference to the average bid and asked prices of such stock as of June 30, 2013, was approximately \$188,201,000.

The number of shares outstanding of the issuer's common equity as of March 12, 2014 was 25,131,673.

Documents Incorporated by Reference

Portions of the Registrant's definitive proxy statement for its 2013 annual meeting of stockholders are incorporated by reference in Part III of this report.

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Part I

The Company was previously a “smaller reporting company” that determined that it no longer qualified as such as of its June 30, 2013 determination date, at which time the Company met the definition of an “accelerated filer.” In accordance with SEC Release 33-8876, the Company has elected to comply with the disclosure requirements for a smaller reporting company in connection with the preparation of this annual report on Form 10-K.

Item 1. Business

Overview

Derma Sciences, Inc. (“Derma Sciences”) and its subsidiaries Sunshine Products, Inc., Derma Sciences Canada Inc., Derma First Aid Products, Inc., MedEfficiency, Inc. and Derma Sciences Europe LTD are referred to collectively as “we,” “our,” “us” and the “Company.” Our executive offices are located at 214 Carnegie Center, Suite 300, Princeton, New Jersey 08540. Derma Sciences was incorporated under the laws of Colorado on September 10, 1984. On June 3, 1996, we changed our state of domicile to Pennsylvania and on September 14, 2012, we changed our state of domicile to Delaware.

Derma Sciences is a tissue regeneration company focused on three segments of the wound care marketplace: pharmaceutical wound care, advanced wound care and traditional wound care products. Our strategic objectives are to grow the Company by continuing to progress the development of DSC127, our angiotensin analog pharmaceutical compound with an initial indication for the treatment of diabetic foot ulcers, growing and expanding our existing line of novel advanced wound care products and managing our traditional wound care products to sustain and grow this line where possible, while deploying the appropriate amount of human and financial resources available. The Company maintains manufacturing facilities in Toronto, Canada and Nantong, China and a well-established network of third party suppliers for its products. The majority of our products are sold through distributors to various health care providers such as wound care centers, extended care facilities, acute care facilities, home health care agencies and physicians’ offices. Certain products are sold directly to care givers and through retail channels. The Company markets its products principally through direct sales representatives in the United States (the “U.S.”), Canada and the United Kingdom (the “U.K.”), and through independent distributors within other select international markets.

Products

Pharmaceutical Wound Care

In 2013, we commenced a Phase 3 clinical trial for DSC127, an angiotensin analog licensed from the University of Southern California for the treatment of diabetic foot ulcers. The compound has been shown to improve epithelialization, granulation and vascularization, accelerating wound healing in a variety of normal and diabetic models. This finding suggests that DSC127 produces different actions at the wound site during various stages of healing. DSC127 has successfully completed a Phase 1 study in healthy volunteers and a Phase 2 study on patients with diabetic foot ulcers. Full results of the study were published by a major international advanced wound care journal in July 2012 (Wound Repair and Regeneration 20:482-490). There were no safety concerns observed in the preclinical, Phase 1 and Phase 2 trials of DSC127 for diabetic foot ulcers.

The Phase 3 clinical trial for diabetic foot ulcers is expected to be completed by the end of 2015. If successful, New Drug Application (“NDA”) approval by the U.S. Food and Drug administration (“FDA”) would be expected in 2017.

Beyond the initial indication for diabetic foot ulcers, we have begun preclinical testing for scar reduction. We anticipate having the results of this study in the second half of 2014. In addition, we are presently evaluating the feasibility of initiating clinical testing for radiation dermatitis using this angiotensin analog. Testing has been ongoing since 2011 for the treatment and/or prevention of tissue damage related to radiation exposure as a result of a nuclear attack. A grant for up to \$14 million was made available for this testing by Biomedical Advanced Research and Development Authority (“BARDA”) to our development partners, US Biotest, the inventors of the angiotensin analog.

Pending NDA approval for each respective indication, the potential markets for this compound include: (1) the \$10 billion chronic wound market; (2) the \$8 billion scar prevention/reduction market; (3) the \$6 billion burn market; and (4) the \$6 billion radiation and other wound markets.

Advanced Wound Care

Our advanced wound care product line consists of the following:

MEDIHONEY offers a line of patented dressings, comprised of a high percentage of Active *Leptospermum* Honey. This unique type of honey has been shown in scientific studies to have antimicrobial, anti-inflammatory and immune-modulatory activities. *MEDIHONEY* dressings are ideal for the management of non-chronic and hard-to-heal wounds including chronic ulcers, burns and post-operative wounds. The dressings are non-toxic and have been shown in a large scale, randomized controlled study to promote healing.

TCC-EZ is a patented market leading off-loading system for patients with diabetic foot ulcers. Total contact casting (TCC) has been shown in multiple randomized controlled studies to achieve 89% healing rates. However, traditional TCC is utilized in a small percentage of cases (< 5%) due to various factors, such as long application times, frequency of application error and patient dissatisfaction as a result of the heavy nature of the cast. *TCC-EZ* virtually eliminates these issues as it can be applied in less than one-third the time of a traditional TCC. *TCC-EZ* allows for a much more simplified process, so application errors are uncommon, and the cast itself is significantly lighter than a traditional TCC cast, due to its open weave pattern.

AMNIOEXCEL and *AMNIOMATRIX* represent our entry into the \$500 million skin substitute market. Licensed in January 2014, we will introduce these products by the third quarter of 2014. *AMNIOEXCEL* is an amniotic extracellular membrane product that is a sterile, room-temperature stable, re-absorbable tissue allograft derived from human amnion, providing a natural scaffold for tissue repair and regeneration. *AMNIOMATRIX* is a cryopreserved liquid allograft derived from human placenta tissue used as a wound covering in the treatment of localized tissue defects. The addressable skin substitute market includes traumatic injuries, burns, surgical wounds, complex chronic and acute wounds and other soft-tissue defects.

XTRASORB provides a novel, proprietary line of dressings that utilizes super-absorbent polymer technologies. While other absorbing dressings currently on the market use open cell structures to capture fluid, *XTRASORB* dressings convert fluid within the dressings to a gel, thus locking the exudates into the dressings. *XTRASORB* dressings have a distinct advantage over alternative products due to their ability to absorb more fluid and segregate the fluid from the wound, thus avoiding further wound deterioration. Studies have shown these dressings are able to reduce wound exposure to harmful and damaging matrix metalloproteinases ("MMP's"). These dressings can absorb up to 20 times their weight in wound fluid and compare favorably to the market leading dressings at a cost effective price point.

BIOGUARD is a line of patented first and secondary dressings containing an active antimicrobial compound. This compound, a cationic biocide, is intrinsically bound to the dressing through a proprietary process that results in the inability for the compound to separate from the dressing. These dressings are ideal for prophylactic use in the prevention of hospital or community acquired infections through wound sites, especially for burns. The dressings have been shown to kill 99.9% of virulent bacteria such as methicillin resistant *staphylococcus aureus* (MRSA) in less than one minute, and 99.999% of MRSA in less than one hour.

Other advanced wound care products include *ALGICELL AG*, a proprietary antimicrobial dressing with ionic silver as its active ingredient; and a range of moist, occlusive dressings such as hydrocolloids, foams, hydrogels, alginates, additional silver antimicrobial dressings, cleansers and our proprietary *DERMAGRAN* products.

Our advanced wound care products are the main focus of our sales and marketing resources. Our promoted advanced wound care products are differentiated in the marketplace and carry higher gross profit margins. We continue to evaluate synergistic products and technologies within the advanced wound care market for consideration in the expansion of our advanced wound care product line.

Traditional Wound Care

Our traditional wound care product line consists of the following:

A broad line of branded gauze sponges and bandages, non-adherent impregnated dressings, retention devices, paste bandages and other compression devices for the medical markets;

A broad line of branded and private-label adhesive bandages and related first aid products for the medical, industrial, private label and retail markets;

Private-label wound care products utilizing our manufacturing capabilities for a number of U. S. and international health care companies;

A line of rigid and proprietary flexible wound closure strips, nasal tube fasteners and a variety of catheter fasteners for the medical markets; and

A line of general purpose and specialized skin care products for the institutional medical market.

Our traditional wound care products for the most part are not differentiated in the marketplace and carry lower gross profit margins. We sell these products principally through distributors or, in the case of private label products, directly to customers on the basis of quality, price and customer service. At times, we have the opportunity to bundle these products with the sale of our advanced wound care products. As such, this product line does not require a significant investment in sales and marketing resources to sustain it. To the extent opportunities for growth are available, we will invest accordingly.

Sales and Marketing

Our sales and marketing infrastructure is divided into two groups, Advanced Wound Care and Traditional Wound Care. The Advanced Wound Care group is comprised of the group president and the sales and marketing infrastructure that supports the global sale of our advanced wound care products. This infrastructure includes the Company's global advanced wound care marketing, clinical, product development and sales organizations. The advanced wound care group's principal objective is to create care giver demand for our products. The Traditional Wound Care group is comprised of the group president and the global marketing and sales infrastructure that support the global sale of our traditional wound care products. This infrastructure includes the global commodity wound care, first aid products and contract manufacturing marketing and sales organizations, together with the corporate accounts team that supports both groups. The traditional wound care group's principal objective is to create distributor and private label demand for our products.

Marketing

Our advanced wound care global marketing team is comprised of a vice president, four product managers and two graphic artists at corporate headquarters. While the majority of this teams' time is spent supporting the U.S. market, they are also responsible for supporting our rest of world marketing efforts by working closely with local management.

Our traditional wound care marketing efforts consist principally of direct expenses in support of the business. These efforts are for the most part managed by sales personnel. As needed, the advanced wound care team will assist with creative marketing requirements.

Clinical

Our advanced wound care global clinical team is located in the U.S. and is comprised of a director, five clinicians and a clinical project manager. The director and project manager are located at corporate headquarters, while the clinicians are geographically disbursed one to each of five sales regions. All team members contribute to the development of clinical evidence in support of our advanced wound care products, the process of which is managed by the project manager. While the majority of this teams' time is spent supporting the U.S. market, they are also responsible for supporting clinical efforts throughout the rest of the world working closely with local management.

Product Development

In 2014, we added a product development manager to oversee and coordinate our advanced wound care product development efforts, working closely with our operations teams and licensors.

Sales

Our advanced wound care global sales team is comprised of a vice president and two sales administrators at corporate headquarters. In the U.S., our field sales force consists of five regions, each consisting of a regional manager, a product specialist and ten territory managers. Our Europe, Middle East and Africa (“EMEA”) sales team is comprised of a general manager and a sales administrator headquartered in the United Kingdom (“U.K.”). The general manager is responsible for managing a direct sales force of six in the U.K. consisting of a sales manager and five territory managers, together with distributor relationships throughout the rest of EMEA. Our Asia Pacific and Latin America (“APLA”) sales team is led by a vice president at corporate headquarters who is responsible for managing distributor relationships throughout APLA. Our plan is to add regional in-market distributor sales support within EMEA and APLA as our business grows in these markets.

Our traditional wound care sales team is comprised of a vice president of distribution and contract manufacturing, a vice president of first aid products and a vice president of corporate accounts located at corporate headquarters. The vice president of distribution and contract manufacturing is responsible for managing our U.S. distributor and global private label medical relationships. The vice president of first aid products, working with a number of independent brokers, is responsible for managing our branded and private label first aid business. The vice president of corporate accounts, working with two field directors and two sales operations specialists located at corporate headquarters, is responsible for managing our relationship with group purchasing organizations in the U.S., as well as providing sales analytics for sales management, commission and third party fee payment. Our Canada sales team reports directly to the group president and is responsible for supporting both our advanced and traditional lines of products. The team is comprised of a sales manager and a sales administrator located in our Toronto sales office, together with three territory managers and a manufacturer’s representative covering the major population centers.

Competition

Many of our competitors are larger and have greater resources than we do. The advanced wound care sector of the global medical device marketplace is characterized by evolving technology and intense competition. We believe that we have assembled a broad range of proprietary advanced wound care products capable of effectively competing in the marketplace. We are recognized for both our entrepreneurial culture that cost effectively incubates product development and our ability to commercialize new advanced wound care products offering superior value. Our traditional wound care products compete in a very intense commodity oriented global marketplace. We offer a broad range of traditional wound care products, some of which have a degree of product differentiation. While our competitors sell products that are in many respects comparable to ours, we have been successful in this environment selling our traditional wound care products on the basis of quality, price and customer service.

Product Sourcing

Our Operations team headquartered in Toronto, Canada manages our supply chain function which consists of internal product manufacturing, third party supply of product, regulatory, distribution and inventory management. Our main manufacturing facility is located in Toronto and manufactures a broad range of advanced and traditional wound care products. We have a small facility in Nantong, China which we use principally for low volume and labor intensive traditional wound care gauze products. We have a contract manufacturing relationship with a supplier in China for adhesive bandages and related first aid products and one in Mexico for paste bandages. All of these facilities are ISO certified.

A significant portion of our products are sourced directly from a long standing global network of third party suppliers. We require that all suppliers conform to the standards set forth in the Good Manufacturing Practice regulations promulgated by the FDA and local health agencies. The majority of these products are manufactured using readily available components. Accordingly, there are numerous companies capable of manufacturing these products to applicable specifications and regulatory standards.

We are contractually obligated to source the bulk honey used in our MEDIHONEY products exclusively from the product licensor. Both parties effectively manage demand versus capacity on a continuous basis and maintain adequate safety stock levels to guard against any interruption in supply. Other sources of bulk honey exist. Should the licensor be unable to supply, we have the right to source our requirements elsewhere.

We are contractually obligated to source a key component of our TCC-EZ product exclusively from the product licensor. Both parties effectively manage demand versus capacity on a continuous basis and we maintain a reasonable level of safety stock to guard against interruption in supply.

We are contractually obligated to source AMNIOEXCEL and AMNIOMATRIX products exclusively from the product licensor. Both parties effectively manage demand versus capacity on a continuous basis and maintain adequate safety stock levels to guard against any interruption in supply. The licensor has agreed to qualify and maintain a qualified back up supplier for these products to protect against a long term interruption in supply.

Given the oversight of our manufacturing facilities and our third party suppliers, the availability of other suppliers and our inventory management policy concerning safety stock levels, we do not believe that a temporary interruption of supply or the loss of one or more suppliers would have a long-term detrimental impact on our supply chain operations.

Patents, Trademarks, Proprietary and Non-Proprietary Technology

We own or license a number of trademarks covering the Company and its products. In addition, we own or license over 50 U.S. patents, corresponding foreign patents and patent applications. Most of the patents relating to the DSC127, MEDIHONEY and BIOGUARD technologies are held under license agreements of indefinite duration. We also have a number of non-patented formulations and process technologies that, together with the aforementioned patents, provide competitive advantages in the marketplace.

Government Regulation

The manufacture, distribution and advertising of our products are subject to various U.S. and foreign agencies. In addition, we are subject to regulation regarding occupational safety, laboratory practices, environmental protection and hazardous substance control and may be subject to other present and future U.S. and foreign regulations. We believe we are in compliance with all such laws, regulations and standards currently in effect and that the cost of continued compliance will not have a material adverse effect on us.

Employees

Derma Sciences had 258 full-time and 4 part-time employees at December 31, 2013. Of these employees, 117 are located in the U.S., 99 in Canada, 37 in China and nine in Europe. The Company considers employee relations to be satisfactory.

Item 1A. Risk Factors

We have a history of losses and can offer no assurance of future profitability.

We incurred net losses of \$23,964,053 in 2013 and \$12,070,431 in 2012, and additional losses in previous years. At December 31, 2013, we had an accumulated deficit of \$64,170,811. We cannot offer any assurance that we will be able to generate sustained or future earnings.

Our liquidity may be dependent upon amounts available through additional debt or equity financings.

We have a history of operating losses and negative cash flow from operating activities. As such, we have utilized funds from offerings of our equity securities to fund our operations. We have taken steps to improve our overall liquidity and believe we have sufficient liquidity to meet our needs for the next twelve months. However, in the event our cash flow from operating activities is insufficient to meet our requirements, we may be forced either to secure a line of credit or seek additional equity financing. The sale of additional securities could result in additional dilution to our stockholders. The incurrence of indebtedness would result in increased debt service obligations and could result in operating and financing covenants that would restrict our operations. There can be no assurance that such financing would be available or, if available, that such financing could be obtained upon terms acceptable to us.

The results of preclinical studies and completed clinical trials are not necessarily predictive of future results, and our current drug candidates may not have favorable results in later studies or trials.

Preclinical studies and Phase 1 and Phase 2 clinical trials are not primarily designed to test the efficacy of a drug candidate, but rather to test safety, to study pharmacokinetics and pharmacodynamics, and to understand the drug candidate's side effects at various doses and schedules. Favorable results in early studies or trials may not be repeated in later studies or trials, including continuing preclinical studies and large-scale Phase 3 clinical trials, and our drug candidates in later-stage trials may fail to show desired safety and efficacy despite having progressed through earlier-stage trials. Unfavorable results from ongoing preclinical studies or clinical trials could result in delays, modifications or abandonment of ongoing or future clinical trials, or abandonment of a clinical program. Preclinical and clinical results are frequently susceptible to varying interpretations that may delay, limit or prevent regulatory approvals or commercialization. Negative or inconclusive results or adverse medical events during a clinical trial could cause a clinical trial to be delayed, repeated or terminated, or a clinical program to be abandoned.

We rely on third parties to conduct our clinical trials and many of our preclinical studies. If those parties do not successfully carry out their contractual duties or meet expected deadlines, our drug candidates may not advance in a timely manner or at all.

In the course of our preclinical testing and clinical trials, we rely on third parties, including laboratories, investigators, clinical contract research organizations ("CROs"), and manufacturers, to perform critical services for us. For example, we rely on third parties to conduct our clinical trials and many of our preclinical studies. CROs are responsible for many aspects of the trials, including finding and enrolling subjects for testing and administering the trials. Although we rely on these third parties to conduct our clinical trials, we are responsible for ensuring that each of our clinical trials is conducted in accordance with its investigational plan and protocol. Moreover, the FDA and foreign regulatory authorities require us to comply with regulations and standards, commonly referred to as good clinical practices, or GCPs, for conducting, monitoring, recording, and reporting the results of clinical trials to ensure that the data and results are scientifically credible and accurate, and that the trial subjects are adequately informed of the potential risks of participating in clinical trials. Our reliance on third parties does not relieve us of these responsibilities and requirements. These third parties may not be available when we need them or, if they are available, may not comply with all regulatory and contractual requirements or may not otherwise perform their services in a timely or acceptable manner, and we may need to enter into new arrangements with alternative third parties and our clinical trials may be extended, delayed or terminated. These independent third parties may also have relationships with other commercial entities, some of which may compete with us. In addition, if such third parties fail to perform their obligations in compliance with our clinical trial protocols or GCPs, our clinical trials may not meet regulatory requirements or may need to be repeated. As a result of our dependence on third parties, we may face delays or failures outside of our direct control. These risks also apply to the development activities of collaborators, and we do not control their research and development, clinical trial or regulatory activities.

Our foreign operations are essential to our economic success and are subject to various unique risks.

Our future operations and earnings will depend to a large extent on the results of our international operations and our ability to maintain a continuous supply of wound care products from our international operations and suppliers. While we do not envision any adverse change to our international operations or suppliers, adverse changes to these operations, as a result of political, governmental, regulatory, economic, exchange rate, labor, logistical or other factors, could have a material adverse effect on our future operating results.

The rate of reimbursement for the purchase of our products by government and private insurance is subject to change.

Sales of several of our wound care products depend partly on the ability of our customers to obtain reimbursement for the cost of our products from government health administration agencies such as Medicare and Medicaid. Both government health administration agencies and private insurance firms continuously seek to reduce healthcare costs. Our ability to commercialize our products successfully will depend in part on the extent to which reimbursement for the costs of such products and related treatments will be available from government health administration authorities, private health insurers and other third-party payors. Significant uncertainty exists as to the reimbursement status of newly approved medical products. The continuing efforts of the government, insurance companies, managed care organizations and other payors of healthcare services to contain or reduce costs of healthcare may adversely affect:

- Our ability to set a price we believe is fair for our products;
- Our ability to generate revenues or achieve or maintain profitability; and
- The availability to us of capital.

Payors are increasingly attempting to contain healthcare costs by limiting both coverage and the level of reimbursement, particularly for new therapeutic products or where payors perceive that the target indication of the new product is well served by existing drugs or other treatments. Accordingly, even if coverage and reimbursement are provided, market acceptance of our products would be adversely affected if the amount of coverage and/or reimbursement available for the use of our products proved to be unprofitable for healthcare providers or less profitable than alternative treatments.

There have been federal and state legislation changes which have subjected the pricing of healthcare goods and services to government control and made other changes to the U.S. healthcare system. While we cannot predict the outcome of current or future legislation, we anticipate, particularly given the recent enactment of healthcare reform legislation that Congress and state legislatures will continue to introduce initiatives directed at lowering the total cost of healthcare. In addition, in certain foreign markets the pricing of drugs is subject to government control and reimbursement may in some cases be unavailable or insufficient. It is uncertain if future legislation, whether domestic or abroad, will be adopted that might affect our products. It is also uncertain what actions federal, state or private payors for healthcare treatment and services may take in response to any such healthcare reform proposals or legislation. Any such healthcare reforms could have a material and adverse effect on the marketability of any products for which we ultimately receive FDA or other regulatory agency approval or for which we receive government sponsored reimbursements.

Our success may depend upon our ability to protect our patents and proprietary technology.

We own patents, both in the U.S. and abroad, for several of our products, and rely upon the protection afforded by our patents and trade secrets to protect our technology. Our future success may depend upon our ability to protect our intellectual property. However, the enforcement of intellectual property rights can be both expensive and time consuming. Therefore, we may not be able to devote the resources necessary to prevent infringement of our intellectual property. Also, our competitors may develop or acquire substantially similar technologies without infringing our patents or trade secrets. For these reasons, we cannot be certain that our patents and proprietary technology will provide us with a competitive advantage.

Government regulation plays a significant role in our ability to acquire and market products.

Government regulation by the U.S. FDA and similar agencies in other countries is a significant factor in the development, manufacturing and marketing of many of our products and in our acquisition or licensing of new products. Complying with government regulations is often time consuming and expensive and may involve delays or actions adversely impacting the marketing and sale of our current or future products.

A significant portion of our products are sourced from third parties.

A significant portion of our products are sourced in raw, semi-finished and finished form directly from third party suppliers. None of these sourced products presently account for more than 10% of our sales with the exception of *Medihoney* and *TCC-EZ*. We maintain good relations with our third party suppliers. With the exception of *Medihoney* and *TCC-EZ*, there are several third party suppliers available for each of our products. If a current supplier were unable or unwilling to continue to supply our products, sale of the affected products could be delayed for the period necessary to secure a replacement.

The technology utilized in many of our advanced wound care products is licensed from third parties and could become unavailable.

A significant percentage of our advanced wound care products utilize technology that we license on an exclusive basis from third parties. These products include *Medihoney* dressings, *Bioguard* dressings and *TCC-EZ* total contact casts. The licensing agreements that we have with the owners of these technologies are of limited duration (with the exception of *Medihoney* and *Bioguard*, which are in perpetuity) and renewals of the agreements are at the discretion of the licensors. In addition, in some instances, the maintenance of the license agreements requires that we meet various minimum sales and/or minimum royalty requirements. If we fail to meet the minimum sales or minimum royalty requirements of a given license agreement, there is a possibility that the agreement will be cancelled or not renewed or that our exclusivity under the license agreement will be withdrawn. If any of these events were to occur, our ability to sell the products utilizing the licensed technology could be lost or compromised and our revenues and potential profits could be adversely affected.

Competitors could invent products superior to ours and cause our products and technology to become obsolete.

The wound care sector of the medical products industry is characterized by rapidly evolving technology and intense competition. Our competitors currently manufacture and distribute a variety of products that are in many respects comparable to our products. Many suppliers of competing products are considerably larger and have much greater resources than we do. In addition, many specialized products companies have formed collaborations with large, established companies to support research, development and commercialization of wound care products which may be competitive with ours. Academic institutions, government agencies and other public and private research organizations are also conducting research activities and may commercialize wound care products on their own or through joint ventures. While we have no specific knowledge of products under development by our competitors, it is possible that these competitors may develop technologies and products that are more effective than any we currently have. If this occurs, any of our products and technology affected by these developments could become obsolete.

Although we are insured, any material product liability claims could adversely affect our business.

We sell over-the-counter products and medical devices and are exposed to the risk of lawsuits claiming alleged injury caused by our products. Among the grounds for potential claims against us are injuries due to alleged product inefficacy and injuries resulting from infection due to allegedly non-sterile products. Although we carry product liability insurance with limits of \$1.0 million per occurrence and \$2.0 million aggregate with \$10.0 million in umbrella coverage, this insurance may not be adequate to reimburse us for all damages that we could suffer as a result of successful product liability claims. Also, defending against a claim could be time consuming and costly. No material product liability claim has ever been made against us and we are not aware of any pending product liability claims. However, a successful material product liability suit could adversely affect our business.

The potential increase in common shares due to the conversion, exercise or vesting of outstanding dilutive securities may have a depressive effect upon the market value of our shares.

Up to 4,962,541 shares of our common stock were potentially issuable at December 31, 2013 upon the conversion, exercise or vesting of outstanding convertible preferred stock, warrants, options and restricted stock units. The shares of common stock potentially issuable upon conversion, exercise or vesting of these securities are substantial compared to the 17,347,071 shares of common stock outstanding at December 31, 2013.

Earnings per share of common stock may be substantially diluted by the existence of these dilutive securities regardless of whether they are converted, exercised or issued. This dilution of earnings per share could have a depressive effect upon the market value of our common stock.

Our stock price has been volatile and this volatility is likely to continue.

Historically, the market price of our common stock has been volatile. The high and low bid prices for the years 2009 through 2013 are set forth in the table below:

Derma Sciences, Inc.
Trading Range – Common Stock

Year	Low	High
2009	\$ 1.92	\$ 6.80
2010	\$ 4.40	\$ 9.00
2011	\$ 4.50	\$ 12.72
2012	\$ 6.94	\$ 11.89
2013	\$ 9.93	\$ 15.45

Events that may affect our common stock price include:

- Outcome of DSC127 development;
- Quarter to quarter variations in our operating results;
- Changes in earnings estimates by securities analysts;
- Changes in interest rates or other general economic conditions;
- Changes in market conditions in the wound care industry;
- Fluctuations in stock market prices and trading volumes of similar companies;
- Discussion of us or our stock price by the financial and scientific press and in online investor communities;
- Additions or departures of key personnel;
- Changes in third party reimbursement policies;
- The introduction of new products either by us or by our competitors; and
- The loss of a major customer.

Although publicly traded securities are subject to price and volume fluctuations, it is likely that our common stock will experience these fluctuations to a greater degree than the securities of more established and better capitalized organizations.

We have not paid, and we are unlikely to pay in the near future, cash dividends on our securities.

We have never paid any cash dividends on our common or preferred stock and do not anticipate paying cash dividends in the foreseeable future. The payment of dividends by us will depend on our future earnings, financial condition and such other business and economic factors as our management may consider relevant.

Our common stock does not have a vigorous trading market and you may not be able to sell your securities when desired.

We have a limited active public market for our common shares. We cannot assure you that a more active public market will develop thereby allowing you to sell large quantities of our shares. Consequently, you may not be able to readily liquidate your investment.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

Our headquarters are located in Princeton, New Jersey. In addition to the lease relative to our headquarters, we have entered into leases for office, manufacturing, and distribution facilities. Our facilities, locations, size, monthly rent and lease expirations are set forth in the table below:

Location	Use	Segment	Square Footage	Base Monthly Rent	Lease Expiration
Princeton, New Jersey	Corporate Headquarters	Other	15,065	\$35,628	November 2018
Fenton, Missouri	Distribution	Advanced and Traditional Wound Care	42,400	\$14,568	March 2015
Houston, Texas	Distribution	Traditional Wound Care	52,770	\$17,781	March 2015
Toronto, Canada	Manufacturing, Distribution & Offices	Advanced and Traditional Wound Care and Other	76,399	\$31,326	August 2017
Maidenhead, U.K.	Offices	Advanced and Traditional Wound Care	450	\$2,350	July 2017
Nantong, China	Manufacturing & Offices	Traditional Wound Care	11,388	\$2,065	December 2015

We believe that our facilities are adequate to meet our office, manufacturing and distribution requirements for the foreseeable future.

Item 3. Legal Proceedings

None.

Item 4. Mine Safety Disclosures

Not applicable.

Part II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock is traded on the NASDAQ Capital Market under the symbol "DSCI." The following table sets forth the high and low bid prices for our common stock during each of the indicated calendar quarters:

<u>Quarter Ended</u>	<u>High</u>	<u>Low</u>
March 31, 2013	\$ 12.89	\$ 10.78
June 30, 2013	\$ 14.92	\$ 9.93
September 30, 2013	\$ 15.45	\$ 12.00
December 31, 2013	\$ 13.24	\$ 10.67
March 31, 2012	\$ 9.99	\$ 6.94
June 30, 2012	\$ 10.21	\$ 8.55
September 30, 2012	\$ 10.65	\$ 9.10
December 31, 2012	\$ 11.89	\$ 10.20

The stock prices reflect inter-dealer prices without retail mark-up, mark-down or commission and may not necessarily represent actual transactions. There is no public market for our preferred stock.

Holders of common stock. As of the close of business on March 12, 2014 there were approximately 857 holders of record of our common stock. We believe that the number of beneficial holders of our common stock is substantially greater. On March 12, 2014, the closing sales price of our common stock as reported on the NASDAQ Capital Market was \$13.87.

Dividends and dividend policy. We have never paid any cash dividends on our common stock and do not anticipate paying cash dividends in the foreseeable future. The payment of dividends by us will depend on our future earnings, financial condition and such other business and economic factors as our management may consider relevant.

Securities authorized for issuance under equity compensation plans. The information called for by this item is incorporated by reference to our definitive proxy statement relating to our 2014 annual meeting of stockholders, which we will file with the Securities and Exchange Commission within 120 days after December 31, 2013.

Recent sales of unregistered securities. All prior sales of unregistered securities have been previously reported on a quarterly report on Form 10-Q or a current report on Form 8-K.

Item 6. Selected Financial Data

Not applicable.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

This annual report on Form 10-K includes certain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, but are not limited to, statements about the confidence, strategies, plans, expectations, intentions, objectives, technologies, opportunities, market demand or acceptance of new or existing products of the Company, and other statements contained in this annual report that are not historical facts. Forward-looking statements in this annual report or hereafter included in other publicly available documents filed with the Securities and Exchange Commission reports to our stockholders and other publicly available statements issued or released by us involve known and unknown risks, uncertainties and other factors that could cause our actual results, performance (financial or operating) or achievements to differ from the future results, performance (financial or operating) or achievements expressed or implied by such forward-looking statements. Such future results are based upon management's best estimates, current conditions and the most recent results of operations. When used in this annual report, the words "expect," "anticipate," "intend," "plan," "believe," "seek," "estimate" and similar expressions are generally intended to identify forward-looking statements, because these forward-looking statements involve risks and uncertainties. There are important factors that could cause actual results to differ materially from those expressed or implied by these forward-looking statements, including our plans, objectives, expectations and intentions, changes in political, economic, business, competitive, market and regulatory factors and other factors that are discussed under the section in this annual report entitled "Risk Factors." Neither we nor any other person assume responsibility for the accuracy or completeness of these forward-looking statements. We are under no duty to update any of the forward-looking statements after the date of this annual report to conform these statements to actual results.

Year Ended December 31, 2013 Compared to Year Ended December 31, 2012

Overview

The following table highlights the year ended December 31, 2013 versus 2012 operating results:

	Year Ended December 31,		Variance	
	2013	2012		
Gross sales	\$ 88,841,450	\$ 83,024,063	\$ 5,817,387	7.0%
Sales adjustments	(9,130,470)	(10,375,865)	1,245,395	12.0%
Net sales	79,710,980	72,648,198	7,062,782	9.7%
Cost of sales	50,320,506	47,507,349	2,813,157	5.9%
Gross profit	29,390,474	25,140,849	4,249,625	16.9%
Selling, general and administrative expense	42,044,484	32,485,368	9,559,116	29.4%
Research and development expense	11,335,672	7,123,123	4,212,549	59.1%
Other income, net	(185,740)	(26,729)	(159,011)	*
Total expenses	53,194,416	39,581,762	13,612,654	34.4%
Loss before income taxes	(23,803,942)	(14,440,913)	(9,363,029)	(64.8%)
Income tax expense (benefit)	160,111	(2,370,482)	2,530,593	*
Net loss	\$ (23,964,053)	\$ (12,070,431)	\$ (11,893,622)	(98.5%)

* not meaningful

Gross to Net Sales Adjustments

Gross to net sales adjustments are comprised of the following:

	Year Ended December 31,	
	2013	2012
Gross sales	\$ 88,841,450	\$ 83,024,063
Trade rebates	(6,083,940)	(7,623,597)
Distributor fees	(984,947)	(1,368,645)
Sales incentives	(978,770)	(503,563)
Returns and allowances	(394,656)	(316,258)
Cash discounts	(688,157)	(563,802)
Total adjustments	<u>(9,130,470)</u>	<u>(10,375,865)</u>
Net sales	<u>\$ 79,710,980</u>	<u>\$ 72,648,198</u>

Trade rebates decreased in 2013 versus 2012 principally due to lower sales in Canada, and a decrease in the rebate percentage due to a change in product mix towards lower rebated products, partially offset by an increase in U.S. sales subject to rebate. The decrease in distributor fees is commensurate with the decrease in Canadian sales upon which the fees are based. The increase in sales incentives reflects higher sales subject to incentives. The increase in sales returns and allowances reflects higher U.S. sales in 2013 versus 2012. The increase in cash discounts principally relates an increase in U.S. sales to customers that normally take the cash discount along with higher U.S. sales subject to cash discount.

Rebate Reserve Roll-Forward

A roll-forward of the trade rebate accruals for the years ended December 31, 2013 and 2012 were as follows:

	December 31,	
	2013	2012
Beginning balance – January 1	\$ 2,466,091	\$ 2,195,006
Rebates paid	(6,803,038)	(7,352,512)
Rebates accrued	<u>6,083,940</u>	<u>7,623,597</u>
Ending balance – December 31	<u>\$ 1,746,993</u>	<u>\$ 2,466,091</u>

The \$719,098 decrease in the trade rebate reserve balance at December 31, 2013 from December 31, 2012 principally reflects a decrease in sales subject to rebate in Canada, partially offset by an increase in U.S. sales subject to rebate. There has been no other significant change in the nature of our business in 2013 as it relates to the accrual and subsequent payment of rebates.

Net Sales and Gross Margin

The following table highlights the product line net sales and gross margin for the years ended December 31, 2013 versus 2012:

	Year Ended December 31,		Variance	
	2013	2012		
Net sales	\$ 79,710,980	\$ 72,648,198	\$ 7,062,782	9.7%
Cost of sales	<u>50,320,506</u>	<u>47,507,349</u>	<u>2,813,157</u>	5.9%
Gross profit	<u>\$ 29,390,474</u>	<u>\$ 25,140,849</u>	<u>\$ 4,249,625</u>	16.9%
Gross profit %	<u>36.9%</u>	<u>34.6%</u>		

Net sales increased \$7,062,782, or 9.7% (10.3% adjusted for exchange), in 2013 versus 2012. Advanced wound care sales increased \$9,095,813, or 36.6%, to \$33,928,535 in 2013 from \$24,832,722 in 2012. Traditional wound care sales decreased \$2,033,031, or 4.3%, to \$45,782,445 in 2013 from \$47,815,476 in 2012.

Sales from our U.S. operating subsidiaries increased \$9,795,177, or 17.6%, to \$65,348,270 in 2013 from \$55,553,093 in 2012. The increase was driven by higher advanced wound care sales of \$8,331,887, or 38.8%, and traditional wound care sales of \$1,463,290, or 4.3%. Excluding TCC sales, which were positively impacted by our April 2012 acquisition of MedEfficiency, advanced wound care sales increased by 30.2%, led by Medihoney, Xtrasorb and Bioguard. The traditional wound care sales increase was led by higher private label and first aid product sales which included an initial stocking order for a large U.S. retail pharmacy chain of approximately \$1,100,000. Sales from our Canadian operating subsidiary decreased \$3,586,741, or 24.9% (22.0% adjusted for exchange), to \$10,811,358 in 2013 from \$14,398,099 in 2012. This decrease was driven by lower end user demand of 7.4% due to business lost in 2013, a significant reduction in sales to our exclusive distributor as a result of the distributor's decision to rebalance its inventory, and an unfavorable exchange of \$415,925 due to weakening of the Canadian dollar. Sales from our international operating subsidiary increased \$854,346, or 31.7% (33.0% excluding exchange) to \$3,551,352 in 2013 from \$2,697,006 in 2012. The increase was driven by higher advanced wound care sales of \$735,953 and traditional wound care sales of \$118,393.

Gross profit increased \$4,249,625, or 16.9%, in 2013 versus 2012. Advanced wound care gross profit increased \$4,378,877, or 35.1%, to \$16,837,797 in 2013 from \$12,458,920 in 2012. Traditional wound care gross profit decreased \$129,252, or 1.0%, to \$12,552,677 in 2013 from \$12,681,929 in 2012. The overall gross profit margin percentage increased to 36.9% in 2013 from 34.6% in 2012. The increase in gross profit dollars reflected higher sales, coupled with the higher gross profit margin percentage. The higher gross margin percentage principally reflected an increase in higher margined advanced wound care sales, partially offset by higher product costs.

Selling, General and Administrative Expenses

The following table highlights selling, general and administrative expenses by type for the years ended December 31, 2013 versus 2012:

	Year Ended December 31,		Variance	
	2013	2012		
Distribution	\$ 2,345,041	\$ 2,073,893	\$ 271,148	13.1%
Marketing	5,480,275	3,572,629	1,907,646	53.4%
Sales	17,903,341	14,244,048	3,659,293	25.7%
General and administrative	16,315,827	12,594,798	3,721,029	29.5%
Total	\$ 42,044,484	\$ 32,485,368	\$ 9,559,116	29.4%

Selling, general and administrative expenses increased \$9,559,116, or 29.4% (29.8% adjusted for exchange), in 2013 versus 2012.

Distribution expense increased \$271,148, or 13.1% (13.6% adjusted for exchange), in 2013 versus 2012. The increase reflected higher operating costs in support of our growing base of sales.

Marketing expense increased \$1,907,646, or 53.4% (53.6% adjusted for exchange), in 2013 versus 2012. The increase was attributable to higher compensation expense associated with the issuance of the December 2012 and 2013 executive stock based awards, two new marketing and two new clinical personnel added in 2012 and 2013, travel expenses, and promotional and product development costs principally in support of our advanced wound care growth initiatives, partially offset by lower recruiting costs.

Sales expense increased \$3,659,293, or 25.7% (26.0% adjusted for exchange), in 2013 versus 2012. The increase was principally attributable to incremental costs consisting of compensation and benefits, commission, travel and sample expenses associated with the expansion of the advanced wound care sales force in the U.S., Canada, and the U.K., which was completed during the second quarter of 2012, along with the incremental investment of an international sales management position to support our international growth, higher equity based compensation expense, and administrative fees associated with group purchasing and sales data collection programs.

General and administrative expenses increased \$3,721,029, or 29.5% (30.1% adjusted for exchange), in 2013 versus 2012. This increase reflects higher legal costs, compensation expense associated with the December 2012 and 2013 executive and director's equity based awards, compensation and benefits related to annual salary increases and the addition of seven new positions in 2012 and 2013 to support our growth, coupled with higher professional service costs, information technology costs associated with an information systems integration project, insurance and corporate office expenses.

Research and Development Expense

Research and development expense increased \$4,212,549, or 59.1%, to \$11,335,672 in 2013 from \$7,123,123 in 2012. The increase reflected the ramp up and continuation of DSC127 Phase 3 related expenses as the project moved into its clinical trial phase during the first quarter of 2013.

