GEOGLOBAL RESOURCES INC.
Form 10-Q/A
June 25, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q/A
Amendment No. 2

(Mark One)

þ Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended June 30, 2007;

or

o 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: 1-32158

GEOGLOBAL RESOURCES INC.

(Exact name of registrant as specified in its charter)

DELAWARE	33-0464753
(State or other jurisdiction of incorporation of organization)	(I.R.S. employer identification no.)

SUITE #310, 605 – 1 STREET SW, CALGARY, ALBERTA, CANADA T2P 3S9

(Address of principal executive offices, zip code)

403/777-9250

(Registrant's Telephone Number, Including Area Code)

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

YES [X] NO [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

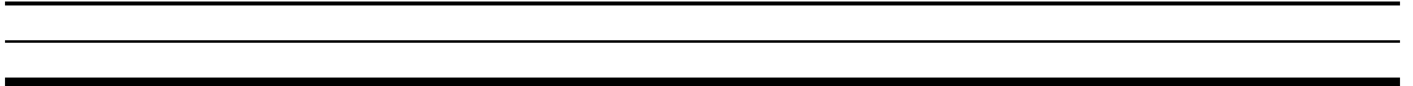
Large accelerated filer Accelerated filer þ Non-accelerated filer

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

YES [ ]   NO [X]

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

Class	Outstanding at August 13, 2007
COMMON STOCK, PAR VALUE $.001 PER SHARE	72,205,755



GEOGLOBAL RESOURCES INC.
(a development stage enterprise)
QUARTERLY REPORT ON FORM 10-Q/A

This Form 10-Q/A Amendment No. 2 is being filed to amend the GeoGlobal Resources Inc. (the "Company") Quarterly Report on Form 10-Q for the six months ended June 30, 2007. The amendment arose out of a need to restate certain financial statements previously filed with the Securities and Exchange Commission in order to correct certain errors relating to the Company's reporting of stock based compensation in compliance with FAS 123R.

This Form 10-Q/A does not reflect events occurring after the filing of the original Form 10-Q or the 10-Q/A Amendment No. 1 or modify or update those disclosures. Information not affected by the amendment is unchanged and reflects the disclosure made at the time of the original filing of the Form 10-Q with the Securities and Exchange Commission on August 14, 2007 or the Form 10-Q/A Amendment No. 1 filed on September 12, 2007. The following items have been amended as a result of the restatement:

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PART I. FINANCIAL INFORMATION
Item 1. CONSOLIDATED FINANCIAL STATEMENTS

GEOGLOBAL RESOURCES INC.
(a development stage enterprise)
CONSOLIDATED BALANCE SHEETS
(Unaudited)

	June 30, 2007 US $	December 31, 2006 US $
	Restated note 6c	Restated note 6c
Assets		
Current		
Cash and cash equivalents	55,355,586	32,362,978
Accounts receivable	198,806	202,821
Cash call receivable	62,547	--
Prepaids and deposits	111,864	31,232
	55,728,803	32,597,031
Restricted cash (note 9a)	3,197,616	3,590,769
Property and equipment (note 3)	633,620	183,427
Oil and gas interests, not subject to depletion (note 4)	14,766,572	12,121,334
	74,326,611	48,492,561
Liabilities		
Current		
Accounts payable	643,729	1,888,103
Accrued liabilities	212,959	33,487
Due to related companies (notes 7c, 7d and 7e)	28,067	33,605
	884,755	1,955,195
Stockholders' Equity (note 5)		
Capital stock		
Authorized		
100,000,000 common shares with a par value of US$0.001 each		
1,000,000 preferred shares with a par value of US$0.01 each		
Issued		
72,205,755 common shares (December 31, 2006 – 66,208,255)	57,614	51,617
Additional paid-in capital	80,315,585	52,900,900
Deficit accumulated during the development stage	(6,931,343)	(6,415,151)
	73,441,856	46,537,366
	74,326,611	48,492,561

See Commitments, Contingencies and Guarantees (note 9)
The accompanying notes are an integral part of these Consolidated Financial Statements

GEOGLOBAL RESOURCES INC.
(a development stage enterprise)
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three months ended June 30,		Six months ended June 30,		Period from Inception, August 21, 2002 to June 30, 2007
	2007 US $	2006 US $	2007 US $	2006 US $	US $
	Restated note 6c	Restated note 6c	Restated note 6c	Restated note 6c	Restated note 6c
Expenses (notes 6b, 7c, 7d and 7e)					
General and administrative	478,711	389,777	951,287	661,981	3,946,929
Consulting fees (recovered)	(22,523)	90,100	68,678	169,017	4,806,455
Professional fees	109,922	65,187	341,494	100,928	1,094,170
Depreciation	12,694	11,310	24,344	20,999	235,654
	578,804	556,374	1,385,803	952,925	10,083,208
Other expenses (income)					
Equipment costs recovered	--	--	--	--	(19,395)
Gain on sale of equipment	--	--	--	--	(42,228)
Foreign exchange (gain) loss	(8,210)	(2,752)	(12,719)	(1,421)	13,828
Interest income	(421,199)	(427,749)	(856,892)	(827,618)	(3,104,070)
	(429,409)	(430,501)	(869,611)	(829,039)	(3,151,865)
Net loss and comprehensive loss for the period	(149,395)	(125,873)	(516,192)	(123,886)	(6,931,343)
Net loss per share – basic and diluted (note 5g)	0.00	0.00	(0.01)	0.00	

The accompanying notes are an integral part of these Consolidated Financial Statements

GEOGLOBAL RESOURCES INC.
(a development stage enterprise)
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three months ended June 30,		Six months ended June 30,		Period from Inception, August 21, 2002 to June 30,
	2007 US $	2006 US $	2007 US $	2006 US $	2007 US $
	Restated note 6c	Restated note 6c	Restated note 6c	Restated note 6c	Restated note 6c
Cash flows provided by (used in) operating activities					
Net loss	(149,395)	(125,873)	(516,192)	(123,886)	(6,931,343)
Adjustment to reconcile net loss to net cash used in operating activities:					
Depreciation	12,694	11,310	24,344	20,999	235,654
Gain on sale of equipment	--	--	--	--	(42,228)
Stock-based compensation (note 6b)	76,290	94,233	338,773	179,328	4,953,426
Changes in operating assets and liabilities:					
Accounts receivable	(39,053)	129,964	4,015	(1,037)	(123,806)
Prepaids and deposits	31,628	--	(80,632)		(111,864)
Accounts payable	(34,459)	(23,951)	89,574	29,160	124,225
Accrued liabilities	(33,487)	14,700	(33,487)	(17,500)	--
Due to related companies	19,171	(37,926)	(5,538)	(119,282)	(13,689)
	(116,611)	62,457	(179,143)	(32,218)	(1,909,625)
Cash flows provided by (used in) investing activities					
Oil and gas interests	(884,355)	(1,753,645)	(2,380,958)	(3,980,626)	(11,337,007)
Property and equipment	(123,793)	(20,726)	(474,537)	(60,983)	(909,846)
Proceeds on sale of equipment	--	--	--	--	82,800
Cash acquired on acquisition	--	--	--	--	3,034,666
Restricted cash (note 9a)	(2,920)	(1,173,462)	393,153	(1,209,836)	(3,197,616)
Changes in investing assets and liabilities:					
Cash call receivable	(62,547)	(15,464)	(62,547)	(33,885)	(62,547)
Accounts payable	170,665	861,438	(1,402,238)	1,155,515	402,206
Accrued liabilities	(24,684)	(595,573)	212,959	522,427	212,959
	(927,634)	(2,697,432)	(3,714,168)	(3,607,388)	(11,774,385)
Cash flows provided by (used in) financing activities					
Proceeds from issuance of common shares and 2007 stock purchase warrants	28,700,475	548,100	28,720,675	2,717,900	74,952,165
Share issuance costs	(1,903,046)	(45,000)	(1,903,046)	(58,552)	(4,068,917)
Changes in financing liabilities:					
Note payable (note 7a)	--	--	--	--	(2,000,000)
Accounts payable	68,290	--	68,290	(10,800)	129,368

Due to related companies	--	--	--	--	26,980
	26,865,719	503,100	26,885,919	2,648,548	69,039,596
Net increase (decrease) in cash and cash equivalents	25,821,474	(2,131,875)	22,992,608	(991,058)	55,355,586
Cash and cash equivalents, beginning of period	29,534,112	37,178,205	32,362,978	36,037,388	--
Cash and cash equivalents, end of period	55,355,586	35,046,330	55,355,586	35,046,330	55,355,586
Cash and cash equivalents					
Current bank accounts	582,336	434,496	582,336	434,496	582,336
Term deposits	54,773,250	34,611,834	54,773,250	34,611,834	54,773,250
	55,355,586	35,046,330	55,355,586	35,046,330	55,355,586

The accompanying notes are an integral part of these Consolidated Financial Statements

GeoGlobal Resources Inc.
(a development stage enterprise)
Notes to the Consolidated Financial Statements
(Unaudited)
June 30, 2007

1. Nature of Operations

The Company is engaged primarily in the pursuit of petroleum and natural gas through exploration and development in India. Since inception, the efforts of GeoGlobal have been devoted to the pursuit of Production Sharing Contracts (“PSC”) with the Gujarat State Petroleum Corporation ("GSPC"), Oil India Limited ("OIL") among others, and the Government of India ("GOI") and the development thereof. To date, the Company has not earned revenue from these operations and is considered to be in the development stage. The recoverability of the costs incurred to date is uncertain and dependent upon achieving commercial production or sale, the ability of the Company to obtain sufficient financing to fulfill its obligations under the PSCs in India and upon future profitable operations and upon finalizing agreements.

On August 29, 2003, all of the issued and outstanding shares of GeoGlobal Resources (India) Inc. ("GeoGlobal India") were acquired by GeoGlobal Resources Inc., formerly Suite101.com, Inc. As a result of the transaction, the former shareholder of GeoGlobal India held approximately 69.3% of the issued and outstanding shares of GeoGlobal Resources Inc. This transaction is considered an acquisition of GeoGlobal Resources Inc. (the accounting subsidiary and legal parent) by GeoGlobal India (the accounting parent and legal subsidiary) and has been accounted for as a purchase of the net assets of GeoGlobal Resources Inc. by GeoGlobal India. Accordingly, this transaction represents a recapitalization of GeoGlobal India, the legal subsidiary, effective August 29, 2003. These consolidated financial statements are issued under the name of GeoGlobal Resources Inc. but are a continuation of the financial statements of the accounting acquirer, GeoGlobal India. The assets and liabilities of GeoGlobal India are included in the consolidated financial statements at their historical carrying amounts. As a result, the stockholders' equity of GeoGlobal Resources Inc. is eliminated and these consolidated financial statements reflect the results of operations of GeoGlobal Resources Inc. only from the date of the acquisition.

GeoGlobal Resources Inc. changed its name from Suite101.com, Inc. after receiving shareholder approval at the Annual Shareholders Meeting held on January 8, 2004. Collectively, GeoGlobal Resources Inc., GeoGlobal India and its other wholly-owned direct and indirect subsidiaries, are referred to as the "Company" or “GeoGlobal”.

2. Significant Accounting Policies

a) Basis of presentation
The accompanying unaudited interim consolidated financial statements have been prepared in accordance with the accounting principles generally accepted in the United States for interim financial information and with Regulation S-X and the instructions to Form 10-Q under the U.S. Securities and Exchange Act of 1934, as amended. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the six months ended June 30, 2007 are not necessarily indicative of the results that may be expected for the year ended December 31, 2007.

These consolidated financial statements include the accounts of (i) GeoGlobal Resources Inc., from the date of acquisition, being August 29, 2003, (ii) GeoGlobal Resources (India) Inc., incorporated under the Business Corporations Act (Alberta), Canada on August 21, 2002 and continued under the Companies Act of Barbados, West

Indies on June 27, 2003, which is a wholly-owned subsidiary of GeoGlobal Resources Inc., (iii) GeoGlobal Resources (Canada) Inc., incorporated under the Business Corporations Act (Alberta), Canada on September 4, 2003, which is a wholly-owned subsidiary of GeoGlobal Resources Inc., (iv) GeoGlobal Resources (Barbados) Inc. incorporated under the Companies Act of Barbados, West Indies on September 24, 2003, which is the wholly-owned subsidiary of GeoGlobal Resources (Canada) Inc., and (v) GeoGlobal Oil & Gas (India) Private Limited, incorporated under the Companies Act, 1956, Maharashtra, India on May 5, 2006.

GeoGlobal Resources Inc.
(a development stage enterprise)
Notes to the Consolidated Financial Statements
(Unaudited)
June 30, 2007

2. Basis of presentation (continued)

b) Stock-based compensation plan
In prior periods, reporting on the impact of stock-based compensation, such as employee stock options, on the Company's net loss and net loss per share was required only on a pro-forma basis.

In December, 2004, the Financial Accounting Standards Board issued a revision to Standard 123, Accounting for Stock-Based Compensation. The Statement of Financial Accounting Standards 123(R), Share-Based Payment ("FAS 123(R)"), requires the recognition of compensation cost for stock-based compensation arrangements with employees, consultants and directors based on their grant date fair value using the Black-Scholes option-pricing model. Compensation expense is recorded over the awards' respective requisite service, with corresponding entries to paid-in capital.

The Company adopted FAS 123(R) using the modified-prospective-transition method on January 1, 2006. The impact of this adoption required the Company to recognize a charge for past stock-based compensation options granted of US$367,596 over the subsequent 3 years in accordance with their respective vesting periods (see note 6).