Other Income, net

Other income, net increased \$159,011 to \$185,740 in 2013 from \$26,729 in 2012. The increase reflects an increase in short term investments, mainly certificates of deposits, which earned interest in 2013, a gain on foreign currency exchange, as well as a dividend received from Comvita in connection with the Company's equity investment that was made in 2013.

Income Taxes

We recognized a \$160,111 income tax expense in 2013 consisting of a \$120,330 U.S. income tax expense and a foreign income tax expense of \$39,781. The U.S. income tax expense consists of a current tax expense of \$5,365 and a deferred tax expense of \$114,965. The deferred tax expense was due to differences in financial reporting and tax treatment of goodwill of \$153,619 net of amortization for financial reporting but not tax purposes of acquired MedEfficiency identified intangible assets of \$38,654.

Due to uncertainties surrounding our ability to use our U.S. and U.K. net operating loss carry forwards and net deferred tax assets, a full valuation allowance for the U.S. and U.K. net deferred tax assets has been provided.

Net Loss

We generated a net loss of \$23,964,053, or \$1.40 per share (basic and diluted), in 2013 compared to a net loss of \$12,070,431, or \$0.97 per share (basic and diluted), in 2012.

Liquidity and Capital Resources

Cash Flow and Working Capital

At December 31, 2013 and 2012, we had cash and cash equivalents of \$6,501,586 and \$41,616,657, respectively. The \$35,115,071 decrease in cash and cash equivalents reflected net cash used in operating activities of \$17,202,157 and investing activities of \$20,291,776, together with an exchange rate effect of \$209,990, partially offset by cash provided by financing activities of \$2,588,852.

Net cash used in operating activities of \$17,202,157 resulted from \$14,701,664 cash used in operations (net loss plus non-cash items) together with \$2,500,493 cash used from the net change in operating assets and liabilities. Higher receivables, inventory and prepaid expenses, offset by higher accounts payable and accrued liabilities were the main drivers behind the net cash used in connection with the net change in operating assets and liabilities. The increase in receivables reflects a higher level of current sales. The increase in inventory reflects a build-up to support new products, growth of the international business and improved customer service levels in certain segments of our business. The increase in prepaid expenses reflected advance payments for the Phase 3 clinical trial and timing of other operating expenditure payments. The increase in accounts payable reflected the increase in business, while the increase in accrued expenses and other current liabilities principally reflected higher accrued 2013 bonus compensation and related taxes partially offset by a decrease in the Canadian sales net rebate due to lower sales volume and timing.

Net cash used in investing activities of \$20,291,776 included cash used for the net purchase of investments of \$19,246,000, which included \$7,000,000 to acquire Comvita stock, \$695,776 for capital expenditures and \$350,000 for other intangibles. The majority of the capital expenditures are being made to upgrade and expand our manufacturing capabilities and purchase computer equipment in connection with the upgrade of the U.S. and Canadian computer systems.

Net cash provided by financing activities of \$2,588,852 included net proceeds of \$2,817,001 from the exercise of warrants and stock options partially offset by the payment of payroll withholding taxes related to stock compensation of \$228,149 in connection with net share settlements.

Working capital decreased \$21,145,366 at December 31, 2013 to \$40,040,002 from \$61,185,368 at December 31, 2012. This decrease principally reflected the net cash outflow from operating activities and the net purchase of long-term investments, partially offset by net cash provided by the exercise of warrants and stock options. We believe this level of working capital is sufficient to support our existing operations for the next twelve months.

Financing Arrangements

In September 2013, we purchased 2,272,277 shares of Comvita common stock for \$7,000,000. Comvita will use the proceeds from this investment to purchase additional apiaries and upgrade and expand its Manuka honey processing capabilities. This investment will assist Comvita in its effort to better ensure the supply of medical-grade honey in an environment of growing global demand.

In January 2014, the Company raised \$80,675,000 (net of \$5,575,000 in estimated commission and other offering expenses) from the sale of 7,500,000 shares of the Company's common stock at \$11.50 per share. The Company plans to use the net proceeds from the offering for the continued development of its pharmaceutical product DSC127, for sales force expansion and for general corporate purposes.

Also in January 2014, the Company entered into a license, market development and commercialization agreement with BioDLogics, LLC ("BioD") relating to their human placental based products and intellectual property related thereto and paid an initial license fee of \$1,250,000 and granted BioD warrants to purchase 100,000 shares of the Company's common stock.

Prospective Assessment

Our strategic objective is to build the Company by both continuing to progress DSC127, with an initial indication for the treatment of diabetic foot ulcers, as well as in-licensing, developing and launching novel higher margin advanced wound care products while utilizing our cash on-hand and cash flow provided by our traditional wound care business (to the extent possible) to fund this objective. In addition, we will continue to evaluate external opportunities to leverage our core capabilities for growth and additional development programs on new indications for DSC127. To the extent we determine that we cannot finance our growth initiatives internally, additional sources of funding may be available to us through the sale of equity, the sale of licensing rights to DSC127, jointly developing products with third parties and/or selling a portion of our existing business.

The launch of a number of advanced wound product line extensions in recent years and the acquisition of the MedEfficiency line of TCC products in April 2012 and the licensing of the BioD human placental products in January 2014 bodes well for the future growth of our higher-margined advanced wound care products both domestically and abroad. We continue to work on our pipeline and have identified several new products and product line extensions that are capable of contributing to future sales growth.

Our strategy for growth is:

- Assuming the existing resources in place are generating the expected return, we will continue to expand our worldwide investment in sales and marketing resources in support of our higher-margined advanced wound care products. In March 2013, we entered into an exclusive agreement for the international rights to sell products incorporating the casting element within TCC-EZ. Additional sales and marketing resources will continue to be prudently added as needed to support the continued growth of this segment of our business. In April 2013, we hired a Vice President of International Sales to manage the Asia Pacific and Latin American international markets. We have established a presence in Europe through a direct sales organization in the U.K. and through distributors in a number of other countries, as well as a presence in Australia, New Zealand, South Korea, and various countries throughout Latin America and the Middle East through distributors. We plan to expand our sales and marketing in this and other areas of the world employing a direct sales force or distributor model as the basis for conducting business, as circumstances dictate.
- While the potential commercial launch of DSC127 is estimated to be three years away (pending the acceptance of a New Drug Application (“NDA”) by the U.S. FDA), we believe the market potential of this product for diabetic foot ulcers and other indications that we have the rights to are significant. Our toxicology and chemistry, manufacturing and control programs are proceeding as planned. All aspects of the clinical program are in place. Since the start-up of the clinical trials earlier this year, we continue to make progress initiating and activating sites and enrolling patients. We are working closely with the clinical research organization managing the trials and others to ensure the trials are progressing as planned. At this time, we are working towards completion of the last trial by the end of 2015. The cost of the preparation and execution of the Phase 3 program up to the point of NDA submission is presently estimated to be approximately \$55 to \$60 million. This includes the costs for the clinical, manufacturing and the toxicology (nonclinical) programs. Beyond the initial indication of the treatment of diabetic foot ulcers, we have initiated pre-clinical activities for scar prevention, and anticipate having initial data in the second half of 2014 to help determine whether or not to progress towards an Investigational New Drug application.
- We will continue to nurture our traditional wound care business in an effort to sustain it and grow it where possible, utilizing the appropriate amount of human and financial resources to achieve our objectives. While this area of our business presently represents a significant (albeit diminishing) percentage of our sales and realizes lower gross profit margins, it generates positive cash flow as it does not require extensive sales and marketing resources to sustain it. Maintenance and growth of this business is important to us as we utilize this cash flow to help support our advanced wound care and pharmaceutical wound care growth initiatives.

With the cash on hand as of December 31, 2013, together with the funds raised in January 2014, we anticipate having sufficient liquidity to meet our existing operating and product development needs for the next twelve months. Further, if needed, we believe the continued success of our advanced wound care business and the development of DSC127 will serve to improve our ability to raise equity or generate capital through licensing the rights going forward to fund prospective growth initiatives.

Our common stock is traded on the NASDAQ Capital Market under the symbol “DSCI.” We have paid no cash dividends in respect of our common stock and do not intend to pay cash dividends in the near future

Additional Financial Information

Off-Balance Sheet Arrangements

As of December 31, 2013, we had no off-balance sheet arrangements.

Inflation

Our management currently believes that inflation has not had, and does not currently have, a material impact on continuing operations.

Critical Accounting Policies

Estimates and assumptions are required in the determination of sales deductions for trade rebates, sales incentives, discounts and allowances. Significant estimates and assumptions are also required in determining the appropriateness of amortization periods for identifiable intangible assets, the potential impairment of goodwill and the valuation of inventory. Some of these judgments can be subjective and complex and, consequently, actual results may differ from these estimates. For any individual estimate or assumption made by us, there may also be other reasonable estimates or assumptions. We believe, however, that given current facts and circumstances, it is unlikely that applying any such other reasonable judgment would cause a material adverse effect on the consolidated results of operations, financial position or cash flows for the periods presented. Our most critical accounting policies were discussed with the Audit Committee of the Board of Directors and are described below.

Revenue Recognition and Adjustments to Revenue

We sell our products through our own direct sales force and through independent distributors and manufacturers' representatives. The primary end users of our products are nursing homes, hospitals, clinics and home healthcare agencies. We recognize revenue from the sale of our products when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collectability is reasonably assured, which is generally at the time of shipment or receipt by our customers, depending on the terms of the related sales or distribution agreement. When we recognize revenue from the sale of our products, we simultaneously adjust revenue for estimated trade rebates and distribution fees (in Canada), and estimates of returns and allowances, cash discounts and other sales incentives.

A trade rebate represents the difference between the invoice price to the wholesaler/distributor and the end user's contract price. These rebates are estimated monthly based on historical experience, distributor rebate submission trends, estimated distributor inventory levels, and existing contract sales terms with our distributors and end users. We have a contract with our exclusive Canadian distributor and we pay a fixed fee based on sales subject to the fee (as defined) for distribution services in Canada. Because the services performed by the distributor cannot be separated from the purchase of our products by the distributor, we treat this distribution fee as a reduction of revenue. The distribution fee is accrued monthly based on net sales to the distributor multiplied by the ratio of recent historical distributor fee expense to net sales. The percentage of distributor fee expense to net sales is re-evaluated quarterly for reasonableness.

Sales incentives represent credits granted to specific customers based on attainment of pre-determined sales objectives. Sales incentives are accrued monthly in accordance with the terms of the underlying sales incentive agreement and actual customer sales. Sales incentive agreements are generally for a period of one year.

We provide our customers certain limited return rights and we have a formal returned goods policy that guides the disposition of returns with our customers. We accrue for sales returns and allowances and cash discounts monthly based on current sales and historical activity. We do not offer our customers price protection rights or concessions. Returns were less than 1% of gross sales in both 2013 and 2012.

We continually monitor the factors that influence rebates and fees, returns and allowances, and other discounts and sales incentives and make adjustments as necessary

Goodwill

At December 31, 2013, we had \$13,457,693 of goodwill of which \$6,337,967 related to the MedEfficiency acquisition in April 2012, \$4,679,684 related to the First Aid Products acquisition in November 2007, and \$2,440,042 related to the Western Medical acquisition in April 2006. We assess the impairment of goodwill annually in the fourth quarter or whenever events or changes in circumstances indicate that the carrying value of goodwill may not be recoverable. The assessment is performed using the two-step process required by accounting guidance relating to goodwill. The first step is a review for potential impairment, while the second step measures the amount of the impairment, if any. The first step of the goodwill impairment test compares the fair value of a reporting unit with its carrying amount, including goodwill. For 2013 and 2012, the first step of our goodwill impairment test reflected a fair value in excess of the carrying value of our reporting units. Accordingly, we did not perform the second step of this test during these periods.

The cash generating unit level or reporting unit at which we test goodwill for impairment is the operating segment level. Products are allocated to each segment based on the nature and intended use of the product. The Medefficiency goodwill is allocated to our advanced wound care segment and the First Aid Products and Western Medical goodwill to our traditional wound care segment.

For 2013 and 2012 and consistent with prior periods, we estimated the fair value of our segments using the “income approach,” where we use a discounted cash flow model (“DCF”) in preparing our goodwill impairment assessment. This approach calculates fair value by estimating the after-tax cash flows attributable to a segment and then discounting these after-tax cash flows to a present value using a risk-adjusted discount rate. We selected this method as being the most meaningful in preparing our goodwill assessments because we believe the income approach most appropriately measures our income producing assets.

Significant estimates used in the fair value calculation include: (i) estimates of future revenue and expense growth; (ii) future estimated effective tax rates; (iii) future estimated capital expenditures; (iv) future required investments in working capital; (v) average cost of capital; and (vi) the terminal value of the reporting unit.

The amount and timing of future cash flows within our DCF analysis is based on our five year forecast. Beyond our five year forecast we assumed a terminal value to calculate the value of cash flows beyond the last projected period in our DCF analysis. Annual revenue growth rates in our DCF model reflect expected growth in our advanced and traditional wound care products. The weighted average cost of capital used to discount cash flows for the annual 2013 goodwill impairment test was 17%.

There have been no substantial changes to the methodology employed, significant assumptions or calculations applied in the first step of the goodwill impairment test over the past several years.

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, additional inventory write-downs may be required. The provision for the write-down of inventory is recorded in cost of sales.

Stock-Based Compensation

We record compensation expense associated with stock options and other equity-based compensation based on the fair value at the grant date and recognized over the requisite service and performance periods. We estimate the fair value of stock options as of the date of grant using the Black-Scholes option pricing model for service and performance based awards. We use the quoted market price for service and performance based restricted share units and binomial/lattice option pricing model for market based awards. Significant judgment and the use of estimates to value the equity-based compensation, particularly surrounding Black-Scholes or binomial/lattice pricing model assumptions such as stock price volatility and expected option lives are made.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 8. Financial Statements and Supplementary Data

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Derma Sciences, Inc.:

We have audited the accompanying consolidated balance sheets of Derma Sciences, Inc. and subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of comprehensive loss, stockholders' equity, and cash flows for each of the years in the two-year period ended December 31, 2013. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Derma Sciences, Inc. and subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Derma Sciences Inc.'s internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control – Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 13, 2014 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Philadelphia, Pennsylvania
March 13, 2014

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Derma Sciences, Inc.:

We have audited Derma Sciences, Inc.'s internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control – Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Derma Sciences, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Derma Sciences, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control – Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Derma Sciences, Inc. and subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of comprehensive loss, stockholders' equity, and cash flows for each of the years in the two-year period ended December 31, 2013, and our report dated March 13, 2014 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Philadelphia, Pennsylvania
March 13, 2014

DERMA SCIENCES, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

	December 31,	
	2013	2012
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 6,501,586	\$ 41,616,657
Short-term investments	15,478,000	3,730,000
Accounts receivable, net	7,332,756	7,085,713
Inventories	16,472,640	13,670,588
Prepaid expenses and other current assets	3,746,753	3,209,031
Total current assets	49,531,735	69,311,989
Long-term investments	7,858,140	498,000
Equipment and improvements, net	2,953,469	3,304,852
Identifiable intangible assets, net	14,635,998	17,128,883
Goodwill	13,457,693	13,457,693
Other assets	139,318	141,213
Total Assets	\$ 88,576,353	\$ 103,842,630
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	\$ 4,522,508	\$ 3,993,687
Accrued expenses and other current liabilities	4,969,225	4,132,934
Total current liabilities	9,491,733	8,126,621
Long-term liabilities	242,325	268,517
Deferred tax liability	1,694,147	1,736,299
Total Liabilities	11,428,205	10,131,437
Commitments and Contingencies (note 14)		
Stockholders' Equity		
Convertible preferred stock, \$.01 par value; 1,468,750 shares authorized; issued and outstanding 73,332 at December 31, 2013 and December 31, 2012 (liquidation preference of \$3,222,368 at December 31, 2013)	733	733
Common stock, \$.01 par value; 35,000,000 shares authorized; issued and outstanding 17,347,071 at December 31, 2013 and 16,524,723 at December 31, 2012	173,471	165,247
Additional paid-in capital	140,064,607	132,163,083
Accumulated other comprehensive income	1,080,148	1,588,888
Accumulated deficit	(64,170,811)	(40,206,758)
Total Stockholders' Equity	77,148,148	93,711,193
Total Liabilities and Stockholders' Equity	\$ 88,576,353	\$ 103,842,630

See accompanying consolidated notes.

DERMA SCIENCES, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Loss

	Year ended December 31,	
	2013	2012
Net Sales	\$ 79,710,980	\$ 72,648,198
Cost of sales	50,320,506	47,507,349
Gross Profit	<u>29,390,474</u>	<u>25,140,849</u>
Operating expenses		
Selling, general and administrative	42,044,484	32,485,368
Research and development	11,335,672	7,123,123
Total operating expenses	<u>53,380,156</u>	<u>39,608,491</u>
Operating loss	(23,989,682)	(14,467,642)
Other income, net	(185,740)	(26,729)
Loss before income taxes	(23,803,942)	(14,440,913)
Income tax provision (benefit)	160,111	(2,370,482)
Net Loss	<u>(23,964,053)</u>	<u>(12,070,431)</u>
Other Comprehensive (Loss) Income		
Foreign currency translation adjustment	(370,880)	86,357
Unrealized loss on equity securities	(137,860)	-
Total other comprehensive (loss) income	<u>(508,740)</u>	<u>86,357</u>
Comprehensive Loss	<u>\$ (24,472,793)</u>	<u>\$ (11,984,074)</u>
Net loss per common share – basic and diluted	<u>\$ (1.40)</u>	<u>\$ (0.97)</u>
Shares used in computing net loss per common share – basic and diluted	<u>17,056,632</u>	<u>12,488,263</u>

See accompanying consolidated notes.

DERMA SCIENCES, INC. AND SUBSIDIARIES

Consolidated Statements of Stockholders' Equity

	Convertible Preferred Stock		Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount	Shares	Amount				
Balance, January 1, 2012	73,332	\$ 733	10,577,632	\$ 105,776	\$ 77,374,821	\$ 1,502,531	\$(28,136,327)	\$ 50,847,534
Net loss	-	-	-	-	-	-	(12,070,431)	(12,070,431)
Foreign currency translation adjustment	-	-	-	-	-	86,357	-	86,357
Issuance of common stock, net of issuance costs of \$4,605,439	-	-	5,646,300	56,463	51,404,590	-	-	51,461,053
Shares withheld for minimum payroll taxes	-	-	-	-	(80,550)	-	-	(80,550)
Exercise of warrants and options, net of issuance costs of \$10,560	-	-	255,210	2,552	1,223,068	-	-	1,225,620
Vesting of restricted stock units	-	-	43,081	431	(431)	-	-	-
Issuance of common stock	-	-	2,500	25	(25)	-	-	-
Stock-based compensation	-	-	-	-	2,241,610	-	-	2,241,610
Balance, December 31, 2012	73,332	733	16,524,723	165,247	132,163,083	1,588,888	(40,206,758)	93,711,193
Net loss	-	-	-	-	-	-	(23,964,053)	(23,964,053)
Foreign currency translation adjustment	-	-	-	-	-	(370,880)	-	(370,880)
Unrealized loss on investment	-	-	-	-	-	(137,860)	-	(137,860)
Shares withheld for minimum payroll taxes	-	-	-	-	(228,149)	-	-	(228,149)
Exercise of warrants and options, net of issuance costs of \$45,368	-	-	556,855	5,568	2,811,433	-	-	2,817,001
Vesting of restricted stock units	-	-	120,957	1,210	(1,210)	-	-	-
Issuance of common stock	-	-	4,450	45	(45)	-	-	-
Stock-based compensation	-	-	-	-	5,320,896	-	-	5,320,896
Preferred stock reset (note 10)	-	-	140,086	1,401	(1,401)	-	-	-
Balance, December 31, 2013	73,332	\$ 733	17,347,071	\$ 173,471	\$140,064,607	\$ 1,080,148	\$(64,170,811)	\$ 77,148,148

See accompanying consolidated notes.

DERMA SCIENCES, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

	Year ended December 31,	
	2013	2012
Operating Activities		
Net loss	\$ (23,964,053)	\$ (12,070,431)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation of equipment and improvements	878,151	1,021,402
Amortization of identifiable intangible assets	2,842,885	2,274,161
Provision for bad debts	43,930	49,492
Allowance for sales adjustments	38,257	69,091
Provision for inventory obsolescence	7,317	350,798
Loss on disposal of equipment	11,917	31,424
Deferred rent	(13,215)	9,491
Stock-based compensation	5,320,896	2,241,610
Deferred income taxes	132,156	(2,507,355)
Changes in operating assets and liabilities:		
Accounts receivable	(266,828)	(329,962)
Inventories	(3,042,090)	(3,265,213)
Prepaid expenses and other current assets	(589,842)	(812,983)
Other assets	(77,023)	(4,535)
Accounts payable	574,347	(399,919)
Accrued expenses and other current liabilities	901,038	1,438,656
Net cash used in operating activities	<u>(17,202,157)</u>	<u>(11,904,273)</u>
Investing Activities		
Investment in acquired business, net of cash acquired	-	(14,357,578)
Purchase of investments	(33,723,000)	(6,469,000)
Proceeds from sale of investments	14,477,000	7,715,000
Purchase of equipment and improvements	(695,776)	(826,208)
Purchase of intangible assets	(350,000)	(2,300,000)
Proceeds from sale of equipment	-	47,215
Net cash used in investing activities	<u>(20,291,776)</u>	<u>(16,190,571)</u>
Financing Activities		
Proceeds from the sale of common stock, net of costs	-	51,461,053
Proceeds from exercise of stock options and warrants, net of costs	2,817,001	1,225,620
Payment of withholding taxes related to employee stock compensation	(228,149)	(80,550)
Net cash provided by financing activities	<u>2,588,852</u>	<u>52,606,123</u>
Effect of exchange rate changes on cash	(209,990)	(4,972)
Net (decrease) increase in cash and cash equivalents	<u>(35,115,071)</u>	<u>24,506,307</u>
Cash and cash equivalents		
Beginning of year	41,616,657	17,110,350
End of year	<u>\$ 6,501,586</u>	<u>\$ 41,616,657</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest	<u>\$ 893</u>	<u>\$ 2,200</u>
Taxes	<u>\$ -</u>	<u>\$ -</u>

See accompanying consolidated notes.

DERMA SCIENCES, INC. AND SUBSIDIARIES

Notes To Consolidated Financial Statements

1. Description of Business

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

2. 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 in consolidation.

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

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 during the period. Translation adjustments are reported as a component of stockholders’ equity in accumulated other comprehensive income. For the Company’s foreign subsidiaries, exchange rate fluctuations on foreign currency denominated assets and liabilities other than the functional currency resulted in income of \$140,721 and \$47,738 for the years ended December 31, 2013 and 2012, respectively, which is included in the Consolidated Statement of Comprehensive Loss as follows:

	2013	2012
Cost of sales	\$ 57,894	\$ 7,031
Other income, net	(198,615)	(54,769)
Total	<u>\$ (140,721)</u>	<u>\$ (47,738)</u>

Exchange rate fluctuations of foreign currency denominated assets and liabilities associated with inventory are included in cost of sales, while all other such fluctuations are included in other income, net.

Concentration of Credit Risk – Financial instruments that subject the Company to a concentration of credit risk consist principally of cash and cash equivalents, investments in debt securities and accounts receivable. The Company maintains cash and cash equivalents with various financial institutions in amounts which at times may exceed federally insured limits. Accounts are guaranteed by the Federal Deposit Insurance Corporation up to \$250,000. The Company has not experienced any losses in such accounts. The Company does not require collateral or other security to support credit sales, but provides an allowance for doubtful accounts based on historical experience and specifically identified risks. Accounts receivable are charged off against the allowance for doubtful accounts when management determines that recovery is unlikely and the Company ceases collection efforts.

DERMA SCIENCES, INC. AND SUBSIDIARIES

Notes To Consolidated Financial Statements

Inventories – Inventories consist 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.

Equipment and improvements – Equipment and improvements are stated at cost and are depreciated on a straight-line basis over the estimated useful lives of the assets ranging from three to 10 years. Leasehold improvements are amortized over the lesser of their useful lives or the remaining lease term.

Fair Value of Financial Instruments – The carrying value of cash equivalents, accounts receivable, prepaid expenses and other current assets, and accounts payable reported in the consolidated balance sheets equal or approximate fair value due to their short term nature.

Identifiable Intangible Assets – Identifiable intangible assets, which consist of product license rights, developed technology and supply agreements, and other identifiable intangible assets, are amortized over one to 13 years on a straight-line basis.

Long Lived Assets – The Company reviews its long-lived assets with definitive lives whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. If the carrying amount of the asset or group of assets exceeds its net realizable value, the asset will be written down to its fair value.

Goodwill – The Company tests goodwill for impairment using a two-step process. The first step tests for potential impairment, while the second step measures the amount of impairment, if any. The Company uses a discounted cash flow analysis to complete the first step in this process. If the first step indicates an impairment, i.e. when the carrying value exceeds the fair value, then the second step is required to determine the implied fair value of goodwill. The implied fair value of goodwill is calculated in the same manner that goodwill is calculated in a business combination. The allocation is to be performed as if the reporting unit had just been acquired and the fair value of the unit was the purchase price. The goodwill impairment equals the carrying value of goodwill less the implied fair value of goodwill. The Company performs its goodwill impairment test as of December 31st of each year, or more frequently if impairment indicators are present.

Stock-Based Compensation – Stock-based compensation for share-based awards with employees and non-employee directors, such as grants of stock options and restricted share units, are recognized in the consolidated financial statements based on the fair value of the award at the grant date on a straight-line basis over the requisite service or performance periods. Stock-based compensation for share-based awards granted to consultants are recognized based on the fair value of the award on a straight-line basis over the requisite service or performance periods and are revalued at the end of each period until the award vests. The Company estimates the fair value of stock options using the Black-Scholes option-pricing model for service and performance based awards. The fair value of restricted share units is based on the quoted market price for service and performance based awards, and by using a binomial/lattice pricing model for market based awards. The Company issues new common stock shares upon exercise of share-based awards.

Income Taxes – Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and the respective tax bases. Deferred tax assets, including tax loss and credit carryforwards, and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred income tax expense represents the change during the period in the deferred tax assets and deferred tax liabilities. The components of the deferred tax assets and liabilities are individually classified as current and non-current based on their characteristics. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. The effect of income tax positions is recognized only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs.

DERMA SCIENCES, INC. AND SUBSIDIARIES

Notes To Consolidated Financial Statements

The Company measures and recognizes the tax implications of positions taken or expected to be taken in its tax returns on an ongoing basis. In 2013 and 2012, the Company had no unrecognized tax benefits or liabilities, and no adjustment to its financial position, results of operations or cash flows were required. The Company records interest and penalties related to tax matters within other income, net on the accompanying Consolidated Statements of Comprehensive Loss. These amounts are not material to the consolidated financial statements for the periods presented. The Company's U.S. tax returns are subject to examination by federal and state taxing authorities. Tax years prior to 2010 are no longer subject to federal examination. However, the Company's federal net operating losses for tax years 1999 through 2009 will remain subject to examination until the losses are utilized or expire. State tax years 2009 to 2013 remain open to examination by the various state jurisdictions in which the Company is subject to tax. Tax years prior to 2005 are no longer subject to examination in Canada. The U.K. tax returns since the inception of the subsidiary in 2010 are subject to examination.

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

Advertising and Promotion Costs – Advertising and promotion costs are charged to expense as incurred and were \$3,082,221 and \$2,243,387 in 2013 and 2012, respectively.

Royalties – The Company recognizes royalty expenses associated with the products sold at the time the related sale occurs and records them as a component of cost of sales. Royalty expense for the years ended December 31, 2013 and 2012 was \$1,741,742 and \$1,395,567, respectively.

Net Loss per Share – Net loss per common share – basic is computed by dividing net loss by the weighted average number of common shares outstanding for the period. Net loss per common share – diluted reflects the potential dilution of earnings by including the effects of the assumed exercise, conversion or issuance of potentially issuable shares of common stock (“potentially dilutive securities”), including those attributable to stock options, warrants, convertible preferred stock and restricted share units in the weighted average number of common shares outstanding for a period, if dilutive. The effects of the assumed exercise of warrants and stock options are determined using the treasury stock method. Potentially dilutive securities have not been included in the computation of diluted loss per share for the years ended December 31, 2013 and 2012 as the effect would be anti-dilutive.

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

	Year Ended December 31,	
	2013	2012
Excluded dilutive shares:		
Convertible preferred stock	73,332	73,332
Additional stock issuable related to conversion of preferred stock	49,154	-
Restricted share units	720,550	786,900
Stock options	1,814,233	1,639,985
Warrants	2,305,272	2,930,154
Total dilutive shares	<u>4,962,541</u>	<u>5,430,371</u>

DERMA SCIENCES, INC. AND SUBSIDIARIES

Notes To Consolidated Financial Statements

Recently Issued Accounting Pronouncements - In February 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*, which requires companies to present information about reclassifications out of accumulated other comprehensive income in a single note or on the face of the financial statements. The updated standard is effective for fiscal years, and interim periods within those years, beginning after December 15, 2012, with early adoption permitted. The adoption of this standard did not have a material impact on the Company’s consolidated financial statements.

3. Acquisition

On April 16, 2012, the Company acquired all of the outstanding stock of MedEfficiency, Inc. (“MedEfficiency”) pursuant to the terms of an Agreement and Plan of Merger. The purchase price was \$14,475,000 and was funded by the Company with cash on hand. The Company incurred transaction and transition related costs totaling \$1,256,853 related to the purchase, which were charged to selling, general and administrative expense in the 2012 Consolidated Statement of Comprehensive Loss.

MedEfficiency develops, manufactures and markets medical devices for treating chronic wounds and lower extremity injuries, specializing in total contact casting (“TCC”) products. The TCC-EZ total contact cast system is MedEfficiency’s lead product, in addition to a line of traditional and specialized contact casts and related equipment. The Company has distributed MedEfficiency’s TCC products since 2008 under an exclusive distribution agreement.

The acquisition has been accounted for as a purchase. Accordingly, the results of operations of MedEfficiency have been included in the consolidated financial statements commencing April 17, 2012. The allocation of the purchase price to the estimated fair value of the assets acquired and the liabilities assumed is outlined below:

Current assets	\$ 925,817
Equipment	29,579
Acquired intangible assets	10,700,000
Goodwill	<u>6,337,967</u>
Total assets acquired	17,993,363
Current liabilities	653,315
Deferred tax liability	<u>2,982,470</u>
Total liabilities assumed	<u>3,635,785</u>
Net assets acquired	<u>\$ 14,357,578</u>
Purchase price	\$ 14,475,000
Less cash acquired	117,422
Net cash paid	<u>\$ 14,357,578</u>

The allocation of the purchase price to the assets acquired and liabilities assumed was based on an independent valuation study to establish the fair value of the identifiable intangible assets acquired. The identifiable intangible assets acquired consist of developed technology and patents, customer relationships, a supply agreement, trade names and trademarks and non-compete agreements. The Company recorded the excess of the purchase price over the fair values of the identifiable assets acquired and liabilities assumed as goodwill. While the acquired intangible assets are amortizable for financial reporting purposes, the acquired intangible assets and goodwill are not deductible for tax purposes. Deferred taxes have been recorded associated with the acquisition for the basis differences for financial reporting and income tax purposes for the acquired identifiable intangible assets at the effective tax rates for the period in which the deferred tax asset and liability are expected to reverse. All of the assets acquired, including goodwill, and liabilities assumed are included in the Advanced Wound Care segment.

DERMA SCIENCES, INC. AND SUBSIDIARIES

Notes To Consolidated Financial Statements

The unaudited pro forma information below presents combined results of operations as if the acquisition had occurred at the beginning of the periods presented instead of April 16, 2012. The pro forma information is based on historical results adjusted for the effect of purchase accounting and is not necessarily indicative of the results of operations of the combined entity had the acquisition occurred at the beginning of the periods presented, nor is it necessarily indicative of future results.

	Year ended, December 31, 2012 (Unaudited)
Net Sales	<u>\$ 74,035,688</u>
Net Loss	<u>\$ (12,762,551)</u>
Net Loss per common share - basic and diluted	<u>\$ (1.02)</u>
Weighted average number of shares - basic and diluted	<u>12,488,263</u>

4. Cash and Cash Equivalents and Investments

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. Money market mutual funds consist of funds deposited into mutual funds investing in U.S. government and non-government obligations. The Company maintains cash and cash equivalents and money market mutual funds with various domestic and foreign financial institutions within the ordinary course of business, which at times may exceed jurisdictional insurance limits.

Investments in debt securities

Investments in debt securities includes certificates of deposit purchased with an original maturity greater than three months which are deposited in various U.S. financial institutions and are fully insured by the Federal Deposit Insurance Corporation. The Company intends to hold the certificates of deposit to maturity and accordingly these investments are carried at amortized cost. Investments in debt securities with maturities greater than one year from the balance sheet date are classified as a long-term asset.

Investment in equity securities

In 2013, the Company purchased 2,272,277 shares of Comvita Limited ("Comvita") common stock for \$7,000,000. The equity investment represented 7.3% of Comvita's outstanding shares on the date of purchase. In conjunction with this investment, the Company's chairman and chief executive officer was named to Comvita's board of directors. Comvita will use the proceeds from this investment to purchase additional apiaries and upgrade and expand its Manuka honey processing capabilities. This investment will assist Comvita in its effort to better ensure supply for the Company's medical-grade honey requirements in an environment of growing global demand for Manuka honey.

DERMA SCIENCES, INC. AND SUBSIDIARIES

Notes To Consolidated Financial Statements

The investment in Comvita common stock is classified as an available-for-sale investment carried at fair value, with any unrealized gains and losses associated with the investment included in accumulated other comprehensive income and any dividends received recorded in other income. The investment is classified as a long term asset. As of December 31, 2013, the fair value of the Comvita common stock was \$6,862,140 as determined by the quoted market price of the outstanding stock on the New Zealand stock exchange. The \$137,860 decrease in fair value from cost was recorded in accumulated other comprehensive income. In December 2013, Comvita declared a dividend, the Company's share of which was \$75,421, net of taxes.

Cash and cash equivalents and investments at December 31, 2013 and 2012 consisted of the following:

	December 31,	
	2013	2012
Cash	\$ 5,265,903	\$ 4,909,663
Money market mutual funds	1,235,683	36,706,994
Cash and cash equivalents	<u>6,501,586</u>	<u>41,616,657</u>
Investments in debt securities	16,474,000	4,228,000
Investment in equity securities	<u>6,862,140</u>	<u>-</u>
Total investments	<u>23,336,140</u>	<u>4,228,000</u>
Total cash and cash equivalents and investments	<u>\$ 29,837,726</u>	<u>\$ 45,844,657</u>

The following table provides fair value information as of December 31, 2013:

	Total carrying value as of December 31, 2013	Fair Value Measurements, Using		
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Cash and cash equivalents	\$ 6,501,586	\$ 6,501,586	\$ -	\$ -
Investments in debt securities	16,474,000	16,463,473	-	-
Investment in equity securities	6,862,140	6,862,140	-	-
Total Investments	<u>23,336,140</u>	<u>23,325,613</u>	<u>-</u>	<u>-</u>
Total	<u>\$ 29,837,726</u>	<u>\$ 29,827,199</u>	<u>\$ -</u>	<u>\$ -</u>

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The following table provides fair value information as of December 31, 2012:

	Total carrying value as of December 31, 2012	Fair Value Measurements, Using		
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Cash and cash equivalents	\$ 41,616,657	\$ 41,616,657	\$ -	\$ -
Investments in debt securities	4,228,000	4,216,156	-	-
Total	\$ 45,844,657	\$ 45,832,813	\$ -	\$ -

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets. Level 2 inputs are quoted prices for similar assets in active markets or inputs that are observable for the asset, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument. Level 3 inputs are unobservable inputs based on management's own assumptions used to measure assets at fair value. A financial asset's classification is determined based on the lowest level input that is significant to the fair value measurement.

5. Accounts Receivable, net

Accounts receivable, net includes the following:

	December 31,	
	2013	2012
Accounts receivable	\$ 7,781,482	\$ 7,557,862
Less: Allowance for doubtful accounts	(97,729)	(147,843)
Allowance for trade rebates	(218,700)	(197,650)
Allowance for cash discounts and returns	(132,297)	(126,656)
Accounts receivable, net	\$ 7,332,756	\$ 7,085,713

6. Inventories

Inventories include the following:

	December 31,	
	2013	2012
Finished goods	\$ 11,044,746	\$ 9,574,685
Work in process	1,009,315	554,129
Packaging materials	1,408,521	991,157
Raw materials	3,010,058	2,550,617
Total inventory	\$ 16,472,640	\$ 13,670,588

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7. Equipment and Improvements, net

Equipment and improvements, net include the following:

	December 31,	
	2013	2012
Machinery and equipment	\$ 7,102,144	\$ 7,135,714
Furniture and fixtures	911,879	843,149
Leasehold improvements	<u>2,300,500</u>	<u>2,226,022</u>
	10,314,523	10,204,885
Less: accumulated depreciation	<u>(7,361,054)</u>	<u>(6,900,033)</u>
Total equipment and improvements, net	<u>\$ 2,953,469</u>	<u>\$ 3,304,852</u>

8. Identifiable Intangible Assets, net

Costs of identifiable intangible assets associated with previous acquisitions, as well as payments in connection with obtaining product license rights, are included as identifiable intangible assets. During 2013, the Company paid \$250,000 associated with Medihoney developed technology and \$100,000 associated with the international TCC-EZ supply agreement.

Identifiable intangible assets, net include the following:

	December 31,		Amortization Period
	2013	2012	
Product license rights	\$ 8,217,126	\$ 7,967,126	6-10 years
Developed technology and supply agreements	7,700,000	7,600,000	5-7 years
Other	<u>6,400,000</u>	<u>6,400,000</u>	1-10 years
	22,317,126	21,967,126	
Less accumulated amortization	<u>(7,681,128)</u>	<u>(4,838,243)</u>	
Total identifiable intangible assets, net	<u>\$ 14,635,998</u>	<u>\$ 17,128,883</u>	

During the years ended December 31, 2013 and 2012, amortization expense was recorded as follows:

	2013	2012
Cost of sales	\$ 2,009,472	\$ 1,461,411
Selling, general and administrative expenses	<u>833,413</u>	<u>812,750</u>
Total amortization expense	<u>\$ 2,842,885</u>	<u>\$ 2,274,161</u>

Amortization expense for product license rights and developed technology and supply agreements is included as a component of cost of sales and amortization of other identifiable intangible assets is included in selling, general and administrative expense in the Consolidated Statement of Comprehensive Loss.

DERMA SCIENCES, INC. AND SUBSIDIARIES

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Amortization expense for 2013 and 2012 and estimated amounts thereafter by year are as follows:

	Product License Rights	Developed Technology and Supply Agreements	Other	Total
Amortization expense for year ended December 31, 2013	\$ 908,758	\$ 1,100,714	\$ 833,413	\$ 2,842,885
Weighted Average Useful Life	6.0	5.3	3.2	4.8
Amortization expense for year ended December 31, 2012	\$ 692,363	\$ 769,048	\$ 812,750	\$ 2,274,161
Estimated amortization expense for years ending December 31,				
2014	\$ 946,613	\$ 1,105,715	\$ 775,000	\$ 2,827,328
2015	946,613	1,105,715	775,000	2,827,328
2016	946,613	1,105,715	626,250	2,678,578
2017	946,613	1,105,715	281,667	2,333,995
2018	946,613	1,025,295	165,000	2,136,908
Thereafter	987,990	382,083	461,788	1,831,861
	<u>\$ 5,721,055</u>	<u>\$ 5,830,238</u>	<u>\$ 3,084,705</u>	<u>\$ 14,635,998</u>

9. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities include the following:

	December 31,	
	2013	2012
Accrued compensation and related taxes	\$ 2,529,211	\$ 1,929,524
Accrued Canadian sales rebate, net (note 14)	252,671	636,633
Accrued royalties	361,559	427,075
Accrued sales incentives and other fees	546,296	316,209
Other	1,279,488	823,493
Total accrued expenses and other current liabilities	<u>\$ 4,969,225</u>	<u>\$ 4,132,934</u>

At December 31, 2013 and 2012, the amount of the Canadian accrued sales rebate and other reserves exceeded the amount of the underlying trade receivables outstanding. The net credit balance in trade receivables was reclassified for financial reporting purposes to accrued expense to recognize it as a net liability.

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Notes To Consolidated Financial Statements

10. Stockholders' Equity

Preferred Stock

There are 18,598 shares of series A convertible preferred stock outstanding at December 31, 2013. The series A preferred stock is convertible into common stock on a one-for-one basis, bears no dividend, has a liquidation preference of \$32.00 per share, votes as a class on matters affecting the series A preferred stock and has voting rights identical to the common stock on all other matters.

There are 54,734 shares of series B convertible preferred stock outstanding at December 31, 2013. The series B preferred stock is convertible into common stock on a one-for-one basis, bears no dividend, has a liquidation preference of \$48.00 per share, votes as a class on matters affecting the series B preferred stock and has voting rights identical to the common stock on all other matters.

The certificates of designations, voting powers, preferences and rights of the Company's series A and B and former C and D convertible preferred stock provide, among other items, that the 1:1 preferred stock to common stock conversion ratio will be adjusted as of the closing date of any offering of common stock issued at less than the prevailing market price. In the event the market price exceeds the offering price of the common stock, the conversion ratios of any series of preferred stock then outstanding are to be adjusted in accordance with a prescribed formula.

Subsequent to the issuances of the preferred stock, the Company has undertaken a number of common stock offerings that would impact the above described adjustments to the preferred stock conversion ratios. As of December 31, 2013, current series A and B preferred stockholders holding 73,332 preferred shares are entitled to receive an aggregate of 121,089 shares (47,757 additional shares) of common stock upon conversion of their holdings, as a result of the conversion ratio adjustments. The number of shares issuable upon conversion is subject to further adjustment should the Company in the future undertake one or more offerings of its common stock at less than the prevailing market price. Previous preferred stockholders who have converted their preferred shares will receive an additional 1,397 shares of common stock as a result of the conversion ratio adjustments. In 2013 the Company issued 140,086 common shares to prior holders of the preferred stock based on the adjustment of the conversion ratios.

The 49,154 incremental shares associated with the conversion ratio adjustment will be recorded to common stock at par with the offset to additional paid in capital as all of the convertible preferred stock was issued prior to the November 16, 2000 effective date of certain provisions of ASC 470 (formerly, EITF 00-27 *Application of Issue No. 98-5 to Certain Convertible Instruments*).

Common Stock

On May 22, 2013, stockholders of the Company approved the proposal to increase the number of authorized shares of common stock from 25,000,000 to 35,000,000. On May 29, 2013, the Company amended its Articles of Incorporation to reflect the increase in the number of authorized shares of common stock.

During 2013, the Company issued 822,348 shares of common stock consisting of 556,855 shares upon the exercise of stock purchase warrants and options for which the Company received \$2,817,001 (net of \$45,368 in expenses), 140,086 shares in connection with the preferred stock ratio adjustments, 120,957 shares in connection with the vesting of 145,650 shares of restricted common stock units net of the shares withheld for payment of withholding taxes, and 4,450 shares to a retired director of the Company for consulting services.

In 2012, the Company received net cash proceeds of \$51,461,053 (net of \$4,605,439 in commission and other offering expenses) from the sale of 5,646,300 shares of common stock. On April 5, 2012, 2,125,000 common stock shares were sold at \$9.25 per share and on December 5, 2012, 3,521,300 common stock shares were sold at \$10.34 per share. The Company used and intends to continue to use the net proceeds from the offerings for the continued development of its pharmaceutical product DSC127 and for general corporate purposes.

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During 2012, the Company issued 255,210 shares of common stock upon the exercise of stock purchase warrants and options and received \$1,225,620 (net of \$10,560 in issuance costs); 43,081 net shares of common stock in connection with the vesting of 51,500 shares of restricted stock units, net of the shares withheld for payment of minimum withholding taxes; and 2,500 shares of common stock to a retiring director of the Company for past services.

Stock Purchase Warrants

At December 31, 2013, the Company had warrants outstanding to purchase shares of the Company's common stock consisting of the following:

Series	Number of Warrants	Exercise Price	Expiration Date
L	6,250	\$ 3.12	March 31, 2014
N	100,000	\$ 6.25	February 22, 2015
O	230,900	\$ 5.50	February 22, 2015
P	2,187	\$ 6.25	February 16, 2015
Q	133,333	\$ 5.50	February 22, 2015
R	1,832,602	\$ 9.90	June 22, 2016
Total		<u>\$ 2,305,272</u>	

During 2013, a total of 624,882 warrants were exercised on a for cash and cashless basis consisting of 367,814 Series K, 200,893 Series J, 53,667 Series O, and 2,508 Series P warrants. A total of 421,465 shares of common stock were issued in connection with the 2013 warrant exercises. In 2012 a total of 135,548 warrants were exercised on a cash basis consisting of 47,333 series O, 66,965 series J and 21,250 series K warrants. A total of 135,548 shares of common stock were issued in connection with the 2012 warrant exercises.

Equity Based Compensation

Under the Derma Sciences, Inc. 2012 Equity Incentive Plan (the "EIP Plan") the Company is authorized to issue shares of common stock. On May 22, 2013, stockholders of the Company approved the proposal to increase the number of authorized shares of common stock the Company can issue from 2,812,500 to 4,500,000. The EIP Plan authorizes the Company to grant equity-based and cash-based incentive compensation in the form of stock options, stock appreciation rights, restricted shares, restricted share units, other share-based awards and cash-based awards, for the purpose of providing the Company's employees, non-employee directors and consultants with incentives and rewards for performance. At December 31, 2013, options to purchase 1,814,233 shares and 720,550 restricted share units were issued and outstanding under the EIP Plan and 1,394,480 shares were available for grant.

Stock Options

The EIP Plan permits the granting of both incentive and nonqualified stock options to employees and nonqualified stock options to non-employee directors and consultants of the Company. The option exercise price may not be less than the fair market value of the stock on the date of the grant of the option. The duration of each option may not exceed 10 years from the date of grant.

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For the years ended December 31, 2013 and 2012, the fair value of each option award was estimated at the date of grant using the Black-Scholes option-pricing model. The weighted-average assumptions for the years ended December 31, 2013 and 2012 were as follows:

	<u>2013</u>	<u>2012</u>
Risk-free interest rate	1.22%	1.11%
Volatility factor	69.9%	73.6%
Dividend yield	0%	0%
Expected option life (years)	6.14	6.25

The risk-free rate utilized represents the U.S. treasury yield curve rate for the expected option life at the time of grant. The volatility factor was calculated based on the Company's historical stock price volatility equal to the expected life of the option at the grant date. The dividend yield is 0% since the Company does not anticipate paying dividends in the near future. The simplified expected option life method is used to determine the expected option life for Company employees and directors while the contractual option life period is utilized for consultants.

Based on the Company's historical experience of options that were forfeited before becoming fully vested, the Company has assumed an annualized forfeiture rate of 1.0% for all options. The Company will record additional expense if the actual forfeiture rate is lower than estimated, and will record a recovery of prior expense if the actual forfeiture rate is higher than estimated.

A summary of the Company's stock option activity and related information for the years ended December 31, 2013 and 2012 follows:

	<u>2013</u>		<u>2012</u>	
	<u>Options</u>	<u>Weighted Average Exercise Price</u>	<u>Options</u>	<u>Weighted Average Exercise Price</u>
Outstanding – beginning of year	1,639,985	\$ 6.38	1,582,683	\$ 5.82
Granted	421,480	\$ 12.14	268,160	\$ 8.93
Forfeited	(36,878)	\$ 10.99	(61,825)	\$ 7.53
Exercised	(184,824)	\$ 5.50	(149,033)	\$ 4.37
Expired	(25,530)	\$ 13.16	-	-
Outstanding – end of year	<u>1,814,233</u>	<u>\$ 7.67</u>	<u>1,639,985</u>	<u>\$ 6.38</u>
Expected to vest – end of year	<u>1,796,091</u>	<u>\$ 7.67</u>	<u>1,623,585</u>	<u>\$ 6.38</u>
Exercisable at end of year	<u>1,443,409</u>	<u>\$ 6.84</u>	<u>1,208,077</u>	<u>\$ 5.86</u>

During 2013 and 2012, the Company granted 300,880 and 199,460 service based options and 120,600 and 68,700 performance based options to Company employees, directors and consultants, respectively. The weighted average fair value per share of options granted during the years ended December 31, 2013 and 2012 was \$8.30 and \$5.93, respectively.

During 2013, 184,824 stock options were exercised on a for cash and cashless basis. A total of 135,390 shares of common stock were issued in connection with the 2013 stock option exercises. During 2012, 149,033 stock options were exercised on a for cash or cashless basis. A total of 119,662 common stock shares were issued in connection with the 2012 stock option exercises.

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The aggregate intrinsic value of outstanding and exercisable stock options was \$6,287,268 and \$5,967,544, respectively, at December 31, 2013. The intrinsic value represents the difference between the Company's closing stock price on the last trading day of the year of \$10.82 and the exercise price of the options, multiplied by the number of in-the-money stock options that would have been received by the option holders had all exercised their options on December 31, 2013. The intrinsic value of options exercised in 2013 and 2012 was \$1,286,818 and \$792,315, respectively.

The following table summarizes information related to stock options outstanding and exercisable at December 31, 2013:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted- Average Remaining Contractual Life	Weighted- Average Exercise Price	Number Exercisable	Weighted- Average Exercise Price
\$2.88 - \$4.00	251,961	3.38	\$ 3.43	251,961	\$ 3.43
\$4.01 - \$6.00	473,412	5.18	\$ 5.13	463,912	\$ 5.13
\$6.01 - \$10.00	610,470	6.77	\$ 8.03	500,799	\$ 7.95
\$10.01 - \$13.99	478,390	8.59	\$ 11.97	226,737	\$ 11.66
	<u>1,814,233</u>	6.36	\$ 7.67	<u>1,443,409</u>	\$ 6.84

During the years ended December 31, 2013 and 2012, stock option compensation expense was recorded as follows:

	2013	2012
Cost of sales	\$ 95,726	\$ 39,789
Selling, general and administrative expenses	2,087,827	1,470,269
Research and development	165,581	103,289
Total stock option compensation expense	\$ 2,349,134	\$ 1,613,347

As of December 31, 2013, there was \$1,645,272 of unrecognized compensation cost related to non-vested service based awards granted under the plan. These costs are expected to be recognized over the options' remaining weighted average vesting period of 1.91 years. There was no unrecognized compensation cost related to non-vested performance based awards at December 31, 2013.

Restricted Share Units

The Company has issued service, performance and market based restricted share units to employees and directors of the Company. Expense for restricted share awards is amortized on a straight-line basis over the awards' vesting period.

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The following table summarizes the restricted share unit activity for the period:

	2013		2012	
	Number of Units	Weighted Average Fair Value	Number of Units	Weighted Average Fair Value
Unvested – beginning of year	786,900	\$ 8.78	51,500	\$ 7.07
Granted	79,300	13.65	786,900	8.78
Vested	(145,650)	10.18	(51,500)	7.07
Unvested – end of year	<u>720,550</u>	<u>\$ 9.03</u>	<u>786,900</u>	<u>\$ 8.78</u>

In May 2013, the Company granted 38,200 restricted share units to members of the board of directors which will vest one year from the grant date. The fair market value at the grant date determined by the quoted market price was \$525,632, or \$13.76 per share. In February 2013, the Company granted 26,100 performance based restricted share units to executives which vested on December 31, 2013. The fair market value at the grant date was \$359,136, or \$13.76 per share.

Also during 2013, the Company granted 10,000 service-based restricted share units to a new board member vesting 25% each year beginning one year from grant date and 5,000 restricted share units to a former member of the board for past services, which were immediately vested. The aggregate fair market value at the grant date determined by the quoted market price of these awards was \$198,000.

In December 2012, the Company granted 330,000 service-based restricted share units to employees and members of the board of directors which will vest 25% annually over a four year period from the grant date. The fair market value at the grant date determined by the quoted market price was \$3,544,200, or \$10.74 per share. Also in December 2012, the Company granted 405,000 market-based restricted share units to employees which will vest three years from the grant date based on the achievement of certain market conditions. The fair market value at the grant date determined by the binomial/lattice pricing model was \$2,904,700, or \$7.17 per share.

Also during 2012, the Company granted 27,900 performance-based restricted share units to employees vesting one year from grant date and 24,000 service based restricted share units to members of the board of directors vesting one year from grant date. The aggregate fair market value at the grant date determined by the quoted market price of these awards was \$459,205.

In connection with the vesting of restricted share unit awards during the year ended December 31, 2013, 24,693 common stock shares with a fair value of \$228,149 were withheld in satisfaction of employee tax withholding obligations. In connection with the vesting of restricted share unit awards during the year ended December 31, 2012, 8,419 common stock shares with a fair value of \$80,550 were withheld in satisfaction of employee minimum tax withholding obligations.

During 2013 and 2012, restricted share unit compensation expense was \$2,634,340 and \$490,870, respectively, and included in selling, general and administrative expense.

As of December 31, 2013, the intrinsic value of the non-vested awards was \$7,796,351 and there was \$4,702,124 of unrecognized compensation cost related to unvested restricted share unit awards. These costs are expected to be recognized over the restricted shares units' remaining weighted average vesting period of 2.11 years.

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During 2013, in consideration of prior service to the Company, a retiring director received 5,000 restricted share units, accelerated vesting of any unvested stock options and restricted share units and extended the date to exercise vested stock options to the earlier of 36 months or the awards original expiration date (versus 90 days) from the date of the retirement. Also, during 2013, the Company granted 4,450 shares of common stock to a former director for consulting services. An additional \$337,422 of stock based compensation expense was recognized during 2013 and included in selling, general and administrative expense in connection with these activities. During 2012, in consideration of prior service to the Company, a retiring director received 2,500 shares of common stock, acceleration of vesting of any unvested restricted share units and extension of the date to exercise vested stock options to 36 months (versus 90 days) as of that date. Included in stock based compensation is a charge of \$137,393 in connection with these benefits.

Shares Reserved for Future Issuance

At December 31, 2013, the Company had reserved the following shares of common stock for future issuance:

Convertible preferred shares (Series A – B)	73,332
Additional stock issuable related to conversion of preferred stock	49,154
Common stock options outstanding	1,814,233
Common stock warrants outstanding	2,305,272
Restricted share units outstanding	720,550
Common stock equivalents available for grant	1,394,480
Total common stock shares reserved	<u>6,357,021</u>

11. Operating Segments

The Company operates in three segments: advanced wound care, traditional wound care and pharmaceutical wound care products. They are managed separately as each segment requires different technology, marketing and sales strategies. Advanced wound care products principally consist of both novel and otherwise differentiated dressings, bandages and ointments designed to promote wound healing and/or prevent infection. Traditional wound care products principally consist of commodity related dressings, ointments, gauze bandages, adhesive bandages, wound closer strips, catheter fasteners and skin care products. Pharmaceutical wound care products consist of DSC127, a novel product for the treatment of a variety of dermal applications.

Advanced and traditional wound care products are marketed globally to acute care, extended care, home health care, wound and burn care clinics and physician offices. The Company utilizes a broad network of well-established distributors to deploy the majority of its products to end users. A smaller portion of the Company's sales are sold directly to care providers and through retail. The advanced and traditional wound care products are both manufactured internally and sourced from third party suppliers. The majority of marketing expenses are deployed in support of advanced wound care products with traditional wound care products requiring limited support. The Company utilizes direct sales representatives, distributor relationships and contractual relationships with buying groups and wound care service providers to sell its products. Direct sales representatives are used solely in support of advanced wound care sales in the U.S. and the U.K. and for both advanced and traditional wound care products in Canada.

The pharmaceutical wound care segment is presently limited to the development of DSC127 for diabetic foot ulcers and pre-clinical work on scar prevention.

Each operating segment is managed at the segment contribution level consisting of gross profit minus direct expense consisting of distribution, marketing, sales, research and development and intangible amortization expenses. Expenses are allocated directly by segment to the extent possible. Expenses common to all three operating segments are allocated consistently using activity based assumptions. The aggregation or allocation of indirect expenses by segment is not practical.

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Operating segment sales, gross profit, segment contribution and other related information for 2013 and 2012 are as follows:

	Year Ended December 31, 2013				Total Company
	Advanced Wound Care	Traditional Wound Care	Pharmaceutical Wound Care	Other	
Net sales	\$ 33,928,535	\$ 45,782,445	\$ -	\$ -	\$ 79,710,980
Gross profit	16,837,797	12,552,677	-	-	29,390,474
Direct expense	(21,404,045)	(5,059,141)	(11,434,557)	-	(37,897,743)
Segment contribution	\$ (4,566,248)	\$ 7,493,536	\$ (11,434,557)	-	(8,507,269)
Indirect expenses				\$ (15,456,784)	(15,456,784)
Net loss					\$ (23,964,053)
Depreciation	\$ 477,118	\$ 264,841	\$ -	\$ 136,192	\$ 878,151
Amortization	\$ 2,557,805	\$ 285,080	\$ -	\$ -	\$ 2,842,885

As of December 31, 2013

Equipment and improvements, net	\$ 2,188,389	\$ 562,480	\$ -	\$ 202,600	\$ 2,953,469
Identifiable intangible assets, net	\$ 13,614,210	\$ 1,021,788	\$ -	\$ -	\$ 14,635,998
Goodwill	\$ 6,337,967	\$ 7,119,726	\$ -	\$ -	\$ 13,457,693

Year Ended December 31, 2012

	Year Ended December 31, 2012				Total Company
	Advanced Wound Care	Traditional Wound Care	Pharmaceutical Wound Care	Other	
Net sales	\$ 24,832,722	\$ 47,815,476	\$ -	\$ -	\$ 72,648,198
Gross profit	12,458,920	12,681,929	-	-	25,140,849
Direct expense	(17,658,759)	(4,246,714)	(7,177,823)	-	(29,083,296)
Segment contribution	\$ (5,199,839)	\$ 8,435,215	\$ (7,177,823)	-	(3,942,447)
Indirect expenses				\$ (8,127,984)	(8,127,984)
Net loss					\$ (12,070,431)
Depreciation	\$ 629,466	\$ 246,780	\$ -	\$ 145,156	\$ 1,021,402
Amortization	\$ 1,950,161	\$ 324,000	\$ -	\$ -	\$ 2,274,161

As of December 31, 2012

Equipment and improvements, net	\$ 2,194,498	\$ 708,653	\$ -	\$ 401,701	\$ 3,304,852
Identifiable intangible assets, net	\$ 15,822,016	\$ 1,306,867	\$ -	\$ -	\$ 17,128,883
Goodwill	\$ 6,337,967	\$ 7,119,726	\$ -	\$ -	\$ 13,457,693

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A geographical breakdown of the Company's sales, gross profit and equipment and improvements, net are as follows:

	<u>United States</u>	<u>Canada</u>	<u>Other</u>	<u>Total</u>
2013				
Net sales	\$ 61,234,755	\$ 11,084,430	\$ 7,391,795	\$ 79,710,980
Gross profit	\$ 23,956,554	\$ 2,371,054	\$ 3,062,866	\$ 29,390,474
Equipment and improvements, net	\$ 459,859	\$ 2,258,544	\$ 235,066	\$ 2,953,469
2012				
Net sales	\$ 51,325,289	\$ 14,758,829	\$ 6,564,080	\$ 72,648,198
Gross profit	\$ 18,609,115	\$ 3,747,557	\$ 2,784,177	\$ 25,140,849
Equipment and improvements, net	\$ 390,925	\$ 2,610,462	\$ 303,465	\$ 3,304,852

12. Income Taxes

Loss before income taxes for the year ended December 31, 2013 and 2012 consist of the following components:

	<u>2013</u>	<u>2012</u>
Domestic	\$ (23,145,554)	\$ (14,590,416)
Foreign	(658,388)	149,503
Loss before income taxes	<u>\$ (23,803,942)</u>	<u>\$ (14,440,913)</u>

The components of income taxes (benefit) for the year ended December 31 are as follows:

	<u>2013</u>	<u>2012</u>
Current:		
Federal	\$ -	\$ -
State	5,365	-
Foreign	22,590	136,873
Total current	<u>27,955</u>	<u>136,873</u>
Deferred:		
Federal	149,108	(2,291,057)
State	(34,143)	(219,463)
Foreign	17,191	3,165
Total deferred	<u>132,156</u>	<u>(2,507,355)</u>
Total income taxes	<u>\$ 160,111</u>	<u>\$ (2,370,482)</u>

DERMA SCIENCES, INC. AND SUBSIDIARIES

Notes To Consolidated Financial Statements

In 2013, the Company recognized a \$160,111 income tax expense consisting of a \$120,330 U.S. income tax expense and a foreign income tax expense of \$39,781. The U.S. income tax expense consists of a current tax expense of \$5,365 and a deferred tax expense of \$114,965. The deferred tax expense is due to differences in financial reporting and tax treatment of goodwill of \$153,619 net of amortization for financial reporting but not tax purposes of acquired MedEfficiency identified intangible assets of \$38,654.

The reconciliation of income tax computed at the U.S. federal statutory tax rates to income tax expense along with percentage of loss before income taxes for the year ended December 31, 2013 and 2012 is as follows:

	2013		2012	
Tax benefit at federal statutory rate	\$ (8,093,340)	34.0%	\$ (4,909,912)	34.0%
State tax, net of federal benefit	(750,351)	3.2	(578,855)	4.0
Foreign tax	74,612	(0.3)	-	-
Nondeductible expenses	637,797	(2.7)	781,791	(5.4)
Other	(50,860)	0.2	(220,266)	1.5
Change in valuation allowance	8,342,253	(35.1)	2,556,760	(17.7)
Income taxes	<u>\$ 160,111</u>	<u>(0.7%)</u>	<u>\$ (2,370,482)</u>	<u>16.4%</u>

Significant components of the Company's deferred tax assets and liabilities are as follows:

	December 31,	
	2013	2012
Deferred tax assets:		
Net operating loss carryforwards	\$ 17,327,134	\$ 10,077,826
Equity based compensation	1,281,192	798,701
Allowance for sales deductions	165,142	182,002
Amortization of identified intangibles	1,698,913	1,698,492
Inventory adjustments	619,189	689,307
Other	776,549	502,479
Deferred tax assets	<u>21,868,119</u>	<u>13,948,807</u>
Deferred tax liabilities:		
Prepaid expenses	(152,489)	(135,914)
Goodwill	(1,181,379)	(1,027,760)
Depreciation	(299,541)	(192,438)
Identified Intangibles	(2,780,224)	(3,365,512)
Other	(654)	(552)
Deferred tax liabilities	<u>(4,414,287)</u>	<u>(4,722,176)</u>
Valuation allowance	<u>(19,119,723)</u>	<u>(10,777,470)</u>
Net deferred tax liabilities	<u>\$ (1,665,891)</u>	<u>\$ (1,550,839)</u>

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Notes To Consolidated Financial Statements

The net deferred tax liability of \$1,665,891 consists of a net noncurrent deferred tax liability of \$1,694,147 and a net current deferred tax asset of \$28,256 as of December 31, 2013. The net deferred tax liability includes a U.S. deferred tax liability of \$1,181,379 related to differences in the basis for financial reporting and tax purposes for goodwill, a deferred liability of \$225,309 related to intangible assets acquired from MedEfficiency and a \$259,203 net deferred tax liability related to the Company's Canadian operations. The deferred tax asset is included in prepaid expenses and other current assets in the Consolidated Balance Sheet.

At December 31, 2013, the Company has U.S. federal net operating loss carry forwards of approximately \$46,343,000 that begin to expire in 2018. For U.S. state income tax purposes, the Company has net operating loss carry forwards in a number of jurisdictions in varying amounts and with varying expiration dates. Federal and state net operating loss carryforwards include excess stock-based compensation benefit deductions of which, if recognized in the future, will be recorded as additional paid in capital in the Consolidated Balance Sheet. The Company also has \$1,015,000 in research and development tax credit carry forwards and \$179,000 in foreign tax credit carry forwards which begin to expire in 2031 and 2019, respectively.

The Company has determined that the amount by which the U.S. federal net operating loss carryforwards can be utilized in any year is limited under the Internal Revenue Code Section 382 regarding changes in ownership of corporations. Due to uncertainties surrounding the Company's ability to use its net operating loss carryforwards, foreign tax credit and realize the other net deferred tax assets based on historical operating results and ownership change limitations a full valuation allowance has been provided as of December 31, 2013 and 2012 for the deferred tax assets for the U.S. and U.K.

13. Retirement Benefits

The Company maintains a profit sharing 401(k) plan for eligible full-time U.S. employees. Participants may contribute a fixed percentage of their salary to the plan, subject to IRS limitations. The Company makes a matching contribution up to a maximum amount of each participant's annual base salary earnings contributed to the plan. During 2013 and 2012, the Company matched 100% on the first 4% of each participant's contributed annual base salary. Company contributions to the plan for the years ended December 31, 2013 and 2012 were \$303,913 and \$208,654, respectively.

The Company's Canadian subsidiary maintains a group retirement savings plan (Registered Retirement Savings Plan) for eligible full time Canadian employees. The Canadian subsidiary makes a matching contribution to the plan based on a percentage of each participant's contributed annual gross earnings. Employee contribution limits to the group retirement savings plan are set by the Canada Customs and Revenue Agency. During 2013 and 2012, the Company matched 100% on the first 4% of each participant's contributed annual gross earnings. The Company's Canadian subsidiary's contributions to the plan for the year ended December 31, 2013 and 2012 were \$133,319 and \$109,442, respectively.

14. Commitments and Contingencies

Operating Leases

The Company has non-cancelable operating lease agreements for its facilities and equipment expiring in various years through 2019. Total lease expense under these lease agreements was \$1,227,718 and \$1,544,575 in 2013 and 2012, respectively. Total minimum lease payments under each lease are recorded on a straight-line basis to lease expense over the lease term. Differences between the recognition of lease expense on a straight-line basis and payments owed and/or free rent are recorded as deferred rent. Tenant improvement allowances are recorded as deferred lease expense as received, and amortized to lease expense over the lesser of the corresponding asset life or the lease term. At December 31, 2013 and 2012, the Company had deferred rent of \$242,325 and \$268,517, respectively, recorded in long-term liabilities on the Consolidated Balance Sheet.

DERMA SCIENCES, INC. AND SUBSIDIARIES

Notes To Consolidated Financial Statements

The leases generally provide for scheduled increases in future minimum annual lease payments over the life of the lease and for renewal options consistent with the terms of the existing lease. It is expected that these leases will be renewed or replaced by leases on other property and equipment, as needed.

Minimum future lease payments under existing operating leases as of December 31, 2013 are:

Minimum Future Rental Payments	
<u>Year Ending December 31,</u>	<u>Amount</u>
2014	\$1,289,799
2015	1,043,225
2016	940,565
2017	804,561
2018	490,598
Thereafter	4,014
Net minimum future rental payments	\$ 4,572,762

Comvita Licensing Agreement

In February 2010, the Company entered into a new agreement with Comvita under which the Company received perpetual and exclusive worldwide licensing rights for Manuka Honey based Medihoney wound and skin care products for all markets outside of the consumer market (the "Comvita Agreement"). The Comvita Agreement supersedes the prior agreement, which was terminated as of the effective date. The Comvita Agreement also provides that Comvita will serve as the Company's exclusive supplier for Manuka Honey and will not provide Manuka Honey to any other entities for use in the professional medical-surgical marketplace. The Comvita Agreement calls for graduated royalty payments based on sales and milestone payments of up to \$20,000,000 based on achievement of specified net sales objectives of which \$2,000,000 has been incurred and paid through December 31, 2013. The license rights may be terminated or rendered non-exclusive by Comvita if the Company fails to meet certain minimum royalty requirements.

In October 2012, the Company met the criteria for payment of the second Medihoney milestone payment under the Comvita Agreement based on achieving Medihoney sales in excess of \$10,000,000 for the trailing twelve month period. During the year, the \$1,000,000 milestone payment was recorded as an addition to the Medihoney license intangible asset and is being amortized to cost of sales. Another milestone payment of \$1,000,000 was made in a prior year.

Comvita is a major stockholder of the Company and its Chief Executive Officer serves on the Company's Board of Directors. The Company purchased \$2,266,964 and \$1,653,075 of medical grade honey from Comvita in 2013 and 2012, respectively. In addition, the Company incurred Medihoney royalties of \$1,240,818 and \$901,826 in 2013 and 2012, respectively. Amounts due to Comvita for raw material purchases and royalties totaled \$421,578 and \$288,596 at December 31, 2013 and 2012, respectively. During 2013, the Company also purchased an equity investment in Comvita stock for \$7,000,000 (note 4).

Quick-Med Technologies, Inc. – License Agreement

In July 2012, the Company entered into a new patent and technology license agreement (the "QMT Agreement") with Quick-Med Technologies, Inc. ("QMT") relating to QMT's proprietary anti-microbial technology (the "Technology") utilized in the Company's Bioguard products. The QMT Agreement supersedes a prior agreement, which had been in effect since March 2007.

Under the QMT Agreement, QMT granted to the Company an exclusive, royalty-bearing right and license to make, use and sell products incorporating the Technology worldwide, except for India (the "Territory"). If the Company does not achieve the first commercial sale of a product incorporating the Technology in Europe and in Asia and Central and South America by certain dates, or in the event that, for a given calendar year, the Company fails to meet a minimum net sales requirement under the QMT Agreement, QMT has the right, as its sole remedy within each geographic area affected, to either terminate the QMT Agreement or convert the exclusive license in that geographic area to a non-exclusive license. Unless otherwise terminated pursuant to the QMT Agreement, the term of the QMT Agreement continues, with respect to each country in the Territory, until the expiration of the patent rights in that country.

DERMA SCIENCES, INC. AND SUBSIDIARIES

Notes To Consolidated Financial Statements

In 2012, the Company paid QMT an upfront license fee of \$1,300,000. This upfront fee has been capitalized as an identifiable intangible asset and is being amortized over its estimated useful life of seven years. In addition to the upfront license fee, royalties are payable to QMT based upon a sliding scale of the Company's net sales of products incorporating the Technology and declining as net sales increase. The QMT Agreement also requires the Company to make certain milestone payments of up to \$3,500,000 to QMT based upon the achievement of certain net sales levels for four consecutive calendar quarters. In 2013 and 2012, the Company incurred QMT royalties of \$202,377 and \$279,537, respectively.

In the event that QMT desires to sell the Technology, patent rights and improvements or QMT receives a bona fide offer from an unaffiliated third party to purchase the same during the term of the QMT Agreement, the Company has the right of first negotiations or right of first refusal, respectively, relating to any such sale.

USC License Agreement

In November 2007, the Company entered into a license agreement (the "License Agreement") with the University of Southern California ("USC") pursuant to which the Company acquired exclusive rights to a number of U.S. and foreign patents and non-exclusive rights to one patent, together with trade secrets and know-how, related to an angiotensin analog (the patents, trade secrets and know-how, collectively, the "Angiotensin Analog Technology"). The Angiotensin Analog Technology relates to all dermal applications including applications for the treatment of chronic wounds such as diabetic ulcers, leg ulcers associated with venous insufficiency, pressure ulcers (bed sores), burns and surgical scars.

The Company paid to or on behalf of USC an initial license fee which was charged to expense. The Company will pay USC royalties relative to sales of products employing the Angiotensin Analog Technology (the "Angiotensin Products") at specified rates in respect of revenues less than \$100 million and revenues equal to or greater than \$100 million, respectively, together with milestone payments of up to \$9,625,000 predicated upon obtaining FDA approval of the various indications for the Angiotensin Products, as well as the attainment of various sales objectives.

The compound employing the Angiotensin Analog Technology is classified as a "drug," the sale of which is conditioned upon FDA approval. The process of obtaining FDA approval for the compound consists of subjecting the compound to a series of pre-clinical and clinical studies, these latter known as Phase 1, Phase 2 and Phase 3 studies.

Our first product, DSC 127, utilizing this compound for the treatment of diabetic foot ulcers has successfully undergone pre-clinical, Phase 1 and Phase 2 clinical studies for use in the treatment of diabetic foot ulcers. The first of two Phase 3 clinical trials commenced in the first quarter of 2013, with the second commencing during the second quarter of 2013.

The Company is under no obligation to undertake or complete further studies in respect of the Angiotensin Analog Technology. Should it not do so, the Company may either sublicense the Angiotensin Analog Technology to one or more third parties or release the Angiotensin Analog Technology to USC. In this latter event, USC would reimburse the Company for certain of its costs incident to clinical studies that have heretofore been performed.

DERMA SCIENCES, INC. AND SUBSIDIARIES

Notes To Consolidated Financial Statements

Canadian Distribution Agreement

In May 2005, the Company entered into a distribution agreement with a Canadian company to serve as the exclusive distributor of its products in Canada. The agreement also appoints the distributor as the Company's servicing agent to fulfill supply contracts held directly by the Company. The agreement was most recently amended in January 2011, extending it through April 2016. The Company recognizes revenue under the agreement when title and risk of loss pass to the distributor and collectability is reasonably assured, which is at the time product is shipped to the distributor. Payment terms from the distributor are 30 days. Either party has the right to terminate the agreement when an event of default (as defined) has occurred with respect to the other party. The distributor is entitled to continue to sell or otherwise dispose of all inventory owned by it from and after the date of contract expiration or termination. If termination of the agreement is not occasioned by breach by the distributor, the distributor will be entitled on notice to the Company to return saleable inventory (as defined) to the Company. Estimated returns are reserved at the time of sale. Since the inception of the agreement, sales returns have been minimal.

The distributor assumes responsibility for customer service, product delivery and maintenance and warehousing of sufficient inventory to meet agreed upon order fulfillment requirements. On an ongoing basis, the distributor places inventory replenishment orders with the Company at agreed upon prices, 120 days in advance of scheduled delivery. Unless amended, each order becomes non-cancelable 90 days in advance of scheduled delivery.

With respect to sales made by the distributor, the Company pays the distributor an agreed upon distribution fee. The Company reimburses the distributor for the difference between the price paid by the distributor and the Company's contract price with the end customer, upon submission by the distributor of an agreed upon rebate report. The distribution fee is recorded as a reduction of revenue under this agreement.

Executive Employment Agreements

The five executive officers of the Company are appointed by and serve at the discretion of the Board of Directors pursuant to one year employment agreements that are subject to renewal annually as of April 1st. The agreements were renewed in March 2013. The agreements provide for annual salary and provision for bonus and equity based compensation assuming financial and personal objectives are met. The agreements also outline certain obligations that may be triggered by a change in control and severance for failure to renew an agreement other than for cause.

New Cast Industry Co., Ltd. Supply Agreement

On March 27, 2013, the Company entered into a supply agreement (the "International Agreement") with New Cast Industry Co., Ltd. ("NCIC") relating to NCIC's proprietary technology for the casting element within the TCC-EZ total contact casting system (the "Technology"). The Company has been purchasing product from NCIC utilizing the Technology in the TCC-EZ series of total contact casting system products for TCC-EZ product sales within North America pursuant to the supply agreement dated April 17, 2012 (the "North America Agreement"), and intends to continue to do so.

Under the International Agreement, NCIC agreed to exclusively supply the Company with its product utilizing the Technology and granted the Company the exclusive right to sell products incorporating the Technology outside North America. If the Company does not achieve the first commercial sale of a product incorporating the Technology in Latin America, Europe, Middle East, Australia, Asia and India (the "Territory") by certain dates, NCIC has the right, as its sole remedy, to convert the exclusive license in the Territory to a non-exclusive license. Unless otherwise terminated pursuant to the terms of the International Agreement, the term is for five years with automatic five year renewals.

DERMA SCIENCES, INC. AND SUBSIDIARIES

Notes To Consolidated Financial Statements

In consideration for the exclusive international rights set forth above, the Company paid NCIC \$200,000. Provided this agreement has not been terminated as a result of a breach by the Company, NCIC will refund \$100,000 to the Company on the first anniversary of the International Agreement. The initial cost of \$100,000 has been capitalized as an identifiable intangible asset and is being amortized over the initial five year term of the agreement, and a \$100,000 deposit has been recorded. Further, the International Agreement includes milestone payments of up to \$1,000,000 to NCIC based upon achievement of international net sales levels during a calendar year.

Contingencies

On occasion, the Company is involved in claims and other legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company's consolidated financial position, results of operations, or liquidity.

15. Subsequent Events

BioDLogics, LLC License Agreement

On January 14, 2014, the Company entered into a license, market development and commercialization agreement (the "Agreement") with BioDLogics, LLC ("BioD") relating to BioD's human placental based products (the "Licensed Products") and intellectual property related thereto.

Under the Agreement, BioD granted to the Company an exclusive, perpetual, royalty-bearing license to use, offer for sale and sell, the Licensed Products in North America (the "Territory"), including the rights to sublicense solely as provided in the Agreement, for a broad range of dermal applications, (the "Field"). During the term of the Agreement, the Company must use diligent efforts, and will be responsible for the sale and marketing of the Licensed Products in the Field throughout the Territory. As part of its commercialization efforts, the Company will fund clinical studies in support of the Field pursuant to the Agreement.

The Company agreed to pay to BioD an initial license fee of \$1,250,000 and granted BioD a warrant to purchase 100,000 shares of the Company's common stock. One quarter (25%) of the warrant is exercisable immediately at a price of \$11.81, while the remaining 75% of the warrant becomes exercisable, if at all, upon the achievement of certain milestones. The warrant expires five years from the date of issuance in January 2019. In addition to the initial license fee and warrant, royalties are payable to BioD based upon a sliding scale of the Company's net sales of Licensed Products within the Territory and declining as net sales increase. The Agreement also requires the Company to make milestone payments to BioD of up to \$19,750,000 based upon the achievement of certain development events and annual net sales levels.

The Agreement may be terminated as follows: (i) upon mutual agreement of the parties; (ii) by BioD if the Company challenges certain BioD patents or trade secrets; (iii) by BioD if the Company fails to meet the annual minimum net sales requirement under the Agreement, unless the Company pays the difference between the amount of royalties that would have been due had the minimum annual net sales for such year been achieved and royalty payments made by the Company with respect to net sales during such year plus any milestone payments payable; or (iv) by either party in the event of a material breach or certain events of bankruptcy.

Equity Offering

On January 29, 2014, the Company raised \$80,675,000 (net of \$5,575,000 in estimated commission and other offering expenses) from the sale of 7,500,000 shares of the Company's common stock at \$11.50 per share. The Company plans to use the net proceeds from the offering for the continued development of its pharmaceutical product DSC127, for sales force expansion and for general corporate purposes.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the year covered by this annual report, our president and chief executive officer (our principal executive officer) and our executive vice president and chief financial officer (our principal financial officer) performed an evaluation of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act. Our disclosure controls and procedures are designed to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management to allow timely decisions regarding required disclosures. Based on this evaluation, our president and chief executive officer and our executive vice president and chief financial officer have concluded that our disclosure controls and procedures were effective as of December 31, 2013.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for our Company. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the U.S.. Our management conducted an assessment of the effectiveness of our internal control over financial reporting as of December 31, 2013 based on criteria established in *Internal Control – Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Based on this assessment, management believes that, as of December 31, 2013, our internal control over financial reporting was effective.

Item 9B. Other Information.

None.

Part III

Item 10. Directors, Executive Officers and Corporate Governance

Information in response to this Item is incorporated herein by reference to our definitive proxy statement for our 2014 annual meeting of stockholders to be filed with the Securities and Exchange Commission no later than 120 days after December 31, 2013.