3. Property and Equipment

	June 30, 2007 US$	December 31, 2006 US$
Computer and office equipment	338,327	324,419
Accumulated depreciation	(193,426)	(169,082)
	144,901	155,337
Office building	488,720	28,090
	633,621	183,427

4. Oil and Gas Interests

	June 30, 2007 US$ Restated note 6c	December 31, 2006 US$ Restated note 6c
Exploration – India		
Exploration costs incurred in:		
2002	21,925	21,925
2003	178,829	178,829
2004	506,269	506,269
2005	3,250,700	3,250,700
2006	8,163,611	8,163,611

	12,121,334	12,121,334
2007	2,645,238	--
	14,766,572	12,121,334

a) Exploration costs – India

The exploration costs incurred to date are not subject to depletion and cover six exploration blocks, known as the KG Offshore Block, the Mehsana Block, the Sanand/Miroli Block, the Ankleshwar Block, the DS 03 Block and the Tarapur Block. It is anticipated that all or certain of these exploration costs may be subject to depletion commencing in the year 2007.

GeoGlobal Resources Inc.
(a development stage enterprise)
Notes to the Consolidated Financial Statements
(Unaudited)
June 30, 2007

4. Oil and Gas Interests (continued)

b) Capitalized overhead costs

Included in the US$2,645,238 of exploration cost additions during the six months ended June 30, 2007 (year ended December 31, 2006 – US$8,163,611) are certain overhead costs capitalized by the Company in the amount of US$1,461,235 (year ended December 31, 2006 – US$2,791,520) directly related to the exploration activities in India. The capitalized overhead amount includes capitalized stock-based compensation of US$264,280 (year ended December 31, 2006 - US$1,424,225) (see note 6b) of which US$114,100 (year ended December 31, 2006 – US$323,283) was for the account of a related party (see note 7c). Further, the capitalized overhead amount includes US$946,955 (year ended December 31, 2006 - US$1,000,705) which was paid to third parties. The balance of US$250,000 was paid to and on behalf of a related party (year ended December 31, 2006 – US$366,590) (see note 7c). These costs related to the exploration activities in India are incurred solely by and on behalf of the Company in providing its services under the Carried Interest Agreement ("CIA") and are therefore not reimbursable under the CIA (see note 4c).

c) Carried Interest Agreement

On August 27, 2002, GeoGlobal entered into a CIA with GSPC, which grants the Company a 10% Carried Interest ("CI") (net 5% - see note 4d) in the KG Offshore Block. The CIA provides that GSPC is responsible for GeoGlobal's entire share of any and all costs incurred during the Exploration Phase prior to the date of initial commercial production.

Under the terms of the CIA, all of GeoGlobal's and Roy Group (Mauritius) Inc.'s ("RGM"), a related party (see note 7b) proportionate share of capital costs for exploration and development activities will be recovered by GSPC without interest over the projected production life or ten years, whichever is less, from oil and natural gas produced on the Exploration Block. GeoGlobal is not entitled to any share of production until GSPC has recovered the Company's share of the costs and expenses that were paid by GSPC on behalf of the Company and RGM.

As at June 30, 2007, GSPC has incurred costs of Rs 177.06 crore (approximately US$40.7 million) (December 31, 2006 – Rs 114.96 crore (approximately US$26.1 million)) attributable to GeoGlobal under the CIA of which 50% is for the account of RGM.

GeoGlobal has been advised by GSPC, that GSPC is seeking payment of the amount by which the exploration costs attributable to GeoGlobal under the PSC relating to the KG Offshore Block exceeds the amount that GSPC deems it is obligated to pay on behalf of GeoGlobal (including the net 5% participating interest of RGM) under the terms of the CIA. GSPC asserts that the Company is required to pay 10% of the exploration expenses over and above US$59.23 million. GSPC asserts that the amount payable is US$44.68 million including interest of US$4.43 million as of June 30, 2007. GeoGlobal disputes this assertion of GSPC. See note 9d.

GeoGlobal Resources Inc.
(a development stage enterprise)
Notes to the Consolidated Financial Statements
(Unaudited)
June 30, 2007

4. Oil and Gas Interests (continued)

d) Participating Interest Agreement

On March 27, 2003, GeoGlobal entered into a Participating Interest Agreement (“PIA”) with RGM, whereby GeoGlobal assigned and holds in trust for RGM subject to GOI consent, 50% of the benefits and obligations of the PSC covering the Exploration Block KG-OSN-2001/3 ("KG Offshore Block") and the CIA leaving GeoGlobal with a net 5% participating interest in the KG Offshore Block and a net 5% carried interest in the CIA. Under the terms of the PIA, until the GOI consent is obtained, GeoGlobal retains the exclusive right to deal with the other parties to the KG Offshore Block and the CIA and is entitled to make all decisions regarding the interest assigned to RGM, RGM has agreed to be bound by and be responsible for the actions taken by, obligations undertaken and costs incurred by GeoGlobal in regard to RGM's interest and to be liable to GeoGlobal for its share of all costs, interests, liabilities and obligations arising out of or relating to the RGM interest. RGM has agreed to indemnify GeoGlobal against any and all costs, expenses, losses, damages or liabilities incurred by reason of RGM's failure to pay the same. Subject to obtaining the government consent to the assignment, RGM is entitled to all income, receipts, credits, reimbursements, monies receivable, rebates and other benefits in respect of its 5% interest which relate to the KG Offshore Block. GeoGlobal has a right of set-off against sums owing to GeoGlobal by RGM. In the event that the Indian government consent is delayed or denied, resulting in either RGM or GeoGlobal being denied an economic benefit it would have realized under the PIA, the parties agreed to amend the PIA or take other reasonable steps to assure that an equitable result is achieved consistent with the parties' intentions contained in the PIA. As a consequence of this transaction the Company reports its holdings under the KG Offshore Block and CIA as a net 5% participating interest ("PI").

GeoGlobal Resources Inc.
(a development stage enterprise)
Notes to the Consolidated Financial Statements
(Unaudited)
June 30, 2007

5. Capital Stock

a) Common shares

	Number of shares	Capital stock US $	Additional paid-in capital US $
			Restated note 6c
Balance at December 31, 2002	1,000	64	--
2003 Transactions			
Capital stock of GeoGlobal at August 29, 2003	14,656,687	14,657	10,914,545
Common shares issued by GeoGlobal to acquire GeoGlobal India	34,000,000	34,000	1,072,960
Share issuance costs on acquisition	--	--	(66,850)
Elimination of GeoGlobal capital stock in recognition of reverse takeover	(1,000)	(14,657)	(10,914,545)
Options exercised for cash	396,668	397	101,253
December 2003 private placement financing (note 5d)	6,000,000	6,000	5,994,000
Share issuance costs on private placement	--	--	(483,325)
Stock-based compensation	--	--	62,913
	55,052,355	40,397	6,680,951
Balance as at December 31, 2003	55,053,355	40,461	6,680,951
2004 Transactions			
Options exercised for cash	115,000	115	154,785
Broker Warrants exercised for cash (note 5d)	39,100	39	58,611
Stock-based compensation	--	--	350,255
	154,100	154	563,651
Balance as at December 31, 2004	55,207,455	40,615	7,244,602
2005 Transactions			
Options exercised for cash	739,000	739	1,004,647
2003 Stock Purchase Warrants exercised for cash	2,214,500	2,214	5,534,036
Broker Warrants exercised for cash (note 5d)	540,900	541	810,809
September 2005 private placement financing (note 5c)	4,252,400	4,252	27,636,348
Share issuance costs on private placement (note 5c)	--	--	(1,541,686)
Stock-based compensation	--	--	4,354,256
	7,746,800	7,746	37,798,410
Balance as at December 31, 2005	62,954,255	48,361	45,043,012
2006 Transactions			

Options exercised for cash (note 5f(i))	2,284,000	2,285	2,706,895
Options exercised for notes receivable	184,500	185	249,525
2003 Stock Purchase Warrants exercised for cash (note 5e(i))	785,500	786	1,962,964
Share issuance costs	--	--	(74,010)
Stock-based compensation (note 6b)	--	--	3,012,514
	3,254,000	3,256	7,857,888
Balance as at December 31, 2006	66,208,255	51,617	52,900,900
2007 Transactions			
Options exercised for cash (note 5f(i))	317,500	317	320,358
June 2007 private placement financing (note 5b)	5,680,000	5,680	28,394,320
Compensation options	--	--	705,456
Share issuance costs on private placement (note 5b)	--	--	(2,608,502)
Stock-based compensation (note 6b)	--	--	603,053
	5,997,500	5,997	27,414,685
Balance as at June 30, 2007	72,205,755	57,614	80,315,585

GeoGlobal Resources Inc.
(a development stage enterprise)
Notes to the Consolidated Financial Statements
(Unaudited)
June 30, 2007

5. Capital Stock (continued)

b) June 2007 Financing
During June 2007, GeoGlobal completed the sale of 5,680,000 Units of its securities at US$5.00 per Unit for aggregate gross cash proceeds of US$28,400,000.

Each Unit is comprised of one common share and one half of one warrant. One full warrant ("2007 Stock Purchase Warrant") entitles the holder to purchase one additional common share for US$7.50, for a term of two years expiring June 20, 2009. The 2007 Stock Purchase Warrants are subject to accelerated expiration in the event that the price of the Company's common shares on the American Stock Exchange is US$12.00 or more for 20 consecutive trading days, the resale of the shares included in the Units and issuable on exercise of the 2007 Stock Purchase Warrants has been registered under the US Securities Act of 1933, as amended (the "Act"), and the hold period for Canadian subscribers has expired. In such events, the warrant term will be reduced to 30 days from the date of issuance of a news release announcing such accelerated expiration of the warrant term. At August 13, 2007 since not all such events have occurred, the accelerated expiration of the warrant term was not triggered.

The proceeds from the issuance of the Units have been allocated between the common shares and the 2007 Stock Purchase Warrants based on their fair value. The fair value of the common share was determined based on the market price of the stock the day the financing closed. The fair value of the 2007 Stock Purchase Warrant was based on a Black-Scholes option model and the following weighted average assumptions as at the date of grant as follows:

Risk-free interest rate	4.97%
Expected life	2.0 years
Contractual life	2.0 years
Expected volatility	69%
Expected dividend yield	Nil%

The resulting allocation of the fair value to the common shares and the 2007 Stock Purchase Warrants (included as additional paid-in capital) was $24,992,000 and $3,408,000 respectively.

Costs of US$1,903,046 were incurred in issuing shares in these transactions which included a fee of US$1,704,000 paid to the placement agents with respect to the sale of the 5,680,000 Units, and, in addition, compensation options ("2007 Compensation Options") were issued to the placement agents entitling them to purchase an aggregate of 340,800 common shares at an exercise price of US$5.00 per share until June 20, 2009. The 2007 Compensation Options are also subject to accelerated expiration on the same terms and conditions as the warrants issued in the transaction.

The Company assigned a fair value of $705,456 to the 2007 Compensation Options based on a Black-Scholes option model and the following weighted average assumptions as at the date of grant as follows:

Risk-free interest rate	4.97%
Expected life	2.0 years
Contractual life	2.0 years
Expected volatility	69%
Expected dividend yield	nil%

The total issuance costs of $2,608,502 associated with the private placement financing were allocated to the common shares and the 2007 Stock Purchase Warrants on the same basis utilized for the allocation of the private placement financing proceeds as follows:

	Common Shares	2007 Stock Purchase Warrants
	US$	US$
Proceeds from private placement financing	24,992,000	3,408,000
Issuance costs from private placement financing	(2,295,482)	(313,020)
Balance June 30, 2007	22,696,518	3,094,980

GeoGlobal Resources Inc.
(a development stage enterprise)
Notes to the Consolidated Financial Statements
(Unaudited)
June 30, 2007

5. Capital Stock (continued)

Also, pursuant to the terms of the transaction, GeoGlobal entered into a Registration Rights Agreement with the placement agents whereby the Company agreed to prepare and file at its expense with the SEC as promptly as practicable and in any event prior to 5:00 pm eastern time on August 17, 2007 a registration statement under the US Securities Act of 1933, as amended, for an offering on a continuous shelf basis of the shares of Common Stock included in the Units and issuable on exercise of the Purchase Warrants included in the Units. Such registration statement is also to include the shares of Common Stock issuable to the placement agents on exercise of the compensation options. In the event GeoGlobal fails to file the registration statement with the U.S. Securities and Exchange Commission prior to 5:00 pm eastern time on August 17, 2007, each purchaser of the Units, including the placement agents on exercise of their compensation options, will receive for nominal consideration, an additional 0.10 of one Unit on the same terms, except that the placement agents will receive the right to purchase an additional 0.10 of one share only.

c) September 2005 Financing
During September 2005, GeoGlobal completed the sale of 3,252,400 Units of its securities at US$6.50 per Unit, together with a concurrent sale of an additional 1,000,000 Units on the same terms, for aggregate gross cash proceeds of US$27,640,600.

Each Unit is comprised of one common share and one half of one warrant. One full warrant ("2005 Stock Purchase Warrant") entitles the holder to purchase one additional common share for US$9.00, for a term of two years expiring September 2007. The 2005 Stock Purchase Warrants are subject to accelerated expiration in the event that the price of the Company's common shares on the American Stock Exchange is US$12.00 or more for 20 consecutive trading days, the resale of the shares included in the Units and issuable on exercise of the 2005 Stock Purchase Warrants has been registered under the US Securities Act of 1933, as amended (the “Act”), and the hold period for Canadian subscribers has expired. In such events, the warrant term will be reduced to 30 days from the date of issuance of a news release announcing such accelerated expiration of the warrant term. At August 13, 2007 since not all such events have occurred, the accelerated expiration of the warrant term was not triggered.

Costs of US$1,541,686 were incurred in issuing shares in these transactions which included a fee of US$1,268,436 paid to Jones Gable & Company Limited with respect to the sale of the 3,252,400 Units, and, in addition, compensation options ("2005 Compensation Options") were issued to Jones Gable & Company Limited entitling it to purchase an additional 195,144 Units at an exercise price of US$6.50 per Unit through their expiration in September 2007. The 2005 Compensation Options are also subject to accelerated expiration on the same terms and conditions as the warrants issued in the transaction.

d) December 2003 Financing
On December 23, 2003, GeoGlobal completed a brokered private placement of 5,800,000 units at US$1.00 each, together with a concurrent private placement of an additional 200,000 units on the same terms, for aggregate gross cash total proceeds of US$6,000,000.