Item 11. Executive Compensation

Information in response to this Item is incorporated herein by reference to our definitive proxy statement for our 2014 annual meeting of stockholders to be filed with the Securities and Exchange Commission no later than 120 days after December 31, 2013.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information in response to this Item is incorporated herein by reference to our definitive proxy statement for our 2014 annual meeting of stockholders to be filed with the Securities and Exchange Commission no later than 120 days after December 31, 2013.

Item 13. Certain Relationships and Related Transactions, and Director Independence

Information in response to this Item is incorporated herein by reference to our definitive proxy statement for our 2014 annual meeting of stockholders to be filed with the Securities and Exchange Commission no later than 120 days after December 31, 2013.

Item 14. Principal Accounting Fees and Services

Information in response to this Item is incorporated herein by reference to our definitive proxy statement for our 2014 annual meeting of stockholders to be filed with the Securities and Exchange Commission no later than 120 days after December 31, 2013.

Part IV

Item 15. Exhibits, Financial Statement Schedules

(a) Financial Statements

- (1) Financial statements and related documents are listed in the Index under Item 8 of this report.
- (2) All financial statement schedules are omitted because they are not applicable, not material or the required information is shown in the financial statements or notes thereto.

(b) Exhibits

<u>Exhibit Number</u>	<u>Description</u>
2.01	Agreement and Plan of Merger, dated March 27, 2012, by and among the Company, ME Merger Sub Inc., MedEfficiency, Inc. and MedE SR LLC (previously filed as Exhibit 2.1 to the Company's Form 8-K filed on March 30, 2012 and incorporated herein by reference).
2.02	Agreement and Plan of Merger, dated September 5, 2012 by and between Derma Sciences, Inc., a Pennsylvania corporation and Derma Sciences, Inc., a Delaware corporation (previously filed as Exhibit 2.1 to the Company's Form 8-K filed on September 20, 2012 and incorporated herein by reference).
3.01	Certificate of Incorporation of Derma Sciences, Inc., as amended on May 29, 2013±
3.02	By-Laws of Derma Sciences, Inc. (previously filed as Exhibit 3.2 to the Company's Form 8-K filed on September 20, 2012 and incorporated herein by reference).
4.01	Form of Warrant to Purchase Common Stock relative to the private placement of common stock and series R warrants effected on June 23, 2011 (previously filed as Exhibit 4.01 to the Company's Form 8-K filed on June 21, 2011 and incorporated herein by reference).
10.01*	Employment Agreement, dated March 7, 2012, between the Company and Edward J. Quilty (previously filed as Exhibit 10.01 to the Company's Form 8-K filed on March 13, 2012 and incorporated herein by reference).
10.02*	Employment Agreement, dated March 7, 2012, between the Company and John E. Yetter, CPA (previously filed as Exhibit 10.02 to the Company's Form 8-K filed on March 13, 2012 and incorporated herein by reference).
10.03*	Employment Agreement, dated March 7, 2012, between the Company and Robert C. Cole (previously filed as Exhibit 10.03 to the Company's Form 8-K filed on March 13, 2012 and incorporated herein by reference).

- 10.04* Employment Agreement, dated March 12, 2012, between the Company and Frederic Eigner (previously filed as Exhibit 10.05 to the Company's Form 8-K filed on March 13, 2012 and incorporated herein by reference).
- 10.05* Employment Agreement, dated March 8, 2012, between the Company and Barry J. Wolfenson (previously filed as Exhibit 10.04 to the Company's Form 8-K filed on March 13, 2012 and incorporated herein by reference).
- 10.06* Amendment to Employment Agreement, dated December 20, 2012, between the Company and Edward J. Quilty (previously filed as Exhibit 10.3 to the Company's Form 8-K filed on December 21, 2012 and incorporated herein by reference).
- 10.07* Amendment to Employment Agreement, dated December 20, 2012, between the Company and John E. Yetter, CPA (previously filed as Exhibit 10.4 to the Company's Form 8-K filed on December 21, 2012 and incorporated herein by reference).
- 10.08* Amendment to Employment Agreement, dated December 20, 2012, between the Company and Barry Wolfenson (previously filed as Exhibit 10.5 to the Company's Form 8-K filed on December 21, 2012 and incorporated herein by reference).
- 10.09* Amendment to Employment Agreement, dated December 20, 2012, between the Company and Robert C. Cole (previously filed as Exhibit 10.6 to the Company's Form 8-K filed on December 21, 2012 and incorporated herein by reference).
- 10.10* Amendment to Employment Agreement, dated December 20, 2012, between the Company, Derma Canada and Frederic Eigner (previously filed as Exhibit 10.7 to the Company's Form 8-K filed on December 21, 2012 and incorporated herein by reference).
- 10.11* Second Amendment to Employment Agreement, dated March 27, 2013, between the Company and Edward J. Quilty (previously filed as Exhibit 10.11 to the Company's Form 10-K filed on March 28, 2013 and incorporated herein by reference).
- 10.12* Second Amendment to Employment Agreement, dated March 27, 2013, between the Company and John E. Yetter, CPA (previously filed as Exhibit 10.12 to the Company's Form 10-K filed on March 28, 2013 and incorporated herein by reference).
- 10.13* Second Amendment to Employment Agreement, dated March 27, 2013, between the Company and Barry Wolfenson (previously filed as Exhibit 10.13 to the Company's Form 10-K filed on March 28, 2013 and incorporated herein by reference).
- 10.14* Second Amendment to Employment Agreement, dated March 27, 2013, between the Company and Robert C. Cole (previously filed as Exhibit 10.14 to the Company's Form 10-K filed on March 28, 2013 and incorporated herein by reference).
- 10.15* Second Amendment to Employment Agreement, dated March 27, 2013, between the Company, Derma Canada Inc. and Frederic Eigner (previously filed as Exhibit 10.15 to the Company's Form 10-K filed on March 28, 2013 and incorporated herein by reference).
- 10.16* The Derma Sciences, Inc. Amended and Restated Stock Option Plan, dated February 9, 2011 (previously filed as Exhibit 10.06 to the Company's Form 10-K filed on March 29, 2011 and incorporated herein by reference).
- 10.17* The Derma Sciences, Inc. Restricted Stock Plan, dated March 31, 2006 (previously filed as Appendix D to the Company's Proxy Statement filed on April 5, 2006 and incorporated herein by reference).
- 10.18* Form of Restricted Share Unit Agreement (Executive Officer) (previously filed as Exhibit 10.1 to the Company's Form 8-K filed on December 21, 2012 and incorporated herein by reference).
- 10.19* Form of Performance-Based Restricted Share Unit Agreement (Executive Officer) (previously filed as Exhibit 10.2 to the Company's Form 8-K filed on December 21, 2012 and incorporated herein by reference).
- 10.20* 2013 Director Compensation Program (previously filed as Exhibit 10.1 to the Company's Form 8-K filed on May 24, 2013 and incorporated herein by reference).
- 10.21* Amended and Restated Derma Sciences, Inc. 2012 Equity Incentive Plan (previously filed as Exhibit 10.2 to the Company's Form 8-K filed on May 24, 2013 and incorporated herein by reference).
- 10.22 License Agreement, dated November 2, 2007, between the Company and the University of Southern California (previously filed as Exhibit 10.01 to the Company's Form 8-K filed on November 8, 2007 and incorporated herein by reference).
- 10.23 Patent and Technology License Agreement, dated March 23, 2007, between the Company and Quick-Med Technologies, Inc. (previously filed as Exhibit 10.01 to the Company's Form 8-K filed on March 29, 2007 and incorporated herein by reference).
- 10.24 Clinical Services Agreement, dated January 22, 2008, between the Company and U.S. Biotest, Inc. (previously filed as Exhibit 10.01 to the Company's Form 8-K filed on January 28, 2008 and incorporated herein by reference).
- 10.25 Form of Purchase Agreement relative to the private placement of common stock and series K warrants effected on April 2, 2008 (previously filed as Exhibit 10.01 to the Company's Form 8-K filed on April 7, 2008 and incorporated herein by reference).

- 10.26 License Agreement, dated February 23, 2010, between the Company and Comvita New Zealand Ltd. (previously filed as Exhibit 10.01 to the Company's Form 8-K filed on March 1, 2010 and incorporated herein by reference).
- 10.27 Restraint Agreement, dated February 23, 2010, between the Company and Comvita New Zealand Ltd. (previously filed as Exhibit 10.02 to the Company's Form 8-K filed on March 1, 2010 and incorporated herein by reference).
- 10.28 Collaborative Research and Development Agreement, dated February 23, 2010, between the Company and Comvita New Zealand Ltd. (previously filed as Exhibit 10.03 to the Company's Form 8-K filed on March 1, 2010 and incorporated herein by reference).
- 10.29 Medical Honey Supply Agreement, dated February 23, 2010, between the Company and Comvita New Zealand Ltd. (previously filed as Exhibit 10.04 to the Company's Form 8-K filed on March 1, 2010 and incorporated herein by reference).
- 10.30 Manufacturing Agreement, dated February 23, 2010, between the Company and Comvita New Zealand Ltd. (previously filed as Exhibit 10.05 to the Company's Form 8-K filed on March 1, 2010 and incorporated herein by reference).
- 10.31 Nominating Agreement, dated February 18, 2010, between the Company and Comvita New Zealand Ltd. (previously filed as Exhibit 10.01 to the Company's Form 8-K filed on February 24, 2010 and incorporated herein by reference).
- 10.32 Forbearance Agreement, dated March 31, 2009, between the Company and Western Medical, Inc. (previously filed as Exhibit 10.01 to the Company's Form 8-K filed on April 6, 2009 and incorporated herein by reference).
- 10.33 Separation and Release Agreement by and between Derma Sciences, Inc. and Derma First Aid Products, Inc., and Daniel Rivest, effective as of March 31, 2010 (previously filed as Exhibit 10.01 to the Company's Form 8-K filed on April 1, 2010 and incorporated herein by reference).
- 10.34 Form of Securities Purchase Agreement relative to the private placement of common stock and series R warrants effected on June 23, 2011 (previously filed as Exhibit 10.01 to the Company's Form 8-K filed on June 21, 2011 and incorporated herein by reference).
- 10.35 Form of Registration Rights Agreement relative to the private placement of common stock and series R warrants effected on June 23, 2011 (previously filed as Exhibit 10.02 to the Company's Form 8-K filed on June 21, 2011 and incorporated herein by reference).
- 10.36** Patent and Technology License Agreement, dated July 12, 2012, between the Company and Quick-Med Technologies, Inc. (previously filed as Exhibit 10.1 to the Company's Form 10-Q filed on August 13, 2012 and incorporated herein by reference).
- 10.37 Subscription Agreement, dated September 3, 2013, between Derma Sciences, Inc. and Comvita Limited (previously filed as Exhibit 10.1 to the Company's Form 10-Q filed on November 12, 2013 and incorporated herein by reference).
- 10.38±** License, Market Development and Commercialization Agreement, dated January 14, 2014, by and among the Company and BioDLogics, LLC
- 21.1± Information relative to subsidiaries.
- 23.1± Consent of KPMG LLP.
- 31.1± Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley act of 2002.
- 31.2± Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley act of 2002.
- 32.1± Certification of the Principal Executive Officer pursuant to U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2± Certification of the Principal Financial Officer pursuant to U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS± XBRL Instance Document
- 101.SCH± XBRL Taxonomy Extension Schema Document
- 101.CAL± XBRL Taxonomy Extension Calculation Linkbase Document
- 101.LAB± XBRL Taxonomy Extension Labels Linkbase Document
- 101.PRE± XBRL Taxonomy Extension Presentation Linkbase Document

* Management contract or compensatory plan.

** We requested confidential treatment of certain provisions contained in this exhibit. The copy filed as an exhibit omits the information subject to the confidential treatment request.

± Filed herewith.

SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DERMA SCIENCES, INC.

March 13, 2014

By: /s/ Edward J. Quilty
Edward J. Quilty
Chairman, President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on March 13, 2014.

Signatures:	Title:
<u>/s/ Edward J. Quilty</u> Edward J. Quilty	President, Chief Executive Officer and Chairman of the Board of Directors(Principal Executive Officer)
<u>/s/ John E. Yetter</u> John E. Yetter, CPA	Executive Vice President, Finance and Chief Financial Officer (Principal Financial and Accounting Officer)
<u>/s/ Srini Conjeevaram</u> Srini Conjeevaram	Director
<u>/s/ Stephen T. Wills</u> Stephen T. Wills, CPA, MST	Director
<u>/s/ C. Richard Stafford, Esq.</u> C. Richard Stafford, Esq.	Director
<u>/s/ Paul Gilbert</u> Paul Gilbert	Director
<u>/s/ Robert G. Moussa</u> Robert G. Moussa	Director
<u>/s/ Bruce F. Wesson</u> Bruce F. Wesson	Director
<u>/s/ Brett Hewlett</u> Brett Hewlett	Director
<u>/s/ Amy S. Paul</u> Amy S. Paul	Director

CERTIFICATE OF INCORPORATION

OF

DERMA SCIENCES, INC.
(as amended on May 29, 2013)

I, the undersigned, for the purpose of creating and organizing a corporation under the provisions of and subject to the requirements of the General Corporation Law of the State of Delaware (the “**DGCL**”), certify as follows:

Article I
NAME

The name of the corporation is Derma Sciences, Inc. (the “**Corporation**”).

Article II
REGISTERED OFFICE AND AGENT

The address of the registered office of the Corporation in the State of Delaware is 901 N. Market Street, Suite 705, Wilmington, County of New Castle, Delaware 19801 and the name of its registered agent at such address is Delaware Corporate Services, Inc.

Article III
CORPORATE PURPOSE

The nature of the business or purposes to be conducted or promoted by the Corporation is to engage in any lawful act or activity for which corporations may be organized under the DGCL.

Article IV
CAPITAL STOCK

Section 1. The Corporation shall be authorized to issue two classes of shares of capital stock to be designated, respectively, the “Common Stock” and the “Preferred Stock”; the total number of shares of capital stock which the Corporation shall have the authority to issue is 36,468,750, comprised of 35,000,000 shares of Common Stock, par value \$0.01 and 1,468,750 shares of Preferred Stock, par value \$0.01 with such designations, voting rights, preferences, limitations and special rights as set forth in Sections 3 and 4 of this Article IV, or as the board of directors of the Corporation may designate pursuant to Section 2 of this Article IV.

Section 2. The Board of Directors is authorized, subject to limitations prescribed by law and the provisions of this Article IV, to provide for the issuance of the shares of Preferred Stock in series, and by filing a certificate pursuant to the applicable law of the State of Delaware, to establish from time to time the number of shares to be included in each such series, and to fix the designation, powers, preferences, rights and privileges of the shares of each such series and the qualifications, limitations or restrictions thereof.

Section 3. There is hereby established series of preferred stock of the Corporation, par value \$.01 per share, to be designated "Series A Convertible Preferred Stock" (the "Series A Preferred Stock") and to consist of 218,750, with the voting powers, designations, preferences and relative, participating, optional or other rights and the qualifications, limitations or restrictions thereon as follows:

1. **VOTING RIGHTS.** The holders of Series A Preferred Stock shall have the right to vote, together with the holders of all the outstanding shares of Common Stock and not by classes, except as otherwise required by applicable law on all matters on which holders of Common Stock are entitled to vote. Each holder of shares of Series A Preferred Stock shall have the right to cast one vote for each share.
2. **LIQUIDATION OR DISSOLUTION.** Subject to the prior rights of the Corporation's creditors and holders of securities senior to the Series A Preferred Stock in respect of distributions upon liquidation, dissolution or winding-up of the Corporation, in the event of the voluntary or involuntary liquidation, dissolution or winding-up of the Corporation, the holders of Series A Preferred Stock shall be entitled to receive the purchase price per share (the "Liquidation Preference"), together with accrued and unpaid dividends payable thereon to the date fixed for payment of such distribution, if any, which shall be payable on a pro rata basis among holders of Preferred and Common Stock, all of which shall be paid in cash. If, upon any such liquidation, dissolution or winding-up of the Corporation, the assets distributable among the holders of Series A Preferred Stock (and any series of preferred stock ranking in parity with the Series A Preferred Stock in respect of distributions upon liquidation, dissolution or winding-up of the Corporation) shall be insufficient to permit the payment in full to such holders of the preferential amount payable to such holders determined as aforesaid, then the holders of Series A Preferred Stock will share ratably in any distribution of the Corporation's assets in proportion to the respective preferential amounts that would have been payable if such assets were sufficient to permit payment in full of all such amounts. After payment of the full amount of the liquidating distribution to which they are entitled, the holders of Series A Preferred Stock will not be entitled to any further participation in any distribution of assets by the Corporation. Under this Section 2, a distribution of assets in any dissolution, winding-up, liquidation or reorganization shall include (a) any consolidation or merger of the Corporation with or into any other corporation in which the Corporation is not the surviving corporation, (b) a sale or other disposition of all or substantially all of the Corporation's assets in consideration for cash and/or the issuance of equity securities of another corporation, or (c) a Change of Control of the Company. Under this Section 2, a distribution of assets in any dissolution, winding-up, liquidation or reorganization shall not include any dissolution, liquidation, winding-up or reorganization of the Corporation immediately followed by reincorporation of a successor corporation, provided that the dissolution, liquidation, winding-up or reorganization does not amend, alter, or change the preferences or rights of the Series A Preferred Stock or the qualifications, limitations or restrictions thereof in a manner that adversely affects the Series A Preferred Stock.

3. CONVERSION RIGHTS.

- (a) Conversion of Series A Preferred Stock. Each share of Series A Preferred Stock shall be convertible at the option of the holder thereof into one fully paid and non-assessable share of Common Stock, (“Conversion Share(s)”) subject to the provisions set forth herein.
- (b) Mechanics of Conversion. The holder of any shares of Series A Preferred Stock may exercise the conversion right as to any part thereof by delivering to the Corporation during regular business hours, at the office of the Corporation at 214 Carnegie Center, Suite 300, Princeton, New Jersey 08540, a conversion notice in the form attached to the purchase agreement pursuant to which the Series A Preferred Stock is issued (the “Conversion Notice”). The Conversion Notice shall state that the holder elects to convert its share subject to applicable securities laws, (i) the name(s) in which the certificate(s) representing the Conversion Shares to which such holder is entitled are to be issued, and (ii) the telecopier number or e-mail address to which the Corporation shall telecopy or send its confirmation described below. Notice given by telecopier to telecopier number (609) 514-8554, Attention: Edward J. Quilty or sent by e-mail as a PDF to mthomaier@dermasciences.com, Attention: Mary Jean Thomaier, shall be deemed notice for purposes of this paragraph and shall be deemed given when receipt is acknowledged by transmit confirmation report. Immediately upon receipt of any Conversion Notice, the Corporation shall, by telecopier or e-mail, confirm receipt thereof at the telecopier number or e-mail address included thereon, which confirmation shall set forth the number of Conversion Shares to be issued by the Corporation as a result of such conversion. The Conversion Notice shall be deemed accepted by the Corporation provided the holder surrenders, or causes any agent for the holder to surrender, the certificate(s) for the Series A Preferred Stock to be converted, duly endorsed or assigned in blank or to the Corporation, at any location set forth above, within seven (7) business days after delivery of the Conversion Notice. Provided that the certificate(s) are delivered in accordance with the preceding sentence, the conversion shall be deemed to have been effected on the date of delivery of the Conversion Notice by telecopier or by e-mail as a PDF, and such date is referred to herein as the “Conversion Date.” Within three (3) business days of receipt by the Corporation of the certificate(s) representing the Series A Preferred Stock, the Corporation shall issue to such holder a certificate or certificates representing the number of full Conversion Shares which such holder is entitled to receive. Unless (i) such Conversion Shares have been held long enough to satisfy the holding period set forth in Rule 144(k) (or any successor provision) promulgated under the Securities Act, (ii) such shares become freely tradeable pursuant to another exemption under the Securities Act, or (iii) the converting holder purchased such shares pursuant to a current prospectus under an effective registration statement covering the purchase and sale of such shares, the certificate(s) representing the Conversion Shares will bear the following legend:

THE SHARES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED. THE SHARES HAVE BEEN ACQUIRED FOR INVESTMENT AND MAY NOT BE SOLD, TRANSFERRED OR ASSIGNED IN THE ABSENCE OF EITHER AN EFFECTIVE REGISTRATION STATEMENT FOR THESE SHARES UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR AN OPINION OF COUNSEL THAT REGISTRATION IS NOT REQUIRED UNDER SAID ACT. THESE SHARES ARE SUBJECT TO CERTAIN REGISTRATION RIGHTS AS SET FORTH IN A REGISTRATION RIGHTS AGREEMENT, A COPY OF WHICH MAY BE OBTAINED FROM THE CORPORATION.

If the Registration Statement as hereinafter defined shall have been declared effective by the Securities and Exchange Commission, the certificate(s) evidencing the Conversion Shares will bear the following legend:

THE SHARES REPRESENTED BY THIS CERTIFICATE HAVE BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED. THE SHARES MAY BE SOLD PURSUANT TO THE REGISTRATION STATEMENT PROVIDED THAT THE HOLDER COMPLIES WITH THE PROSPECTUS DELIVERY REQUIREMENTS UNDER THE SECURITIES ACT OF 1933, AS AMENDED, AND THE SALE IS IN COMPLIANCE WITH THE PLAN OF DISTRIBUTION AS SET FORTH IN THE PROSPECTUS. THESE SHARES ARE SUBJECT TO CERTAIN REGISTRATION RIGHTS AS SET FORTH IN A REGISTRATION RIGHTS AGREEMENT, A COPY OF WHICH MAY BE OBTAINED FROM THE CORPORATION.

The person in whose name the certificate(s) for the Conversion Shares are to be issued shall be deemed to have become a stockholder of record on the applicable Conversion Date unless the transfer books of the Corporation are closed on that date, in which event he or she shall be deemed to have become a stockholder of record on the next succeeding date on which the transfer books are open, but the Conversion Ratio shall be that in effect on the Conversion Date. Upon conversion of only a portion of the number of whole shares covered by a certificate representing shares of Series A Preferred Stock surrendered for conversion, the Corporation shall issue and deliver to or upon the written order of the holder of the certificate so surrendered for conversion, at the expense of the Corporation, a new certificate covering the number of shares of Series A Preferred Stock representing the unconverted portion of the certificate so surrendered, which new certificate shall entitle in all respects the holder thereof to the rights of Series A Preferred Stock represented thereby to the same extent as if the certificate theretofore covering such unconverted shares had not been surrendered for conversion.

- (c) Fractional Shares. No fractional shares of Common Stock or scrip shall be issued upon conversion of shares of Series A Preferred Stock. If more than one share of Series A Preferred Stock shall be surrendered for conversion at any one time by the same holder, the number of full shares of Common Stock issuable upon conversion thereof shall be computed on the basis of the aggregate number of shares of Series A Preferred Stock so surrendered. Instead of any fractional shares of Common Stock which would otherwise be issuable upon conversion of any shares of Series A Preferred Stock, the Corporation shall pay a cash adjustment in respect of such fractional interest in an amount determined on the basis of the then Current Market Price per share of Common Stock. Fractional interests shall not be entitled to dividends, and the holders thereof shall not be entitled to any rights as stockholders of the Corporation in respect of such fractional interests.

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- (d) Adjustments to Conversion Ratio for Certain Events. The number of Conversion Shares underlying each Preferred Share (the “Conversion Ratio”) shall be subject to adjustment from time to time as set forth in this subsection (d).
- (i) In case at any time, or from time to time, the Corporation shall: (A) take a record of the holders of its Common Stock for the purpose of entitling them to receive a dividend or other distribution payable in shares of capital stock; (B) subdivide its outstanding shares of Common Stock into a larger number of shares; (C) combine its outstanding shares of Common Stock into a smaller number of shares; or (D) issue by reclassification or recapitalization of its Common Stock any other class or series of shares of the Corporation (including any such reclassification or recapitalization in connection with a consolidation or merger in which the Corporation is the continuing corporation), the Conversion Ratio in effect at the time of the record date for such dividend or of the effective date of such subdivision, combination, reclassification or recapitalization shall be proportionately adjusted so that the holder of any Series A Preferred Stock surrendered for conversion after such time shall be entitled to receive the aggregate number and kind of shares which, if such Series A Preferred Stock had been converted immediately prior to such time, such holder would have owned or have been entitled to receive. Such adjustment shall be made successively whenever any event listed above shall occur. In the event that such dividend or distribution is not so made, the Conversion Ratio shall again be adjusted to be the Conversion Ratio which would then be in effect if such record date has not been fixed.
- (ii) In case at any time, or from time to time, the Corporation shall (except as hereinafter provided) issue or sell any Additional Shares of Common Stock for a consideration per share of Common Stock less than the Current Market Price, then the Conversion Ratio shall, on the date specified below for determining the Current Market Price, be adjusted to that number determined by multiplying the Conversion Ratio in effect immediately prior to such adjustment by a fraction the numerator of which shall be the number of shares of Common Stock outstanding immediately prior to the issuance of the Additional Shares of Common Stock (including shares deemed to have been issued pursuant to subsection (d)(iii) below) plus the number of shares of Common Stock which the aggregate consideration for the total number of such Additional Shares of Common Stock so issued would purchase at the Current Market Price, and the denominator of which shall be the number of shares of Common Stock outstanding immediately prior to the issuance of such Additional Shares of Common Stock plus the number of such Additional Shares of Common Stock so issued (including shares deemed to have been issued pursuant to subsection (d)(iii) below). For the purposes of this subsection (d)(ii), the date as of which the Current Market Price per share of Common Stock shall be computed shall be the earlier of (A) the date on which the Corporation shall enter into a legally binding contract for the issuance or sale of such Additional Shares of Common Stock or (B) the date of the actual issuance of such Additional Shares of Common Stock. The provisions of this subsection (d)(ii) shall not apply to any issuance of Additional Shares of Common Stock for which an adjustment is provided under subsection (i) hereof. No adjustment shall be made under this subsection (d)(ii) upon the issuance of any Additional Shares of Common Stock which are issued pursuant to the exercise of any warrants or other subscription or purchase rights or pursuant to the exercise of any conversion or exchange rights in any Convertible Securities, if any such adjustment shall previously have been made upon the issuance of such warrants or other rights or upon the issuance of such Convertible Securities (or upon the issuance of any warrant or other rights therefor) pursuant to subsection (d)(iii) hereof. Adjustments shall be made successively whenever such an issuance of Additional Shares of Common Stock shall occur. In the event that such Additional Shares of Common Stock are not so issued or sold, the Conversion Ratio shall again be adjusted to be the Conversion Ratio which would then be in effect if such issuance had not occurred.

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- (iii) In case at any time, or from time to time, the Corporation shall take a record of the holders of the Common Stock for the purpose of entitling them to receive a distribution of, or shall otherwise issue, any warrants or other rights to subscribe for or purchase any Additional Shares of Common Stock or any Convertible Securities and the consideration per share for which Additional Shares of Common Stock may at any time thereafter be issuable pursuant to such warrants or other rights or pursuant to the terms of such Convertible Securities shall be less than the Current Market Price, then the Conversion Ratio immediately thereafter shall be adjusted as provided in subsection (d)(ii) hereof on the basis that (a) the maximum number of Additional Shares of Common Stock issuable pursuant to all such warrants or other rights or necessary to effect the conversion or exchange of all such Convertible Securities shall be deemed to have been issued as of the date for the determination of the Current Market Price per share of Common Stock as hereinafter provided, and (b) the aggregate consideration for such maximum number of Additional Shares of Common Stock shall be deemed to be the minimum consideration received and receivable by the Corporation for the issuance of such Additional Shares of Common Stock pursuant to such warrants or other rights or pursuant to the terms of such Convertible Securities. For the purposes of this subsection (d)(iii), the date as of which the Current Market Price per share of Common Stock shall be computed shall be the earliest of (i) the date on which the Corporation shall take a record of the holders of its Common Stock for the purpose of entitling them to receive any such warrants or other rights, (ii) the date on which the Corporation shall enter into a legally binding contract for the issuance of such warrants or other rights or (iii) the date of actual issuance of such warrants or other rights. Such reduction shall be made successively whenever such a record date is fixed. In the event that such rights or warrants are not so issued or (if issued) to the extent not exercised, the Conversion Ratio shall again be adjusted to be the Conversion Ratio, as the case may be, which would then be in effect if such record date had not been fixed or such unexercised rights or warrants had not been issued.

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- (iv) In case at any time, or from time to time, the Corporation shall take a record of the holders of its Common Stock for the purpose of entitling them to receive a distribution, by dividend or otherwise, of evidences of its indebtedness or assets (including securities, but excluding (A) any dividend or distribution referred to in subsection (d)(i) hereof and (B) any dividend or distribution paid in cash out of funds legally available therefor of the Corporation), then in each such case the Conversion Ratio in effect after such record date shall be determined by multiplying the Conversion Ratio, in effect immediately prior to such record date by a fraction, of which the numerator shall be the total number of outstanding shares of Common Stock multiplied by the Current Market Price on such record date, less the fair market value (as determined by the Board of Directors of the Corporation, whose determination shall be conclusive) of the portion of the assets or evidences of indebtedness so to be distributed, and of which the denominator shall be the total number of outstanding shares of Common Stock multiplied by such Current Market Price. Such adjustment shall be made successively whenever such a record date is fixed. In the event that such distribution is not so made, the Conversion Ratio shall again be adjusted to be the Conversion Ratio which would then be in effect if such record date had not been fixed.
- (v) No adjustment in the Conversion Ratio shall be required unless such adjustment would require an increase or decrease of at least one percent (1%) in such Conversion Ratio; provided, however, that any adjustment which by reason of this paragraph (v)(d) is not required to be made shall be carried forward and taken into account in any subsequent adjustment. All calculations under this subsection (d) shall be made to the nearest cent or to the nearest 1/100 of a share, as the case may be.
- (e) No Impairment. The Corporation will not, by amendment of its Certificate of Incorporation or through any reorganization, transfer of assets, consolidation, merger, dissolution, issue or sale of securities or any other voluntary action, avoid or seek to avoid the observance or performance of any of the terms to be observed or performed hereunder by the Corporation, but will at all times in good faith assist in the carrying out of all the provisions of this Section 3 and in the taking of all such action as may be necessary or appropriate in order to protect the conversion rights of the holders of the Series A Preferred Stock against impairment.
- (f) Notice Provisions.
- (i) Whenever the Conversion Ratio shall be adjusted pursuant to subsection (d) hereof, the Corporation shall forthwith obtain a certificate signed by the Corporation's chief financial officer, setting forth, in reasonable detail, the event requiring the adjustment and the method by which such adjustment was calculated (including a description of the basis on which the Corporation's independent public accountants determined the fair value of any evidences of indebtedness, shares of stock, other securities or property or assets or warrants or other subscription or purchase rights referred to in subsections (d)(ii) through (d)(v) hereof) and specifying the new Conversion Ratio and (if applicable) describing the amount and kind of common stock, securities, property or assets or cash which may be received upon conversion of the Series A Preferred Stock, after giving effect to such adjustment. The Corporation shall promptly cause a signed copy of such certificate to be delivered to each holder of Series A Preferred Stock.

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- (ii) In case the Corporation shall propose (A) to pay any dividend payable in stock of any class to the holders of its Common Stock or to make any other distribution to the holders of its Common Stock, (B) to offer to the holders of its Common Stock rights to subscribe for or to purchase any Convertible Securities or Additional Shares of Common Stock or shares of stock of any class or any other securities, rights or options, (C) to effect any reclassification of its Common Stock (other than a reclassification involving only the subdivision or combination of outstanding shares of Common Stock), (D) to effect any capital reorganization, (E) to effect any consolidation, merger or sale, transfer or other distribution of all or substantially all its property, assets or business, or (F) to effect the liquidation, dissolution or winding-up of the Corporation, then in each such case, the Corporation shall give to each holder of Series A Preferred Stock a notice of such proposed action, which shall specify the date on which a record is to be taken for the purposes of such stock dividend, distribution or rights, or the date on which such reclassification, reorganization, consolidation, merger, sale, transfer, disposition, liquidation, dissolution or winding-up is to take place and the date of participation therein by the holders of Common Stock, if any such date is to be fixed, and shall also set forth such facts with respect thereto as shall be reasonably necessary to indicate the effect of such action on the Common Stock and the Conversion Ratio after giving effect to any adjustment which will be required as a result of such action. Such notice shall be so given in the case of any action covered by (A) or (B) above at least 20 days prior to the record date for determining holders of the Common Stock for purposes of such action and, in the case of any other such action, at least 20 days prior to the date of the taking of such proposed action or the date of participation therein by the holders of Common Stock, whichever shall be the earlier.
- (g) Treasury Stock. The sale or other disposition of any issued shares of Common Stock owned or held by or for the account of the Corporation shall be deemed an issuance thereof for purposes of subsection (d) hereof, but until so issued such shares shall not be deemed to be outstanding.

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- (h) Computation of Consideration. To the extent that any Additional Shares of Common Stock or any Convertible Securities or any warrants or other rights to subscribe for or purchase any Additional Shares of Common Stock or any Convertible Securities shall be issued for a cash consideration, the consideration received by the Corporation therefor shall be deemed to be the amount of the cash received by the Corporation therefor, or, if such Additional Shares of Common Stock or Convertible Securities are offered by the Corporation for subscription, the subscription price, or, if such Additional Shares of Common Stock or Convertible Securities are sold to underwriters or dealers for public offering without a subscription offering, the initial public offering price, in any such case excluding any amounts paid or receivable for accrued interest or accrued dividends and without deduction of any compensation, discounts or expenses paid or incurred by the Corporation for and in the underwriting of, or otherwise in connection with, the issue thereof. To the extent that such issuance shall be for a consideration other than cash, then, except as herein otherwise expressly provided, the amount of such consideration shall be deemed to be the fair value of such consideration at the time of such issuance as determined by the Board of Directors of the Corporation. The consideration for any Additional Shares of Common Stock issuable pursuant to any warrants or other rights to subscribe for or purchase the same shall be the consideration received by the Corporation for issuing such warrants or other rights, plus the additional consideration payable to the Corporation upon the exercise of such warrants or other rights. The consideration for any Additional Shares of Common Stock issuable pursuant to the terms of any Convertible Securities shall be the consideration received by the Corporation for issuing any warrants or other rights to subscribe for or purchase such Convertible Securities, plus the consideration paid or payable to the Corporation in respect of the subscription for or purchase of such Convertible Securities, plus the additional consideration, if any, payable to the Corporation upon the exercise of the right of conversion or exchange in such Convertible Securities. In case of the issuance at any time of any Additional Shares of Common Stock or Convertible Securities in payment or satisfaction of any dividend upon any class of stock other than Common Stock or in payment of any debt, the Corporation shall be deemed to have received for such Additional Shares of Common Stock or Convertible Securities a consideration equal to the amount of such dividend or debt so paid or satisfied.
- (i) Fractional Interests. In computing adjustments under this Section 3, fractional interests in Common Stock shall be taken into account to the nearest one-hundredth of a share.
- (j) Antidilution Provisions. No adjustment shall be made as a result of any increase in the number of Additional Shares of Common Stock issuable or any decrease in the consideration payable upon any issuance of Additional Shares of Common Stock, pursuant to any provisions intended solely to avoid dilution contained in any warrants, rights or Convertible Securities.
- (k) When Adjustment Not Required.
- (i) If the Corporation shall take a record of the holders of its Common Stock for the purpose of entitling them to receive a dividend or distribution or subscription or purchase rights and shall, thereafter and before the distribution to stockholders thereof, legally abandon its plan to pay or deliver such dividend, distribution, subscription or purchase rights, then thereafter no adjustment shall be required by reason of the taking of such record and any such adjustment previously made in respect thereof shall be rescinded and annulled.

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- (ii) If the Corporation declares or makes any dividend or distribution with respect to Common Stock, other than regular cash dividends or dividends payable solely in shares of Common Stock, and each holder of Series A Preferred Stock concurrently receives dividends or distributions equal in amount and in the same kind of property (whether cash, securities or other property) as such holder would be entitled to receive if all of the outstanding Series A Preferred Stock were converted into Common Stock as of the record date of such dividend or distribution with respect to Common Stock, then thereafter no adjustment shall be required with respect to such dividend or distribution.
 - (l) Other Action Affecting Common Stock. If a state of facts shall occur which, without being specifically controlled by the other provisions of this Section 3, would not fairly protect the conversion rights of the Series A Preferred Stock in accordance with the essential intent and principles of such provisions, then the Board of Directors of the Corporation shall in good faith make an adjustment in the application of such provisions, in accordance with such essential intent and principles, so as to protect such conversion rights.
 - (m) Necessary Corporate Action. Before taking any action which would result in an adjustment in the Conversion Ratio, the Corporation shall obtain all such authorizations or exemptions thereof, or consents thereto, as may be necessary from any public regulatory body or bodies having jurisdiction thereof.
 - (n) Taxes Upon Conversion. The Corporation shall pay all documentary, stamp or other transaction taxes attributable to the issuance or delivery of shares of Common Stock upon conversion of any shares of Series A Preferred Stock.
 - (o) Reservation of Common Stock. The Corporation shall at all times reserve and keep available out of its authorized but unissued shares of Common Stock solely for the purpose of effecting the conversion of shares of Series A Preferred Stock, the full number of whole shares of Common Stock then deliverable upon the conversion of all shares of Series A Preferred Stock at the time outstanding. All shares of Common Stock which shall be so issuable shall, when issued upon conversion of all or any portion of the Series A Preferred Stock, be duly and validly issued and fully paid and non-assessable and free from all taxes, liens and charges with respect to the issuance thereof. Upon conversion of Series A Preferred Stock, the shares of Series A Preferred Stock so converted shall have the status of authorized and unissued Preferred Stock, and the number of shares of Series A Preferred Stock which the Corporation shall have authority to issue shall be decreased by any such conversion.
 - (p) Dividends Constitute Corporate Debt. All dividends accrued and unpaid on Series A Preferred Stock to and including the date of conversion, whether or not declared by the Board of Directors, shall constitute a debt of the Corporation payable without interest to the converting holders and shall be paid by the Corporation on the Conversion Date, in its option, either in cash or by the issuance of Dividend Shares as provided in Section 4 hereof.

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4. **NO PREEMPTIVE RIGHTS.** No holder of Series A Preferred Stock shall have any preemptive or preferential right of subscription to any shares of stock of the Corporation, or to options, warrants or other interests therein or therefor, or to any obligations convertible into stock of the Corporation, issued or sold, or any right of subscription to any thereof other than such, if any, as the Board of Directors, in its discretion, from time to time may determine and at such price or prices as the Board of Directors from time to time may fix pursuant to the authority conferred by the Corporation's Certificate of Incorporation.
5. **CERTAIN RESTRICTIONS.** So long as any Series A Preferred Stock is outstanding, the Corporation shall not, without the consent of holders of a majority of the outstanding shares of Series A Preferred Stock, (i) purchase, redeem or otherwise acquire any shares of any class of the Corporation's outstanding capital stock, (ii) issue any class or series of any class of capital stock which ranks prior to or pari passu with the Series A Preferred Stock with respect to dividend rights or rights on liquidation, winding-up or dissolution of the Corporation, (iii) amend, alter or change the preferences or rights of any series or class of capital stock of the Corporation (including the Series A Preferred Stock) or the qualifications, limitations or restrictions thereof if such amendment, alteration or change adversely affects the Series A Preferred Stock, (iv) increase the authorized number of shares of Series A Preferred Stock, (v) take any action which results in the liquidation, acquisition, merger or sale of the Company or all or substantially all of its assets, (vi) take any action which results in a change in the principal business of the Company, or (vii) take any action which results in the repurchase of equity securities, other than the repurchase of equity securities from Company employees.
6. **DEFINITIONS.**
- (a) "Additional Shares of Common Stock" shall mean all shares of Common Stock issued by the Corporation after November 10, 1997, except Common Stock which may be issued pursuant to: (i) the conversion of the Series A Preferred Stock; (ii) the exercise by the holders thereof of the Corporation's common stock purchase warrants (the "Warrants"); (iii) the exercise by the holders thereof of any options which may be granted pursuant to the Corporation's Stock Option Plan; (iv) the exercise by the holders thereof of any currently issued options; and (v) the exercise by employees of the Corporation or any of its subsidiaries of options granted pursuant to any stock option plan which may hereafter be adopted by the Corporation where the exercise price of such options is not less than the fair market value of a share of Common Stock on the date of grant thereof.
- (b) "Change in Control" shall mean a merger or consolidation of the Corporation with any other corporation, other than a merger or consolidation which would result in the voting securities of the Corporation outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) at least fifty percent (50%) of the total of the voting power represented by the voting securities of the Corporation or such surviving entity outstanding immediately after such merger or consolidation or, except as provided under Section 2 hereof, the closing of a sale or disposition by the Corporation of all or substantially all of the Corporation's assets (other than to a subsidiary or subsidiaries of the Corporation).
- (c) "Common Stock" shall mean the shares of common stock of the Corporation, par value \$.01 per share, and any stock into which such Common Stock may hereinafter be changed.