Each unit is comprised of one common share and one half of one warrant. One full warrant ("2003 Stock Purchase Warrant"), entitles the holder to purchase one additional common share for US$2.50, for a term of two years from date

of closing. The 2003 Stock Purchase Warrants are subject to accelerated expiration 30 days after issuance of a news release to that effect in the event that the common shares trade at US$4.00 or more for 20 consecutive trading days and if the resale of the shares has been registered under the 1933 Act and the hold period for Canadian subscribers has expired. Also issued as additional consideration for this transaction were 580,000 Broker Warrants.

The 580,000 Broker Warrants described above entitled the holder to purchase 580,000 common shares at an exercise price of US$1.50 per share which were fully exercised before they expired on December 23, 2005 for gross proceeds of US$870,000.

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5. Capital Stock (continued)

e) Warrants and Compensation Options

i) 2003 Stock Purchase Warrants

During the three months ended March 31, 2006, all remaining Purchase Warrants issued in December 2003 were exercised which resulted in the issuance of 785,500 common shares for gross proceeds of US$1,963,750. As at June 30, 2007, none of such Purchase Warrants remain to be exercised.

ii) 2005 Stock Purchase Warrants

During the six months ended June 30, 2007, none of the 2005 Stock Purchase Warrants were exercised, therefore all of the 2005 Stock Purchase Warrants remained outstanding, which if exercised, would result in the issuance of 2,126,200 common shares for gross proceeds of US$19,135,800.

iii) Compensation Option Warrants

During the six months ended June 30, 2007, none of the 97,572 2005 Compensation Option Warrants have been issued as a result of the 2005 Compensation Options not being exercised. If the 2005 Compensation Options are exercised and the 2005 Compensation Option Warrants issued, such Warrants if exercised, would result in the issuance of 97,572 common shares for gross proceeds of US$878,148.

iv) 2007 Stock Purchase Warrants

As at June 30, 2007, none of the 2,840,000 2007 Stock Purchase Warrants were exercised .. If fully exercised, the 2007 Stock Purchase Warrants would result in the issuance of 2,840,000 common shares for gross proceeds of US$21,300,000.

f) Options

i) Stock Options

During the three and six months ended June 30, 2007, 20,000 and 297,500 options respectively (December 31, 2006 – 2,468,500) were exercised under GeoGlobal's 1998 Stock Incentive Plan at a price of US$1.01 for gross proceeds of US$20,200 and US$300,475 respectively (December 31, 2006 - US$2,709,180).

ii) 2007 Compensation Options

As at June 30, 2007, none of the 340,800 2007 Compensation Options were exercised. If fully exercised, the 2007 Compensation Options would result in the issuance of 340,800 common shares for gross proceeds of US$1,704,000.

g) Weighted-average number of shares

For purposes of the determination of net loss per share, the basic and diluted weighted-average number of shares outstanding for the three and six months ended June 30, 2007 was 61,835,426 and 62,526,778 respectively (three and six months ended June 30, 2006 – 59,147,997 and 58,841,639 respectively). The numbers for the three and six months ended June 30, 2007 and the three and six months ended June 30, 2006 exclude the 5,000,000 shares currently held in escrow.

6. Stock Options

a) The Company's 1998 Stock Incentive Plan

Under the terms of the 1998 Stock Incentive Plan (the "Plan"), as amended, 12,000,000 common shares have been reserved for issuance on exercise of options granted under the Plan. As at June 30, 2007, the Company had 3,305,697 (December 31, 2006 – 3,650,697) common shares remaining for the grant of options under the Plan. The Board of Directors of the Company may amend or modify the Plan at any time, subject to any required stockholder approval. The Plan will terminate on the earliest of: (i) 10 years after the Plan Effective Date, being December 2008; (ii) the date on which all shares available for issuance under the Plan have been issued as fully-vested shares; or, (iii) the termination of all outstanding options in connection with certain changes in control or ownership of the Company.

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6. Stock Options (continued)

b) Stock-based compensation

The Company adopted FAS 123(R), using the modified-prospective-transition method on January 1, 2006. Under this method, the Company is required to recognize compensation cost for stock-based compensation arrangements with employees and directors based on their grant date fair value using the Black-Scholes option-pricing model, such cost to be expensed over the compensations' respective vesting periods. For awards with graded vesting, in which portions of the award vest in different periods, the Company recognizes compensation costs on a straight-line basis over the vesting periods for each separate vested tranche.

The following table summarizes stock-based compensation for employees and non-employee consultants:

	Three months ended June 30,		Six months ended June 30,		Period from Inception, Aug 21, 2002 to June 30,
	2007	2006	2007	2006	2007
	US $	US $	US $	US $	US $
	Restated note 6c	Restated note 6c	Restated note 6c	Restated note 6c	Restated note 6c
Stock based compensation					
Consolidated Statements of Operations					
General and administrative	234,383	94,233	503,049	179,328	1,551,526
Consulting fees	(158,093)	--	(164,276)	--	3,401,900
	76,290	94,233	338,773	179,328	4,953,426
Consolidated Balance Sheets					
Oil and gas interests					
Exploration costs - India	117,076	(44,664)	264,280	504,825	3,429,565
	193,366	49,569	603,053	684,153	8,382,991

i) At January 1, 2006, the impact of the adoption of FAS123(R) required the Company to recognize a charge for past stock-based compensation options granted of US$367,596 over the next 3 years in accordance with their respective vesting periods. For the three and six months ended June 30, 2007, June 30, 2006 and the period of inception from August 21, 2002 to June 30, 2007, US$14,073, US$85,095, US$28,146, US$170,190 and US$239,274, respectively of this charge was recognized in the Consolidated Statements of Operations as general and administrative expense resulting in an increase in the net loss and comprehensive loss for each of the periods in the same amount with no additional impact on the net loss per share – basic and diluted for the periods. For the six months ended June 30, 2007 and June 30, 2006, US$nil and US$67,425 of this charge was recognized in the Consolidated Balance Sheets as Oil and gas interests, not subject to depletion.

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6. Stock Options (continued)

Prior to the adoption of FAS 123(R), the Company used the intrinsic value method of accounting for employee and director stock-based compensation. As all options have been granted at exercise prices based on the market value of the Company's common shares at the date of grant, no compensation cost was recognized under the intrinsic value based method of accounting. For the period from inception August 21, 2002 to December 31, 2005, had employee compensation expense been determined based on the fair value at the grant date consistent with FAS123(R) pro-forma net loss and pro-forma net loss per share would have been as follows:

	Period from Inception, Aug 21, 2002 to Dec 31, 2005 US$
	Restated note 6c
Pro-forma basis	
Stock-based compensation	
Oil and gas interests	438,309
General and administrative	679,882
Oil and gas interests	
As reported	3,957,723
Pro-forma	4,396,032
Net loss	
As reported	(4,866,348)
Pro-forma	(5,546,230)

c) Restatement

The periods ended June 30, 2007, 2006, the period from inception August 21, 2002 to June 30, 2007 and the year ended December 31, 2006 have been restated due to an error in the classification and calculation for stock-based compensation for non-employee consultants.

The following is a summary of the effects of this restatement on the Company's Consolidated Balance Sheets at June 30, 2007 and December 31, 2006 and the Consolidated Statements of Operations for the three and six months ended June 30, 2007 and 2006 and for the period from inception of August 21, 2002 to June 30, 2007.

	As Reported	Adjustment		As Restated
	June 30, 2007 US$	June 30, 2007 US$	Period of Inception to Dec 31, 2006	June 30, 2007 US$

			US$	
Balance Sheets				
Oil and gas interests	12,580,737	(212,761)	2,398,596	14,766,572
Additional paid-in capital	75,036,707	(544,197)	5,823,073	80,315,583
Deficit accumulated	(3,838,302)	331,436	(3,424,477)	(6,931,343)
Stockholders' equity	71,256,019	(212,761)	2,398,596	73,441,854

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6. Stock Options (continued)

	As Reported		Adjustment		As Restated	
	3 months ended June 30, 2007 US$	Period of Inception to June 30, 2007 US$	3 months ended June 30, 2007 US$	Period of Inception to June 30, 2007 US$	3 months ended June 30, 2007 US$	Period of Inception to June 30, 2007 US$
Statements of Operations						
General & administrative	393,135	3,290,851	85,576	656,078	478,711	3,946,929
Consulting fees	304,726	2,435,517	(327,249)	2,436,963	(22,523)	4,872,480
Net loss and comprehensive loss	(391,068)	(3,838,302)	241,673	(3,093,041)	(149,395)	(6,931,343)
Net loss per share - basic and diluted	(0.01)		0.01		0.00	

	6 months ended June 30, 2007 US$	Period of Inception to June 30, 2007 US$	6 months ended June 30, 2007 US$	Period of Inception to June 30, 2007 US$	6 months ended June 30, 2007 US$	Period of Inception to June 30, 2007 US$
Statements of Operations						
General & administrative	780,135	3,290,851	171,152	656,078	951,287	3,946,929
Consulting fees	571,266	2,435,517	(502,588)	2,436,963	68,678	4,872,480
Net loss and comprehensive loss	(847,628)	(3,838,302)	331,436	(3,093,041)	(516,192)	(6,931,343)
Net loss per share - basic and diluted	(0.01)		0.00		(0.01)	

	3 months ended June 30, 2006 US$	Period of Inception to June 30, 2006 US$	3 months ended June 30, 2006 US$	Period of Inception to June 30, 2006 US$	3 months ended June 30, 2006 US$	Period of Inception to June 30, 2006 US$
Statements of Operations						
General & Administrative	295,544	1,587,369	94,233	179,328	389,777	1,766,697
Consulting fees	90,100	842,349	--	3,026,364	90,100	3,868,713
Stock-based compensation	94,233	213,041	(94,233)	(213,041)	--	--
Net loss and comprehensive loss	(125,873)	(1,997,583)	--	(2,992,651)	(125,873)	(4,990,234)
Net loss per share	0.00		0.00		0.00	

- basic and diluted

	6 months ended June 30, 2006 US$	Period of Inception to June 30, 2006 US$	6 months ended June 30, 2006 US$	Period of Inception to June 30, 2006 US$	6 months ended June 30, 2006 US$	Period of Inception to June 30, 2006 US$
Statements of Operations						
General & administrative	482,653	1,587,369	179,328	179,328	661,981	1,766,697
Consulting fees	169,017	842,349	--	3,026,364	169,017	3,868,713
Stock-based compensation	213,041	213,041	(213,041)	(213,041)	--	--
Net loss and comprehensive loss	(157,599)	(1,997,583)	33,713	(2,992,651)	(123,886)	(4,990,234)
Net loss per share - basic and diluted	0.00		0.00		0.00	

The restatement had no impact on the Consolidated Statements of Cash Flows for the three and six months ended June 30, 2007 and 2006 and for the period of inception of August 21, 2002 to June 30, 2007 and 2006, therefore, no changes have been reflected.

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6. Stock Options (continued)

d) Black-Scholes Assumptions

During the periods ended June 30, 2007 and 2006, 230,000 and 200,000 options were granted to the Company's directors and employees under the terms of the 1998 Stock Incentive Plan. The fair value of each option granted was estimated on the date of grant using the Black-Scholes option-pricing model. Weighted average assumptions used in the valuation are disclosed in the following table:

	Three months ended June 30, 2007	Three months ended June 30, 2006	Six months ended June 30, 2007	Six months ended June 30, 2006
	Restated note 6c	Restated note 6c	Restated note 6c	Restated note 6c
Fair value of stock options granted	$ US2.02	$ US2.06	$ US2.02	$ US2.06
Risk-free interest rate	4.9%	4.2%	4.9%	4.2%
Volatility	69%	70%	69%	70%
Expected life	2.0 years	1.0 years	2.0 years	1.0
Dividend yield	0%	0%	0%	0%

During the periods ended June 30, 2007 and 2006, options of 150,000 and nil, respectively, were granted to non-employee consultants in exchange for services under the terms of the 1998 Stock Incentive Plan. The Company believes that the estimated fair value of the stock options more readily measurable that the fair value of services rendered. The fair value of each option granted to non-employee consultants is calculated at each reporting date using the Black-Scholes option-pricing model. Weighted average assumptions used in the valuation are disclosed in the following table:

	Three months ended June 30, 2007	Three months ended June 30, 2006	Six months ended June 30, 2007	Six months ended June 30, 2006
	Restated note 6c	Restated note 6c	Restated note 6c	Restated note 6c
Fair value of stock options granted	$ US1.58	$ US3.89	$ US1.58	$ US3.89
Risk-free interest rate	4.9%	4.8%	4.9%	4.8%
Volatility	56%	60%	56%	60%
Expected life	1.0 years	0.2 years	1.0 years	0.2 years
Dividend yield	0%	0%	0%	0%

i) The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant.
ii) Expected volatilities are based on, historical volatility of the Company's stock, and other factors.
iii) The expected life of options granted represents the period of time that the options are expected to be outstanding and is derived from historical exercise behavior and current trends.

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6. Stock Options (continued)

e) Stock option table

During the six months ended June 30, 2007, the options as set out below were granted for services provided to the Company:

Grant date mm/dd/yy	Option exercise price US $	Fair Value at Original Grant Date US$	Expiry date mm/dd/yy	Vesting date mm/dd/yy	Balance Dec 31/06 #	Granted during the period #	Cancelled (c) Expired (x) Exercised (e) during the period iv) #	Balance Jun 30/07 iii) #	Balance Exercisable Jun 30/07 #
12/09/03	1.18	0.24	08/31/06	Vested	--	--	--	--	--
12/30/03	1.50	0.32	08/31/06	Vested	--	--	--	--	--
01/17/05	1.01	0.38	i) 06/30/07	Vested	352,500	--	317,500 (e) 35,000 (x)	--	--
01/18/05	1.10	0.62	08/31/08	Vested	600,000	--	--	600,000	600,000
01/25/05	1.17	0.43	08/31/06	Vested	--	--	--	--	--
06/14/05	3.49	1.55	06/14/15	Vested	150,000	--	--	150,000	150,000
08/24/05	6.50	2.38	08/24/08	Vested	110,000	--	--	110,000	110,000
10/03/05	6.81	3.07	10/03/15	Vested	16,666	--	-	16,666	16,666
10/03/05	6.81	3.83	10/03/15	10/03/07	16,667	--	--	16,667	--
10/03/05	6.81	4.38	10/03/15	10/03/08	16,667	--	--	16,667	--
06/14/06	5.09	2.06	06/14/16	Vested	200,000	--	--	200,000	20,000
07/25/06	3.95	1.14	12/31/09	Vested	100,000	--	--	100,000	100,000
07/25/06	3.95	1.39	12/31/09	07/25/07	660,000	--	--	660,000	--
07/25/06	3.95	1.60	12/31/09	12/31/07	50,000	--	--	50,000	--
07/25/06	3.95	1.78	12/31/09	07/25/08	145,000	--	--	145,000	--
07/25/06	3.95	2.01	12/31/09	07/25/09	70,000	--	--	70,000	--
07/25/06	3.95	1.14	07/25/16	Vested	500,000	--	--	500,000	500,000
07/25/06	3.95	1.14	07/25/16	07/25/07	500,000	--	--	500,000	--
11/24/06	7.52	2.47	11/24/09	Vested	10,000	--	--	10,000	10,000
11/24/06	7.52	2.92	11/24/09	12/31/07	10,000	--	--	10,000	--
11/24/06	7.52	3.70	11/24/09	12/31/08	10,000	--	--	10,000	--
03/30/07	6.11	2.02	ii) 03/30/10	12/31/07	--	50,000	--	50,000	--
03/30/07	6.11	2.69	ii) 03/30/10	12/31/08	--	50,000	--	50,000	--
03/30/07	6.11	2.82	ii) 03/30/10	03/30/09	--	50,000	--	50,000	--
05/16/07	5.09	1.51		12/31/07	--	10,000	--	10,000	--

			ii) 05/16/10						
05/16/07	5.09	2.09	ii) 05/16/10	12/31/08	--	10,000	--	10,000	--
05/16/07	5.09	2.09	ii) 05/16/10	05/31/09	--	10,000	--	10,000	--
06/20/07	5.06	2.08	ii) 06/20/17	06/20/08	--	200,000	--	200,000	--
					3,517,500	380,000	352,500	3,545,000	1,506,666

i) On August 30, 2006, the Board of Directors of the Company passed a resolution with respect to the remaining stock options issued on January 17, 2005 to (a) extend the expiry date of all then outstanding options from August 31, 2006 to the earlier of June 30, 2007 or 60 days following the date of a "Commercial Discovery" as defined under the terms of the PSC on Block KG-OSN-2001/3 and (b) to extend the vesting date of certain of these options to the earlier of the date of a "Commercial Discovery" as defined under the terms of the PSC on Block KG-OSN-2001/3 or May 31, 2007, as long as drilling operations are continuing on the KG Offshore Block. This resolution resulted in an added incremental stock-based compensation cost of $11,440 with respect to the seven employees. At June 30, 2007, none of these options remain to be exercised.

ii) During the six months ended June 30, 2007, the Company granted options to purchase 380,000 shares exercisable at various prices between $5.06 and $6.11 and expire on dates between March 30, 2010 and June 20, 2017, which vest in their entirety on vesting dates between December 31, 2007 and May 31, 2009.

iii) As at June 30, 2007, there were 3,545,000 options outstanding at various prices which, if exercised, would result in gross proceeds of US$13,562,550.

iv) During the three and six months ended June 30, 2007, there were 297,500 and 317,500 options exercised respectively, at $1.01 per share for gross proceeds of US$300,475 and US$320,675 respectively. On June 30, 2007, 35,000 options expired.

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7. Related Party Transactions

Related party transactions are measured at the exchange amount which is the amount of consideration established and agreed by the related parties.

a) Note payable
On August 29, 2003, as part of an Acquisition, a US$2,000,000 promissory note was issued to the sole shareholder of GeoGlobal India. On each of August 29, 2003, October 15, 2003, January 15, 2004 and June 30, 2004, US$500,000 of the note was repaid. The promissory note was non-interest bearing and the capital stock of GeoGlobal India collateralized the repayment of the note. The collateral has been released.

b) Roy Group (Mauritius) Inc.
Roy Group (Mauritius) Inc. is related to the Company by common management and is controlled by a director of the Company who is also a principal shareholder of the Company. On March 27, 2003, the Company entered into a Participating Interest Agreement (see note 4d) with the related party.

c) Roy Group (Barbados) Inc. ("Roy Group")
Roy Group is related to the Company by common management and is controlled by an officer and director of the Company who is also a principal shareholder of the Company. On August 29, 2003, the Company entered into a Technical Services Agreement ("TSA") with Roy Group to provide services to the Company as assigned by the Company and to bring new oil and gas opportunities to the Company. On January 31, 2006, the terms of the agreement were amended to extend the term of the agreement from August 31, 2006 to December 31, 2007. Roy Group receives consideration of US$350,000 per year, as outlined and recorded below:

	Three months ended June 30,		Six months ended June 30,		Period from Inception, Aug 21, 2002 to June 30,
	2007 US $	2006 US $	2007 US $	2006 US $	2007 US $
Consolidated Statements of Operations					
Consulting fees	17,500	17,500	35,000	35,000	233,667
Consolidated Balance Sheets					
Oil and gas interests					
Exploration costs – India (note 4b)	70,000	70,000	140,000	140,000	934,666
	87,500	87,500	175,000	175,000	1,168,333

During the three and six months ended June 30, 2007, the Company recognized compensation cost for stock-based compensation arrangements with the principal of Roy Group as outlined and recorded below:

Consolidated Statement of Operations					
Consulting fees	14,262	--	28,525	--	109,346
Consolidated Balance Sheets					
Oil & gas interests					
Exploration costs – India (note 4b)	57,050	--	114,100	--	437,383
	71,312	--	142,625	--	546,729

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7. Related Party Transactions (continued)

Roy Group was also reimbursed during the three and six months ended June 30, 2007 on a cost recovery basis, for medical insurance and expenses; travel, hotel, meals and entertainment expenses; computer costs; and amounts billed by third parties incurred during the periods as outlined and recorded below:

	Three months ended June 30,		Six months ended June 30,		Period from Inception, Aug 21, 2002 to June 30,
	2007 US $	2006 US $	2007 US $	2006 US $	2007 US $
Consolidated Statements of Operations					
General and administrative	--	41,072	--	75,172	153,539
Consolidated Balance Sheets					
Accounts receivable	--	227	--	227	21,597
Oil and gas interests					
Exploration costs – India (note 4b)	--	20,355	75,000	56,093	459,387
Property and equipment	--	1,330	--	1,330	37,595
	--	62,984	75,000	132,822	672,118

At June 30, 2007 the Company owed Roy Group (Barbados) Inc. US$23,625 (December 31, 2006 - US$29,976) for services provided and expenses incurred on behalf of the Company and pursuant to the TSA. These amounts bear no interest and have no set terms of repayment.

d) D.I. Investments Ltd. ("DI")

DI is related to the Company by common management and is controlled by an officer and director of the Company. DI charged consulting fees up to December 31, 2006 for management, financial and accounting services rendered, as outlined and recorded below:

	Three months ended June 30,		Six months ended June 30,		
	2007 US $	2006 US $	2007 US $	2006 US $	Period from Inception, Aug 21, 2002

					to June 30, 2007 US $
Consolidated Statements of Operations					
Consulting fees	--	46,250	--	92,500	516,715

During the three and six months ended June 30, 2007, the Company recognized compensation cost for stock-based compensation arrangements with the principal of the related party as outlined and recorded below:

Consolidated Statement of Operations					
Consulting fees	--	--	--	--	404,104

DI was also reimbursed on a cost recovery basis, for office costs, including rent, parking, office supplies and telephone as well as travel, hotel, meals and entertainment expenses incurred during the periods as outlined and recorded below:

Consolidated Statements of Operations					
General and administrative					
Office costs	98	6,323	1,223	19,504	180,293
Travel, hotel, meals and entertainment	--	915	--	1,007	48,686
Consolidated Balance Sheets					
Accounts receivable	6	3,309	73	7,439	27,462
Property and equipment	--	--	--	--	4,107
	104	10,547	1,296	27,950	260,548

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7. Related Party Transactions (continued)

At June 30, 2007, the Company owed DI US$nil (December 31, 2006 –US$nil) as a result of services provided and expenses incurred on behalf of the Company. These amounts bear no interest and have no set terms of repayment.

Subsequent to December 31, 2006, the services of the officer and director are provided to GeoGlobal pursuant to an oral arrangement for an annual consulting fee of US$185,000.

e) Amicus Services Inc. ("Amicus")
Amicus is related to the Company by virtue of being controlled by the brother of an officer and director of the Company. Amicus charged consulting fees for IT and computer related services rendered, as outlined below:

	Three months ended June 30,		Six months ended June 30,		Period from Inception, Aug 21, 2002 to June 30,
	2007 US $	2006 US $	2007 US $	2006 US $	2007 US $
Consolidated Statements of Operations					
Consulting fees	12,742	20,001	26,292	38,882	163,408

Amicus was also reimbursed on a cost recovery basis, for office costs, including parking, office supplies and telephone as well as travel and hotel expenses incurred during the periods as outlined and recorded below:

Consolidated Statements of Operations					
General and administrative	(3,392)	789	2,841	789	7,309
Consolidated Balance Sheets					
Accounts receivable	912	1,451	1,654	2,143	11,928
Property and equipment	--	--		--	1,599
	(2,480)	2,240	4,495	2,932	20,836

At June 30, 2007, the Company owed Amicus Services Inc. US$4,442 (December 31, 2006 – US$3,629) as a result of services provided and expenses incurred on behalf of the Company. These amounts bear no interest and have no set terms of repayment.

8. Segmented Information

The Company's petroleum and natural gas exploration activities are conducted in India. Management of the Company considers the operations of the Company as one operating segment. The following information relates to the Company's geographic areas of operation.

	June 30, 2007 US$	December 31, 2006 US$
Oil and gas interests		
India	14,766,572	12,121,334

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9. Commitments, Contingencies and Guarantees

a) Restricted cash

i) The PSCs contain provisions whereby the joint venture participants must provide the GOI a bank guarantee in the amount of 35% of the participant's share of the minimum work program for a particular phase, to be undertaken annually during the budget period April 1 to March 31. These bank guarantees have been provided to the GOI and serve as guarantees for the performance of such minimum work program and are in the form of irrevocable letters of credit which are secured by term deposits of the Company in the same amount.

The term deposits securing these bank guarantees are as follows:

	June 30, 2007	December 31, 2006
	US $	US $
Exploration Block		
Mehsana	155,000	711,445
Sanand/Miroli	910,000	905,000
Ankleshwar	950,000	600,000
Tarapur	940,000	1,200,000
DS 03	175,000	110,000
	3,130,000	3,526,445

ii) The Company has provided to its bankers as security for credit cards issued to employees for business purposes two term deposits, one in the amount of US$30,000 and the other in the amount of US$37,616 (Cdn$40,000).

b) Production Sharing Contracts

The Company is required to expend funds on the exploration activities to fulfill the terms of the minimum work commitment based on our participating interest for Phase I pursuant to the PSCs in respect of each of our exploration blocks as follows:

i) Mehsana - Acquire, process and interpret 75 square kilometers of 3D seismic and drill 7 exploratory wells between 1,000 and 2,200 meters.

ii) Sanand/Miroli - Acquire, process and interpret 200 square kilometers of 3D seismic and drill 12 exploratory wells between 1,500 and 3,000 meters.

iii) Ankleshwar - Acquire, process and interpret 448 square kilometers of 3D seismic and drill 14 exploratory wells between 1,500 and 2,500 meters.

iv) DS 03 Block - Gravity and geochemical surveys and a 12,000 line kilometer aero magnetic survey.

v) DS 04 Block - Gravity and magnetic and geochemical surveys; acquire, process and interpret 325 LKM of 2-D seismic; and drill 10 core holes to a depth of approximately 500 meters.

vi) Tarapur Block - The third and final phase of exploratory activities on the Tarapur Block had a term of 2 years expiring November 22, 2007 with a work commitment to drill one well to a depth of 3,000 meters or to the Deccan trap. This requirement has been completed and all areas not encompassing a commercial discovery after November 22, 2007 will be relinquished back to the GOI. Oil and Natural Gas Corporation Limited of India has the right to participate into the development of any commercial discovery on the Tarapur Block by acquiring a 30% participating interest as provided under the PSC. The exercise of this right would result in the reduction of our PI to 14%.

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9. Commitments, Contingencies and Guarantees (continued)

vii) NELP-VI Blocks
On March 2, 2007, the Company along with its joint venture partners executed PSCs with the GOI covering four new exploration blocks awarded under the sixth round of the New Exploration Licensing Policy (NELP-VI).

The Company is also required to fund its participating interest for Phase I exploration and development costs incurred in fulfilling the minimum work commitments under these PSCs as outlined below. The Company's share of these costs is estimated to total approximately US$28.3 million for all four blocks over the four years of Phase I. The Production Exploration Licences ("PELs") have not yet been issued on three of these four new blocks, therefore, the Phase I work commitment has not commenced.

1) KG Onshore Block - Reprocess 564 LKM of 2-D seismic; conduct a gravity and magnetic and geochemical survey; acquire, process and interpret 548 sq kms of 3-D seismic; and drill 12 exploratory wells between 2,000 and 5,000 meters.
2) RJ Block 20 - Reprocess 463 LKM of 2-D seismic; conduct a gravity and magnetic and geochemical survey; acquire, process and interpret 250 LKM of 2-D seismic and 700 sq kms of 3-D seismic; and drill a total of 12 exploratory wells between 2,000 and 2,500 meters.
3) RJ Block 21 - Reprocess 463 LKM of 2-D seismic; conduct a gravity and magnetic and geochemical survey; acquire, process and interpret 310 LKM of 2-D seismic and 611 sq kms of 3-D seismic; and drill a total of 8 exploratory wells between 2,000 and 2,500 meters.