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- (d) "Conversion Date" shall have the meaning such term is given in Section 3(b) hereof.
 - (e) "Conversion Notice" shall have the meaning such term is given in Section 3(b) hereof.
 - (f) "Conversion Ratio" shall have the meaning such term is given in Section 3(d) hereof.
 - (g) "Conversion Shares" shall have the meaning such term is given in Section 3(a) hereof.
 - (h) "Convertible Securities" shall mean evidences of indebtedness, shares of stock or other securities which are convertible into or exercisable or exchangeable for, with or without payment of additional consideration in cash or property, for Additional Shares of Common Stock, either immediately or upon the arrival of a specified date or the happening of a specified event.
 - (i) "Current Market Price" per share of Common Stock at any date herein specified shall mean the average of the daily market prices for 5 consecutive Trading Days ending on the last trading day prior to such date, except that for purposes of Section 3(c) hereof, the "Current Market Price" per share of Common Stock shall mean the market prices on the Trading Day therein specified.
 - (j) The market price for each such Trading Day shall be (i) if the Common Stock is quoted on the Nasdaq National Market or Nasdaq Small Cap Market, the reported last sales price, or (ii) if the Common Stock is listed or admitted to trading on a national securities exchange, the last reported sales prices regular way, or (iii) if the Common Stock is quoted on the NASD OTC Bulletin Board, the average of the closing bid and asked prices regular way, or (iv) if the Common Stock is not so quoted, as reasonably determined by the Board of Directors of the Corporation.
 - (k) "Liquidation Preference" shall have the meaning such term is given in Section 2 hereof.
 - (l) "Person" shall mean any individual, corporation, association, company, business trust, partnership, joint venture, joint-stock company, trust, unincorporated organization or association or government or any agency or political subdivision thereof.
 - (m) "Securities Act" shall mean the Securities Act of 1933, as amended.
 - (n) "Trading Day" shall mean any day on which trading takes place (a) in the over-the-counter-market and prices reflecting such trading are published by the National Association of Securities Dealers Automated Quotation System or (b) if the Common Stock is then listed or admitted to trading on a national securities exchange, on the principal national securities exchange on which the Common Stock is then listed or admitted to trading.

Section 4. There is hereby created a series of preferred stock of the Corporation, par value \$.01 per share, to be designated “Series B Convertible Preferred Stock” (the “Series B Preferred Stock”) and to consist of 416,668, with the voting powers, designations, preferences and relative, participating, optional or other rights and the qualifications, limitations or restrictions thereon as follows:

1. **VOTING RIGHTS.** The holders of Series B Preferred Stock shall have the right to vote, together with the holders of all the outstanding shares of Common Stock and not by classes, except as otherwise required by applicable law, on all matters on which holders of Common Stock are entitled to vote. Each holder of shares of Series B Preferred Stock shall have the right to cast one vote for each share.

2. **LIQUIDATION OR DISSOLUTION.** Subject to the prior rights of the Corporation’s creditors and holders of securities equal or senior to the Series B Preferred Stock in respect of distributions upon liquidation, dissolution or winding-up of the Corporation, in the event of the voluntary or involuntary liquidation, dissolution or winding-up of the Corporation, the holders of Series B Preferred Stock shall be entitled to receive the purchase price per share (the “Liquidation Preference”), together with accrued and unpaid dividends payable thereon to the date fixed for payment of such distribution, if any, which shall be payable on a pro rata basis among holders of Preferred and Common Stock, all of which shall be paid in cash. If, upon any such liquidation, dissolution or winding-up of the Corporation, the assets distributable among the holders of Series B Preferred Stock (and any series of preferred stock ranking in parity with the Series B Preferred Stock in respect of distributions upon liquidation, dissolution or winding-up of the Corporation) shall be insufficient to permit the payment in full to such holders of the preferential amount payable to such holders determined as aforesaid, then the holders of Series B Preferred Stock will share ratably in any distribution of the Corporation’s assets in proportion to the respective preferential amounts that would have been payable if such assets were sufficient to permit payment in full of all such amounts. For purposes of the foregoing, the Corporation’s Series A Convertible Preferred Stock shall rank in parity with the Series B Preferred. After payment of the full amount of the liquidating distribution to which they are entitled, the holders of Series B Preferred Stock will not be entitled to any further participation in any distribution of assets by the Corporation. Under this Section 2, a distribution of assets in any dissolution, winding-up, liquidation or reorganization shall include (a) any consolidation or merger of the Corporation with or into any other corporation in which the Corporation is not the surviving corporation, (b) a sale or other disposition of all or substantially all of the Corporation’s assets in consideration for cash and/or the issuance of equity securities of another corporation, or (c) a Change of Control of the Company. Under this Section 2, a distribution of assets in any dissolution, winding-up, liquidation or reorganization shall not include any dissolution, liquidation, winding-up or reorganization of the Corporation immediately followed by reincorporation of a successor corporation, provided that the dissolution, liquidation, winding-up or reorganization does not amend, alter, or change the preferences or rights of the Series B Preferred Stock or the qualifications, limitations or restrictions thereof in a manner that adversely affects the Series B Preferred Stock.

3. **CONVERSION RIGHTS.**
 - (a) **Conversion of Series B Preferred Stock.** Each share of Series B Preferred Stock shall be convertible at the option of the holder thereof into one fully paid and non-assessable share of Common Stock, (“Conversion Share(s)”) subject to the provisions set forth herein.

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- (b) **Mechanics Of Conversion.** The holder of any shares of Series B Preferred Stock may exercise the conversion right as to any part thereof by delivering to the Corporation during regular business hours, at the office of the Corporation at 214 Carnegie Center, Suite 300, Princeton, New Jersey 08540, a conversion notice in the form attached to the purchase agreement pursuant to which the Series B Preferred Stock is issued (the "Conversion Notice"). The Conversion Notice shall state that the holder elects to convert its share subject to applicable securities laws, (i) the name(s) in which the certificate(s) representing the Conversion Shares to which such holder is entitled are to be issued, and (ii) the telecopier number or e-mail address to which the Corporation shall telecopy or send its confirmation described below. Notice given by telecopier to telecopier number (609) 514-8554, Attention: Edward J. Quilty or sent by e-mail as a PDF to mthomaier@dermasciences.com, Attention: Mary Jean Thomaier, shall be deemed notice for purposes of this paragraph and shall be deemed given when receipt is acknowledged by transmit confirmation report. Immediately upon receipt of any Conversion Notice, the Corporation shall, by telecopier or e-mail, confirm receipt thereof at the telecopier number or e-mail address included thereon, which confirmation shall set forth the number of Conversion Shares to be issued by the Corporation as a result of such conversion. The Conversion Notice shall be deemed accepted by the Corporation provided the holder surrenders, or causes any agent for the holder to surrender, the certificate(s) for the Series B Preferred Stock to be converted, duly endorsed or assigned in blank or to the Corporation, at any location set forth above, within seven (7) business days after delivery of the Conversion Notice. Provided that the certificate(s) are delivered in accordance with the preceding sentence, the conversion shall be deemed to have been effected on the date of delivery of the Conversion Notice by telecopier or by e-mail as a PDF, and such date is referred to herein as the "Conversion Date." Within three (3) business days of receipt by the Corporation of the certificate(s) representing the Series B Preferred Stock, the Corporation shall issue to such holder a certificate or certificates representing the number of full Conversion Shares which such holder is entitled to receive. Unless (i) such Conversion Shares have been held long enough to satisfy the holding period set forth in Rule 144(k) (or any successor provision) promulgated under the Securities Act, (ii) such shares become freely tradeable pursuant to another exemption under the Securities Act, or (iii) the converting holder purchased such shares pursuant to a current prospectus under an effective registration statement covering the purchase and sale of such shares, the certificate(s) representing the Conversion Shares will bear the following legend:

THE SHARES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED. THE SHARES HAVE BEEN ACQUIRED FOR INVESTMENT AND MAY NOT BE SOLD, TRANSFERRED OR ASSIGNED IN THE ABSENCE OF EITHER AN EFFECTIVE REGISTRATION STATEMENT FOR THESE SHARES UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR AN OPINION OF COUNSEL THAT REGISTRATION IS NOT REQUIRED UNDER SAID ACT. THESE SHARES ARE SUBJECT TO CERTAIN REGISTRATION RIGHTS AS SET FORTH IN A REGISTRATION RIGHTS AGREEMENT, A COPY OF WHICH MAY BE OBTAINED FROM THE CORPORATION.

If the Registration Statement as hereinafter defined shall have been declared effective by the Securities and Exchange Commission, the certificate(s) evidencing the Conversion Shares will bear the following legend:

THE SHARES REPRESENTED BY THIS CERTIFICATE HAVE BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED. THE SHARES MAY BE SOLD PURSUANT TO THE REGISTRATION STATEMENT PROVIDED THAT THE HOLDER COMPLIES WITH THE PROSPECTUS DELIVERY REQUIREMENTS UNDER THE SECURITIES ACT OF 1933, AS AMENDED, AND THE SALE IS IN COMPLIANCE WITH THE PLAN OF DISTRIBUTION AS SET FORTH IN THE PROSPECTUS. THESE SHARES ARE SUBJECT TO CERTAIN REGISTRATION RIGHTS AS SET FORTH IN A REGISTRATION RIGHTS AGREEMENT, A COPY OF WHICH MAY BE OBTAINED FROM THE CORPORATION.

The person in whose name the certificate(s) for the Conversion Shares are to be issued shall be deemed to have become a stockholder of record on the applicable Conversion Date unless the transfer books of the Corporation are closed on that date, in which event he or she shall be deemed to have become a stockholder of record on the next succeeding date on which the transfer books are open, but the Conversion Ratio shall be that in effect on the Conversion Date. Upon conversion of only a portion of the number of whole shares covered by a certificate representing shares of Series B Preferred Stock surrendered for conversion, the Corporation shall issue and deliver to or upon the written order of the holder of the certificate so surrendered for conversion, at the expense of the Corporation, a new certificate covering the number of shares of Series B Preferred Stock representing the unconverted portion of the certificate so surrendered, which new certificate shall entitle in all respects the holder thereof to the rights of Series B Preferred Stock represented thereby to the same extent as if the certificate theretofore covering such unconverted shares had not been surrendered for conversion.

- (c) Fractional Shares. No fractional shares of Common Stock or scrip shall be issued upon conversion of shares of Series B Preferred Stock. If more than one share of Series B Preferred Stock shall be surrendered for conversion at any one time by the same holder, the number of full shares of Common Stock issuable upon conversion thereof shall be computed on the basis of the aggregate number of shares of Series B Preferred Stock so surrendered. Instead of any fractional shares of Common Stock which would otherwise be issuable upon conversion of any shares of Series B Preferred Stock, the Corporation shall pay a cash adjustment in respect of such fractional interest in an amount determined on the basis of the then Current Market Price per share of Common Stock. Fractional interests shall not be entitled to dividends, and the holders thereof shall not be entitled to any rights as stockholders of the Corporation in respect of such fractional interests.
- (d) Adjustments To Conversion Ratio For Certain Events. The number of Conversion Shares underlying each Preferred Share (the "Conversion Ratio") shall be subject to adjustment from time to time as set forth in this subsection (d).

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- (i) In case at any time, or from time to time, the Corporation shall: (A) take a record of the holders of its Common Stock for the purpose of entitling them to receive a dividend or other distribution payable in shares of capital stock; (B) subdivide its outstanding shares of Common Stock into a larger number of shares; (C) combine its outstanding shares of Common Stock into a smaller number of shares; or (D) issue by reclassification or recapitalization of its Common Stock any other class or series of shares of the Corporation (including any such reclassification or recapitalization in connection with a consolidation or merger in which the Corporation is the continuing corporation), the Conversion Ratio in effect at the time of the record date for such dividend or of the effective date of such subdivision, combination, reclassification or recapitalization shall be proportionately adjusted so that the holder of any Series B Preferred Stock surrendered for conversion after such time shall be entitled to receive the aggregate number and kind of shares which, if such Series B Preferred Stock had been converted immediately prior to such time, such holder would have owned or have been entitled to receive. Such adjustment shall be made successively whenever any event listed above shall occur. In the event that such dividend or distribution is not so made, the Conversion Ratio shall again be adjusted to be the Conversion Ratio which would then be in effect if such record date has not been fixed.
- (ii) In case at any time, or from time to time, the Corporation shall (except as hereinafter provided) issue or sell any Additional Shares of Common Stock for a consideration per share of Common Stock less than the Current Market Price, then the Conversion Ratio shall, on the date specified below for determining the Current Market Price, be adjusted to that number determined by multiplying the Conversion Ratio in effect immediately prior to such adjustment by a fraction the numerator of which shall be the number of shares of Common Stock outstanding immediately prior to the issuance of the Additional Shares of Common Stock (including shares deemed to have been issued pursuant to subsection (d)(iii) below) plus the number of shares of Common Stock which the aggregate consideration for the total number of such Additional Shares of Common Stock so issued would purchase at the Current Market Price, and the denominator of which shall be the number of shares of Common Stock outstanding immediately prior to the issuance of such Additional Shares of Common Stock plus the number of such Additional Shares of Common Stock so issued (including shares deemed to have been issued pursuant to subsection (d)(iii) below). For the purposes of this subsection (d)(ii), the date as of which the Current Market Price per share of Common Stock shall be computed shall be the earlier of (A) the date on which the Corporation shall enter into a legally binding contract for the issuance or sale of such Additional Shares of Common Stock or (B) the date of the actual issuance of such Additional Shares of Common Stock. The provisions of this subsection (d)(ii) shall not apply to any issuance of Additional Shares of Common Stock for which an adjustment is provided under subsection (d)(i) hereof. No adjustment shall be made under this subsection (d)(ii) upon the issuance of any Additional Shares of Common Stock which are issued pursuant to the exercise of any warrants or other subscription or purchase rights or pursuant to the exercise of any conversion or exchange rights in any Convertible Securities, if any such adjustment shall previously have been made upon the issuance of such warrants or other rights or upon the issuance of such Convertible Securities (or upon the issuance of any warrant or other rights therefor) pursuant to subsection (d)(iii) hereof. Adjustments shall be made successively whenever such an issuance of Additional Shares of Common Stock shall occur. In the event that such Additional Shares of Common Stock are not so issued or sold, the Conversion Ratio shall again be adjusted to be the Conversion Ratio which would then be in effect if such issuance had not occurred.

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- (iii) In case at any time, or from time to time, the Corporation shall take a record of the holders of the Common Stock for the purpose of entitling them to receive a distribution of, or shall otherwise issue, any warrants or other rights to subscribe for or purchase any Additional Shares of Common Stock or any Convertible Securities and the consideration per share for which Additional Shares of Common Stock may at any time thereafter be issuable pursuant to such warrants or other rights or pursuant to the terms of such Convertible Securities shall be less than the Current Market Price, then the Conversion Ratio immediately thereafter shall be adjusted as provided in subsection (d)(ii) hereof on the basis that (A) the maximum number of Additional Shares of Common Stock issuable pursuant to all such warrants or other rights or necessary to effect the conversion or exchange of all such Convertible Securities shall be deemed to have been issued as of the date for the determination of the Current Market Price per share of Common Stock as hereinafter provided, and (B) the aggregate consideration for such maximum number of Additional Shares of Common Stock shall be deemed to be the minimum consideration received and receivable by the Corporation for the issuance of such Additional Shares of Common Stock pursuant to such warrants or other rights or pursuant to the terms of such Convertible Securities. For the purposes of this subsection (d)(iii), the date as of which the Current Market Price per share of Common Stock shall be computed shall be the earliest of (I) the date on which the Corporation shall take a record of the holders of its Common Stock for the purpose of entitling them to receive any such warrants or other rights, (II) the date on which the Corporation shall enter into a legally binding contract for the issuance of such warrants or other rights or (III) the date of actual issuance of such warrants or other rights. Such reduction shall be made successively whenever such a record date is fixed. In the event that such rights or warrants are not so issued or (if issued) to the extent not exercised, the Conversion Ratio shall again be adjusted to be the Conversion Ratio, as the case may be, which would then be in effect if such record date had not been fixed or such unexercised rights or warrants had not been issued.

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- (iv) In case at any time, or from time to time, the Corporation shall take a record of the holders of its Common Stock for the purpose of entitling them to receive a distribution, by dividend or otherwise, of evidences of its indebtedness or assets (including securities, but excluding (A) any dividend or distribution referred to in subsection (d)(i) hereof and (B) any dividend or distribution paid in cash out of funds legally available therefor of the Corporation), then in each such case the Conversion Ratio in effect after such record date shall be determined by multiplying the Conversion Ratio, in effect immediately prior to such record date by a fraction, of which the numerator shall be the total number of outstanding shares of Common Stock multiplied by the Current Market Price on such record date, less the fair market value (as determined by the Board of Directors of the Corporation, whose determination shall be conclusive) of the portion of the assets or evidences of indebtedness so to be distributed, and of which the denominator shall be the total number of outstanding shares of Common Stock multiplied by such Current Market Price. Such adjustment shall be made successively whenever such a record date is fixed. In the event that such distribution is not so made, the Conversion Ratio shall again be adjusted to be the Conversion Ratio which would then be in effect if such record date had not been fixed.
- (v) No adjustment in the Conversion Ratio shall be required unless such adjustment would require an increase or decrease of at least one percent (1%) in such Conversion Ratio; provided, however, that any adjustment which by reason of this paragraph subsection (d)(v) is not required to be made shall be carried forward and taken into account in any subsequent adjustment. All calculations under this subsection (d) shall be made to the nearest cent or to the nearest 1/100 of a share, as the case may be.
- (e) No Impairment. The Corporation will not, by amendment of its Certificate of Incorporation or through any reorganization, transfer of assets, consolidation, merger, dissolution, issue or sale of securities or any other voluntary action, avoid or seek to avoid the observance or performance of any of the terms to be observed or performed hereunder by the Corporation, but will at all times in good faith assist in the carrying out of all the provisions of this Section 3 and in the taking of all such action as may be necessary or appropriate in order to protect the conversion rights of the holders of the Series B Preferred Stock against impairment.
- (f) Notice Provisions.
- (i) Whenever the Conversion Ratio shall be adjusted pursuant to subsection (d) hereof, the Corporation shall forthwith obtain a certificate signed by the Corporation's chief financial officer, setting forth, in reasonable detail, the event requiring the adjustment and the method by which such adjustment was calculated (including a description of the basis on which the Corporation's independent public accountants determined the fair value of any evidences of indebtedness, shares of stock, other securities or property or assets or warrants or other subscription or purchase rights referred to in subsections (d)(ii) through (d)(v) hereof) and specifying the new Conversion Ratio and (if applicable) describing the amount and kind of common stock, securities, property or assets or cash which may be received upon conversion of the Series B Preferred Stock, after giving effect to such adjustment. The Corporation shall promptly cause a signed copy of such certificate to be delivered to each holder of Series B Preferred Stock.

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- (ii) In case the Corporation shall propose (A) to pay any dividend payable in stock of any class to the holders of its Common Stock or to make any other distribution to the holders of its Common Stock, (B) to offer to the holders of its Common Stock rights to subscribe for or to purchase any Convertible Securities or Additional Shares of Common Stock or shares of stock of any class or any other securities, rights or options, (C) to effect any reclassification of its Common Stock (other than a reclassification involving only the subdivision or combination of outstanding shares of Common Stock), (D) to effect any capital reorganization, (E) to effect any consolidation, merger or sale, transfer or other distribution of all or substantially all its property, assets or business, or (F) to effect the liquidation, dissolution or winding-up of the Corporation, then in each such case, the Corporation shall give to each holder of Series B Preferred Stock a notice of such proposed action, which shall specify the date on which a record is to be taken for the purposes of such stock dividend, distribution or rights, or the date on which such reclassification, reorganization, consolidation, merger, sale, transfer, disposition, liquidation, dissolution or winding-up is to take place and the date of participation therein by the holders of Common Stock, if any such date is to be fixed, and shall also set forth such facts with respect thereto as shall be reasonably necessary to indicate the effect of such action on the Common Stock and the Conversion Ratio after giving effect to any adjustment which will be required as a result of such action. Such notice shall be so given in the case of any action covered by (A) or (B) above at least 20 days prior to the record date for determining holders of the Common Stock for purposes of such action and, in the case of any other such action, at least 20 days prior to the date of the taking of such proposed action or the date of participation therein by the holders of Common Stock, whichever shall be the earlier.
- (g) Treasury Stock. The sale or other disposition of any issued shares of Common Stock owned or held by or for the account of the Corporation shall be deemed an issuance thereof for purposes of subsection (d) hereof, but until so issued such shares shall not be deemed to be outstanding.

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- (h) **Computation Of Consideration.** To the extent that any Additional Shares of Common Stock or any Convertible Securities or any warrants or other rights to subscribe for or purchase any Additional Shares of Common Stock or any Convertible Securities shall be issued for a cash consideration, the consideration received by the Corporation therefor shall be deemed to be the amount of the cash received by the Corporation therefor, or, if such Additional Shares of Common Stock or Convertible Securities are offered by the Corporation for subscription, the subscription price, or, if such Additional Shares of Common Stock or Convertible Securities are sold to underwriters or dealers for public offering without a subscription offering, the initial public offering price, in any such case excluding any amounts paid or receivable for accrued interest or accrued dividends and without deduction of any compensation, discounts or expenses paid or incurred by the Corporation for and in the underwriting of, or otherwise in connection with, the issue thereof. To the extent that such issuance shall be for a consideration other than cash, then, except as herein otherwise expressly provided, the amount of such consideration shall be deemed to be the fair value of such consideration at the time of such issuance as determined by the Board of Directors of the Corporation. The consideration for any Additional Shares of Common Stock issuable pursuant to any warrants or other rights to subscribe for or purchase the same shall be the consideration received by the Corporation for issuing such warrants or other rights, plus the additional consideration payable to the Corporation upon the exercise of such warrants or other rights. The consideration for any Additional Shares of Common Stock issuable pursuant to the terms of any Convertible Securities shall be the consideration received by the Corporation for issuing any warrants or other rights to subscribe for or purchase such Convertible Securities, plus the consideration paid or payable to the Corporation in respect of the subscription for or purchase of such Convertible Securities, plus the additional consideration, if any, payable to the Corporation upon the exercise of the right of conversion or exchange in such Convertible Securities. In case of the issuance at any time of any Additional Shares of Common Stock or Convertible Securities in payment or satisfaction of any dividend upon any class of stock other than Common Stock or in payment of any debt, the Corporation shall be deemed to have received for such Additional Shares of Common Stock or Convertible Securities a consideration equal to the amount of such dividend or debt so paid or satisfied.
- (i) **Fractional Interests.** In computing adjustments under this Section 3, fractional interests in Common Stock shall be taken into account to the nearest one-hundredth of a share.
- (j) **Antidilution Provisions.** No adjustment shall be made as a result of any increase in the number of Additional Shares of Common Stock issuable or any decrease in the consideration payable upon any issuance of Additional Shares of Common Stock, pursuant to any provisions intended solely to avoid dilution contained in any warrants, rights or Convertible Securities.
- (k) **When Adjustment Not Required.**
- (i) If the Corporation shall take a record of the holders of its Common Stock for the purpose of entitling them to receive a dividend or distribution or subscription or purchase rights and shall, thereafter and before the distribution to stockholders thereof, legally abandon its plan to pay or deliver such dividend, distribution, subscription or purchase rights, then thereafter no adjustment shall be required by reason of the taking of such record and any such adjustment previously made in respect thereof shall be rescinded and annulled.
- (ii) If the Corporation declares or makes any dividend or distribution with respect to Common Stock, other than regular cash dividends or dividends payable solely in shares of Common Stock, and each holder of Series B Preferred Stock concurrently receives dividends or distributions equal in amount and in the same kind of property (whether cash, securities or other property) as such holder would be entitled to receive if all of the outstanding Series B Preferred Stock were converted into Common Stock as of the record date of such dividend or distribution with respect to Common Stock, then thereafter no adjustment shall be required with respect to such dividend or distribution.

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- (l) **Other Action Affecting Common Stock.** If a state of facts shall occur which, without being specifically controlled by the other provisions of this Section 3, would not fairly protect the conversion rights of the Series B Preferred Stock in accordance with the essential intent and principles of such provisions, then the Board of Directors of the Corporation shall in good faith make an adjustment in the application of such provisions, in accordance with such essential intent and principles, so as to protect such conversion rights.
 - (m) **Necessary Corporate Action.** Before taking any action which would result in an adjustment in the Conversion Ratio, the Corporation shall obtain all such authorizations or exemptions thereof, or consents thereto, as may be necessary from any public regulatory body or bodies having jurisdiction thereof.
 - (n) **Taxes Upon Conversion.** The Corporation shall pay all documentary, stamp or other transaction taxes attributable to the issuance or delivery of shares of Common Stock upon conversion of any shares of Series B Preferred Stock.
 - (o) **Reservation Of Common Stock.** The Corporation shall at all times reserve and keep available out of its authorized but unissued shares of Common Stock solely for the purpose of effecting the conversion of shares of Series B Preferred Stock, the full number of whole shares of Common Stock then deliverable upon the conversion of all shares of Series B Preferred Stock at the time outstanding. All shares of Common Stock which shall be so issuable shall, when issued upon conversion of all or any portion of the Series B Preferred Stock, be duly and validly issued and fully paid and non-assessable and free from all taxes, liens and charges with respect to the issuance thereof. Upon conversion of Series B Preferred Stock, the shares of Series B Preferred Stock so converted shall have the status of authorized and unissued Preferred Stock, and the number of shares of Series B Preferred Stock which the Corporation shall have authority to issue shall be decreased by any such conversion.
 - (p) **Dividends Constitute Corporate Debt.** All dividends accrued and unpaid on Series B Preferred Stock to and including the date of conversion, whether or not declared by the Board of Directors, shall constitute a debt of the Corporation payable without interest to the converting holders and shall be paid by the Corporation on the Conversion Date, in its option, either in cash or by the issuance of Dividend Shares as provided in Section 4 hereof.
4. **NO PREEMPTIVE RIGHTS.** No holder of Series B Preferred Stock shall have any preemptive or preferential right of subscription to any shares of stock of the Corporation, or to options, warrants or other interests therein or therefor, or to any obligations convertible into stock of the Corporation, issued or sold, or any right of subscription to any thereof other than such, if any, as the Board of Directors, in its discretion, from time to time may determine and at such price or prices as the Board of Directors from time to time may fix pursuant to the authority conferred by the Corporation's Certificate of Incorporation.

5. **CERTAIN RESTRICTIONS.** So long as any Series B Preferred Stock is outstanding, the Corporation shall not, without the consent of holders of a majority of the outstanding shares of Series B Preferred Stock, (i) purchase, redeem or otherwise acquire any shares of any class of the Corporation's outstanding capital stock, (ii) issue any class or series of any class of capital stock which ranks prior to or pari passu with the Series B Preferred Stock with respect to dividend rights or rights on liquidation, winding-up or dissolution of the Corporation, (iii) amend, alter or change the preferences or rights of any series or class of capital stock of the Corporation (including the Series B Preferred Stock) or the qualifications, limitations or restrictions thereof if such amendment, alteration or change adversely affects the Series B Preferred Stock, (iv) increase the authorized number of shares of Series B Preferred Stock, (v) take any action which results in the liquidation, acquisition, merger or sale of the Company or all or substantially all of its assets, (vi) take any action which results in a change in the principal business of the Company, or (vii) take any action which results in the repurchase of equity securities, other than the repurchase of equity securities from Company employees.

6. **DEFINITIONS.**

- (a) "Additional Shares of Common Stock" shall mean all shares of Common Stock issued by the Corporation after June 15, 1998, except Common Stock which may be issued pursuant to: (i) the conversion of the Series B Preferred Stock; (ii) the exercise by the holders thereof of the Corporation's common stock purchase warrants (the "Warrants"); (iii) the exercise by the holders thereof of any options which may be granted pursuant to the Corporation's Stock Option Plan; (iv) the exercise by the holders thereof of any currently issued options; and (v) the exercise by employees of the Corporation or any of its subsidiaries of options granted pursuant to any stock option plan which may hereafter be adopted by the Corporation where the exercise price of such options is not less than the fair market value of a share of Common Stock on the date of grant thereof.
- (b) "Change in Control" shall mean a merger or consolidation of the Corporation with any other corporation, other than a merger or consolidation which would result in the voting securities of the Corporation outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) at least fifty percent (50%) of the total of the voting power represented by the voting securities of the Corporation or such surviving entity outstanding immediately after such merger or consolidation or, except as provided under Section 2 hereof, the closing of a sale or disposition by the Corporation of all or substantially all of the Corporation's assets (other than to a subsidiary or subsidiaries of the Corporation).
- (c) "Common Stock" shall mean the shares of common stock of the Corporation, par value \$.01 per share, and any stock into which such Common Stock may hereinafter be changed.
- (d) "Conversion Date" shall have the meaning such term is given in Section 3(b) hereof.
- (e) "Conversion Notice" shall have the meaning such term is given in Section 3(b) hereof.
- (f) "Conversion Ratio" shall have the meaning such term is given in Section 3(d) hereof.

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- (g) "Conversion Shares" shall have the meaning such term is given in Section 3(a) hereof.
 - (h) "Convertible Securities" shall mean evidences of indebtedness, shares of stock or other securities which are convertible into or exercisable or exchangeable for, with or without payment of additional consideration in cash or property, for Additional Shares of Common Stock, either immediately or upon the arrival of a specified date or the happening of a specified event.
 - (i) "Current Market Price" per share of Common Stock at any date herein specified shall mean the average of the daily market prices for 5 consecutive Trading Days ending on the last trading day prior to such date, except that for purposes of Section 3(c) hereof, the "Current Market Price" per share of Common Stock shall mean the market prices on the Trading Day therein specified. The market price for each such Trading Day shall be (i) if the Common Stock is quoted on the Nasdaq National Market or Nasdaq Small Cap Market, the reported last sales price, or (ii) if the Common Stock is listed or admitted to trading on a national securities exchange, the last reported sales prices regular way, or (iii) if the Common Stock is quoted on the NASD OTC Bulletin Board, the average of the closing bid and asked prices regular way, or (iv) if the Common Stock is not so quoted, as reasonably determined by the Board of Directors of the Corporation.
 - (j) "Liquidation Preference" shall have the meaning such term is given in Section 2 hereof.
 - (k) "Person" shall mean any individual, corporation, association, company, business trust, partnership, joint venture, joint-stock company, trust, unincorporated organization or association or government or any agency or political subdivision thereof.
 - (l) "Securities Act" shall mean the Securities Act of 1933, as amended.
 - (m) "Trading Day" shall mean any day on which trading takes place (i) in the over-the-counter-market and prices reflecting such trading are published by the National Association of Securities Dealers Automated Quotation System or (ii) if the Common Stock is then listed or admitted to trading on a national securities exchange, on the principal national securities exchange on which the Common Stock is then listed or admitted to trading.

Article V
NAME AND ADDRESS OF INCORPORATOR

The name and mailing address of the incorporator of the Corporation are:

Name	Address
Todd E. Mason	335 Madison Avenue, 12th Floor New York, New York 10017

Article VI
DIRECTORS

Section 1. Unless and except to the extent that the by-laws of the Corporation (the “**By-laws**”) shall so require, the election of directors of the Corporation need not be by written ballot.

Section 2. To the fullest extent permitted by law, a director of the Corporation shall not be personally liable to the Corporation or to its stockholders for monetary damages for any breach of fiduciary duty as a director. No amendment to, modification of or repeal of Section 2 of this Article VI shall apply to or have any effect on the liability or alleged liability of any director of the Corporation for or with respect to any acts or omissions of such director occurring prior to such amendment.

Section 3. In furtherance of, and not in limitation of, the powers conferred by statute, the board of directors is expressly authorized to adopt, amend or repeal the By-laws or adopt new By-laws without any action on the part of the stockholders; *provided , however* , that the stockholders may make additional by-laws and may alter and repeal any by-laws whether such by-laws were originally adopted by them or otherwise by the affirmative vote of the holders of at least two-thirds of the voting power of the shares of the Corporation entitled to vote.

Article VII
INDEMNIFICATION OF DIRECTORS, OFFICERS AND OTHERS

Section 1. The Corporation shall indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the Corporation) by reason of the fact that he or she is or was a director, officer, employee or agent of the Corporation, or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys’ fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him or her in connection with such action, suit or proceeding if he or she acted in good faith and in a manner he or she reasonably believed to be in, or not opposed to, the best interests of the Corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that the person seeking indemnification did not act in good faith and in a manner which he or she reasonably believed to be in or not opposed to the best interests of the Corporation, and, with respect to any criminal action or proceeding, had reasonable cause to believe that his or her conduct was unlawful.

Section 2. The Corporation shall indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the Corporation to procure a judgment in its favor by reason of the fact that he or she is or was a director, officer, employee or agent of the Corporation, or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against expenses (including attorneys' fees) actually and reasonably incurred by him or her in connection with the defense or settlement of such action or suit if he or she acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the best interests of the Corporation and except that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the Corporation unless and only to the extent that the Court of Chancery of the State of Delaware or the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which the Court of Chancery or such other court shall deem proper.

Section 3. To the extent that a director, officer, employee or agent of the Corporation has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in Sections 1 and 2 of this Article VII, or in defense of any claim, issue or matter therein, he or she shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by him or her in connection therewith.

Section 4. Any indemnification under Sections 1 and 2 of this Article VII (unless ordered by a court) shall be made by the Corporation only as authorized in the specific case upon a determination that indemnification of the director, officer, employee or agent is proper in the circumstances because he or she has met the applicable standard of conduct set forth in such Sections 1 and 2. Such determination shall be made (i) by the board of directors of the Corporation by a majority vote of a quorum consisting of directors who were not parties to such action, suit or proceeding, or (ii) if such a quorum is not obtainable, or, even if obtainable, a quorum of disinterested directors so directs, by independent legal counsel in a written opinion or (iii) by the stockholders of the Corporation.

Section 5. Expenses (including attorneys' fees) incurred by an officer or director in defending any civil, criminal, administrative or investigative action, suit or proceeding may be paid by the Corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such director or officer to repay such amount if it shall ultimately be determined that he or she is not entitled to be indemnified by the Corporation authorized in this Article VII. Such expenses (including attorneys' fees) incurred by other employees and agents may be so paid upon such terms and conditions, if any, as the board of directors of the Corporation deems appropriate.

Section 6. The indemnification and advancement of expenses provided by, or granted pursuant to, the other sections of this Article VII shall not be deemed exclusive of any other rights to which those seeking indemnification or advancement of expenses may be entitled under any law, by-law, agreement, vote of stockholders or disinterested directors or otherwise, both as to action in an official capacity and as to action in another capacity while holding such office.

Section 7. For purposes of this Article VII, references to “the Corporation” shall include, in addition to the resulting corporation, any constituent corporation (including any constituent of a constituent) absorbed in a consolidation or merger which, if its separate existence had continued, would have had power and authority to indemnify its directors, officers, employees or agents so that any person who is or was a director, officer, employee or agent of such constituent corporation, or is or was serving at the request of such constituent corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, shall stand in the same position under the provisions of this Article VII with respect to the resulting or surviving corporation as he or she would have with respect to such constituent corporation if its separate existence had continued.

Section 8. For purposes of this Article VII, references to “other enterprises” shall include employee benefit plans; references to “fines” shall include any excise taxes assessed on a person with respect to an employee benefit plan; and references to “serving at the request of the Corporation” shall include any service as a director, officer, employee or agent of the Corporation which imposes duties on, or involves service by, such director, officer, employee or agent with respect to any employee benefit plan, its participants or beneficiaries; and a person who acted in good faith and in a manner he or she reasonably believed to be in the interest of the participants and beneficiaries of an employee benefit plan shall be deemed to have acted in a manner “not opposed to the best interests of the Corporation” as referred to in this Article VII.

Section 9. The indemnification and advancement of expenses provided by, or granted pursuant to, this Article VII shall, unless otherwise provided when authorized or ratified, continue as to a person who has ceased to be a director, officer, employee or agent and shall inure to the benefit of the heirs, executors and administrators of such a person.

Article VIII
AMENDMENT

The Corporation shall have the right, subject to any express provisions or restrictions contained in the Certificate of Incorporation of the Corporation (the “**Certificate of Incorporation**”) or the By-laws, from time to time, to amend the Certificate of Incorporation or any provision thereof in any manner now or hereafter provided by law, and all rights and powers of any kind conferred upon a director or stockholder of the Corporation by the Certificate of Incorporation or any amendment thereof are conferred subject to such right.

Article IX
FORUM SELECTION

Unless the Corporation consents in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware shall be the sole and exclusive forum for (i) any derivative action or proceeding brought on behalf of the Corporation, (ii) any action asserting a claim for breach of a fiduciary duty owed by any director, officer, employee or agent of the Corporation to the Corporation or the Corporation's stockholders, (iii) any action asserting a claim arising pursuant to any provision of the DGCL, the Certificate of Incorporation or the By-laws or (iv) any action asserting a claim governed by the internal affairs doctrine, in each case subject to said Court of Chancery having personal jurisdiction over the indispensable parties named as defendants therein.

[SIGNATURE PAGE FOLLOWS]

I, THE UNDERSIGNED, being the incorporator, for the purpose of forming a corporation pursuant to the DGCL, do make this Certificate of Incorporation, hereby acknowledging, declaring, and certifying that the foregoing Certificate of Incorporation is my act and deed and that the facts herein stated are true, and have accordingly hereunto set my hand this 10th day of August 2012.

Incorporator

By: /s/ Todd E. Mason

Name: Todd E. Mason

LICENSE, MARKET DEVELOPMENT AND COMMERCIALIZATION AGREEMENT

This **LICENSE, MARKET DEVELOPMENT AND COMMERCIALIZATION AGREEMENT** (the “**Agreement**”) is entered into as of January 14, 2014 (the “**Effective Date**”) by and between **BioDLogics, LLC**, a Delaware limited liability company having a principal place of business at 1715 Aaron Brenner Drive, Suite 204, Memphis, TN 38120 (“**BIOD**”), and **DERMA SCIENCES, INC.**, a Delaware corporation having a principal place of business at 214 Carnegie Center, Suite 300, Princeton, NJ 08540 (“**Derma**”). Derma and BIOD may each be referred to as a “**Party**” or collectively be referred to as the “**Parties**”.