Under the terms of all the PSCs, the Company is also required to keep in force a financial and performance guarantee, whereby the Company unconditionally and irrevocably guarantees to the GOI to fulfill or cause to be fulfilled all of its obligations under the PSCs.

c) KG Offshore Block
Our PSCs relating to the exploration blocks in India provide that by the end of the first phase of the exploration phases the contracting parties shall have drilled a certain number of wells. The first phase of the exploration period relating to the PSC for the KG Offshore Block expired without the required minimum of at least fourteen exploration wells being drilled during the first phase. GSPC is the operator on the KG Offshore Block.

On July 4, 2007, the Directorate General of Hydrocarbons (“DGH”), a body under the Ministry of Petroleum & Natural Gas, advised GSPC that, because of the worldwide supply and availability shortage of offshore drilling rigs, on June 20, 2007 the Government of India had issued new policy guidelines for the merger of exploration phases of PSCs granted under NELP III and NELP IV and for the substitution of additional meterage drilled in deeper wells against the total meterage commitment as part of the minimum work program in the PSCs.

On July 12, 2007, GSPC, on behalf of the contracting parties for the KG Offshore Block, notified DGH that it was exercising the option granted under the new policies to request a merger of Phases I and II of the KG Offshore Block work program called the New Phase I with the effect of establishing a new work program phase expiring March 11, 2008 and to merge the minimum work program (“MWP”) of Phase II and Phase III into a new phase to be called New Phase II. In addition, GSPC exercised the option to substitute a total meterage drilled commitment in the new work

program phase that would be irrespective of the number of wells drilled. Under these new policies, any contractors who exercise this option would be required to relinquish 50% of the contract area at the end of the New Phase I. Approval of the merger of the Phase I and II into a New Phase I and the merger of the minimum work program of existing Phase II and Phase III as New Phase II from the GOI is currently outstanding.

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9. Commitments, Contingencies and Guarantees (continued)

On July 13, 2007, the Operating Committee under the KG Offshore Block PSC had approved GSPC's recommendation of exercising the option under the policy guidelines The MWP for the New Phase I would be to drill 33,102 meters. GSPC informed DGH, that as at July 16, 2007 a total of 31,225 meters have been drilled, requiring the drilling of an additional 1,877 meters before March 11, 2008 in order to complete the MWP for the New Phase I. At the end of the New Phase I on March 11, 2008, the contracting parties will be required to relinquish 50% of the Contract Area of the KG Offshore Block that is not a Discovery or Development Area as defined in the PSC. The New Phase II would have a term of 1.5 years expiring September 11, 2009 and the drilling of a further 12,250 meters would be required in order to meet the minimum work program.

As at August 13, 2007, seven exploratory wells have been drilled on the exploration block for a total of 31,225 total vertical meters drilled, leaving 1,877 meters to be drilled to complete the New Phase I commitment and 12,250 meters to be drilled to complete the Phase II commitment. An eighth exploratory well, the KG#28 was drilled to 5,258 meters on the exploration block, however the KG#28 well has been classified as an appraisal well as defined under the PSC by the management committee.

Unless approval is granted by the GOI to merge Phases I and II of the work program under the new policy guidelines, we may be liable for the consequences of non-fulfillment of the minimum work commitment in a given time frame under the PSC. The PSC has provisions for termination of the PSC on account of various reasons specified therein including material breach of the contract. Termination rights can be exercised after giving ninety days written notice. This failure to timely complete the minimum work commitment, though we have been advised by GSPC there is no precedent, may be deemed by the GOI to be a failure to comply with the provisions of the contract in a material particular.

The termination of the PSC by the GOI would result in our loss of our interest in the KG Offshore Block other than areas determined to encompass "commercial discoveries". The PSC sets forth procedures whereby the operator can obtain the review of the management committee under the PSC as to whether a discovery on the exploration block should be declared a commercial discovery under the PSC. Those procedures have not been completed at present with respect to the discovery on the KG Offshore Block and, accordingly, as of August 13, 2007, no areas on the KG Offshore Block have been determined formally to encompass "commercial discoveries" as that term is defined under the PSC.

In the event the PSC for the KG Offshore Block is terminated by the GOI, or in the event the work program is not fulfilled by the end of the relevant exploration phase, the PSC provides that each party to the PSC is to pay to the GOI its participating interest share of an amount which is equal to the amount that would be required to complete the minimum work program for that phase. We are of the view that GSPC, under the terms of our CIA, would be liable for our participating interest share of the amount required to complete the minimum work program for the phase

Certain exploration costs related to the KG Offshore Block are incurred solely by and on behalf of the Company in providing its services under the CIA and are therefore not reimbursable under the CIA. As such, these costs have been capitalized in the Company's accounts under Oil and gas interests and at June 30, 2007, amount to US$4,785,672 (December 31, 2006 - US$3,111,676).

d) Carried Interest Agreement Dispute

the Company has been advised by GSPC, that GSPC is seeking payment of the amount by which the exploration costs attributable to the Company under the PSC relating to the KG Offshore Block exceeds the amount that GSPC deems it is obligated to pay on behalf of the Company (including the net 5% participating interest of RGM) under the terms of the CIA. GSPC asserts that the Company is required to pay 10% of the exploration expenses over and above US$59.23 million. GSPC asserts that this amount payable is US$44.68 million including interest of US$ 4.43 million as of June 30, 2007.

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9. Commitments, Contingencies and Guarantees (continued)

The Company has advised GSPC that, under the terms of the CIA, the PSC, and the Joint Operating Agreement dated August 7, 2003 (the "JOA"), GSPC has no right to seek the payment and that it believes the payment GSPC is seeking is in breach of the CIA. The Company further reminded GSPC, that the Company under the terms of the CIA, shall be carried by GSPC for 100% of all of its share of any costs during the exploration phase prior to the start of commercial production. The Company obtained the opinion of external Indian legal counsel which supports management's position with respect to the dispute.

The Company intends to vigorously protect its contractual rights in accordance with the dispute resolution process under the CIA, the PSC and the JOA as may be appropriate.

Should GSPC be successful in asserting some or all of its claim, the resulting expenditures would be recorded in the Company's Balance Sheet as an increase to oil and gas interests.

e) Corporate Head Office

Our corporate head office is located at Suite #310, 605 – 1 Street SW, Calgary, Alberta, T2P 3S9 Canada. These premises are leased for a term of two years ending April 30, 2009 at an annual rental of approximately US$80,000 for base rent and operating costs. These premises include approximately 3,088 square feet which we consider adequate for our present activities.

10. Comparative figures

a) As the Company is in its development stage, these figures represent the accumulated amounts of the continuing entity for the period from inception August 21, 2002 to June 30, 2007.

b) Certain comparative figures have been restated and reclassified to conform to the presentation adopted in the current period. The restatement is due to an error in the classification of stock-based compensation in the first quarter of 2006. The impact of this restatement was a decrease in the net loss and comprehensive loss for the three month period ending March 31, 2006 of US$ 33,713 and a corresponding increase in the net loss and comprehensive loss for the three month period ending June 30, 2006. This restatement resulted in increasing the net loss and comprehensive loss for the three month period ending June 30, 2006 from US$125,873 to US$159,586.

11. Recent Accounting Standards

a) Fair Value Measurements

In September 2006, the FASB issued FAS No. 157, "Fair Value Measurements" ("FAS 157"), which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. FAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, and is applicable beginning in the first quarter of 2008. The Company is currently evaluating the impact that FAS 157 will have on its consolidated financial statements.

b) The Fair Value Option for Financial Assets and Financial Liabilities

In February 2007, the FASB issued FAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115”, (“FAS 159”) which permits entities to choose to measure many financial instruments and certain other items at fair value at specified election dates. A business entity is required to report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. This statement is expected to expand the use of fair value measurement. FAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, and is applicable beginning in the first quarter of 2008. The Company is currently evaluating the impact that FAS 159 will have on its consolidated financial statements.

Item 2.MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

Our Business Activities

We are engaged, through subsidiaries and joint ventures in which we are a participant, in the exploration for and development of oil and gas reserves. We initiated these activities in 2003. Through June 30, 2007, our activities have been undertaken in locations where we and our joint venture participants have been granted exploration rights pursuant to Production Sharing Contract's ("PSCs") entered into with the Government of India ("GOI").

At August 13, 2007, we have not reported any proved reserves of oil or natural gas. We have entered into ten PSCs as set out below. Each PSC relates to a separate drilling block onshore or offshore India and each provides for multi-year and multi-phase exploration and drilling activities. Exploration and development activities pursuant to the terms of these agreements are expected to continue throughout 2007.

The PSCs we have entered into with respect to ten exploration blocks are as follows:

- The first of our agreements, entered into in February 2003 under NELP-III, grants exploration rights in an area offshore eastern India in the Krishna Godavari Basin in the State of Andhra Pradesh. We refer to this KG-OSN-2001/3 exploration block as the "KG Offshore Block" and we have a net 5% carried interest ("CI") under this agreement.

- We entered into two agreements which grant exploration rights in areas onshore in the Cambay Basin in the State of Gujarat in western India. These agreements were entered into in February 2004 under NELP-IV and we have a 10% participating interest ("PI") under each of these agreements. We refer to the CB-ONN-2002/2 exploration block as the "Mehsana Block" and the CB-ONN-2002/3 exploration block as the "Sanand/Miroli Block."

- Pursuant to an agreement entered into in April 2005, we purchased from Gujarat State Petroleum Corporation Limited ("GSPC"), a 20% PI in the agreement granting exploration rights granted under NELP-III to an onshore exploration block in the Cambay Basin in the State of Gujarat in western India. We refer to this CB-ON/2 exploration block as the "Tarapur Block".

- In September 2005, we entered into agreements with respect to two areas under NELP-V. One area is located onshore in the Cambay Basin located in the State of Gujarat south-east of our three existing Cambay blocks, for which we hold a 10% PI. We refer to this CB-ONN-2003/2 exploration block as the "Ankleshwar Block". The second area is located onshore in the Deccan Syneclise Basin located in the northern portion of the State of Maharashtra in west-central India for which we hold a 100% PI interest and are the operator. We refer to this DS-ONN-2003/1 exploration block as the "DS 03 Block".

- In March 2007, we signed agreements with respect to four additional locations awarded under NELP-VI. One location is onshore in the Krishna Godavari Basin in the State of Andhra Pradesh adjacent to our KG Offshore Block in eastern India in which we hold a 10% PI. We currently refer to this KG-ONN-2004/1 exploration block as the "KG Onshore Block". The second and third locations include two agreements onshore in north-west India in the Rajasthan Basin in the State of Rajasthan and we hold a 25% PI in each of the agreements. We currently refer to the RJ-ONN-2004/2 exploration block as the "RJ Block 20" and the RJ-ONN-2004/3 exploration block as the "RJ Block 21". The fourth location is onshore in the Deccan Syneclise Basin in the State of Maharashtra adjacent to our DS 03 Block in west-central India for which we hold a 100% PI and are the operator. We currently refer to this DS-ONN-2004/1 exploration block as the "DS 04 Block".

All of our exploration activities should be considered highly speculative.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with, and is qualified in its entirety by, the more detailed information including our Consolidated Financial Statements and the related Notes appearing elsewhere in this Quarterly Report. This Quarterly Report contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from the results and business plans discussed in the forward-looking statements. Factors that may cause or contribute to such differences include those discussed in "Risk Factors," as well as those discussed elsewhere in this Quarterly Report. For further information, refer to the consolidated financial statements and footnotes and management's discussion and analysis thereto included in the Company's annual report on Form 10-KSB and as amended by Form 10-KSB/A for the year ended December 31, 2006.

Restatement

The three and six months ended June 30, 2007, 2006, the period from inception August 21, 2002 to June 30, 2007, and the year ended December 31, 2006 have been restated due to an error in the classification and calculation for stock-based compensation for non-employee consultants.

A COMPARISON OF OUR OPERATING RESULTS FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2007 TO JUNE 30, 2006

Statements of Operations

Three months ended June 30, 2007 and 2006

During the three months ended June 30, 2007, we had expenses of $578,804 compared with expenses of $556,374 during the three months ended June 30, 2006. This increase is primarily the result of our continuing increase in the scale of our participation in oil and gas exploration activities as further outlined in the following.

Our general and administrative expenses increased to $478,711 for the three months ended June 30, 2007 from $389,777 for the three months ended June 30, 2006. These general and administrative expenses include costs related to the corporate head office including administrative salaries and services, rent and office costs, insurance and directors' fees as well our shareholder relations costs which include the American Stock Exchange listing and filing fees and transfer agent fees and services. Also included in our general and administrative expenses are our compensation costs for stock-based compensation arrangements with employees and directors which are being expensed over their respective vesting period. These stock-based compensation costs increased to $234,383 for the three months ended June 30, 2007 versus $94,233 for the same period in 2006. The balance of the increase is a result of an increase in our personnel which is consistent with our increase in the scale of our participation in oil and gas exploration activities.

Our consulting fees decreased to a recovery of $22,523 during the three months ended June 30, 2007 from $90,100 for the three month period ended June 30, 2006. Of this decrease, $158,093 is attributable to a recovery of compensation costs for stock-based compensation with consultants for the three months ended June 30, 2007 versus $nil in the same period of 2006. This decrease is offset by a small increase as a result of the costs of a consultant to model and document our internal controls as required by Section 404 of the Sarbanes Oxley Act which were not incurred in the same period in 2006. These consulting fees include $17,500 (2006 - $17,500) paid under our Technical Services Agreement with a corporation wholly-owned by Mr. Roy and other fees and expenses we incurred in employing various technical and corporate consultants who advised us on a variety of matters.

Professional fees increased to $109,922 during the three months ended June 30, 2007 from $65,187 during the three months ended June 30, 2006. Professional fees include those paid to our auditors for pre-approved audit, accounting and tax services and fees paid to our legal advisors primarily for services provided with regard to filing various periodic reports and other documents and reviewing our various oil and gas and other agreements. The increase is

mostly attributable to an increase in our fees paid to our auditors for additional work incurred in providing our audit services during the three month period ending June 30, 2007 as compared to 2006.

Our other expenses and income during the three months ended June 30, 2007 resulted in income of $429,409 versus $430,501 for the same period in 2006. Interest income remained consistent being $421,199 for the three months ended June 30, 2007 as compared to $427,749 for the three months ended June 30, 2006. This consistency is directly related to the increase in US prime interest rate as compared to 2006 offset by a decrease in our cash balances used in our oil and gas exploration activities. Included in other expenses and income is a foreign exchange gain of $12,719 as compared to a gain for the same period in 2006 of $1,421.

Reflecting the increase in expenses for our general and administrative expenses and professional fees due to the increase in our overall oil and gas exploration activities offset by a recovery of our stock-based compensation expense for non-employee consultants, our net loss increased to $149,395 for the three months ended June 30, 2007 as compared to a net loss of $125,873 for the same period in 2006.

Six months ended June 30, 2007 and 2006
During the six months ended June 30, 2007, we had expenses of $1,385,803 compared with expenses of $952,925 during the six months ended June 30, 2006. This increase is primarily the result of our continuing increase in the scale of our participation in oil and gas exploration activities as further outlined in the following.

Our general and administrative expenses increased to $951,287 from $661,981. These general and administrative expenses include costs related to the corporate head office including administrative salaries and services, rent and office costs, insurance and directors' fees as well our shareholder relations costs which include the American Stock Exchange listing and filing fees and transfer agent fees and services. The increase is primarily the result of an increase of $323,721 in our compensation cost for stock-based compensation arrangements with employees and directors which are being expensed over their respective vesting period. These stock-based compensation costs increased to $503,049 for the six months ended June 30, 2007 as compared to $179,328, for the same period in 2006.

Our consulting fees decreased to $68,678 during the six months ended June 30, 2007 from $169,017 for the same six month period ended June 30, 2006. Of this decrease, $164,276 is attributable to compensation costs for stock-based compensation arrangements with consultants for the six month period ending June 30, 2007 versus $nil for the same period of 2006. This decrease is offset by an increase which is a result of the costs of a consultant to model and document our internal controls as required by Section 404 of the Sarbanes Oxley Act which were not incurred in the same period in 2006. These consulting fees include $35,000 (2006 - $35,000) paid under our Technical Services Agreement with a corporation wholly-owned by Mr. Roy and other fees and expenses we incurred in employing various technical and corporate consultants who advised us on a variety of matters.

Professional fees increased to $341,494 during the six months ended June 30, 2007 from $100,928 during the six months ended June 30, 2006. Professional fees include those paid to our auditors for pre-approved audit, accounting and tax services and fees paid to our legal advisors primarily for services provided with regard to filing various periodic reports and other documents and reviewing our various oil and gas and other agreements. The increase is mostly attributable to an increase in our fees paid to our auditors for additional work incurred in providing our audit services during the six month period ending June 30, 2007 as compared to the same period in 2006.

Our other expenses and income during the six months ended June 30, 2007 resulted in a loss of $869,611 versus $829,039 for the same period in 2006. Interest income remained consistent being $856,892 for the six months ended June 30, 2007 as compared to $827,618 for the six months ended June 30, 2006. This consistency is directly related to the increase in US prime interest rate as compared to 2006 offset by a decrease in our cash balances used in our oil and gas exploration activities. Included in other expenses and income is a foreign exchange gain of $12,719 as compared to a gain for the same period in 2006 of $1,421.

Reflecting the increase in expenses for our general and administrative expenses and professional fees due to the increase in our overall oil and gas exploration activities offset by a recovery of stock-based compensation expense related to non-employee consultants, our net loss increased to $516,192 as compared to a net loss of $123,886 for the same period in 2006.

Liquidity and Capital Resources

At June 30, 2007, our cash and cash equivalents were $55,355,586. Of these funds, $54,773,250 are currently held in term deposits earning interest based on the US prime rate.

Three months ended June 30, 2007 and 2006

The increase in our cash and cash equivalents of $25,821,474 from $32,362,978 at December 31, 2006 is primarily the result of funds provided by financing activities offset by those used in operating and investing activities as follows:

Our net cash used in operating activities during the three months ended June 30, 2007 was $116,611 as compared to provided by operating activities of $62,457 for the three months ended June 30, 2006. This increase is mostly as a result of an increase in expenses which include our consulting and professional fees which is consistent with our increased costs related to our increased oil and gas exploration activities.

Cash used by investing activities during the three months ended June 30, 2007 was $927,634 as compared to $2,697,432 during the three months ended June 30, 2006. Of this decrease, $1,170,542 is directly related to the issuance of bank guarantees in the second quarter of 2006 to the GOI for 35% of our share of the minimum work program for a particular phase, that are to be undertaken during the twelve months, April 1, 2006 to March 31, 2007. These bank guarantees have been provided to the GOI and serve as guarantees for the performance of such minimum work program and are in the form of irrevocable letters of credit which are secured by term deposits of the Company in the same amount. Further these bank guarantees remained basically equivalent in the current quarter as to that of the prior year. The remainder of the decrease again reflects additional expenditures in the second quarter of 2006 versus 2007 with the acquisition of the Tarapur block in 2006.

Cash provided by financing activities for the three months ended June 30, 2007 was $26,865,719 as compared to $503,100 during the three months ended June 30, 2006. During the three months ended June 30, 2007, we completed the sale of 5,680,000 Units of our securities at $5.00 per Unit for aggregate cash gross proceeds of $28,400,000 less share issuance costs of $1,903,046. Further, during the three months ended June 30, 2007, cash of $300,475 was provided from the issuance of 297,500 shares of common stock on the exercise of options. Comparatively, during the three months ended June 30, 2006, cash of $548,100 was provided from the issuance of 415,000 shares of common stock on the exercise of options, net of share issuance costs of $45,000. The balance of the increase is a result of an increase in the accounts payable from financing activities of $68,290 for the second quarter of 2007 compared to $nil for the same period in the prior year..

Six months ended June 30, 2007 and 2006

The increase in our cash and cash equivalents of $22,992,608 from $32,362,978 at December 31, 2006 is primarily the result of funds provided by financing activities net of funds used in operating and investing activities as follows:

Our net cash used in operating activities during the six months ended June 30, 2007 was $179,143 as compared to $32,218 for the six months ended June 30, 2006. This increase is mostly as a result of an increase in expenses which include our general and administrative expenses, as well as our consulting and professional fees which is consistent with our increased costs related to our increased oil and gas exploration activities.

Cash used by investing activities during the six months ended June 30, 2007 was $3,714,168 as compared to $3,607,388 during the six months ended June 30, 2006. This increase is a result of additional expenditures in reducing our accounts payable.

Offsetting the increased investing activity in the first six months ended June 30, 2007 was a reduction in the amount of our bank guarantees of $393,153 versus an increase in such instruments of $1,209,836 in the first six months of 2006. These bank guarantees have been provided to the GOI and serve as guarantees for the performance of minimum work programs and are in the form of irrevocable letters of credit which are secured by term deposits of the Company in the same amount. Further these bank guarantees remained basically equivalent at June 30, 2007 as they were at June 30, 2006. The remainder of the offset reflects additional expenditures in the second quarter of 2006 versus 2007 with the acquisition of the Tarapur block in 2006.

Cash provided by financing activities for the six months ended June 30, 2007 was $26,885,919 as compared to $2,648,548 during the six months ended June 30, 2006. During the six months ended June 30, 2007, we completed the sale of 5,680,000 Units of our securities at $5.00 per Unit for aggregate cash gross proceeds of $28,400,000 less share issuance costs of $1,903,046. Further, during the six months ended June 30, 2007, cash of $320,675 was provided from the issuance of 317,500 shares of common stock on the exercise of options as compared to cash of $2,717,900 which was provided from the issuance of 1,395,500 shares of common stock on the exercise of options and the remaining 2003 Stock Purchase Warrants during the six months ended June 30, 2006. The balance of the increase is a result of an increase in the accounts payable from financing activities of $68,290 for the second quarter of 2007 compared to $nil for the same period in the prior year.

We have been advised by GSPC, that GSPC is seeking payment of the amount by which the exploration costs attributable to us under the PSC relating to the KG Offshore Block exceeds the amount that GSPC deems it is obligated to pay on behalf of us (including the net 5% participating interest of RGM) under the terms of the CIA. GSPC asserts that the Company is required to pay 10% of the exploration expenses over and above US$59.23 million. GSPC asserts that the amount payable by us is US$44.68 million including interest of US$4.43 million as of June 30, 2007. GeoGlobal disputes this assertion of GSPC. See Risk Factors – Risks Relating to Our Oil and Gas Activities - GSPC Is Seeking a Payment From Us In the Amount Of Approximately $44.68 Million On Account of GSPC's Exploration Costs On the KG Offshore Block and Note 9d to Notes to Consolidated Financial Statements.

Our Krishna Godavari Basin Agreements and Exploration Activities

The KG Offshore Block and Our Carried Interest Agreement

At June 30, 2007, GSPC, the operator of the KG Offshore Block, has expended on exploration activities approximately $40.7 million attributable to us under the PSC and the Carried Interest Agreement ("CIA") as compared to $26.1 million at December 31, 2006. Of this amount, 50% is for the account of Roy Group (Mauritius) Inc. ("RGM") under the terms of our Participating Interest Agreement with RGM, which leaves us with a net 5% interest. Under the terms of the CIA, GeoGlobal and RGM are carried by GSPC for 100% of all our share of any costs during the exploration phase on the KG Offshore Block prior to the start date of initial commercial production.

Under the terms of the PSC, GSPC is committed to expend further funds for the exploration of and drilling on the KG Offshore Block. The management committee under the exploration contract relating to the KG Offshore Block has estimated that the total gross budget for the KG Offshore Block for the period April 1, 2007 to March 31, 2008 is $503.6 million. The estimated annual budget for costs to be incurred by GSPC for the twelve month period April 1, 2007 to March 31, 2008 attributable to the 10% carried interest attributable to us and RGM under the CIA is approximately $50.4 million. We are unable to estimate the amount of additional expenditures GSPC will make attributable to us prior to the start date of initial commercial production under the CIA or when, if ever, any commercial production will commence. As provided in the CIA, we will be required to bear the expenditures attributable to us after the start date of initial commercial production on the KG Offshore Block.

We will not realize cash flow from the KG offshore venture until such time as the expenditures attributed to us, including those expenditures made for the account of RGM under the CIA, have been recovered by GSPC from future

production revenue. Under the terms of the CIA, all of our proportionate share of capital costs for exploration and development activities must be repaid to GSPC without interest over the projected production life or ten years, whichever is less.

Matters Relating to Our KG Offshore Block PSC

Our PSCs relating to the exploration blocks in India provide that by the end of the first phase of the exploration phases the contracting parties shall have drilled a certain number of wells. The first phase of the exploration period relating to the PSC for the KG Offshore Block expired without the required minimum of at least fourteen exploration wells being drilled during the first phase. GSPC is the operator on the KG Offshore Block.

On July 4, 2007, the Directorate General of Hydrocarbons ("DGH"), a body under the Ministry of Petroleum & Natural Gas, advised GSPC that, because of the worldwide supply and availability shortage of offshore drilling rigs, on June 20, 2007 the Government of India had issued new policy guidelines for the merger of exploration phases of PSCs granted under NELP III and NELP IV and for the substitution of additional meterage drilled in deeper wells against the total meterage commitment as part of the minimum work program in the PSCs.

On July 12, 2007, GSPC, on behalf of the contracting parties for the KG Offshore Block, notified the DGH that it was exercising the option granted under the new policies to request a merger of Phases I and II of the KG Offshore Block work program called the New Phase I with the effect of establishing a new work program phase expiring March 11, 2008 and to merge the minimum work program ("MWP") of Phase II and Phase III into a new phase to be called New Phase II. In addition, GSPC exercised the option to substitute a total meterage drilled commitment in the new work program phase that would be irrespective of the number of wells drilled. Under these new policies, any contractors who exercise this option would be required to relinquish 50% of the contract area at the end of the New Phase I. Approval of the merger of the Phase I and II into a New Phase I and the merger of the minimum work program of existing Phase II and Phase III as New Phase II from the GOI is currently outstanding.

On July 13, 2007, the Operating Committee under the KG Offshore Block PSC had approved GSPC's recommendation of exercising the option under the policy guidelines The minimum work program for the New Phase I would be to drill 33,102 meters. GSPC informed DGH, that as at July 16, 2007 a total of 31,225 meters have been drilled, requiring the drilling of an additional 1,877 meters before March 11, 2008 in order to complete the minimum work program for the New Phase I. At the end of the New Phase I on March 11, 2008, the contracting parties will be required to relinquish 50% of the Contract Area of the KG Offshore Block that is not a Discovery or Development Area as defined in the PSC. The New Phase II would have a term of 1.5 years expiring September 11, 2009 and the drilling of a further 12,250 meters would be required in order to meet the minimum work program.

As at August 13, 2007, seven exploratory wells have been drilled on the exploration block for a total of 31,225 total vertical meters drilled, leaving 1,877 meters to be drilled to complete the New Phase I commitment and 12,250 meters to be drilled to complete the Phase II commitment. An eighth exploratory well, the KG#28 was drilled to 5,258 meters on the exploration block, however the KG#28 well has been classified as an appraisal well as defined under the PSC by the management committee.