RECITALS

WHEREAS, BIOD owns or has rights to placental based products, including intellectual property relating thereto, and is willing to license such intellectual property to Derma, and Derma desires to accept such license; and

WHEREAS, BIOD and Derma desire to establish a collaboration for the marketing and commercialization of Licensed Products in the Field in the Territory (each, as defined below), in accordance with the terms and conditions set forth herein;

NOW, THEREFORE, in consideration of the foregoing premises and the mutual promises, covenants and conditions contained in this Agreement, the Parties agree as follows:

**ARTICLE 1
DEFINITIONS**

The terms in this Agreement with initial letters capitalized, whether used in the singular or the plural, shall have the meaning set forth below or, if not listed below, the meaning designated elsewhere in this Agreement (and derivative forms of them shall be interpreted accordingly). The terms “include,” “includes,” “including” and derivative forms of them shall be deemed followed by the phrase “without limitation” regardless of whether such phrase appears there (and with no implication being drawn from its inconsistent inclusion or non-inclusion).

“**Acquiror**” has the meaning set forth in Section 14.5.

“**Affiliate**” means, with respect to a Person, any Person that controls, is controlled by or is under common control with such first Person. For purposes of this definition only, “**control**” means (a) to possess, directly or indirectly, the power to direct the management or policies of a Person, whether through ownership of voting securities, by contract relating to voting rights or corporate governance or otherwise, or (b) to own, directly or indirectly, fifty percent (50%) or more of the outstanding securities or other ownership interest of such Person. For the purposes of this Agreement, neither Party shall be considered an Affiliate of the other, and the Affiliates of each Party shall not be considered Affiliates of the other Party or of any of such other Party’s Affiliates.

“**Agreement**” has the meaning set forth in the Preamble.

*** This material has been omitted pursuant to a request for a confidential treatment and filed separately with the Securities and Exchange Commission.

“**Audited Party**” has the meaning set forth in Section 6.8.

“**Auditing Party**” has the meaning set forth in Section 6.8.

“**Bankrupt Party**” has the meaning set forth in Section 11.5.

“**Bankruptcy Code**” has the meaning set forth in Section 11.5.

“**Birth Tissue Product**” shall mean any product derived, in whole or in part (whether membrane, fluid, tissue or cells), from human amnion, chorion, placental membrane, wharton’s jelly, umbilical cord, other afterbirth or human fetal material.

“**Business Day**” means any day (other than a Saturday, Sunday or a legal holiday) on which banks are open for general business in New York, New York.

“**BIOD**” has the meaning set forth in the Preamble.

“**BIOD Indemnitees**” has the meaning set forth in Section 9.2.

“**BIOD Know-How**” means all Know-How Controlled by BIOD as of the Effective Date or during the Term that is necessary or useful for the Commercialization of Licensed Products.

“**BIOD Marks**” has the meaning set forth in Section 7.5(b).

“**BIOD Patents**” means the Patents listed in Exhibit A.

“**BIOD Technology**” means the BIOD Know-How, the BIOD Marks, the BIOD Patents.

“**Claims**” has the meaning set forth in Section 9.1.

“**Commercialization Costs**” means all costs to Commercialize the Licensed Products.

“**Commercialization Plan**” has the meaning set forth in Section 3.2.

“**Commercialize**” or “**Commercialization**” means to market, promote, sell, offer for sale and/or distribute.

“**Competing Product**” means any Birth Tissue Product substantially similar to a Licensed Product in composition, method of manufacture or method of use, other than a Licensed Product or a product manufactured by BIOD or its Affiliates.

“**Confidential Information**” of a Party means any and all information of a confidential or proprietary nature disclosed by such Party to the other Party under this Agreement or under the Prior CDA, whether in oral, written, graphic or electronic form.

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“**Control**” means, with respect to any particular Know-How or Patent, that a Party (a) owns or (b) has a license (other than a license granted to such Party under this Agreement) to such Know-How or Patent and, in each case, has the ability to grant to the other Party access, a license, or a sublicense (as applicable) to such Know-How or Patent on the terms and conditions set forth in this Agreement without violating the terms of any then-existing agreement or other arrangement with any Third Party.

“**Cover**” means, with respect to a particular item and a particular Patent, that such Patent claims or covers, in any of the countries of manufacture, use, and/or sale, (a) the composition of such item, any of its ingredients or formulations or any product containing or that is made using such item (by virtue of such product containing or being made using such item); (b) a method of making or using any of the foregoing things referred to in (a); (c) an item used or present in the manufacture of any of the foregoing things referred to in (a); and/or (d) the method by which such item was discovered or identified, or another item present during or used in such method.

“**Derma**” has the meaning set forth in the Preamble.

“**Derma Indemnitees**” has the meaning set forth in Section 9.1.

“**Derma Permitted Subcontractor**” has the meaning set forth in 3.3.

“**Derma Sublicense Agreement**” has the meaning set forth in Section 2.3(a).

“**Develop**” or “**Development**” means activities that relate to developing a Licensed Product or a Competing Product, including preclinical testing, toxicology testing and clinical trials. Development (with respect to Licensed Products, but not Competing Products) shall exclude manufacturing and Commercialization

“**Development Costs**” means the out-of-pocket and internal costs and expenses associated with particular development activities.

“**Diligent Efforts**” means, with respect to either Party’s obligations under this Agreement, the carrying out of such obligations with a level of effort and resources consistent with the commercially reasonable practices of a similarly situated company that would be applied to the research, development or marketing and commercialization of an allograft product comparable to the Licensed Product at a similar stage of development or commercialization.

“**Dollar**” or “**\$**” means a USA dollar.

“**Enforcement Action**” has the meaning set forth in Section 7.2(b).

“**Event of Bankruptcy**” has the meaning set forth in Section 11.5.

“**Executive Officer**” means, with respect to BIOD, its Chief Executive Officer, and with respect to Derma, its Chief Executive Officer.

“**FD&C Act**” means the USA Federal Food, Drug and Cosmetic Act, as amended.

“**FDA**” means the USA Food and Drug Administration or any successor entity.

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“**Field**” means the following dermal applications: partial and full thickness burns, pressure ulcers, venous ulcers, diabetic ulcers, chronic vascular ulcers, tunnel/undermined wounds, surgical wounds (donor sites/grafts and dehiscence), trauma wounds (abrasions, laceration, second degree burns, and skin tears), radiation induced wounds/burns, post-operative wounds, and draining wounds. For clarity, “Field” does not include, without limitation, ocular, internal surgical, cardiac, ENT, dental, cosmetic, plastic, reconstructive, pain management, urology, OB/GYN, sports medicine or orthopedic applications. For the avoidance of doubt, the Field has been defined to preserve for Derma the exclusive right to Commercialize the Licensed Products to wound care physicians, podiatrists, and other healthcare providers principally treating wound care patients with the types of wounds set forth above. The Parties agree that the Field does not preclude or otherwise limit BIOD’s Commercialization of the Licensed Products under different trade names and marks to healthcare providers in other clinical specialties.

“**First Commercial Sale**” means, with respect to a Licensed Product, the first sale, transfer or disposition for value or for end use to a Third Party of such Licensed Product in the Territory.

“**First Successful Trial Completion Date**” means the date on which the first randomized controlled trial meets the trial primary endpoint of wound closure.

“**Governmental Authority**” means any federal, state, local, municipal, provincial or other governmental authority of any nature (including any governmental division, prefecture, subdivision, department, agency, bureau, branch, office, commission, council, court or other tribunal).

“**Indemnified Party**” has the meaning set forth in Section 9.3.

“**Indemnifying Party**” has the meaning set forth in Section 9.3.

“**Infringement**” has the meaning set forth in Section 7.2(a).

“**Initial License Fee**” has the meaning set forth in Section 6.1.

“**Know-How**” means all technical information and know-how, including inventions, discoveries, trade secrets, specifications, instructions, processes, formulae, expertise, materials, methods, protocols and other technology applicable to formulations, compositions or products or to their manufacture, development, registration, use or marketing or processes for their manufacture, formulations containing them or compositions incorporating or comprising them, and including all biological, chemical, pharmacological, biochemical, toxicological, pharmaceutical, physical and analytical, safety, quality control, manufacturing, preclinical and clinical data, instructions, processes, formula, and expertise.

“**Laws**” means all laws, statutes, rules, regulations, ordinances and other pronouncements having the effect of law of any federal, state, provincial, county, city or other political subdivision.

“**Liabilities**” has the meaning set forth in Section 9.1.

“**License Fees**” has the meaning set forth in Section 6.1.

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“**Licensed Product**” means either BioDExcell amniotic extracellular membrane or AmnioMatrix viable tissue matrix (marketed outside the Field as BioDFactor), to be marketed by Derma under the BIOD Marks set forth in Exhibit B, for use in the Field in the Territory. “**Licensed Products**” shall mean both such products collectively.

“**Milestone Event**” has the meaning set forth in Section 6.2.

“**Milestone Payment**” has the meaning set forth in Section 6.2.

“**Net Sales**” means, with respect to any Licensed Product, gross amounts invoiced by Derma or its Affiliates to Third Parties for the sale or other commercial disposition of such Licensed Product anywhere within the Territory, including sales to wholesale distributors, less deductions from such amounts calculated in accordance with the Accounting Standards so as to arrive at “net sales” under the Accounting Standards.

(a) Net Sales, and any and all set-offs against gross amounts invoiced, shall be determined from books and records maintained in accordance with the Accounting Standards, consistently applied throughout the organization and across all products of the entity whose sales of any Licensed Product are giving rise to Net Sales.

(b) Sales or other commercial dispositions of Licensed Products between Derma and its Affiliates, and Licensed Products provided to Third Parties without charge in connection with research and development, clinical trials, or for use as samples shall be excluded from the computation of Net Sales, and no payments will be payable on such sales or such other commercial dispositions, except where such an Affiliate is an end user of the Licensed Product.

(c) Except as provided in clause (b) of this definition of Net Sales, if a Licensed Product is sold or otherwise commercially disposed of for consideration other than cash or in a transaction that is not at arm’s length between the buyer and the seller, then the gross amount to be included in the calculation of Net Sales shall be the amount that would have been invoiced had the transaction been conducted at arm’s length and for cash. Such amount that would have been invoiced shall be determined, wherever possible, by reference to the average selling price of the relevant Licensed Product in arm’s length transactions in the Territory.

(d) Notwithstanding the foregoing, in the event a Licensed Product is sold as a Combined Product, Net Sales shall be calculated by multiplying the Net Sales of the Combined Product by the fraction $A/(A+B)$, where A is the gross invoice price of the Licensed Product if sold separately and B is the gross invoice price of the other product(s) included in the Combined Product if sold separately. If no such separate sales are made by Derma or its Affiliates, Net Sales of the Combination Product shall be calculated in a manner to be negotiated and agreed upon by the Parties, reasonably and in good faith, prior to any sale of such Combined Product, which shall be based upon the relative value of the active components of such Combined Product.

As used in this definition: (i) “Accounting Standards” means (a) GAAP (United States Generally Accepted Accounting Principles); or (b) IFRS (International Financial Reporting Standards), in either case, consistently applied, and (ii) “Combination Product” means any product that comprises a Licensed Product sold in conjunction with another active component so as to be a combination product (whether packaged together or in the same therapeutic formulation).

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“**Non-Bankrupt Party**” has the meaning set forth in Section 11.5.

“**North America**” means the countries of the United States, Canada and Mexico, their territories and possessions.

“**Party**” or “**Parties**” has the meaning set forth in the Preamble.

“**Pass Through Code**” shall mean the issuance by Medicare for BIODExcel or AmnioMatrix of a transitional designation HCPCS C-Code provided for certain “new” drugs, devices and biological agents that were not being paid for as a hospital outpatient department service as of December 31, 1996, and whose cost is “not insignificant” in relation to the OPPS payment for the procedures or services associated with the new drug, device, or biological.

“**Patents**” means, collectively, (a) pending patent applications (and patents issuing therefrom), issued patents, regional patents, utility models and designs; and (b) reissues, divisions, substitutions, confirmations, renewals, extensions, provisionals, registrations, validations, re-examinations, additions, continuations, continued prosecution applications, continuations-in-part, divisionals, or any Supplementary Protection Certificates or restoration of patent terms of or to any patents, patent applications, utility models or designs, in each case being enforceable within the applicable territory.

“**Person**” means an individual, sole proprietorship, partnership, limited partnership, limited liability partnership, corporation, limited liability company, business trust, joint stock company, trust, unincorporated association, joint venture or other similar entity or organization, including a government or political subdivision, department or agency of a government.

“**Prior CDA**” means that certain Mutual Confidentiality Agreement between the Parties dated November 21, 2013.

“**Product Marks**” has the meaning set forth in Section 7.5(a).

“**Quality Agreement**” has the meaning set forth in Section 4.5.

“**Regulatory Clearance**” means all clearances or registrations necessary, if any, for the commercial sale of a Licensed Product in the Field in the Territory, which shall include satisfaction of all applicable regulatory and notification requirements, but which shall exclude any pricing and reimbursement approvals.

“**Regulatory Authority**” means the FDA or any corollary agency involved in granting Regulatory Clearance in the Territory.

“**Regulatory Materials**” means regulatory applications, submissions, notifications, communications, correspondence, registrations, Regulatory Clearances and/or other filings made to, received from or otherwise conducted with a Regulatory Authority in order to market, manufacture, sell or otherwise Commercialize a Licensed Product in the Field in the Territory.

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“**Remedial Action**” has the meaning set forth in Section 4.6.

“**Revenue**” has the meaning set forth in Section 7.2(f).

“**Royalty Term**” has the meaning set forth in Section 6.3(b).

“**Sell-Off Period**” has the meaning set forth in Section 11.6(c).

“**Supply Agreement**” means that certain Distribution and Supply Agreement entered into by the Parties, dated the date hereof.

“**Term**” has the meaning set forth in Section 11.1.

“**Termination by BIOD for Cause**” has the meaning set forth in Section 11.6(a).

“**Termination by Derma for Cause**” has the meaning set forth in Section 11.7(a).

“**Territory**” means North America.

“**Third Party**” means any Person not including the Parties or the Parties’ respective Affiliates.

“**Third Party In-License Agreement**” means any license agreement between BIOD and any Third Party with respect to any Patents or Know-How within the BIOD Technology that are licensed to BIOD by a Third Party prior to the Effective Date.

“**Threshold Year**” means a period of four consecutive calendar quarters beginning on the first day of the calendar quarter following execution of this Agreement.

“**USA**” means the United States of America, including all possessions and territories thereof.

ARTICLE 2 LICENSES

2.1 License to Derma. Subject to the terms and conditions of this Agreement, BIOD hereby grants to Derma during the Term an exclusive, perpetual, royalty-bearing license, with the right to sublicense solely as provided in Section 2.3, to Commercialize, including to use, offer for sale and sell Licensed Products in the Field in the Territory. Derma shall not, and shall not permit any of its Affiliates to, use or practice any BIOD Technology outside the scope of the license granted to it under this Section 2.1. BIOD hereby expressly retains for itself and others exclusive rights under the BIOD Technology to manufacture Licensed Products (it being understood and agreed that the parties have entered into a Supply Agreement as of the Effective Date to address the supply of Licensed Products).

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2.2 Exclusivity. As partial consideration for the grant of rights set forth in Section 2.1, Derma agrees that during the Term of this Agreement, it and its Affiliates shall not, directly or indirectly, develop, or Commercialize any Competing Product. To induce Derma to enter into this Agreement, BIOD agrees that, during the Term, it will not , Develop, manufacture, or Commercialize any Birth Tissue Product in the Field in the Territory except as contemplated by this Agreement, with the exception of one previously established relationship with Rochal Industries, LLP.

2.3 Derma Sublicense Rights.

(a) Derma shall have the right to grant sublicenses of the licenses granted in Section 2.1 to its Affiliates, in each case, solely as set forth in this Section 2.3 (each such sublicense, a “**Derma Sublicense Agreement**”). Derma shall remain primarily responsible for all of its Affiliates’ activities and any and all failures by its Affiliates to comply with the applicable terms of this Agreement.

(b) Derma shall, within thirty (30) days after granting any Derma Sublicense Agreement, notify BIOD of the grant of such sublicense and provide BIOD with a true and complete copy of the Derma Sublicense Agreement. Each Derma Sublicense Agreement shall be consistent with the terms and conditions of this Agreement and the Affiliate shall be bound by and subject to all applicable terms and conditions of this Agreement in the same manner and to the same extent as Derma is bound thereby.

2.4 BIOD Retained Rights. The licenses granted by BIOD under this Agreement are limited to those grants specifically set forth in Section 2.1 and Section 7.5(b). Nothing in this Agreement will be construed to grant any rights or licenses to any other intellectual property rights of BIOD. All rights, licenses, benefits and privileges not expressly granted to Derma hereunder are reserved by BIOD. For the avoidance of doubt, BIOD shall retain all ownership rights in all BIOD intellectual property, including the BIOD Technology.

2.5 Transition of Existing Relationships. Derma acknowledges that as of the Effective Date, BIOD has existing contractual relationships that grant various Third Parties the non-exclusive right to Commercialize the Licensed Products in the Field in the Territory. Following the public announcement of this Agreement, the Parties shall work together to determine which accounts or relationships may be transferred or assigned to Derma or, in the alternative, terminated in accordance with the applicable provisions of any such agreements.

**ARTICLE 3
COMMERCIALIZATION**

3.1 Commercialization Responsibilities. During the Term, Derma shall use Diligent Efforts to, and shall be responsible for all aspects of, the Commercialization of Licensed Products in the Field throughout the Territory. Such Commercialization responsibilities shall include: (a) developing and executing a commercial launch and pre-launch plan including considerations for the manufacture, packaging and distribution of commercial supplies of the Licensed Products and including a specific plan to diligently establish accounts or relationships with Department of Defense (“DoD”) and Veterans Affairs (“VA”) facilities; (b) negotiating with applicable Governmental Authorities regarding the price and reimbursement status of such Licensed Product; (c) marketing and promotion, including presence at tradeshow and wound care conferences; (d) booking sales and distribution and performance of related services; (e) handling all aspects of order processing, invoicing and collection, inventory and receivables; (f) providing customer support, including handling medical queries, and performing other related functions; and (g) conforming its practices and procedures to applicable Laws relating to the marketing, detailing and promotion of such Licensed Product in the Field in the Territory. Derma shall bear all of the costs and expenses incurred in connection with such Commercialization activities.

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3.2 Commercialization Plan. The strategy for the Commercialization of each Licensed Product shall be described in a comprehensive plan that describes the pre-launch, launch and subsequent Commercialization activities for such Licensed Product in the Field in the Territory for both commercial accounts and DoD/VA accounts reflected separately, which shall include, without limitation, (i) the annual anticipated Net Sales by state or geographic region within the Territory, (ii) the annual anticipated marketing expenses to be incurred within the Territory, (iii) the annual anticipated number of FTEs to be assigned to Commercialize within the Territory, and (iv) a report on pricing, advertising, education, planning, marketing, and sales force training (the “**Commercialization Plan**”). At least ten (10) Business Days prior to finalizing the Commercialization Plan, Derma shall provide a draft of such plan to BIOD for comments and suggestions and Derma shall consider such comments in connection with finalizing the plan.

3.3 Commercial Diligence. During the Term, Derma shall use Diligent Efforts to Commercialize each Licensed Product in the Field throughout the Territory, in each case as soon as Regulatory Clearance has been obtained (if any such clearance is required), and thereafter.

3.4 DSC-127. Derma is currently seeking approval for a drug known as DSC127 which is targeted at early stage treatment of diabetic ulcers. If and when Derma receives full approval of DSC-127, Derma shall have the following obligations:

(i) **Commercialization Spend.** During the 12-month period immediately following receipt of regulatory clearance of DSC127, Derma shall increase the amount it spends on the promotion of Licensed Products by at least *** over the amount Derma spent on the promotion of Licensed Products during the immediately prior 12-month period.

(ii) **Combined Product Detailing.** Derma shall cause its representatives who are detailing DSC127 to also detail Licensed Products with a goal of having the representatives include coverage of Licensed Products in at least *** of their contacts with doctors when they are detailing DSC127. Derma shall detail DSC127 only for its FDA approved indication (projected to be for the treatment of diabetic foot ulcers). Derma representatives shall continue to detail Licensed Products in other areas where the products have been, and could be, commercially successful including the management of venous leg ulcers, other chronic dermal ulcers, and burns.

(iii) **Commission Levels.** Following the product launch of DSC127, Derma shall maintain the commissions paid to its sales representatives with respect to Licensed Products at or above the percentage level of those commissions that Derma paid to its sales representatives with respect to Licensed Products before that product launch.

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(iv) **Confirmation of Diligent Efforts Obligation.** For the avoidance of doubt, Derma's obligation to use Diligent Efforts to Commercialize Licensed Products will continue throughout the Term and will not be lessened or otherwise affected by the approval, launch, or Commercialization of DSC127 if and when that product receives regulatory clearance.

3.5 DFU Study. Derma shall initially fund up to *** for a Diabetic Foot Ulcer (DFU) Study to support obtaining insurance reimbursement approvals for BIODExCel. Data from this or any other study conducted by Derma are not to be used for any other purpose without Derma's prior written consent. If the DFU Study is successful in meeting its primary endpoint and there are no safety or other negative results of the DFU Study, then to the extent that the DFU Study costs less than ***, Derma agrees that it will spend at least the remaining balance of the *** on subsequent studies.

3.6 Records and Reports. Derma shall maintain complete, current and accurate records of (i) all Commercialization work conducted by it or its Affiliates; (ii) all data, Know-How and Patents resulting from such work; and (iii) all Commercialization Costs incurred in connection therewith (collectively, the "**Commercialization Records**"). By the end of the calendar months January and June of each year, Derma shall provide written reports to BIOD on its Commercialization of the Licensed Products, in a form reasonably acceptable to the Parties, detailing (i) all work conducted by it or its Affiliates during the previous six months; (ii) all data, Know-How and Patents resulting from such work during the previous six months; and (iii) all Commercialization Costs incurred in connection therewith during the previous six months. BIOD shall have the right to audit the financial records relating to the Commercialization Costs in accordance with Section 6.8, and shall have the right to review the Commercialization Records at reasonable times.

3.7 Subcontracts. Derma may perform any of its Commercialization obligations under this Agreement through its Affiliates and through one or more subcontractors or consultants, provided that (a) Derma obtains BIOD's prior written consent to the selection of each such subcontractor such consent not to be unreasonably withheld; (b) Derma remains responsible for the work allocated to such Affiliates, subcontractors and consultants to the same extent it would if it had done such work itself; (c) the Affiliate or subcontractor (as the case may be) undertakes in writing obligations of confidentiality and non-use regarding Confidential Information, that are substantially the same as those undertaken by the Parties pursuant to Article 10 hereof, and (d) the Affiliate or subcontractor (as the case may be) agrees in writing to assign to Derma all data, inventions, other Know-How, Patents and other intellectual property developed in the course of performing any such work, in each case to the extent related to the Licensed Product (each, a "**Derma Permitted Subcontractor**"). Without limiting the foregoing, all Derma Permitted Subcontractors shall be subject to the applicable terms and conditions of this Agreement and no agreement with any Derma Permitted Subcontractor shall release Derma from any of its obligations under this Agreement. For purposes of determining Derma liability, any time the term "Derma" is used in this Agreement it includes all subcontractors performing any part of this Agreement on behalf of Derma. Upon BIOD's request, Derma shall remove or replace any subcontractor, if BIOD determines, in its reasonable judgment that the continued use of such subcontractor is not in the best interests of BIOD.

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ARTICLE 4
REGULATORY MATTERS

4.1 Regulatory Activities. BIOD shall be responsible for all regulatory filing requirements under 21 CFR Part 1271 and Section 361 of the Public Health Service Act and may, in its sole discretion, seek to obtain expanded Regulatory Clearance for the Licensed Products. BIOD shall file and own all right, title and interest in all Regulatory Materials designed to obtain or support any such Regulatory Clearance. Upon BIOD's reasonable request and expense, Derma shall cooperate fully with, and provide assistance to, BIOD in connection with the activities set forth in this Section 4.1. As and when Derma develops a bona fide launch and Commercialization plan for either or both of Canada and Mexico, Derma shall use commercially reasonable efforts to obtain and support Regulatory Clearance in Canada and/or Mexico, as the case may be.

4.2 Regulatory Reports; Meetings with Regulatory Authorities. Each Party shall keep the other Party informed of material regulatory developments relating to Licensed Products in the Territory. BIOD shall provide Derma for review and comment all draft material regulatory filings related to the Licensed Products at least ten (10) Business Days in advance of their intended date of submission to any Regulatory Authority and shall consider any comments thereto provided by Derma. BIOD shall notify Derma as soon as practical of any Regulatory Materials (other than routine correspondence) related to the Licensed Products submitted to or received from any Regulatory Authority and shall provide Derma with copies immediately, but in no event more than five (5) Business Days after submission or receipt. BIOD shall provide Derma with reasonable advance notice of all meetings, conferences, and discussions scheduled with any Regulatory Authority concerning a Licensed Product to the extent such meeting affects this Agreement and/or Derma's obligations hereunder, and BIOD shall consider any input from Derma in preparing for such meetings, conferences or discussions. In BIOD's sole discretion, and if permitted by the relevant Regulatory Authority, Derma may be invited to attend such meetings, conferences or discussions at its own expense.

4.3 Regulatory Costs. BIOD shall be solely responsible for all costs and expenses incurred by it in the maintenance of its filing obligations under 21 CFR Part 1271 and Section 361 of the Public Health Service Act and may, in its sole discretion, incur such additional costs and expenses as it deems appropriate in connection with any expanded Regulatory Clearances for a Licensed Product. With respect to filings necessary to maintain Regulatory Clearances during the course of this Agreement, BIOD shall make such filings on a timely basis and shall provide Derma with a copy of all submissions made by it in order to maintain Regulatory Clearances. For the avoidance of doubt, Derma shall be solely responsible for all costs and expenses incurred by either Party in connection with (i) obtaining and/or maintaining coding and insurance reimbursement approvals, including but not limited to clinical or other studies in furtherance of the foregoing; and (ii) regulatory costs and expenses incurred in Canada and/or Mexico.

4.4 Notification of Threatened Action. Each Party shall immediately (but in any event within one Business Day) notify the other Party of any information it receives regarding any threatened or pending action, inspection or communication by or from any Third Party, including a Regulatory Authority, which may affect the Commercialization or regulatory status of a Licensed Product. Upon receipt of such information, the Parties shall consult with each other in an effort to arrive at a mutually acceptable procedure for taking appropriate action.

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4.5 Adverse Event Reporting and Safety Data Exchange. As soon as practical, the Parties shall enter into a commercially reasonable Quality Agreement (the “**Quality Agreement**”). The Quality Agreement shall include customary guidelines and procedures for the receipt, investigation, recordation, communication, and exchange (as between the Parties) of adverse event reports, complaints, and any other information concerning the safety of any Licensed Product.

4.6 Remedial Actions. Each Party shall notify the other Party immediately, and promptly confirm such notice in writing, if it obtains information indicating that any Licensed Product may be subject to any recall, corrective action or other regulatory action with respect to a Licensed Product taken by virtue of applicable Laws (a “**Remedial Action**”). The Parties shall assist each other in gathering and evaluating such information as is necessary to determine the necessity of conducting a Remedial Action. Derma shall, and shall ensure that its Affiliates will, maintain adequate records to permit the Parties to trace the distribution and use of the Licensed Products. BIOD shall have the right to decide whether any Remedial Action with respect to Licensed Products should be commenced and BIOD shall control and coordinate all efforts necessary to conduct such Remedial Action, provided that before taking action, BIOD shall consult with Derma as to the course of Remedial Action to be taken. If Derma disagrees with BIOD as to whether Remedial Action should be taken or what Remedial Action is appropriate, then the Executive Officers of the parties shall convene within 24 hours in an attempt to resolve the disagreement. If the disagreement cannot be resolved by them, then the dispute shall be decided by expedited arbitration pursuant to Article 12, provided that the arbitrator appointed shall have FDA regulatory experience. Notwithstanding the above, the parties shall comply with all orders of the FDA on a timely basis. The cost of any Remedial Action shall be borne by Derma, except that BIOD shall bear the cost of any Remedial Action to the extent the Remedial Action is made necessary by a manufacturing problem or defect affecting a Licensed Product.

**ARTICLE 5
INTENTIONALLY OMITTED**

**ARTICLE 6
COMPENSATION**

6.1 License Fees. As partial consideration for the rights granted to Derma herein, Derma shall pay to BIOD, on the Effective Date, the initial license fee set forth on Schedule 6.1 hereto (the “**Initial License Fee**”). The Initial License Fee shall be non-refundable and shall not be included in any calculation of the Gross Margin Percentage contemplated in Section 6.4 below.

6.2 Milestone Payments. Derma shall make non-refundable, non-creditable (to the calculation of Gross Margin Percentage or otherwise) milestone payments (each, a “**Milestone Payment**”) to BIOD upon the achievement of certain milestone events (each a “**Milestone Event**”) in connection with the Commercialization and/or sale of the Licensed Products as set forth on Schedule 6.2 hereto. Derma shall pay to BIOD each such amount within thirty (30) days after the achievement of the applicable Milestone Event. If any Milestone Event is achieved and Derma has not yet made one or more prior Milestone Payment(s), all previously unpaid Milestone Payments shall be due and payable together with the payment of the Milestone Payment for the first such subsequent Milestone Event achieved.

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6.3 Royalties.

(a) **Royalty Rates.** Derma shall pay to BIOD royalties on aggregate annual Net Sales of all Licensed Products during the Royalty Term as set forth on Schedule 6.3(a) hereto, such royalties to be calculated by multiplying the applicable royalty rate in the table on Schedule 6.3(a) by the corresponding amount of incremental Net Sales of all Licensed Products in the Territory in each calendar year. All such royalties shall be non-refundable when received by BIOD.

(b) **Royalty Term.** Royalties shall be due under this Section 6.3 during the period of time beginning from the First Commercial Sale of a Licensed Product in the Territory until the termination or expiration of this Agreement in accordance with Article 11, below, including through any Sell-Off Period in accordance with Section 11.6(c) (the “**Royalty Term**”).

(c) **Royalty Reports and Payments.** Within twenty (20) days following the end of each calendar quarter, commencing with the calendar quarter in which the First Commercial Sale of any Licensed Product is made anywhere in the Territory, Derma shall provide BIOD with a report containing the following information for the applicable calendar quarter on a Licensed Product-by-Licensed Product basis: (i) the amount of gross sales of such Licensed Product in the Territory, (ii) an itemized calculation of Net Sales in the Territory showing actual sales prices and deductions provided for in the definition of Net Sales, and (iii) a calculation of the royalty payment due on such sales. Within ten (10) days of the delivery of the applicable quarterly report, Derma shall pay in Dollars all amounts due to BIOD pursuant to Section 6.4 with respect to Net Sales by Derma and its Affiliates for such calendar quarter.

6.4 Profit Sharing. As additional compensation, on an annual basis, Derma shall supply BIOD within sixty (60) days of the end of the calendar year a calculation of the Gross Margin Percentage on the sale of Licensed Products. If and to the extent that the Gross Margin Percentage on the sale of Licensed Products exceeds ***, then Derma shall pay to BIOD *** of the amount of gross margin that exceeds the *** Gross Margin Percentage. For purposes of this Agreement, “**Gross Margin Percentage**” means the Net Sales of Licensed Products less Cost of Goods Sold (which shall include royalties payable pursuant to Section 6.3(a)), divided by the Net Sales of Licensed Products.

6.5 Common Stock Warrants. As additional compensation, Derma shall grant to BIOD upon execution hereof warrants to purchase 100,000 shares of Derma common stock pursuant to the Warrant to Purchase Common Stock annexed as Exhibit C hereto with an exercise price per share equal to the closing price of a share of Derma common stock on the date immediately preceding the public announcement of this Agreement.

6.6 Blocked Currency. In each country in the Territory where the local currency is blocked and cannot be removed from the country, royalties accrued on Net Sales in such country shall be paid to BDL in the equivalent amount in Dollars.

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6.7 Foreign Exchange. The rate of exchange to be used in computing the amount of currency equivalent in Dollars of Net Sales invoiced in other currencies shall be made at the closing exchange rate reported in *The Wall Street Journal* for the last Business Day of the applicable calendar quarter.

6.8 Payment Method; Late Payments. All payments due hereunder shall be made in Dollars by wire transfer of immediately available funds into an account in the USA designated by the payee Party. If a Party does not receive payment of any sum due to it on or before the due date (unless the sum is the subject of a good faith dispute), then in addition to any other right that the payee Party may have, the payor Party shall pay to the payee Party a late payment charge at the lower of 1.0% per month or the highest rate permitted by law, compounded daily and calculated on the basis of the number of days actually elapsed in a 365 day year, beginning on the due date and ending on the day prior to the day on which payment is made in full. Interest accruing under this Section shall be due on demand. The accrual or receipt by either Party of interest under this Section shall not constitute a waiver by that Party of any right it may otherwise have to declare a breach of or a default under this Agreement.

6.9 Records. Derma and its Affiliates shall maintain complete and accurate records in sufficient detail to permit BIOD to confirm the accuracy of the calculation of all payments required hereunder. BIOD shall have the right to audit such records in accordance with Section 6.10.

6.10 Audits. For a period of two (2) years from the end of the calendar year in which a payment was due hereunder, upon thirty (30) days prior notice, either Party (the “**Audited Party**”) shall (and shall require that its Affiliates) make such records relating to such payment available, during regular business hours and not more often than once each calendar year, for examination by an independent certified public accountant selected by the other Party (the “**Auditing Party**”), for the purposes of verifying compliance with this Agreement and the accuracy of the financial reports and/or invoices furnished pursuant to this Agreement. The results of any such audit shall be shared by the auditor with both Parties and shall be considered Confidential Information of both Parties. Any amounts shown to be owed by either Party to the other Party shall be paid within thirty (30) days from the auditor’s report, plus interest (as set forth in Section 6.6) from the original due date. The Auditing Party shall bear the full cost of such audit unless such audit discloses a deficiency in the Audited Party’s payments of greater than five percent (5%), in which case the Audited Party shall bear the full cost of such audit.

6.11 Taxes.

(a) Taxes on Income. Each Party shall be solely responsible for the payment of all taxes imposed on its share of income arising directly or indirectly from the efforts of the Parties under this Agreement.

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(b) Tax Cooperation. The Parties agree to cooperate with one another and use reasonable efforts to reduce or eliminate tax withholding or similar obligations in respect of royalties, Milestone Payments, and other payments made by Derma to BIOD under this Agreement. To the extent Derma is required to deduct and withhold taxes on any payment to BIOD, Derma shall pay the amounts of such taxes to the proper Governmental Authority in a timely manner and promptly transmit to BIOD an official tax certificate or other evidence of such withholding sufficient to enable BIOD to claim such payment of taxes. BIOD shall provide Derma any tax forms that may be reasonably necessary in order for Derma not to withhold tax or to withhold tax at a reduced rate under applicable Law. Each Party shall provide the other with reasonable assistance to enable the recovery, as permitted by applicable Laws, of withholding taxes, value added taxes, or similar obligations resulting from payments made under this Agreement, such recovery to be for the benefit of the Party bearing such withholding tax or value added tax. Derma shall require its Affiliates in the Territory to cooperate with BIOD in a manner consistent with this Section (b).

ARTICLE 7 INTELLECTUAL PROPERTY MATTERS

7.1 Prosecution of Patents.

(a) BIOD Prosecuted Patents.

(i) Subject to Section 7.1(a)(ii) below, as between the Parties, BIOD shall have the first right to prepare, file, prosecute and maintain the BIOD Patents both in the Territory and internationally. The costs of preparation, filing, prosecution and maintenance of BIOD Patents in the Territory shall be included in Commercialization costs, and promptly reimbursed by Derma to BIOD. BDL does not represent or warrant that the BIOD Patents, to include the pending patent applications listed in Exhibit A, will matriculate into issued patents.

(ii) If BIOD decides to cease the prosecution or maintenance of any BIOD Patent, it shall notify Derma in writing sufficiently in advance (but in no event less than ten (10) Business Days in advance) of the first date on which failure to act by BIOD might prejudice the prosecution or maintenance of the BIOD Patent so that Derma may, at its discretion, assume the responsibility for the prosecution or maintenance of such BIOD Patent, at Derma's cost and expense. If Derma assumes the prosecution or maintenance of any BIOD Patent, BIOD shall assign to Derma, without further consideration, BIOD's rights in and to that BIOD Patent for Commercialization in the Field in the Territory and BIOD shall retain all rights thereto in connection with the use, exploitation or Commercialization of such BIOD Patent outside the Field or outside the Territory. Notwithstanding the foregoing, Derma agrees not to rescind or take any action that could result in the rescission of any Nonpublication Requests under 35 U.S.C. 122 (b)(2)(B)(i) previously filed by BIOD without the prior written consent of BIOD.

(b) Cooperation. Each Party shall provide the other Party all reasonable assistance and cooperation, at the requesting Party's expense, in the patent prosecution efforts provided above in this Section 7.1, including providing any necessary powers of attorney and executing any other required documents or instruments for such prosecution.

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7.2 Enforcement of BIOD Patents.

(a) **Notification.** If either Party becomes aware of any existing or threatened infringement of the BIOD Patents (an “**Infringement**”), which infringing activity involves the using, making, importing, offering for sale or selling of Licensed Products or a Competing Product or otherwise adversely affects or is reasonably expected to adversely affect the Commercialization of any Licensed Product, it shall promptly notify the other Party in writing to that effect and the Parties shall consult with each other regarding any actions to be taken with respect to such Infringement.

(b) **Joint Enforcement Actions.** Subject to the terms of subpart (c) below, it is anticipated that the Parties will cooperate in the bringing of any appropriate suit or taking of other action against any Third Party engaged in any Infringement (an “**Enforcement Action**”), and that they will share equally (i.e.: 50% to Derma and 50% to BIOD) both in all costs and expenses of, and any Revenues received as a result of any Enforcement Actions.

(c) **Independent Enforcement Actions in Certain Circumstances.**

(i) **BIOD First Right of Independent Enforcement.** If Derma declines to participate in an Enforcement Action on the 50/50 basis contemplated by Section 7.2(b), (x) BIOD will have the right but not the obligation, at its own cost to take such Enforcement Action as it deems appropriate, and (y) Derma will assist and if necessary be joined in any suit that is part of such Enforcement Action, subject to BIOD reimbursing Derma for all costs and expenses incurred by, and indemnifying Derma against any Claims made against, Derma as a result of the Enforcement Action. Any Revenue received as a result of any Enforcement Action so taken by BIOD shall be for the sole account of BIOD.

(ii) **Derma Back-Up Right of Enforcement.** If BIOD declines to participate in an Enforcement Action on the 50/50 basis contemplated by Section 7.2(b), (x) Derma will have the right but not the obligation, at its own cost, to take such Enforcement Action as it deems appropriate, and (y) Derma may join BIOD as a party to any relevant proceedings to the extent reasonably necessary, subject to Derma reimbursing BIOD for all costs and expenses incurred by, and indemnifying BIOD against any Claims made against, BIOD as a result of the Enforcement Action. Any Revenue received as a result of any Enforcement Action so taken by Derma shall be for the sole account of Derma.

(d) **Collaboration.** In the case of any independent Enforcement Actions by either Party, the other Party shall provide to the enforcing Party reasonable assistance in such enforcement, at such enforcing Party’s request and expense, including joining such action as a party plaintiff if required by applicable Laws to pursue such action. The enforcing Party shall keep the other Party regularly informed of the status and progress of such enforcement efforts and shall reasonably consider the other Party’s comments on any such efforts. The non-enforcing Party shall be entitled to separate representation in such matter by counsel of its own choice and at its own expense, but such Party shall at all times cooperate fully with the enforcing Party.

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(e) **Settlement.** Neither Party shall settle any independent Enforcement Action that it brings under Section 7.2(c) in a manner that would negatively impact the applicable BIOD Patents (e.g., shorten the life of such Patents or narrow their scope) without the prior written consent of the other Party, which consent shall not be unreasonably withheld, conditioned, or delayed.

(f) **Revenue Defined.** The term “Revenue” includes all fees, minimum royalties, payments, compensation, or consideration of any kind, including without limitation in-kind payments, forbearance in connection with settlement, equity amounts taken in lieu of cash, or discounts below fair market value of equity received by either Party or its Affiliates as a result of any Enforcement Action, without regard to which entity pays, transfers or otherwise provides the Revenue, or how the Revenue is structured, denominated, or paid transferred or provided.

7.3 Infringement of Third Party Rights in the Territory. If any Licensed Product used or sold by Derma or its Affiliates becomes the subject of a Third Party’s claim or assertion of infringement of a Third Party’s Patent granted by a jurisdiction within the Territory, Derma shall promptly notify BIOD and the Parties shall agree on and enter into a “common interest agreement” wherein the Parties agree to their shared, mutual interest in the outcome of such potential dispute, and thereafter, the Parties shall promptly meet to consider the claim or assertion and the appropriate course of action. Derma shall be solely responsible for the defense of any such infringement claims, at Derma’s cost and expense, but Derma will be entitled to indemnification from BIOD under Section 9.1 with respect to any such costs and expenses if and to the extent those costs and expenses are incurred as a result of the breach or inaccuracy of any representation or warranty made by BIOD in this Agreement.

7.4 Patent Marking. Derma and its Affiliates shall mark each Licensed Product marketed and sold by Derma or its Affiliates hereunder with appropriate patent numbers or indicia.

7.5 Trademarks.

(a) **Product Marks.** Derma shall have the right to use BIOD Marks to brand the Licensed Products and create all Licensed Product labels (as set forth in Section 7.5(b) below) for the Licensed Products (the “**Product Marks**”). Derma shall give the proper attribution on each Licensed Product to BIOD as provider of the BIOD Technology, and otherwise as directed by BIOD. The Parties shall mutually agree upon the form and substance of such attribution rights. BIOD agrees not to use or license for use any trademark using the name “Amnio” during the Term (whether in the Field or outside the Field, or in the Territory or outside the Territory) except (i) for uses outside the Field and (ii) for use in connection with products that are physically different in appearance from any Licensed Product. In the event that Derma desires to brand the Licensed Products using an alternative name, Derma shall first propose such alternative name to BIOD for its approval, which approval shall not be unreasonably withheld, conditioned, or delayed, and Derma shall pay or reimburse BIOD, as the case may be, for all costs and expenses incurred in connection with confirming the availability of such names and protecting the marks associated with their use. In such a case, BIOD will own the Marks for the name.

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(b) **BIOD Marks.** Subject to the terms and conditions of this Agreement, BIOD hereby grants to Derma an exclusive license to use and display, during the Term and in the Field in the Territory, the trademarks as set forth in Exhibit B and any derivations thereof (the “**BIOD Marks**”), to identify (i) on the Licensed Products themselves, (ii) as part of the Product Marks and (iii) on any other labels, promotional materials or Regulatory Materials used in connection with any Licensed Product. Derma shall follow BIOD’s written trademark guidelines at all times as to the use of the BIOD Marks. Other than as expressly set forth herein, use of the BIOD Marks shall not confer on Derma any right to or interest in such trademarks, and Derma acknowledges and agrees that all use of the BIOD Marks and the goodwill generated thereby shall inure solely to the benefit of BIOD. Derma shall not use, adopt, file, register, seek to register or take any other action to use or establish rights in any mark anywhere in the world which is comprised of, derivative of, a combination with, or otherwise confusingly similar to, any BIOD Marks or file any application to register any trademark or trade name that is confusingly similar to the BIOD Marks.

7.6 Inventions Generally. Inventions conceived or reduced to practice in the course of activities performed under or contemplated by this Agreement (including those which are improvements to BIOD Know-How, BIOD Patents or otherwise to BIOD’s intellectual property, or which relate to a Licensed Product), by either BIOD or Derma (or both, jointly) shall be owned by BIOD. Each Party hereby makes all assignments to the other in order to effect the foregoing, and each agrees, at the other’s cost and expense, to take all further actions requested by the other in order to perfect the foregoing assignment. All rights assigned to BIOD by Derma shall be deemed to be BIOD Know-How or BIOD Patents, as applicable.

DSC-127. Inventions conceived or reduced to practice in the course of activities performed under or contemplated by this Agreement that combine BIOD Technology and any new intellectual property associated with DSC 127 but not owned by Derma’s licensor shall be jointly owned by BIOD and Derma. Each Party hereby agrees to cooperate to make all filings in connection with the same and shall share equally all costs and expenses in connection therewith. Notwithstanding the joint ownership, any such inventions shall be deemed to be exclusively licensed to Derma pursuant to the terms of Section 2.1 of this Agreement.

ARTICLE 8 REPRESENTATIONS AND WARRANTIES; COVENANTS

8.1 Mutual Representations and Warranties. Each Party hereby represents and warrants to the other Party as follows:

(a) **Organization.** As of the Effective Date, such Party is an entity duly organized, validly existing and in good standing under the laws of the state of its incorporation or organization, with the requisite legal authority to own and use its properties and assets and to carry on its business as currently conducted. Such Party is not in violation of any of the provisions of its respective certificate or articles of incorporation, formation, bylaws or other organizational or charter documents.

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(b) Authorization; Enforcement. Such Party has the requisite corporate authority to enter into and to consummate the transactions contemplated by this Agreement and otherwise to carry out its obligations hereunder. The execution and delivery by it of this Agreement and the consummation by it of the transactions contemplated hereby have been duly authorized by all necessary corporate action and no further consent or action is required by it, its Board of Directors or its stockholders. This Agreement has been duly executed by such Party and is the valid and binding obligation of such Party enforceable against such Party in accordance with its terms, except (i) as limited by general equitable principles and applicable bankruptcy, insolvency, reorganization, moratorium and other laws of general application affecting enforcement of creditors' rights generally, and (ii) as limited by laws relating to the availability of specific performance, injunctive relief or other equitable remedies.

(c) No Conflicts. The execution, delivery and performance by such Party of this Agreement and the consummation by such Party of the transactions contemplated hereby does not, (i) conflict with or violate any provision of the such Party's certificate or articles of incorporation, bylaws or other organizational or charter documents, (ii) in any material respect, conflict with, or constitute a default (or an event that with notice or lapse of time or both would become a default) under, or give to others any rights of termination, amendment, acceleration or cancellation (with or without notice, lapse of time or both) of, any agreement, credit facility, debt or other instrument or other understanding to which such Party is a party or by which any property or asset of such Party is bound, or affected, other than non-exclusive Distribution and Supply Agreements that may be terminated by BIOD in connection with entering into this Agreement, or (iii) in any material respect, result in a violation of any law, rule, regulation, order, judgment, injunction, decree or other restriction of any court or governmental authority to which such Party is subject, or by which any property or asset of such Party is bound or affected.

8.2 Additional Representations and Warranties of BIOD. BIOD represents and warrants to Derma as follows, as of the Effective Date:

(a) It has sufficient legal and/or beneficial title, ownership or license to the BIOD Technology to grant the licenses to Derma as purported to be granted pursuant to this Agreement;

(b) It has not received any written notice from any Third Party asserting or alleging that any research or development of any Licensed Product by BIOD prior to the Effective Date infringed or misappropriated the intellectual property rights of such Third Party;

(c) Except as set forth in Schedule 8.2(c), there are no pending, and to BIOD's knowledge, no threatened, adverse actions, suits or proceedings against BIOD involving BIOD Technology or any Licensed Product;

(d) The BIOD Patents include all Patents that Cover the Licensed Products that are Controlled by BIOD and/or its Affiliates on the Effective Date;

(e) BIOD is not a party to any Third Party In-License Agreement regarding any Licensed Product; and

*** This material has been omitted pursuant to a request for a confidential treatment and filed separately with the Securities and Exchange Commission.

- (f) There have been no prosecutorial irregularities in prosecuting the BDL Patents.

8.3 Mutual Covenants.

(a) **No Debarment.** In the course of the Commercialization of the Licensed Products, each Party shall not use any employee or consultant who has been debarred by any Regulatory Authority, or, to such Party's knowledge, is the subject of debarment proceedings by a Regulatory Authority. Each Party shall notify the other Party promptly upon becoming aware that any of its employees or consultants has been debarred or is the subject of debarment proceedings by any Regulatory Authority.

(b) **Compliance.** Each Party and its Affiliates shall comply in all material respects with all applicable Laws in the Commercialization of Licensed Products and performance of its obligations under this Agreement, including the statutes, regulations and written directives of the FDA, the EMA and any Regulatory Authority having jurisdiction in the Territory, the FD&C Act, the Prescription Drug Marketing Act, the Federal Health Care Programs Anti-Kickback Law, 42 USAC. 1320a-7b(b), the statutes, regulations and written directives of Medicare, Medicaid and all other health care programs, as defined in 42 USAC. § 1320a-7b(f), and the Foreign Corrupt Practices Act of 1977, each as may be amended from time to time.

8.4 **Disclaimer.** Derma understands that the Licensed Product and Licensed Products are the subject of ongoing clinical research and development and that BIOD cannot assure the efficacy or Regulatory Clearance that may be required with respect to any Licensed Product. In addition, BIOD makes no warranties except as set forth in this Article 8 concerning the BIOD Technology. EXCEPT AS EXPRESSLY STATED IN THIS AGREEMENT NO REPRESENTATIONS OR WARRANTIES WHATSOEVER, WHETHER EXPRESS OR IMPLIED, INCLUDING WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, PATENTABILITY, NON-INFRINGEMENT, OR NON-MISAPPROPRIATION OF THIRD PARTY INTELLECTUAL PROPERTY RIGHTS ARE MADE OR GIVEN BY OR ON BEHALF OF A PARTY, AND ALL IMPLIED REPRESENTATIONS AND WARRANTIES, WHETHER ARISING BY OPERATION OF LAW OR OTHERWISE, ARE HEREBY EXPRESSLY DISCLAIMED.

ARTICLE 9 INDEMNIFICATION

9.1 **Indemnification by BIOD.** Subject to the terms and conditions of this Agreement, BIOD shall indemnify and hold harmless Derma, and its directors, officers, employees, agents, Affiliates and contractors (collectively, the "**Derma Indemnitees**"), from and against all losses, liabilities, damages and expenses, including reasonable attorneys' fees and costs (collectively, "**Liabilities**"), resulting from any claims, demands, actions or other proceedings by any Third Party (including claims based upon products liability) ("**Claims**") to the extent resulting from (a) the breach or inaccuracy of any representation or warranty made by BIOD in this Agreement; or (b) the breach by BIOD of any of its obligations under this Agreement or under the Supply Agreement, including any product liability Claims arising from manufacturing problems or defects (c) activities relating to the Licensed Products prior to the signing of this Agreement. The foregoing indemnity obligation shall not apply to the extent that (i) the Derma Indemnitees fail to comply with the indemnification procedures set forth in Section 9.10.3 and BIOD's defense of the relevant Claims is prejudiced by such failure, or (ii) any Claim arises from, is based on, or results from any activity set forth in Section 9.2(a), 9.2(b) or 9.2(c) for which Derma is obligated to indemnify the BIOD Indemnitees under Section 9.2.

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9.2 Indemnification by Derma. Derma shall indemnify and hold harmless BIOD, and its directors, officers, employees, agents, Affiliates and contractors (collectively, the “**BIOD Indemnitees**”), from and against all Liabilities resulting from any Claims to the extent resulting from (a) the breach or inaccuracy of any representation or warranty made by Derma in this Agreement; (b) the breach by Derma of any of its obligations under this Agreement; or (c) the Commercialization of the Licensed Products by or on behalf of Derma or its Affiliates to the extent the Claim is based on a failure by Derma to adhere to regulatory constraints in its promotional activities. The foregoing indemnity obligation shall not apply to the extent that (i) the BIOD Indemnitees fail to comply with the indemnification procedures set forth in Section 10.3 and Derma’s defense of the relevant Claims is prejudiced by such failure, or (ii) any Claim arises from, is based on, or results from any activity set forth in Section 9.1(a) or 9.1(b) for which BIOD is obligated to indemnify the Derma Indemnitees under Section 9.1.

9.3 Indemnification Procedures. The Party claiming indemnity under this Article 9 (the “**Indemnified Party**”) shall give written notice to the Party from whom indemnity is being sought (the “**Indemnifying Party**”) promptly after learning of such Claim. The Indemnifying Party shall have the right to assume and conduct the defense of the Claim with counsel of its choice, and the Indemnified Party may participate in and monitor such defense with counsel of its own choosing at its sole expense. The Indemnified Party shall provide the Indemnifying Party with reasonable assistance, at the Indemnifying Party’s expense, in connection with the defense of the Claim for which indemnity is being sought. Each Party shall not settle or compromise any Claim without the prior written consent of the other Party, which consent shall not be unreasonably withheld, delayed or conditioned. If the Parties cannot agree as to the application of the foregoing Sections 9.1 and 9.2, each may conduct separate defenses of the Claim, and each Party reserves the right to claim indemnity from the other in accordance with this Article 9 upon the resolution of the underlying Claim.

9.4 Limitation of Liability. NEITHER PARTY SHALL BE LIABLE TO THE OTHER FOR ANY SPECIAL, CONSEQUENTIAL, INCIDENTAL, PUNITIVE, OR INDIRECT DAMAGES, INCLUDING LOST PROFITS, ARISING FROM OR RELATING TO ANY BREACH OF THIS AGREEMENT, REGARDLESS OF ANY NOTICE OF THE POSSIBILITY OF SUCH DAMAGES.

9.5 Insurance. Each Party shall, at all times during the Term of this Agreement and for five (5) years thereafter, obtain and maintain at its own expense the following types of insurance, with limits of liability not less than those specified below:

(a) Commercial general liability insurance against claims for bodily injury and property damage which shall include contractual coverage and product liability coverage, with limits of not less than *** per occurrence and *** in the aggregate (which may be met by a combination of primary, excess and umbrella coverage). The other Party, its officers, directors, representatives and Affiliates shall be named as additional insureds.

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(b) Workers compensation and employers' liability with limits to comply with the statutory requirements of the state(s) in which the Agreement is to be performed. The policy shall include employers' liability for not less than *** per accident.

All policies shall be issued by insurance companies with an A.M. Best's rating of Class A-V (or its equivalent) or higher status. Each Party shall deliver certificates of insurance evidencing coverage as an additional insured to the other Party promptly after the execution of this Agreement and annually thereafter. To the extent permitted by the insurance carriers, all policies provided for herein shall expressly provide that such policies shall not be cancelled, terminated or altered without at least thirty (30) days prior written notice to the insured Party, and each insuring Party shall immediately notify the insured Party in the event that a policy provided for herein is cancelled, terminated or altered.

**ARTICLE 10
CONFIDENTIALITY**

10.1 Confidentiality. During the Term and for a period of five (5) years thereafter, each Party shall maintain all Confidential Information of the other Party in trust and confidence and shall not, without the written consent of the other Party, disclose any Confidential Information of the other Party to any Third Party or use any Confidential Information of the other Party for any purpose other than as necessary in connection with the exercise of rights or discharge of obligations under this Agreement. The confidentiality obligations of this Section 10.1 shall not apply to Confidential Information to the extent that the receiving Party can establish by competent evidence that such Confidential Information: (a) is publicly known prior or subsequent to disclosure without breach of confidentiality obligations by such Party or its employees, consultants or agents; (b) was in such Party's possession at the time of disclosure without any restrictions on further disclosure; (c) is received by such receiving Party, without any restrictions on further disclosure, from a Third Party who has the lawful right to disclose it; or (d) is independently developed by employees or agents of the receiving Party who had no access to the disclosing Party's Confidential Information.

10.2 Authorized Disclosure. Nothing herein shall preclude a Party from disclosing the Confidential Information of the other Party to the extent:

(a) such disclosure is reasonably necessary (i) for the filing or prosecuting of Patents as contemplated by this Agreement; (ii) to comply with the requirement of Regulatory Authorities with respect to obtaining and maintaining Regulatory Clearance (or any pricing and reimbursement approvals) of a Licensed Product; or (iii) for prosecuting or defending litigations as contemplated by this Agreement;

(b) such disclosure is reasonably necessary to its employees, agents, consultants or contractors on a need-to-know basis for the sole purpose of performing its obligations or exercising its rights under this Agreement; provided that in the case of any such agents, consultants or contractors, the disclosees are bound by written obligations of confidentiality and non-use consistent with those contained in this Agreement;

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(c) such disclosure is reasonably necessary to any bona fide potential or actual investor, acquiror, merger partner, or other financial or commercial partner for the sole purpose of evaluating an actual or potential investment, acquisition or other business relationship; provided that in each case, the disclosees are bound by written obligations of confidentiality and non-use consistent with those contained in this Agreement;

(d) such disclosure is reasonably necessary to comply with applicable Laws, including regulations promulgated by applicable security exchanges, a valid order of a court of competent jurisdiction, administrative subpoena or order.

Notwithstanding the foregoing, in the event a Party is required to make a disclosure of the other Party's Confidential Information pursuant to either of Sections 10.2(a) or 10.2(d), such Party shall promptly notify the other Party of such required disclosure and the proposed form of such disclosure and, to the extent commercially reasonable, shall use reasonable efforts to obtain, or to assist the other Party in obtaining, a protective order preventing or limiting the required disclosure.

10.3 Return of Confidential Information. Promptly after the termination or expiration of this Agreement for any reason (but in no event more than 45 days from such termination or expiration), each Party shall return to the other Party all tangible manifestations of such other Party's Confidential Information at that time in the possession of the receiving Party and shall permanently delete all electronic copies or files related thereto. In connection with such return and/or deletion of Confidential Information, the Executive Officers of each Party shall certify in writing that such Party has fully complied with its obligations under this Section 10.3.

10.4 Publicity; Terms of the Agreement; Confidential Treatment.

(a) The Parties agree that the terms of this Agreement (including without limitation any exhibits and schedules hereto) shall be considered Confidential Information of each Party, subject to the special authorized disclosure provisions set forth in Section 10.2 and this Section 10.4.

(b) If either Party desires to make a public announcement concerning the material terms of this Agreement, such Party shall give reasonable prior advance notice of the proposed text of such announcement to the other Party for its prior review and approval (except as otherwise provided herein), such approval not to be unreasonably withheld. A Party commenting on such a proposed press release shall provide its comments, if any, within three (3) business days after receiving the press release for review. In addition, to the extent required by applicable Laws, including regulations promulgated by applicable security exchanges, each Party shall have the right to make a press release announcing the achievement of each milestone under this Agreement as it is achieved, and the achievements of Regulatory Clearances in the Territory as they occur, subject to the other Party's consent as to form and substance of such announcement, which shall not be unreasonably withheld or delayed. In relation to the other Party's review and approval of such an announcement, such other Party may make specific, reasonable comments on such proposed press release within the prescribed time for commentary, but shall not withhold its consent to disclosure of the information that the relevant milestone has been achieved and triggered a payment hereunder. Neither Party shall be required to seek the permission of the other Party to repeat any information regarding the terms of this Agreement that has already been publicly disclosed by such Party, or by the other Party, in accordance with this Section 10.4, provided such information remains accurate as of such time.

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(c) In addition, the Parties acknowledge that either or both Parties may be obligated to file under applicable law and regulation a copy of this Agreement with the USA Securities and Exchange Commission or similar stock exchange authorities. Each Party shall be entitled to make such a required filing; *provided, however*, that it requests confidential treatment of the commercial terms and sensitive technical terms hereof and thereof to the extent such confidential treatment is reasonably available to such Party. In the event of any such filing, each Party shall provide the other Party with a copy of this Agreement marked to show provisions for which such Party intends to seek confidential treatment and shall reasonably consider and incorporate the other Party's comments thereon to the extent consistent with the legal requirements, with respect to the filing Party, governing disclosure of material agreements and material information that must be publicly filed.

10.5 Technical Publication. Neither Party may publish peer reviewed manuscripts or give other forms of public disclosure such as abstracts and media presentations (such disclosure collectively, for purposes of this Section 10.5, "**publication**"), of results of studies carried out under this Agreement, without the opportunity for prior review by the other Party, except to the extent required by applicable Laws. A Party seeking publication shall provide the other Party the opportunity to review and comment on any proposed publication that relates to the Licensed Product at least thirty (30) days (or at least ten (10) days in the case of abstracts and media presentations) prior to its intended submission for publication. The other Party shall provide the Party seeking publication with its comments in writing, if any, within twenty (20) days (or within five (5) days in the case of abstracts and media presentations) after receipt of such proposed publication. The Party seeking publication shall consider in good faith any comments thereto provided by the other Party and shall comply with the other Party's reasonable request to remove any and all of such other Party's Confidential Information from the proposed publication. In addition, the Party seeking publication shall delay the submission for a period up to sixty (60) days in the event that the other Party can demonstrate reasonable need for such delay in order to accommodate the preparation and filing of a patent application. If the other Party fails to provide its comments to the Party seeking publication within such twenty (20)-day period (or five (5)-day period, as the case may be), such other Party shall be deemed not to have any comments, and the Party seeking publication shall be free to publish in accordance with this Section 10.5 after the thirty (30)-day period (or ten (10)-day period, as the case may be) has elapsed. The Party seeking publication shall provide the other Party a copy of the publication at the time of the submission. Each Party agrees to acknowledge the contributions of the other Party and its employees in all publications as scientifically appropriate.

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10.6 Equitable Relief. Each Party acknowledges that its breach of Article 10 of this Agreement may cause irreparable injury to the other Party for which monetary damages may not be an adequate remedy. Therefore, each Party shall be entitled to seek injunctive and other appropriate equitable relief to prevent or curtail any actual or threatened breach of the obligations relating to Confidential Information set forth in this Article 10 by the other Party. The rights and remedies provided to each Party in this Article 10 are cumulative and in addition to any other rights and remedies available to such Party at law or in equity.

**ARTICLE 11
TERM AND TERMINATION**

11.1 Term. The term during which this Agreement is in effect (the “**Term**”) shall commence on the Effective Date and, unless and until this Agreement is terminated pursuant to another section of this Article 11, shall continue thereafter so long as Derma continues to Commercialize any Licensed Product in the Field in the Territory.

11.2 Termination by Mutual Agreement. The Parties may terminate this Agreement in whole or in part as, and at such time, and with such effect, as may be mutually agreed upon in writing by the Parties.

11.3 Termination by BIOD for Patent Challenge or Failure to Meet Thresholds

(a) For Patent Challenge. BIOD may terminate this Agreement in its entirety immediately upon written notice to Derma if Derma or its Affiliates (directly or indirectly, individually or in association with any other person or entity) challenges the validity, enforceability or scope of any BIOD Patent or trade secret anywhere in the world.

(b) For Failure to Meet Thresholds. This Section 11.3(b) will be effective only if the failure of Derma to achieve Net Sales of Licensed Products as set forth below was not attributable, in whole or in part, to a failure by BIOD to supply Licensed Products in quantities sufficient to support achievement of that level of Net Sales. Subject to this limitation, if Net Sales of Licensed Products for any period are less than the annual minimum Net Sales set forth on Schedule 6.4 attached hereto, BIOD may, by notice given to Derma not later than the end of the third calendar month after the end of the fiscal year in which the minimum has not been met, notify Derma that BIOD has elected to terminate this Agreement effective on a date specified in the notice that must be at least three calendar months after the date of the notice. Upon receipt of any such notice from BIOD, Derma will have the option of either (x) agreeing to the termination, in which case the Agreement will terminate on the date specified by BIOD in the notice, or (y) paying to BIOD, within 30 days of receipt of the notice, an amount equal to difference between the royalties paid by Derma to BIOD with respect to Net Sales during that Threshold Year pursuant to Section 6.3 and the amount of royalties that would be owed if the annual minimum Net Sales for that Threshold Year had been achieved plus any milestone payments that are payable under Schedule 6.2 in which case the Agreement will not be terminated but will continue in accordance with its terms. If there are changes after the date of this Agreement in regulations or reimbursement status that materially affect the Licensed Products, the parties agree to negotiate in good faith a reduction of the Net Sales requirements.

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11.4 Termination by Either Party for Material Breach.

(a) Subject to Section 11.4(b), each Party shall have the right to terminate this Agreement in its entirety upon written notice to the other Party if the other Party materially breaches its obligations under this Agreement, or under the Supply Agreement and, after receiving written notice identifying such material breach in reasonable detail, fails to cure such material breach within (i) ten (10) days for any failure to make any payment when due under this Agreement or the Supply Agreement; or (ii) with respect to any other alleged breach, sixty (60) days from the date of such notice.

(b) If the alleged breaching Party disputes in good faith the existence or materiality of a breach specified in a notice provided by the other Party in accordance with Section 11.4(a), and such alleged breaching Party provides the other Party notice of such dispute within the applicable cure period, then the non-breaching Party shall not have the right to terminate this Agreement under Section 11.4(a) unless and until an arbitrator, in accordance with Article 12, has determined that the alleged breaching Party has materially breached the Agreement and such breaching Party fails to cure such breach within the applicable cure period (measured as commencing after the arbitrator's decision). It is understood and agreed that during the pendency of such dispute, all of the terms and conditions of this Agreement shall remain in effect and the Parties shall continue to perform all of their respective obligations hereunder.

11.5 Termination by Either Party for Bankruptcy. To the extent permitted under applicable Laws, if at any time during the Term of this Agreement, an Event of Bankruptcy (as defined below) relating to either Party (the "**Bankrupt Party**") occurs, the other Party (the "**Non-Bankrupt Party**") shall have, in addition to all other legal and equitable rights and remedies available hereunder, the option to terminate this Agreement upon sixty (60) days written notice to the Bankrupt Party. It is agreed and understood that if the Non-Bankrupt Party does not elect to terminate this Agreement upon the occurrence of an Event of Bankruptcy, except as may otherwise be agreed with the trustee or receiver appointed to manage the affairs of the Bankrupt Party, the Non-Bankrupt Party shall continue to make all payments required of it under this Agreement as if the Event of Bankruptcy had not occurred, and the Bankrupt Party shall not have the right to terminate any license granted herein. The term "**Event of Bankruptcy**" means: (a) filing, in any court or agency pursuant to any statute or regulation of any state or country, (i) a petition in bankruptcy or insolvency, (ii) for reorganization or (iii) for the appointment of (or for an arrangement for the appointment of) a receiver or trustee of the Bankrupt Party or of its assets; (b) with respect to the Bankrupt Party, being served with an involuntary petition filed in any insolvency proceeding, which such petition is not dismissed within sixty (60) days after the filing thereof; (c) proposing or being a party to any dissolution or liquidation when insolvent; or (d) making an assignment for the benefit of creditors. Without limitation, the Bankrupt Party's rights under this Agreement shall include those rights afforded by 11 USAC. § 365(n) of the United States Bankruptcy Code (the "**Bankruptcy Code**") and any successor thereto. If the bankruptcy trustee of a Bankrupt Party as a debtor or debtor-in-possession rejects this Agreement under 11 USAC. § 365(o) of the Bankruptcy Code, the Non-Bankrupt Party may elect to retain its rights licensed from the Bankrupt Party hereunder (and any other supplementary agreements hereto) for the duration of this Agreement and avail itself of all rights and remedies to the full extent contemplated by this Agreement and 11 USAC. § 365(n) of the Bankruptcy Code, and any other relevant Laws.

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11.6 Effect of Termination by BIOD for Cause.

(a) General. Upon any termination of this Agreement by BIOD pursuant to Section 11.3 (patent challenge or failure to meet thresholds), or Section 11.4 (material breach), (any such termination being a "Termination by BIOD for Cause"), (i) all licenses and rights granted to Derma under this Agreement shall terminate, (ii) Derma shall immediately transfer and assign to BIOD or its designee all materials, Know-How, Regulatory Materials, licenses, Third Party agreements and other items as are reasonably necessary for BIOD to continue the Commercialization of Licensed Product and Licensed Products and (iii) Derma shall immediately cease all sales, marketing and distribution of Licensed Products, subject to Section 11.6(c). For the avoidance of doubt, Derma shall be entitled to retain all information with respect to its customers.

(b) Additional Effects of Termination by BIOD for Cause. Without limiting the generality of Section 11.6(a), the following rights and consequences shall apply upon any Termination by BIOD for Cause:

(i) Regulatory Materials; Data. To the extent permitted by applicable Laws, Derma shall transfer and assign to BIOD all Regulatory Materials to extent such Regulatory Materials are not owned by BIOD, and related data and Know-How relating to the Licensed Products and shall treat the foregoing as Confidential Information of BIOD (and not of Derma); provided that Derma shall be allowed to retain any such materials that a Regulatory Authority requires Derma to retain under applicable Laws.

(ii) Derma Assignment. Derma hereby irrevocably assigns to BIOD, effective upon such termination, a non-exclusive, fully paid, worldwide, fully transferrable, irrevocable license (with the right to grant sublicenses through multiple tiers) all Patents and Know-How (i) Controlled by Derma (or its Affiliates) as of the effective date of such termination and (ii) related to or useful in connection with Licensed Products.

(iii) Transition Assistance. Derma shall provide such assistance, at no cost to BIOD, for a period of up to 120 days as may be reasonably necessary or useful for BIOD to continue Commercializing Licensed Products throughout the Territory, including assigning or amending as appropriate, upon request of BIOD, any agreements or arrangements with Third Party vendors to Market and/or Commercialize Licensed Products. To the extent that any such contract between Derma and a Third Party is not assignable to BIOD, Derma shall reasonably cooperate with BIOD to arrange to continue to provide such services for a reasonable time after termination. Derma shall not, during such applicable notice period, take any action that could reasonably be expected to have a material adverse impact on the further Commercialization of any Licensed Product.

(iv) Inventories. Subject to Section 11.6(c), BIOD shall have the right to purchase from Derma any and all of the inventory of Licensed Products held by Derma as of the effective date of termination at a price equal to Derma's actual cost to acquire such inventory. BIOD shall notify Derma within thirty (30) days after the effective date of termination whether BIOD elects to exercise such right.

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(c) **Derma's Right to Sell Off.** If the Termination by BIOD for Cause is not a termination by BIOD under Section 11.4 (following a material breach by Derma), Derma, for a period of ninety days (90) from the effective date of termination, shall have the right to market, distribute, offer to sell and sell off then-existing inventory of Licensed Products then on hand (the period referred to in this Section 11.6(c), the "**Sell-Off Period**"). Following the expiration of the Sell Off Period, Derma shall immediately cease all sales, marketing and distribution of the then-existing inventory Licensed Products on hand as of the end of such Sell-Off Period, and BIOD, at its option, shall (x) have the right to purchase from Derma any and all of the inventory of Licensed Products held by Derma as of the last date of the Sell-Off Period at a price equal to Derma's actual cost to acquire such inventory, or (y) instruct Derma to destroy such remaining inventory.

For clarity, Derma shall continue to perform all of its obligations under this Agreement with respect to the Commercialization of Licensed Products until the effective date of termination and shall not modify in any material respects such activities from past practices during such period.

11.7 Effect of Termination by Derma for Cause.

General. Upon any termination of this Agreement by Derma pursuant to Section 11.4 (following a material breach by BIOD), or Section 11.5 (following BIOD's bankruptcy) (any such termination being a "Termination by Derma for Cause"), (i) all right, title and interest in and to the BIOD Marks (including without limitation the name "AmnioMatrix" and any derivations thereof) shall automatically be deemed transferred to Derma, (ii) for a period of not more than 180 days, BIOD shall use Diligent Efforts to identify and qualify an alternative supplier of similar products, (iii) for a period of not more than an additional 180 days, BIOD shall use Diligent Efforts to continue to supply to Derma Licensed Products until such time as the alternative supplier is able to manufacture a sufficient supply of similar products. If an alternative supplier cannot be identified: (i) Derma shall be designated as the alternative supplier for the production of AmnioExCel, and BIOD shall train such supplier or Derma, as the case may be, in the manufacturing process for AmnioExCel; (ii) BIOD shall use Diligent Efforts to transfer, to the extent permitted by law, all Regulatory Clearances with respect to AmnioExCel to Derma for use in the Field in the Territory; (iii) BIOD shall use Diligent Efforts to provide general guidance for the production of a viable tissue matrix, absent the transfer of any BIOD Technology. For the avoidance of doubt, other than the transfer of the AmnioMatrix Mark, BIOD shall be under no obligation to transfer any BIOD Patents, Know-How, or BIOD Technology related to the manufacture or production of AmnioMatrix.

Additional Effects of Termination by Derma for Cause. Without limiting the generality of Section 11.7(a), the following rights and consequences shall apply upon any Termination by Derma for Cause:

(i) **Transition Assistance.** BIOD shall provide such assistance as may be reasonably necessary or useful for Derma to continue the sale of the Licensed Products in the Field throughout the Territory, including assigning or amending as appropriate, upon request of BIOD, any agreements or arrangements with Third Party vendors to further Market and/or Commercialize the Licensed Products. To the extent that any such contract between BIOD and a Third Party is not assignable to Derma, BIOD shall reasonably cooperate with Derma, at Derma's cost and expense, to arrange to continue to provide such services for a reasonable time after termination, but in no event shall such time exceed 120 days without the written agreement of the Parties.

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11.8 Survival. Termination or expiration of this Agreement shall not affect any rights or obligations of the Parties under this Agreement that have accrued prior to the date of termination or expiration. Notwithstanding anything to the contrary, the following provisions shall survive any expiration or termination of this Agreement: Section 6.3, 6.4, 6.8, 6.10, 6.11,7.6, 8.1, 8.2, 8.4, Articles 9 and 10, Sections 11.3, 11.4, 11.6, and 11.7.

**ARTICLE 12
DISPUTE RESOLUTION**

12.1 Disputes. The Parties recognize that disputes as to certain matters may from time to time arise that relate to either Party's rights and/or obligations hereunder. It is the objective of the Parties to establish procedures to facilitate the resolution of disputes arising under this Agreement or the Supply Agreement in an expedient manner by mutual cooperation and without resort to litigation. To accomplish this objective, the Parties agree to follow the procedures set forth in this Article 12 to resolve any controversy or claim arising out of, relating to or in connection with any provision of this Agreement or the Supply Agreement, if and when a dispute arises under this Agreement.

12.2 Internal Resolution. With respect to all disputes arising between the Parties under this Agreement or the Supply Agreement, including any alleged breach or any issue relating to the interpretation or application of this Agreement or the Supply Agreement, if the Parties are unable to resolve such dispute within thirty (30) days after such dispute is first identified by either Party in writing to the other, the Parties shall refer such dispute to the Executive Officers of the Parties for attempted resolution by good faith negotiations within thirty (30) days after such notice is received, including at least one (1) in-person meeting of the Executive Officers within twenty (20) days after such notice is received. If the Executive Officers are not able to resolve such dispute referred to them within such thirty (30) day period, then Section 12.3 shall control.

12.3 Arbitration. Any controversy or claim between the Parties arising out of or relating to this Agreement, the Supply Agreement, or a breach thereof, which cannot be resolved by negotiation pursuant to Section 12.2, will be resolved by binding arbitration administered by the American Arbitration Association (the "AAA") under this Section 12.3 and the AAA's then-current Commercial Arbitration Rules. If any part of this Section 12.3 is held to be unenforceable, it will be severed and will not affect either the duty to arbitrate or any other part of this Section 12.3. The arbitration will be held in Atlanta, Georgia, before a sole disinterested arbitrator who is a former federal or state trial court judge experienced in handling commercial disputes. The arbitrator shall be appointed jointly by the Parties hereto within thirty (30) days following the date on which the arbitration is instituted. If the Parties are unable to agree upon the arbitrator within such thirty (30) day period, the arbitrator shall be appointed in accordance with the AAA's rules for the appointment of an arbitrator from the AAA panel. The arbitrator's award will be final and binding and judgment on the award may be entered in any court having jurisdiction thereof. The arbitrator will not have the power to award punitive or exemplary damages, or any damages excluded by, or in excess of, any damage limitations expressed in this Agreement; provided, however, the Arbitrator will have the power to apportion the costs associated with the arbitration. Issues of arbitrability will be determined in accordance solely with the federal substantive and procedural laws relating to arbitration; in all other respects, the arbitrator will be obligated to apply and follow the substantive law of the State of Delaware .

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12.4 Equitable Relief. Nothing in this Article 12 shall prevent either Party from seeking equitable relief in a court of competent jurisdiction.

**ARTICLE 13
FUTURE PRODUCT DEVELOPMENT**

13.1 New Products. The joint development of new products for use in the Field will be subject to terms of a Joint Development Agreement to be negotiated in good faith between the Parties in connection with any such co-development efforts.

**ARTICLE 14
MISCELLANEOUS**

14.1 Entire Agreement; Amendment. This Agreement, together with the exhibits and schedules attached hereto, which are hereby incorporated herein, represents the entire agreement and understanding between the Parties with respect to its subject matter and supersedes and terminates any prior and/or contemporaneous discussions, representations or agreements, whether written or oral, of the Parties regarding the subject matter hereto, and supersedes, as of the Effective Date, all prior and contemporaneous agreements and understandings between the Parties with respect to the subject matter hereof (including the Prior CDA, provided that Confidential Information disclosed by either party under the Prior CDA shall be deemed to be Confidential Information disclosed pursuant to this Agreement). There are no covenants, promises, agreements, warranties, representations, conditions or understandings, either oral or written, between the Parties other than as are set forth in this Agreement. Amendments or changes to this Agreement shall be valid and binding only if in writing and signed by duly authorized representatives of the Parties.

14.2 Force Majeure. Both Parties shall be excused from the performance of their obligations under this Agreement to the extent that such performance is prevented by force majeure and the nonperforming Party promptly provides notice of the prevention to the other Party. Such excuse shall be continued so long as the condition constituting force majeure continues and the nonperforming Party takes reasonable efforts to remove the condition. For purposes of this Agreement, force majeure shall mean conditions beyond the control of the Parties, including an act of God, war, civil commotion, terrorist act, labor strike or lock-out, epidemic, failure or default of public utilities or common carriers, destruction of production facilities or materials by fire, earthquake, storm or like catastrophe, and failure of plant or machinery (provided that such failure could not have been prevented by the exercise of skill, diligence, and prudence that would be reasonably and ordinarily expected from a skilled and experienced person engaged in the same type of undertaking under the same or similar circumstances). If a force majeure persists for more than ninety (90) days, then the Parties shall discuss in good faith the modification of the Parties' obligations under this Agreement in order to mitigate the delays caused by such force majeure.

*** This material has been omitted pursuant to a request for a confidential treatment and filed separately with the Securities and Exchange Commission.

14.3 Notices. Any notice required or permitted to be given under this Agreement shall be in writing, shall specifically refer to this Agreement, and shall be addressed to the appropriate Party at the address specified below or such other address as may be specified by such Party in writing in accordance with this Section 14.3, and shall be deemed to have been given for all purposes (a) when received, if hand-delivered or sent by confirmed facsimile or a reputable courier service, or (b) five (5) Business Days after mailing, if mailed by first class certified or registered airmail, postage prepaid, return receipt requested.

If to BIOD: BioD, LLC
 Attn.: General Counsel
 1715 Aaron Brenner Drive
 Suite 204
 Memphis, TN 38120

If to Derma: Derma Sciences, Inc.
 Attn.: Chief Executive Officer
 214 Carnegie Center, Suite 300
 Princeton, New Jersey 08540

14.4 No Strict Construction; Headings. This Agreement has been prepared jointly by the Parties and shall not be strictly construed against either Party. Ambiguities, if any, in this Agreement shall not be construed against any Party, irrespective of which Party may be deemed to have authored the ambiguous provision. The headings of each Article and Section in this Agreement have been inserted for convenience of reference only and are not intended to limit or expand on the meaning of the language contained in the particular Article or Section. Except where the context otherwise requires, the use of any gender shall be applicable to all genders, and the word “or” is used in the inclusive sense (and/or). The term “including” as used herein means including, without limiting the generality of any description preceding such term.