Unless approval is granted by the GOI to merge Phases I and II of the work program under the new policy guidelines, we may be liable for the consequences of non-fulfillment of the minimum work commitment in a given time frame under the PSC. The PSC has provisions for termination of the PSC on account of various reasons specified therein including material breach of the contract. Termination rights can be exercised after giving ninety days written notice. This failure to timely complete the minimum work commitment, though we have been advised by GSPC there is no precedence, may be deemed by the GOI to be a failure to comply with the provisions of the contract in a material particular.

The termination of the PSC by the GOI would result in our loss of our interest in the KG Offshore Block other than areas determined to encompass "commercial discoveries". The PSC sets forth procedures whereby the operator can obtain the review of the management committee under the PSC as to whether a discovery on the exploration block should be declared a commercial discovery under the PSC. Those procedures have not been completed at present with

respect to the discovery on the KG Offshore Block and, accordingly, as of August 13, 2007, no areas on the KG Offshore Block have been determined formally to encompass "commercial discoveries" as that term is defined under the PSC.

In the event the PSC for the KG Offshore Block is terminated by the GOI, or in the event the work program is not fulfilled by the end of the relevant exploration phase, the PSC provides that each party to the PSC is to pay to the GOI its participating interest share of an amount which is equal to the amount that would be required to complete the minimum work program for that phase. We are of the view that GSPC, under the terms of our CIA, would be liable for our participating interest share of the amount required to complete the minimum work program for the phase.

The KG Offshore Block Drilling Activities
GSPC currently has contracted with Saipem SPA, part of ENI, Italy, for the Saipem Perro Negro 3 jack-up drilling rig to drill 10 exploratory wells, with an option of extending the contract for 2 additional exploratory wells. As of August 13, 2007, the Saipem Perro Negro 3 drilling rig has drilled five exploratory wells and is currently drilling one appraisal well, the KG#28. Two of the five exploratory wells, the KG#1 drilled in 2004 and the KG#11 drilled in 2005 have both been abandoned. While testing deemed satisfactory by GSPC has been completed, the remaining three exploratory wells, the KG#8 drilled in 2005, and the KG#17 and KG#15 drilled in 2006, all drilled from the KG#8 well platform, have been suspended awaiting the results of future wells drilled from this platform.

On February 6, 2007, the Saipem Perro Negro 3 rig commenced drilling the KG#28 well from the KG#8 platform. The KG#28 well is the sixth well drilled by the Saipem Perro Negro 3 jack-up drilling rig. The KG#28 well, a further exploratory well, has been classified by the Management Committee as an “appraisal well” for the purposes of the PSC. On May 11, 2007, when the well was close to total depth, a gas kick was encountered which was subsequently controlled. The hole was plugged back with cement to just below the 9 5/8 inch casing shoe in order to sidetrack and re-drill the entire 8½ inch section from 4,052 meters measured depth. The well was drilled directionally deviating approximately 1,640 meters east of the KG#8 wellhead location to a total measured depth of 5,258 meters (4,879 total vertical depth). As at August 13, 2007, the well is currently being cased to total depth with a 7 inch liner to be followed by a cased hole logging program after which the perspective intervals will be tested.

GSPC has also entered into a 25 month contract with Atwood Oceanics Inc., a Houston based International Offshore Drilling Contractor, for the Atwood Beacon jack-up drilling rig to drill additional exploration wells on the KG Offshore Block.

On January 3, 2007, the Atwood Beacon rig commenced drilling its first well, the KG#16 exploratory well. The KG#16 well is situated in shallow water of approximately 109 meters and is approximately 5 kilometers East of the location where the Saipem Perro Negro 3 jack-up drilling rig is located. On May 14, 2007 it was announced that GSPC had completed the drilling of the KG#16 well to a total depth (“TD”) of 5,372 meters measured depth. A complete suite of modern logs were run and the well was cased with a 7 inch liner to TD. A testing program was designed based upon independent log analyses, as well as core samples, MDT’s (“Modular Formation Dynamics Tester”) and hydrocarbon shows while drilling.

The testing program was completed on August 1, 2007. DST-1 (drill stem test number 1) and DST-1A involved 45 meters and 33.5 meters of perforations across the interval depth from 4,951 – 5,046 and 4,800 – 4,833.5 meters MD respectively. Both zones were tight and did not flow hydrocarbons to surface. DST-2 was chosen from encouraging independent log analyses over the interval depth of 4,642 to 4,754 meters measured depth, but was abandoned without perforating due to operational problems. DST-3 involved 75 meters of perforations over the interval depth of 4,483 to 4,590 meters measured depth at a stabilized flow rate of 2.21 MMSCFD (million standard cubic feet per day) of gas and 15 BBLS/D (barrels per day) of condensate at a well head flowing pressure of 880 psi through a 24/64 inch choke. DST-4 involved 133 meters of perforations over the interval depth of 4,302 to 4,435 meters measured depth at a stabilized flow rate of 2.52 MMSCFD of gas and 106 BBLS/D of condensate at a well head flowing pressure of 1,880 psi through a 16/64 choke. The testing of the KG#16 well has been completed and it is now planned to be temporarily suspended and evaluated for future pilot testing of stimulation technologies.

On May 14, 2007, it was further announced that GSPC has recently contracted a fourth drilling rig named "Deep Driller 1". The Deep Driller 1 is owned by Sinvest ASA out of Norway and is a jack-up rig capable of operating in water depths of approximately 120 meters. The term of the contract is for two years from the date of spud of the first well.

On May 8, 2007, GSPC commenced drilling the KG#30 exploratory well with the Deep Driller 1. The KG#30 well is situated approximately 15.5 kilometers Northeast of the KG#11 well, and is being drilled vertically in shallow waters of approximately 45 meters. On August 13, 2007 it was announced that GSPC had completed the drilling and casing of the KG#30 well to a total vertical depth of 3,951 meters and a complete suite of modern logs have been run. An open hole DST (drill stem test) was unsuccessful due to mechanical failure. As at August 13, 2007, a testing program based upon independent log analysis has commenced. The KG#30 will be the first exploratory well to test the deepest part of the northern graben in the KG Offshore Block.

GSPC has further entered into a contract with Essar Oilfield Services Limited (“EOSL”), a subsidiary of Essar Shipping & Logistics Ltd. of Cyprus, for a semi-submersible drilling rig named “Essar Wildcat”. The Essar Wildcat is a self propelled drilling rig suitable for deployment in water depths of 400 meters and has a drilling depth capacity of 7,600 meters. The Essar Wildcat has arrived at the KG Offshore Block and is currently undergoing upgrading and maintenance. GSPC intends to commence drilling additional wells in the deeper water in the KG Offshore Block by the third quarter of 2007. The initial term of the EOSL contract is for two years from the date of spud of the first well, with the option of two extensions, each for one year.

The KG Onshore Block Agreement

OIL, as operator for this KG Onshore Block has applied for the Production Exploration Licence ("PEL") from the State of Andhra Pradesh, which when issued will allow OIL to commence the Phase I work program commitments.

Under the PSC for the KG Onshore Block, the Phase I work commitment consists of reprocessing 564 linear kilometers of 2D seismic, conducting a gravity and magnetic and geochemical survey, as well as a seismic acquisition program consisting of 548 sq km of 3D seismic. This Phase I commitment further consists of the drilling of 12 exploration wells to various depths between 2,000 and 5,000 meters. We will be required to fund our 10% proportionate share of the costs incurred in these activities estimated to be approximately $8.5 million over the four years of the first phase of the work commitment with respect to a 10% participating interest in the block and approximately $21.4 million with respect to a 25% participating interest in the block.

Cambay Basin Agreements and Drilling Activities

At June 30, 2007, we are parties to four PSCs relating to exploration blocks in the Cambay Basin. These include the Mehsana Block, the Sanand/Miroli Block, the Ankleshwar Block and the Tarapur Block.

Mehsana Block

This PSC provides that the exploration activities of the first exploration phase, which commenced May 21, 2004, are to be conducted over a period of 2.5 years. During the first exploration phase on this exploration block, the parties are to acquire 75 square kilometres of 3D seismic data, reprocess 650 linear kilometres of 2D seismic data and conduct a geochemical survey, all of which has been completed. In addition, the parties are to drill seven exploratory wells between 1,000 to 2,200 meters. As at August 13, 2007, two of the seven exploration wells have been drilled on this block, the first being CB-2 well drilled to a total vertical depth of 2,500 meters and the second, the CB-3 well was drilled to a total vertical depth of 2,350 meters. Both of these wells did not proceed into a testing program and were subsequently abandoned. On July 31, 2007, Jubilant, as operator, commenced drilling the third exploratory well on the Mehsana Block, the CB-3A well with the WAFA STAR RIG 1 to an estimated total depth of 2,480 meters. As of August 13, 2007 this well is currently drilling at an approximate measured depth of 650 meters.

The first exploration phase relating to the PSC for the Mehsana Block expired without the required minimum of seven wells having been drilled. In October, 2006 the management committee under the PSC for the Mehsana Block approved a proposal to seek from the GOI an extension of the first exploration phase for a six month period from November 21, 2006 to May 20, 2007. Further, on April 6, 2007 the members of the operating committee under the Mehsana Block operating agreement resolved to submit an application to the GOI for extension for an additional six

months to November 20, 2007 to complete the minimum work program under Phase I. In seeking that extension, the joint venture partners agreed to provide a 100% bank guarantee and a 10% cash payment to be agreed upon based on pre-estimated liquidated damages for the unfinished minimum work program as reasonably determined by DGH, which has not yet been determined. As well, the contractor would be required to relinquish 25% of the block pursuant to the provisions of the PSC. The period of extension will be set off against the term of the Second Phase which would reduce Phase II to one year expiring November 20, 2008. Final consent to this extension is awaiting GOI approval.

At June 30, 2007, we have incurred costs of approximately $1.4 million with respect to exploration activities on the Mehsana Block. We estimate that our expenditures for exploration activities during the period April 1, 2007 to March 31, 2008 fiscal year which will include the drilling of the remaining five wells from the Phase I work commitment, will be approximately $1.8 million

Sanand/Miroli Block
This PSC provides that the exploration activities, which commenced July 29, 2004, are to be conducted over a period of 2.5 years. During the first exploration phase on the Sanand/Miroli Block, the parties are to acquire 200 square kilometres of 3-D seismic data, reprocess 1,000 linear kilometres of 2-D seismic data, and conduct a geochemical survey. GSPC as operator has completed these exploration activities which included the acquisition, processing and interpretation of a 463 sq km onshore 3-D seismic program. In addition, we are to drill twelve exploratory wells between 1,500 to 3,300 meters, of which four have been drilled and one is currently drilling as of August 13, 2007.

Drilling operations using the DALMA MR#4 Rig commenced on this block on November 15, 2006 with the drilling of the first of the twelve exploration wells. The M1 well was drilled to a total vertical depth (TVD) of 2,300 meters and was temporarily suspended. The well has subsequently been re-entered and drilled to a TVD of 2,463 meters. The well has been logged, cased and testing has been completed. All four zones that were tested were oil bearing intervals. The uppermost interval was hydraulically fractured and flowed oil at 106 barrels of oil per day (BBL/D). The remaining three oil bearing intervals in M1 are planned to be stimulated using hydraulic fracture stimulation with a workover rig. The GOI has been made aware of this hydrocarbon discovery as per Article 10.1 of the PSC. The same rig spud a second well, the M4 well, on February 24, 2007 which was drilled to a total vertical depth of 2,226 meters. This well was logged, cased and is currently awaiting a workover rig for testing.

A third well, the M2 well, commenced drilling using the DRIPL 1500 HP rig on March 26, 2007 which was drilled to a TVD of 3,308 meters. The well was subsequently tested and abandoned without any success.

The DAKMA MR#4 Rig commenced drilling the SE#4 well on July 12, 2007. The SE#4 well was drilled to a total vertical depth of 2,340 meters. As at August 13, 2007, the well has been logged and cased and is awaiting a workover rig for testing.

The JOHN 1500 RIG commenced drilling the SE#2 well on July 29, 2007. As at August 13, 2007, the SE#2 well is currently drilling at an approximate measured depth of 1,250 meters. .

The first exploration phase relating to the PSC for the Sanand/Miroli Block expired without the required minimum of twelve wells having been drilled. On December 29, 2006 the management committee approved a proposal to seek from the GOI an extension of the first exploration phase for a six month period from January 28, 2007 to July 28, 2007. The period of extension will be set off against the term of the Second Phase which would reduce Phase II to 1.5 years expiring January 28, 2009. Further on July 23, 2007, GSPC as operator, on behalf of the consortium partners has requested from the GOI a one year extension under Annexure-1 SI. No. 3 of the extension policy “where the minimum work program has not been completed but a hydrocarbon discovery is made within the exploration phase and does not want to relinquish the area at the end of the phase.” Under this clause, an additional extension of 12 months may be given subject to the consortium partners providing a 50% Bank Guarantee of the unfinished minimum work program (MWP) and the additional work program. An additional work program which includes AVO processing and Inversion work on the 3D seismic, resulting in a comprehensive geological model. Final consent to this extension is awaiting GOI approval.

As at June 30, 2007 we have incurred costs of approximately $1.1 million with respect to exploration activities on the Sanand/Miroli Block. We estimate that our expenditures for exploration activities during the period April 1, 2007 to March 31, 2008, which will include the drilling of the remaining nine wells from the Phase I work commitment, will

be approximately $2.6 million based on our 10% participating interest.

Ankleshwar Block

Under the terms of our PSC for the Ankleshwar Block, the first phase of our work commitment covers a period of three years and commenced April 1, 2006. The Phase I work commitment was to acquire, process and interpret 448 sq kms of 3-D seismic and reprocess 650 LKM's of 2-D seismic which has been completed. In addition, we are to drill 14 exploratory wells between 1,500 to 2,500 meters. As at June 30, 2007 we have incurred costs of approximately $700,000 on the Ankleshwar Block for our 10% participating interest. We estimate our expenditures for exploration activities during the period April 1, 2007 to March 31, 2008, which includes the drilling of 8 of the 14 exploratory wells, will be approximately $2.7 million based on our 10% participating interest. We anticipate drilling operations will commence in Q4 of 2007.