14.5 Assignment. Neither Party may assign this Agreement without the prior written consent of the other Party, such consent not to be unreasonably withheld. Notwithstanding the foregoing, BIOD may assign without Derma’s consent its rights to payments received under this Agreement. Any permitted assignment shall be binding on the successors of the assigning Party. The BIOD Technology shall exclude any Patents and Know-How Controlled by any Third Party successor to all or substantially all of its member interests, stock or assets relating to the Licensed Products (an “**Acquiror**”), or any Affiliate thereof (excluding the Party hereto) (that becomes an Affiliate of the Acquiror as a result of such transaction) prior to the acquisition and which (i) were not obtained from Derma or its Affiliates or (ii) Cover inventions or comprise Know-How developed outside of and unrelated to any activities under this Agreement. Any attempted or purported assignment in violation of this Section 14.5 shall be null and void.

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14.6 Performance by Affiliates. Each Party may discharge any obligations and exercise any right hereunder through any of its Affiliates. Each Party hereby guarantees the performance by its Affiliates of such Party's obligations under this Agreement, and shall cause its Affiliates to comply with the provisions of this Agreement in connection with such performance. Any breach by a Party's Affiliate of any of such Party's obligations under this Agreement shall be deemed a breach by such Party, and the other Party may proceed directly against such Party without any obligation to first proceed against such Party's Affiliate.

14.7 Further Actions. Each Party agrees to execute, acknowledge and deliver such further instruments, and to do all such other acts, as may be necessary or appropriate in order to carry out the purposes and intent of this Agreement.

14.8 Severability. If any provision of this Agreement is found by a court of competent jurisdiction to be unenforceable, then such provision shall be construed, to the extent feasible, so as to render the provision enforceable, and if no feasible interpretation would save such provision, it shall be severed from the remainder of this Agreement. The remainder of this Agreement shall remain in full force and effect, unless the severed provision is essential and material to the rights or benefits received by either Party. In such event, the Parties shall negotiate, in good faith, and substitute a valid and enforceable provision or agreement that most nearly implements the Parties' intent in entering into this Agreement.

14.9 No Waiver. No provision of this Agreement can be waived except by the express written consent of the Party waiving compliance. Except as specifically provided for herein, the waiver from time to time by either Party of any of its rights or its failure to exercise any remedy shall not operate or be construed as a continuing waiver of same or of any other of such Party's rights or remedies provided in this Agreement.

14.10 Independent Contractors. For all purposes under this Agreement, Derma and BIOD and their respective Affiliates are independent contractors with respect to each other, and shall not be deemed to be an employee, agent, partner or legal representative of the other Party. This Agreement does not grant any Party or its employees, consultants or agents any authority (express or implied) to do any of the following without the prior express written consent of the other Party: create or assume any obligation; enter into any agreement; make any representation or warranty; serve or accept legal process on behalf of the other Party; settle any claim by or against the other Party; or bind or otherwise render the other liable in any way.

14.11 Governing Law. This Agreement shall be governed by the laws of the state of Delaware, without regard to its choice of law provisions that would require the application of the laws of a different jurisdiction.

14.12 Counterparts. This Agreement may be executed in two (2) or more counterparts, each of which shall be deemed an original but all of which together shall constitute the same legal instrument.

14.13 Supply Agreement. The parties agree that upon execution hereof, they shall negotiate in good faith a Supply Agreement for the supply of Licensed Products by BIOD to Derma. The transfer price to Derma under the Supply Agreement shall not exceed *** (amniotic extracellular membrane) and *** (viable tissue matrix). If the Supply Agreement is not executed within ten (10) days of the date of this Agreement, either party may, upon written notice to the other, terminate this Agreement with immediate effect.

*** This material has been omitted pursuant to a request for a confidential treatment and filed separately with the Securities and Exchange Commission.

IN WITNESS WHEREOF, the Parties have executed this Agreement by their duly authorized officers as of the Effective Date.

DERMA SCIENCES, INC.

BIODLOGICS, LLC

By: /s/ Edward J. Quilty

By: /s/ Russell I. Olsen

Name: Edward J. Quilty

Name: Russell I. Olsen

Title: Chairman and Chief Executive Officer

Title: Chief Operating Officer

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Exhibit A

Patents

Claims in U.S. Patent Application No. 13/650,492 (which claims the benefit of U.S. Provisional Application No. 61/553,336), Unpublished (filing date October 12, 2012) (BioDlogics, LLC, applicant) specific to the product, method(s) of manufacture and methods of use of AmnioExCel (BioDExcel) in the Field. Excludes all other claims in the aforementioned patent application not specific to AmnioExCel, its method(s) of manufacture or its method of use in the Field.

Claims in U.S. Patent Application No. 13/664,857 (which claims the benefit of U.S. Provisional Application No. 61/546,104), Unpublished (filing date October 31, 2012) (BioDlogics, LLC, applicant) specific to the product, method(s) of manufacture and methods of use of AmnioMatrix in the Field. Excludes all other claims in the aforementioned patent application not specific to AmnioMatrix, its method(s) of manufacture or its method of use in the Field.

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Exhibit B

Trademarks

AMNIOEXCEL[®]. Certificate of Registration No. 4,411,167 (registration date: October 1, 2013) (BioD, LLC, owner).

AMNIOMATRIX[®]. Certificate of Registration No. 4,258,411 (registration date: December 11, 2012) (BioD, LLC, owner).

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Exhibit C

NEITHER THESE SECURITIES NOR THE SECURITIES ISSUABLE UPON EXERCISE OF THESE SECURITIES HAVE BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), OR APPLICABLE STATE SECURITIES LAWS. THE SECURITIES MAY NOT BE OFFERED FOR SALE, SOLD, TRANSFERRED OR ASSIGNED (I) IN THE ABSENCE OF (A) AN EFFECTIVE REGISTRATION STATEMENT FOR THE SECURITIES UNDER THE SECURITIES ACT OR (B) AN AVAILABLE EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT AND IN ACCORDANCE WITH APPLICABLE STATE SECURITIES LAWS OR BLUE SKY LAWS AS EVIDENCED BY A LEGAL OPINION OF COUNSEL REASONABLY SATISFACTORY TO THE COMPANY AND ITS TRANSFER AGENT OR (II) UNLESS SOLD PURSUANT TO RULE 144 UNDER SAID ACT.

DERMA SCIENCES, INC.

WARRANT TO PURCHASE COMMON STOCK

Warrant No. S-001
Date: January 14, 2014

Original Issue

Derma Sciences, Inc., a Delaware corporation (the "*Company*"), hereby certifies that, for value received, BioDLogics, LLC or its permitted registered assigns (the "*Holder*"), is entitled to purchase from the Company up to a total of 100,000 shares of common stock, \$0.01 par value per share (the "*Common Stock*"), of the Company (each such share, a "*Warrant Share*" and all such shares, the "*Warrant Shares*") at an exercise price per share equal to \$11.81 per share (as adjusted from time to time as provided in Section 10 herein, the "*Exercise Price*"), at such times set forth in Section 4 hereof, and subject to the following terms and conditions:

This Warrant (this "*Warrant*") has been issued pursuant to that certain license, market development and commercialization agreement, dated January 14, 2014, between the Company and BioDLogics, LLC (the "*License Agreement*").

1. Definitions. In addition to the terms defined elsewhere in this Warrant, capitalized terms that are not otherwise defined herein have the meanings given to such terms in the License Agreement.
2. Registration of Warrants. The Company shall register this Warrant, upon records to be maintained by the Company for that purpose (the "*Warrant Register*"), in the name of the record Holder (which shall include the initial Holder or, as the case may be, any registered assignee to which this Warrant is permissibly assigned hereunder) from time to time. The Company may deem and treat the registered Holder of this Warrant as the absolute owner hereof for the purpose of any exercise hereof or any distribution to the Holder, and for all other purposes, absent actual notice to the contrary.

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3. Registration of Transfers. Subject to compliance with all applicable securities laws, the Company shall register the transfer of all or any portion of this Warrant in the Warrant Register, upon surrender of this Warrant, with the Form of Assignment attached as Schedule 2 hereto duly completed and signed, to the Company's transfer agent or to the Company at its address specified in the License Agreement and (x) delivery, at the request of the Company, of an opinion of counsel reasonably satisfactory to the Company to the effect that the transfer of such portion of this Warrant may be made pursuant to an available exemption from the registration requirements of the Securities Act and all applicable state securities or blue sky laws and (y) delivery by the transferee of a written statement to the Company certifying that the transferee is an "accredited investor" as defined in Rule 501(a) under the Securities Act and making the representations and certifications set forth in Section 5 hereof to the Company at its address specified in the License Agreement. Upon any such registration or transfer, a new warrant to purchase Common Stock in substantially the form of this Warrant (any such new warrant, a "New Warrant") evidencing the portion of this Warrant so transferred shall be issued to the transferee, and a New Warrant evidencing the remaining portion of this Warrant not so transferred, if any, shall be issued to the transferring Holder. The acceptance of the New Warrant by the transferee thereof shall be deemed the acceptance by such transferee of all of the rights and obligations in respect of the New Warrant that the Holder has in respect of this Warrant. The Company shall prepare, issue and deliver at its own expense any New Warrant under this Section

4. Exercise and Duration of Warrant.

(a) This Warrant shall be exercisable by the registered Holder as follows:

(i) as to 25% of the Warrant Shares at any time and from time to time on or after the date hereof and through and including 5:30 p.m. New York City time, on January 14, 2019 (the "Expiration Date");

(ii) as to 25% of the Warrant Shares, upon approval of a Pass Through Code for BioDExcel and through and including 5:30 p.m. New York City time, on the Expiration Date;

(iii) as to 25% of the Warrant Shares, if and only if, on or before the date that is seven months from the Company's First Commercial Sale of Licensed Product, Net Sales by the Company to existing customers of BioDLogics, LLC as of the date of the License Agreement have achieved an annualized run rate (based on the last 31 days of Net Sales multiplied by 12) of \$1.0 million and through and including 5:30 p.m. New York City time, on the Expiration Date; and

(iv) as to 25% of the Warrant Shares, if and only if, on or before the date that is seven months from the Company's First Commercial Sale of Licensed Product, Net Sales by the Company to existing customers of the BioDLogics, LLC as of the date of the License Agreement have achieved an annualized run rate (based on the last 31 days of Net Sales multiplied by 12) of \$2.0 million and through and including 5:30 p.m. New York City time, on the Expiration Date.

At 5:30 p.m., New York City time, on the Expiration Date, the portion of this Warrant not exercised prior thereto shall be and become void and of no value and this Warrant shall be terminated and no longer outstanding.

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(b) The Holder may exercise this Warrant by delivering to the Company (i) an exercise notice, in the form attached as Schedule 1 hereto (the “ *Exercise Notice* ”), completed and duly signed, in the manner set forth in Section 13, and (ii) payment of the Exercise Price for the number of Warrant Shares as to which this Warrant is being exercised, and the date on which the last of such items is delivered to the Company (as determined in accordance with the notice provisions hereof) is an “ *Exercise Date*.” The delivery by (or on behalf of) the Holder of the Exercise Notice and the applicable Exercise Price as provided above shall constitute the Holder’s certification to the Company that its representations contained in Section 5 hereof are true and correct as of the Exercise Date as if remade in their entirety. The Holder shall not be required to deliver the original Warrant in order to effect an exercise hereunder, but if it is not so delivered then such exercise shall constitute an agreement by the Holder to deliver the original Warrant to the Company as soon as practicable thereafter. Execution and delivery of the Exercise Notice shall have the same effect as cancellation of the original Warrant and issuance of a New Warrant evidencing the right to purchase the remaining number of Warrant Shares. The Holder shall be deemed the beneficial owner of the Warrant Shares on the Exercise Date.

5. Representations and Warranties of the Holder. The Holder hereby represents and warrants as of the date hereof as follows:

(a) The Holder understands that this Warrant is and the Warrant Shares (together with this Warrant the “ *Securities* ”) will be “restricted securities” and have not been registered under the Securities Act or any applicable state securities law and is acquiring this Warrant and, upon exercise of this Warrant, will acquire the Warrant Shares issuable upon exercise hereof as principal for its own account and not with a view to, or for distributing or reselling such securities or any part thereof in violation of the Securities Act or any applicable state securities laws; *provided, however*, that by making the representations herein, the Holder does not agree to hold any of the Securities for any minimum period of time and reserves the right, subject to the provisions of this Warrant, at all times to sell or otherwise dispose of all or any part of such Securities pursuant to an effective registration statement under the Securities Act or under an exemption from such registration and in compliance with applicable federal and state securities laws. The Holder is acquiring the Securities hereunder in the ordinary course of its business. The Holder does not presently have any agreement, plan or understanding, directly or indirectly, with any person to distribute or effect any distribution of any of the Securities (or any securities which are derivatives thereof) to or through any person or entity; the Holder is not a registered broker-dealer under Section 15 of the Exchange Act or an entity engaged in a business that would require it to be so registered as a broker-dealer.

(b) At the time the Holder was offered this Warrant, it was, and at the date hereof it is, and on each date on which it exercises this Warrant it will be, an “accredited investor” as defined in Rule 501(a) under the Securities Act.

(c) The Holder is not acquiring the Securities as a result of any advertisement, article, notice or other communication regarding the Securities published in any newspaper, magazine or similar media or broadcast over television or radio or presented at any seminar or any other general advertisement.

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(d) The Holder, either alone or together with its representatives, has such knowledge, sophistication and experience in business and financial matters so as to be capable of evaluating the merits and risks of the prospective investment in the Securities, and has so evaluated the merits and risks of such investment. The Holder is able to bear the economic risk of an investment in the Securities and, at the present time, is able to afford a complete loss of such investment.

(e) The Holder acknowledges that it has been afforded (i) the opportunity to ask such questions as it has deemed necessary of, and to receive answers from, representatives of the Company concerning the terms and conditions of the issuance of the Securities and the merits and risks of investing in the Securities; (ii) access to information about the Company and its subsidiaries and their respective financial condition, results of operations, business, properties, management and prospects sufficient to enable it to evaluate its investment; and (iii) the opportunity to obtain such additional information that the Company possesses or can acquire without unreasonable effort or expense that is necessary to make an informed investment decision with respect to the investment. Holder has sought such accounting, legal and tax advice as it has considered necessary to make an informed decision with respect to its acquisition of the Securities.

(f) The Holder has independently evaluated the merits of its decision to acquire the Securities pursuant to the License Agreement. The Holder has consulted such legal, tax and investment advisors as it, in its sole discretion, has deemed necessary or appropriate in connection with its acquisition of the Securities.

(g) The Holder understands that the Securities being offered and issued to it in reliance on specific exemptions from the registration requirements of United States federal and state securities laws and that the Company is relying in part upon the truth and accuracy of, and the Holder's compliance with, the representations, warranties, agreements, acknowledgements and understandings of the Holder set forth herein in order to determine the availability of such exemptions and the eligibility of the Holder to acquire the Securities.

6. Delivery of Warrant Shares. Upon exercise of this Warrant, the Company shall promptly issue or cause to be issued and cause to be delivered to the Holder (i) a certificate for the Warrant Shares issuable upon such exercise, free of restrictive legends, or (ii) an electronic delivery of the Warrant Shares to the Holder's account at the Depository Trust Company ("*DTC*") or a similar organization, unless in the case of clause (i) and (ii) a registration statement covering the resale of the Warrant Shares and naming the Holder as a selling stockholder thereunder is not then effective or the Warrant Shares are not freely transferable without restriction under Rule 144 by Holders who are not affiliates of the Company, in which case such Holder shall receive a certificate for the Warrant Shares issuable upon such exercise with appropriate restrictive legends. The Holder, or any person permissibly so designated by the Holder to receive Warrant Shares, shall be deemed to have become the holder of record of such Warrant Shares as of the Exercise Date. If the Warrant Shares are to be issued free of all restrictive legends, the Company shall, upon the written request of the Holder, use its reasonable best efforts to deliver, or cause to be delivered, Warrant Shares hereunder electronically through DTC or another established clearing corporation performing similar functions, if available; provided, that, the Company may, but will not be required to, change its transfer agent if its current transfer agent cannot deliver Warrant Shares electronically through such a clearing corporation.

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7. Charges, Taxes and Expenses. Issuance and delivery of certificates for shares of Common Stock upon exercise of this Warrant shall be made without charge to the Holder for any issue or transfer tax, transfer agent fee or other incidental tax or expense in respect of the issuance of such certificates, all of which taxes and expenses shall be paid by the Company; *provided, however*, that the Company shall not be required to pay any tax that may be payable in respect of any transfer involved in the registration of any certificates for Warrant Shares or this Warrant in a name other than that of the Holder or an affiliate thereof. The Holder shall be responsible for all other tax liability that may arise as a result of holding or transferring this Warrant or receiving Warrant Shares upon exercise hereof.

8. Replacement of Warrant. If this Warrant is mutilated, lost, stolen or destroyed, the Company shall issue or cause to be issued in exchange and substitution for and upon cancellation hereof, or in lieu of and substitution for this Warrant, a New Warrant, but only upon receipt of evidence reasonably satisfactory to the Company of such loss, theft or destruction (in such case) and, in each case, a customary and reasonable indemnity and surety bond, if requested by the Company. Applicants for a New Warrant under such circumstances shall also comply with such other reasonable regulations and procedures and pay such other reasonable third-party costs as the Company may prescribe. If a New Warrant is requested as a result of a mutilation of this Warrant, then the Holder shall deliver such mutilated Warrant to the Company as a condition precedent to the Company's obligation to issue the New Warrant.

9. Reservation of Warrant Shares. The Company represents and warrants that on the date hereof, it has duly authorized and reserved, and covenants that it will at all times reserve and keep available out of the aggregate of its authorized but unissued and otherwise unreserved Common Stock, solely for the purpose of enabling it to issue Warrant Shares upon exercise of this Warrant as herein provided, the number of Warrant Shares that are initially issuable and deliverable upon the exercise of this entire Warrant, free from preemptive rights or any other contingent purchase rights of persons other than the Holder (taking into account the adjustments and restrictions of Section 10). The Company covenants that all Warrant Shares so issuable and deliverable shall, upon issuance and the payment of the applicable Exercise Price in accordance with the terms hereof, be duly and validly authorized, issued and fully paid and nonassessable. The Company represents and warrants that the Warrant Shares, when issued and paid for in accordance with the terms of this Warrant, will be issued free and clear of all security interests, claims, liens and other encumbrances other than restrictions imposed by applicable securities laws. The Company will take all such action as may be reasonably necessary to assure that such shares of Common Stock may be issued as provided herein without violation of any applicable law or regulation, or of any requirements of any securities exchange or automated quotation system upon which the Common Stock may be listed.

10. Certain Adjustments. The Exercise Price and number of Warrant Shares issuable upon exercise of this Warrant are subject to adjustment from time to time as set forth in this Section 10.

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(a) **Stock Dividends and Splits.** If the Company, at any time while this Warrant is outstanding, (i) pays a stock dividend on its Common Stock or otherwise makes a distribution on any class of capital stock that is payable in shares of Common Stock, (ii) subdivides its outstanding shares of Common Stock into a larger number of shares, (iii) combines its outstanding shares of Common Stock into a smaller number of shares or (iv) issues by reclassification of shares of Common Stock any shares of capital stock of the Company, then in each such case the Exercise Price shall be adjusted to a price determined by multiplying the Exercise Price in effect immediately prior to the effective date of such event by a fraction, the numerator of which shall be the number of shares of Common Stock outstanding on such effective date immediately before giving effect to such event and the denominator of which shall be the number of shares of Common Stock outstanding immediately after giving effect to such event. Any adjustment made pursuant to clause (i) of this paragraph shall become effective immediately after the record date for the determination of stockholders entitled to receive such dividend or distribution, and any adjustment pursuant to clause (ii), (iii) or (iv) of this paragraph shall become effective immediately after the effective date of such subdivision, combination or reclassification.

(b) **Fundamental Transactions.** If, at any time while this Warrant is outstanding (i) the Company effects (A) a consolidation, merger, exchange of shares, recapitalization, reorganization, business combination or other similar event, (1) following which the holders of Common Stock immediately preceding such consolidation, merger, exchange, recapitalization, reorganization, combination or event either (a) no longer hold a majority of the shares of Common Stock or (b) no longer have the ability to elect a majority of the board of directors of the Company or (2) as a result of which shares of Common Stock shall be changed into (or the shares of Common Stock become entitled to receive) the same or a different number of shares of the same or another class or classes of stock or securities of the Company or another entity (collectively, a “*Change of Control Transaction*”), (ii) the Company effects any sale of all or substantially all of its assets in one or a series of related transactions, or (iii) the liquidation affecting the Company (in any such case, a “*Fundamental Transaction*”), then the Holder shall have the right thereafter to receive, upon exercise of this Warrant, the same amount and kind of securities, cash or property as it would have been entitled to receive upon the occurrence of such Fundamental Transaction if it had been, immediately prior to such Fundamental Transaction, the holder of the number of Warrant Shares then issuable upon exercise in full of this Warrant (the “*Alternate Consideration*”), and the Holder shall no longer have the right to receive Warrant Shares upon exercise of this Warrant. The Company shall not effect any such Fundamental Transaction unless prior to or simultaneously with the consummation thereof, any successor to the Company, surviving entity or the corporation purchasing or otherwise acquiring such assets or other appropriate corporation or person shall assume the obligation to deliver to the Holder, such Alternate Consideration as, in accordance with the foregoing provisions, the Holder may be entitled to receive, and the other obligations under this Warrant.

(c) **Number of Warrant Shares.** Simultaneously with any adjustment to the Exercise Price pursuant to paragraph (a) of this Section 10, the number of Warrant Shares that may be purchased upon exercise of this Warrant shall be increased or decreased proportionately, so that after such adjustment the aggregate Exercise Price payable hereunder for the increased or decreased number of Warrant Shares shall be the same as the aggregate Exercise Price in effect immediately prior to such adjustment.

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(d) Calculations. All calculations under this Section 10 shall be made to the nearest cent or the nearest share, as applicable. The number of shares of Common Stock outstanding at any given time shall not include shares owned or held by or for the account of the Company.

(e) Notice of Corporate Events. If, while this Warrant is outstanding, the Company (i) declares a dividend or any other distribution of cash, securities or other property in respect of its Common Stock, including, without limitation, any granting of rights or warrants to subscribe for or purchase any capital stock of the Company, (ii) authorizes or approves, enters into any agreement contemplating or solicits stockholder approval for any Fundamental Transaction or (iii) authorizes the voluntary dissolution, liquidation or winding up of the affairs of the Company, then, the Company shall deliver to the Holder a notice of such transaction at least ten (10) business days prior to the applicable record or effective date on which a person would need to hold Common Stock in order to participate in or vote with respect to such transaction; *provided, however*, that the failure to deliver such notice or any defect therein shall not affect the validity of the corporate action required to be described in such notice.

11. Payment of Exercise Price. The Holder shall pay the Exercise Price in immediately available funds.

12. No Fractional Shares. No fractional Warrant Shares will be issued in connection with any exercise of this Warrant. In lieu of any fractional shares that would otherwise be issuable, the number of Warrant Shares to be issued shall be rounded down to the next whole number and the Company shall pay the Holder in cash the fair market value (based on the Closing Sale Price) for any such fractional shares. For purposes of this Warrant, “*Closing Sale Price*” means, for any security as of any date, the last closing price for such security on the principal trading market for such security.

13. Notices. Any and all notices or other communications or deliveries hereunder (including, without limitation, any Exercise Notice) shall be in writing and shall be deemed given and effective on the earliest of the business day following the date of mailing, if sent by nationally recognized overnight courier service specifying next business day delivery, or upon actual receipt by the person to whom such notice is required to be given, if by hand delivery. The address for such notices or communications shall be as set forth in the License Agreement unless changed by two business days’ prior notice to the other party in accordance with this Section 13.

14. Warrant Agent. The Company shall serve as warrant agent under this Warrant. Upon 30 days’ notice to the Holder, the Company may appoint a new warrant agent. Any corporation into which the Company or any new warrant agent may be merged or any corporation resulting from any consolidation to which the Company or any new warrant agent shall be a party or any corporation to which the Company or any new warrant agent transfers substantially all of its corporate trust or shareholders services business shall be a successor warrant agent under this Warrant without any further act. Any such successor warrant agent shall promptly cause notice of its succession as warrant agent to be mailed (by first class mail, postage prepaid) to the Holder at the Holder’s last address as shown on the Warrant Register.

*** This material has been omitted pursuant to a request for a confidential treatment and filed separately with the Securities and Exchange Commission.

15. Miscellaneous.

(a) **No Rights as a Stockholder.** The Holder, solely in such person's capacity as a holder of this Warrant, shall not be entitled to vote or receive dividends or be deemed the holder of share capital of the Company for any purpose, nor shall anything contained in this Warrant be construed to confer upon the Holder, solely in such person's capacity as the Holder of this Warrant, any of the rights of a stockholder of the Company or any right to vote, give or withhold consent to any corporate action (whether any reorganization, issue of stock, reclassification of stock, consolidation, merger, amalgamation, conveyance or otherwise), receive notice of meetings, receive dividends or subscription rights, or otherwise, prior to the issuance to the Holder of the Warrant Shares which such person is then entitled to receive upon the due exercise of this Warrant. In addition, nothing contained in this Warrant shall be construed as imposing any liabilities on the Holder to purchase any securities, whether such liabilities are asserted by the Company or by creditors of the Company.

(b) **Successors and Assigns.** Subject to the restrictions on transfer set forth in this Warrant and compliance with applicable securities laws, this Warrant may be assigned by the Holder. This Warrant may not be assigned by the Company without the written consent of the Holder except to a successor in the event of a Fundamental Transaction. This Warrant shall be binding on and inure to the benefit of the Company and the Holder and their respective successors and assigns. Subject to the preceding sentence, nothing in this Warrant shall be construed to give to any person other than the Company and the Holder any legal or equitable right, remedy or cause of action under this Warrant.

(c) **Amendment and Waiver.** Except as otherwise provided herein, the provisions of this Warrant may be amended and the Company may take any action herein prohibited, or omit to perform any act herein required to be performed by it, only if the Company has obtained the written consent of the Holder.

(d) **Governing Law; Jurisdiction.** ALL QUESTIONS CONCERNING THE CONSTRUCTION, VALIDITY, ENFORCEMENT AND INTERPRETATION OF THIS WARRANT SHALL BE GOVERNED BY AND CONSTRUED AND ENFORCED IN ACCORDANCE WITH THE LAWS OF THE STATE OF NEW YORK WITHOUT REGARD TO THE PRINCIPLES OF CONFLICTS OF LAW THEREOF. EACH OF THE COMPANY AND THE HOLDER HEREBY IRREVOCABLY SUBMITS TO THE EXCLUSIVE JURISDICTION OF THE STATE AND FEDERAL COURTS SITTING IN THE CITY OF NEW YORK, BOROUGH OF MANHATTAN, FOR THE ADJUDICATION OF ANY DISPUTE HEREUNDER OR IN CONNECTION HERewith OR WITH ANY TRANSACTION CONTEMPLATED HEREBY OR DISCUSSED HEREIN (INCLUDING WITH RESPECT TO THE ENFORCEMENT OF ANY OF THE TRANSACTION DOCUMENTS), AND HEREBY IRREVOCABLY WAIVES, AND AGREES NOT TO ASSERT IN ANY SUIT, ACTION OR PROCEEDING, ANY CLAIM THAT IT IS NOT PERSONALLY SUBJECT TO THE JURISDICTION OF ANY SUCH COURT. EACH OF THE COMPANY AND THE HOLDER HEREBY IRREVOCABLY WAIVES PERSONAL SERVICE OF PROCESS AND CONSENTS TO PROCESS BEING SERVED IN ANY SUCH SUIT, ACTION OR PROCEEDING BY MAILING A COPY THEREOF VIA REGISTERED OR CERTIFIED MAIL OR OVERNIGHT DELIVERY (WITH EVIDENCE OF DELIVERY) TO SUCH PARTY AT THE ADDRESS IN EFFECT FOR NOTICES TO IT UNDER THE LICENSE AGREEMENT AND AGREES THAT SUCH SERVICE SHALL CONSTITUTE GOOD AND SUFFICIENT SERVICE OF PROCESS AND NOTICE THEREOF. NOTHING CONTAINED HEREIN SHALL BE DEEMED TO LIMIT IN ANY WAY ANY RIGHT TO SERVE PROCESS IN ANY MANNER PERMITTED BY LAW. EACH OF THE COMPANY AND THE HOLDER HEREBY WAIVES ALL RIGHTS TO A TRIAL BY JURY.

*** This material has been omitted pursuant to a request for a confidential treatment and filed separately with the Securities and Exchange Commission.

(e) Headings. The headings herein are for convenience only, do not constitute a part of this Warrant and shall not be deemed to limit or affect any of the provisions hereof.

(f) Severability. In case any one or more of the provisions of this Warrant shall be invalid or unenforceable in any respect, the validity and enforceability of the remaining terms and provisions of this Warrant shall not in any way be affected or impaired thereby, and the Company and the Holder will attempt in good faith to agree upon a valid and enforceable provision which shall be a commercially reasonable substitute therefor, and upon so agreeing, shall incorporate such substitute provision in this Warrant.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK,
SIGNATURE PAGE FOLLOWS]

*** This material has been omitted pursuant to a request for a confidential treatment and filed separately with the Securities and Exchange Commission.

IN WITNESS WHEREOF, the parties have caused this Warrant to be duly executed by an authorized officer as of the date first indicated above.

DERMA SCIENCES, INC.

By: /s/ Edward J. Quilty

Name: Edward J. Quilty

Title: Chairman and Chief Executive Officer

BIODLOGICS, LLC.

By: /s/ Donna Best

Name: Donna Best

Title: General Counsel

*** This material has been omitted pursuant to a request for a confidential treatment and filed separately with the Securities and Exchange Commission.

SCHEDULE 1

DERMA SCIENCES, INC.

FORM OF EXERCISE NOTICE

[To be executed by the Holder to purchase shares of Common Stock under the Warrant]

Ladies and Gentlemen:

- (1) The undersigned is the Holder of Warrant No. _____ (the "Warrant") issued by Derma Sciences, Inc., a Delaware corporation (the "Company"). Capitalized terms used herein and not otherwise defined herein have the respective meanings set forth in the Warrant.
- (2) The undersigned hereby exercises its right to purchase _____ Warrant Shares pursuant to the Warrant.
- (3) The Holder shall pay the sum of \$_____ in immediately available funds to the Company in accordance with the terms of the Warrant.
- (4) Pursuant to this Exercise Notice, the Company shall deliver to the Holder Warrant Shares determined in accordance with the terms of the Warrant.

Dated: _____, _____

Name of Holder: _____

By: _____

Name: _____

Title: _____

(Signature must conform in all respects to name of Holder as specified on the face of the Warrant)

*** This material has been omitted pursuant to a request for a confidential treatment and filed separately with the Securities and Exchange Commission.

SCHEDULE 2

DERMA SCIENCES, INC.

FORM OF ASSIGNMENT

[To be completed and executed by the Holder only upon transfer of the Warrant]

FOR VALUE RECEIVED, the undersigned hereby sells, assigns and transfers unto (the "Transferee") the right represented by the within Warrant to purchase shares of Common Stock of Derma Sciences, Inc., a Delaware corporation (the "Company") to which the within Warrant relates and appoints attorney to transfer said right on the books of the Company with full power of substitution in the premises. In connection therewith, the undersigned represents, warrants, covenants and agrees to and with the Company that:

- (a) the offer and sale of the Warrant contemplated hereby is being made in compliance with Section 4(1) of the United States Securities Act of 1933, as amended (the "Securities Act"), or another valid exemption from the registration requirements of Section 5 of the Securities Act and in compliance with all applicable securities laws of the states of the United States;
- (b) the undersigned has not offered to sell the Warrant by any form of general solicitation or general advertising, including, but not limited to, any advertisement, article, notice or other communication published in any newspaper, magazine or similar media or broadcast over television or radio, and any seminar or meeting whose attendees have been invited by any general solicitation or general advertising;
- (c) the undersigned has read the Transferee's investment letter included herewith, and to its actual knowledge, the statements made therein are true and correct; and
- (d) the undersigned understands that the Company may condition the transfer of the Warrant contemplated hereby upon the delivery to the Company by the undersigned or the Transferee, as the case may be, of a written opinion of counsel (which opinion shall be in form, substance and scope customary for opinions of counsel in comparable transactions) to the effect that such transfer may be made without registration under the Securities Act and under applicable securities laws of the states of the United States.

Dated: _____, ____

(Signature must conform in all respects to name of holder as specified on the face of the Warrant)

Address of Transferee

In the presence of:

*** This material has been omitted pursuant to a request for a confidential treatment and filed separately with the Securities and Exchange Commission.

**Schedule 6.1
License Fees**

Initial License Fee: *.**

*** This material has been omitted pursuant to a request for a confidential treatment and filed separately with the Securities and Exchange Commission.

Schedule 6.2

Milestone Payments

For the absence of doubt, each Milestone Payment is payable only once in respect of the first relevant Milestone achieved.

<u>Milestone Event for Licensed Product</u>	<u>Milestone Payment (in Millions)</u>
Initial License Fee upon execution of Agreement	***
At approval of Pass Through Code	***
	(Specifically, *** for BioDExcel and *** for BioDFactor)
At FDA Clearance of 1st 510K dressing related to the Licensed Products (BIOD cost not to exceed lesser of (i) *** or (ii) ***)	***
At FDA Clearance of each subsequent 510K dressing related to the Licensed Products (for each, BIOD cost not to exceed lesser of (i) *** or (ii) ***)	***
Total Commercialization Milestones	***
Sales milestones - Annual Sales	
Annual Net Sales reach ***	***
Annual Net Sales reach ***	***
Annual Net Sales reach ***	***
Annual Net Sales reach ***	***
Total Sales Milestones	***
Total: License Fees and Commercialization/Sales Milestones	***

*** This material has been omitted pursuant to a request for a confidential treatment and filed separately with the Securities and Exchange Commission.

Schedule 6.3(a)
Royalties

Annual Net Sales of Licensed Products in the Territory	Royalty Rate
For that portion of annual aggregate Net Sales of Licensed Products less than or equal to ***	***
For that portion of annual aggregate Net Sales of Licensed Products greater than ***, but less than ***	***
For that portion of annual aggregate Net Sales of Licensed Products greater than ***, but less than ***	***
For that portion of annual aggregate Net Sales of Licensed Products greater than ***	***

For example, if aggregate annual Net Sales of all Licensed Products in the Territory during any calendar year is ***, then royalties payable by Derma would equal ***, comprised of *** + *** = ***

*** This material has been omitted pursuant to a request for a confidential treatment and filed separately with the Securities and Exchange Commission.

**Schedule 6.4
Annual Minimum Net Sales**

	Pass Through Code Issued by December 31, 2015 For BioDExcel	No Pass Through Code Issued by December 31, 2015 For BioDExcel
YR2	***	***
YR3	***	
YR4	***	
YR5	***	

YR6-YR10: minimums equal to the greater of * or the prior year's Net Sales.**

On December 31, 2015, if a C-code has not been issued, the Parties will negotiate in good faith to establish new sales minimums for the remaining term of the Agreement.

After YR4, if there is a material change in reimbursement, regulatory or market conditions which creates significant downward or upward pressure on the sales minimums, the Parties will negotiate in good faith to revise the sales minimums to properly reflect market conditions. If the parties are unable to agree on new sales minimums, the matter shall be submitted to dispute resolution as provided in Article 12.

*** This material has been omitted pursuant to a request for a confidential treatment and filed separately with the Securities and Exchange Commission.

Schedule 8.2(b)
Pending Suits or Proceedings Against BioD, LLC

Innovative Ophthalmic Products, Inc. and Diopter Technologies, Inc. v. BioD, LLC, filed August 16, 2013, in the United States District Court for the Southern District of California alleging patent infringement of U.S. Patent No. 5,932,205 (“the ‘205 Patent”) entitled “Biochemical Contact Lens for Treating Photoablated Corneal Tissue”. Civil Action No. 13CV1908 BEN NLS.*

*This action does not relate to the Licensed Products, but is the only pending suit in which BioD is named as a defendant.

*** This material has been omitted pursuant to a request for a confidential treatment and filed separately with the Securities and Exchange Commission.

Subsidiaries of Derma Sciences, Inc.

Legal Name	Trade Name	State/Province of Incorporation
Derma First Aid Products, Inc.	Derma First Aid Products, Inc.	Pennsylvania, United States
Derma Sciences Canada Inc.	Derma Sciences Canada Inc.	Ontario, Canada
Sunshine Products, Inc.	Sunshine Products, Inc.	Missouri, United States
Derma Sciences Europe, Ltd.	Derma Sciences Europe, Ltd.	England, United Kingdom
MedEfficiency, Inc.	MedEfficiency, Inc.	Delaware, United States

Consent of Independent Registered Public Accounting Firm

The Board of Directors
Derma Sciences, Inc.:

We consent to the incorporation by reference in the Registration Statements (No. 333-127527 and 333-192848) on Form S-8, in the Registration Statements (No. 333-163127 and No.333-164942) on Form S-1 and Form S-1/MEF, respectively, and in the Registration Statements (Nos. 333-138303, 333-148332, 333-151028, 333-135038, 333-175421, 333-185298, 333-192945, and 333-193530) on Form S-3 or Form S-3/MEF, as applicable, of Derma Sciences, Inc. and subsidiaries of our reports dated March 13, 2014, with respect to the consolidated balance sheets of Derma Sciences, Inc. and subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of comprehensive loss, stockholders' equity and cash flows for each of the years in the two-year period ended December 31, 2013, and the effectiveness of internal control over financial reporting as of December 31, 2013, which reports appear in the December 31, 2013 Annual Report on Form 10-K of Derma Sciences, Inc.

/s/ KPMG LLP

Philadelphia, Pennsylvania
March 13, 2014

**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 annual report on Form 10-K of Derma Sciences, Inc. (the “Registrant”);
2. Based on my knowledge, this annual 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 annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual report;
4. The Registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the Registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the Registrant’s internal control over financial reporting that occurred during the Registrant’s most recent fiscal quarter (the Registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant’s internal control over financial reporting;
5. The Registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant’s auditors and the audit committee of the Registrant’s board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant’s ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant’s internal control over financial reporting.

Dated: March 13, 2014

/s/ Edward J. Quilty

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

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

I, John E. Yetter, certify that:

1. I have reviewed this annual report on Form 10-K of Derma Sciences, Inc. (the “Registrant”);
2. Based on my knowledge, this annual 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 annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual report;
4. The Registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the Registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the Registrant’s internal control over financial reporting that occurred during the Registrant’s most recent fiscal quarter (the Registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant’s internal control over financial reporting;
5. The Registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant’s auditors and the audit committee of the Registrant’s board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant’s ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant’s internal control over financial reporting.

Dated: March 13, 2014

/s/ John E. Yetter

John E. Yetter, CPA
Executive Vice President, Finance and Chief Financial Officer
(Principal Financial Officer)

**Certification of Principal Executive Officer
Pursuant to U.S.C. Section 1350
As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

I, Edward J. Quilty, Chairman, President and Chief Executive Officer of Derma Sciences, Inc., hereby certify that the Annual Report on Form 10-K for the period ended December 31, 2013 of Derma Sciences, Inc. (the "Form 10-K") upon my best knowledge and belief fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in the Form 10-K fairly presents, in all material respects, the financial condition and results of operations of Derma Sciences, Inc.

Dated: March 13, 2014

/s/ Edward J. Quilty

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

**Certification of Principal Financial Officer
Pursuant to U.S.C. Section 1350
As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

I, John E. Yetter, Vice President and Chief Financial Officer of Derma Sciences, Inc., hereby certify that the Annual Report on Form 10-K for the period ended December 31, 2013 of Derma Sciences, Inc. (the "Form 10-K") upon my best knowledge and belief fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in the Form 10-K fairly presents, in all material respects, the financial condition and results of operations of Derma Sciences, Inc.

Dated: March 13, 2014

/s/ John E. Yetter

John E. Yetter, CPA

Executive Vice President, Finance and Chief Financial Officer
(Principal Financial Officer)