Tarapur Block

Through August 13, 2007, GSPC has drilled or is drilling fourteen wells on this block, of which; five wells, the Tarapur 1, 5, 7, G, and P have been suspended awaiting a possible future development program; three wells, the Tarapur 4, TS-4, TS-5 are currently testing or waiting to be tested; three wells, the Tarapur 4, TS-1 and TS-3 are currently drilling; and three wells have been abandoned.

GSPC commenced drilling the Tarapur 6 appraisal well on April 28, 2007 to delineate the extent of the Tarapur G discovery before the submission of a further two-well appraisal program to the GOI under the terms of the PSC. The Tarapur 6 well was drilled to a total vertical depth (TVD) of 1,795 meters. After a hydraulic fracture stimulation, the Tarapur 6 flowed oil at a rate of 600 barrels of oil per day. On May 25, 2007 GSPC commenced drilling the Tarapur 4 well with the DALMA MR#1 Rig. The Tarapur 4 was drilled to a total vertical depth of 1,901 meters and was logged and cased and is currently awaiting a workover rig for testing.

On April 26, 2007, GSPC commenced drilling the TS-4 exploratory well. The TS-4 was drilled to a total vertical depth of 2,844 meters. The TS-4 has been logged and cased and as at August 13, 2007, testing of the well with a workover rig has commenced. A further well, the TS-5 commenced drilling on May 22, 2007. The TS-5 was drilled to a total vertical depth of 3,007 meters. The TS-5 has been logged and as at August 13, 2007 is being cased to total depth, after which a testing program will commence. Further, on June 14, 2007 GSPC commenced the drilling of the TS-8 and as at August 13, 2007 is drilling at an approximate depth of 2,960 meters. Two additional wells are currently drilling as at August 13, 2007 in this area. The TS-1 and TS-3 are drilling at an approximate depth of 700 meters and 2,100 meters respectively.

GSPC and the Company intend to continue to aggressively drill additional wells in the Tarapur Block in order to assess the potential of the discovery to date.

To June 30, 2007, we have incurred costs of approximately $4.1 million under the terms of our agreement with GSPC for our 20% PI share of exploration costs. The third and final phase of exploratory activities on the Tarapur Block had a term of 2 years expiring November 22, 2007 with a work commitment to drill one well to a depth of 3,000 meters or to the Deccan trap. This requirement has been completed and all areas not encompassing a commercial discovery after November 22, 2007 will be relinquished back to the GOI. Oil and Natural Gas Corporation Limited of India has the right to participate into the development of any commercial discovery on the Tarapur Block by acquiring a 30% participating interest as provided under the PSC. The exercise of this right would result in the reduction of our PI to 14%.

Estimated total capital expenditures we will be required to contribute to drilling an estimated seven additional appraisal wells on this block, over the period April 1, to November 22, 2007 based on our 20% PI will be approximately $2.7 million.

Financial Commitments

At June 30, 2007, in connection with these four Cambay Basin PSCs, we have provided to the GOI four irrevocable letters of credit totaling $2,955,000 (Mehsana $155,000, Sanand/Miroli $910,000, Ankleshwar $950,000 and Tarapur $940,000) secured by our term deposits in the same amount. These letters of credit serve as guarantees for the performance of the minimum work commitments for the budget period April 1, 2007 to March 31, 2008 of Phase I of these four Cambay Basin Agreements.

In January 2008, the Company issued 26,374 shares of common stock as follows: (a) 12,500 shares in consideration of $105,000 upon exercise of series G warrants, (b) 2,475 shares in consideration of $12,375 upon exercise of 2,475 stock options, and (c) 11,399 shares upon cashless exercise of 22,275 stock options.

Stock Purchase Warrants

At September 30, 2009, the Company had warrants outstanding to purchase 8,795,259 shares of the Company s common stock as outlined below:

Series	Number of Warrants	Exercise Price	Expiration Date
H	331,887	$ 8.00	April 30, 2011
I	94,351	$ 5.76	April 30, 2011
J	267,857	$ 6.16	May 31, 2013
K	399,062	$ 9.60	April 1, 2013
L	6,250	$ 3.12	March 31, 2014
Total	1,099,407		

Stock Options

The Company has a stock option plan under which options to purchase a maximum of 1,250,000 shares of common stock may be issued. The plan permits the granting of both incentive stock options and nonqualified stock options to employees and directors of the Company and certain outside consultants and advisors to 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. Under the plan, options to purchase 207,813 and 45,000 shares of common stock were granted to officers, directors, agents and employees for the nine months ended September 30, 2009 and 2008, respectively, with exercise prices ranging from $2.88 to $8.88 per share. For the nine months ended September 30, 2009 and 2008, 1,875 and 1,250 respectively of plan options were forfeited and for the nine months ended September 30, 2008, 24,750 plan options were exercised. As of September 30, 2009, options to purchase 972,141 shares of the Company s common stock were issued and outstanding under the plan.

The Company has previously granted nonqualified stock options to officers, directors, agents and employees outside of the stock option plan (non-plan options). All non-plan options were granted at the fair market value at the date of grant. During the nine months ended September 30, 2009 and 2008, 29,625 and 5,500 non-plan options expired, respectively. As of September 30, 2009, non-plan options to purchase 207,000 shares of the Company s common stock were issued and outstanding.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

5. Shareholders Equity (continued)

A summary of the Company s stock option activity and related information for the nine months ended September 30, 2009 and 2008 follows:

	2009		2008	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding January 1	1,002,828	$ 5.52	1,027,935	$ 6.24
Granted	207,813	$ 3.04	45,000	$ 7.36
Forfeited	(1,875)	$ 5.60	(1,250)	$ 9.76
Expired	(29,625)	$ 8.88	(5,500)	$ 25.76
Exercised		$	(24,750)	$ 5.04
Outstanding September 30	1,179,141	$ 5.04	1,041,435	$ 6.24
Exercisable at September 30	848,906	$ 5.36	794,873	$ 6.48

During the nine months ended September 30, 2009 and 2008 the fair value of each service and performance based option award was estimated at the date of grant using the Black-Scholes option pricing model. The weighted-average assumptions used during the three and nine months ended September 30, 2009 and 2008 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Risk-free interest rate	2.88 %	3.30 %	2.31 %	3.08 %
Volatility factor	83.73 %	107.5 %	92.16 %	118.07 %
Dividend yield	0 %	0 %	0 %	0 %
Expected option life (years)	6.25	6.25	6.25	6.25
Contractual life (years)	10	10	10	10

In both 2009 and 2008, the risk-free rate utilized represents the U.S. Treasury yield curve rate which approximates the risk-free rate for the expected option life at the time of grant. In 2009 and 2008, the volatility factor was calculated based on the seventy-five month-end closing prices of the Company s common stock preceding the month of stock option grant. The Company uses a seventy-five month volatility period to coincide with the expected stock option life. Based on guidance from Staff Accounting Bulletin 107 and 110, a stock option life of 6.25 years was utilized under the simplified method. The dividend yield is 0% since the Company does not anticipate paying dividends in the near future. Based on the Company s historical experience of options that expire or are cancelled before becoming fully vested, the Company assumed an annualized forfeiture rate of 1.0% for all options. Under the true-up provision of

SFAS 123R, 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.

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5. Shareholders Equity (continued)

The weighted average fair value per share of options granted during the nine months ended September 30, 2009 and 2008 was $2.32 and $6.40, respectively. During the nine months ended September 30, 2009 and 2008, stock option compensation expense was recorded using the fair value method under SFAS 123R as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Cost of sales	$ 23,327	$ 16,158	$ 73,764	$ 42,170
Selling, general and administrative expenses	169,461	170,318	594,894	551,276
Total stock option compensation expense	$ 192,788	$ 186,476	$ 668,658	$ 593,446

As of September 30, 2009, there was $582,257 of unrecognized compensation cost related to nonvested service based awards, $39,375 nonvested performance based awards and $52,941 nonvested market based awards granted under the plan. That cost is expected to be recognized over the options remaining weighted average vesting period of 1.47 years for service and performance based options and 0.15 years for market based options.

For the nine months ended September 30, 2009 and 2008, no income tax benefit was recognized related to stock option activity.

Restricted Common Stock

On May 11, 2006, the Company adopted a restricted common stock plan and reserved 312,500 shares of common stock for issuance.

On May 12, 2006, 21,875 shares of restricted common stock were granted to non-employee members of the Company s board of directors and vested three years from the date of the grant. The fair market value at the date of grant, determined by the quoted market price, was $145,250 or $6.64 per share. The fair market value of the grant was recognized as compensation expense over the three-year service period. For the nine months ended September 30, 2009 and 2008, $18,148 and $36,315 was recorded in operating expense respectively for these grants. On May 12, 2009 all of the outstanding restricted common stock became fully vested.

Shares Reserved for Future Issuance

At September 30, 2009, the Company had reserved the following shares of common stock for future issuance:

Convertible preferred shares (series A D)	285,051

Common stock options available for grant	277,859
Common stock options outstanding	1,179,141
Common stock warrants outstanding (series H L)	1,099,407
Restricted common stock available for grant	290,625
Total common stock shares reserved	3,132,083

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

6. Comprehensive Income (Loss)

The Company s comprehensive income (loss) was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net income (loss) as reported	$139,603	$(701,619)	$(1,178,978)	$(3,381,895)
Other comprehensive income (loss):				
Foreign currency translation adjustment	363,948	(267,176)	610,150	(454,698)
Comprehensive income (loss)	$503,551	$(968,795)	$(568,828)	$(3,836,553)

7. Operating Segments

The Company consists of three operating segments: wound care, wound closure specialty securement devices and skin care. Products in the wound care segment consist of basic and advanced dressings, adhesive strips, ointments and sprays. Wound closure and specialty securement device products include wound closure strips, nasal tube fasteners and a variety of catheter fasteners. The skin care segment consists of antibacterial skin cleansers, hair and body soaps, lotions and moisturizers.

Products in all three operating segments are marketed to long-term care facilities, hospitals, physicians, clinics, home health care agencies and other healthcare institutions. Basic and advanced wound care products are manufactured both internally and outsourced, while the manufacture of skin care products is completely outsourced. Wound closure-specialty securement devices are significantly manufactured in-house. Internally, the segments are managed at the gross profit level. The aggregation or allocation of other costs by segment is not practical.

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DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

7. Operating Segments (continued)

Segment sales, gross profit and other related information for 2009 and 2008 are as follows:

	Three Months Ended September 30, 2009				
	Wound Care	Wound Closure-Specialty Securement Devices	Skin Care	Other	Total Company
Net sales	$ 12,289,311	$ 409,565	$ 183,549		$ 12,882,425
Gross profit	3,765,137	231,070	48,064		4,044,271
Total expenses				$ (3,904,668)	(3,904,668)
Net income					$ 139,603

	Three Months Ended September 30, 2008				
Net sales	$ 12,237,599	$ 388,024	$ 206,951		$ 12,832,574
Gross profit	3,559,460	206,085	61,008		3,826,553
Total expenses				$ (4,528,172)	(4,528,172)
Net loss					$ (701,619)

	Nine Months Ended September 30, 2009				
	Wound Care	Wound Closure-Specialty Securement Devices	Skin Care	Other	Total Company
Net sales	$ 33,023,590	$ 1,307,327	$ 546,741		$ 34,877,658
Gross profit	9,969,307	714,272	142,095		10,825,674
Total expenses				$ (12,004,652)	(12,004,652)
Net loss					$ (1,178,978)

	Nine Months Ended September 30, 2008				
Net sales	$ 35,696,657	$ 1,357,431	$ 587,274		$ 37,641,362
Gross profit	9,591,468	742,020	166,246		10,499,734

Total expenses	$ (13,881,629)	(13,881,629)
Net loss		$ (3,381,895)

The following table presents net sales by geographic region.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
United States	72 %	72 %	72 %	70 %
Canada	23 %	24 %	22 %	25 %
Other	5 %	4 %	6 %	5 %

For the nine months ended September 30, 2009, the Company has a major U.S. customer comprising 14% of U.S. sales and 5% of U.S. operations trade accounts receivable at September 30, 2009. The Company s wholly owned Canadian subsidiary sells to one customer who serves as its exclusive third party distributor and comprises 100% of Canada operations trade accounts receivable at September 30, 2009.

DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

8. Income Taxes

The Company recorded a $47,151 and $3,540 foreign income tax benefit for the nine months ended September 30, 2009 and 2008 respectively, based on the operating results of the Company s wholly owned Canadian subsidiary. The 2009 benefit was comprised of $25,788 current foreign tax benefit and $21,363 deferred foreign tax benefit while the 2008 benefit was all deferred. No benefit was realized for the Company s net loss from U.S. operations in the nine months ended September 30, 2009 and 2008 due to uncertainties surrounding the Company s ability to utilize its net operating loss carry forwards.

Due to uncertainties surrounding the Company s ability to use its U.S. net operating loss carry forwards and net deferred assets, a full valuation allowance has been provided. The Company s wholly owned Canadian subsidiary, based on recent operating profitability and the prospect of future profitable operations, realized its net operating loss carry forward and deferred tax assets and liabilities.

9. Reverse Stock Split

On September 24, 2009 the Board of Directors unanimously adopted a resolution approving and recommending to shareholders for their approval a proposal to grant discretionary authority to the Board of Directors to amend the Company s certificate of incorporation in order to: (i) effect a reverse split of the Company s common and preferred shares (the Reverse Split) at any time within one year after the date of shareholder approval, at any whole number ratio between 1 for 5 and 1 for 10, with the exact exchange ratio and timing of the Reverse Split to be determined by the Board of Directors, and (ii) effect a reduction of the Company s authorized common and preferred shares by a factor corresponding to the Reverse Split exchange ratio (the Proposal). On or about October 6, 2009, a Notice of Special Meeting of Shareholders (Proxy Statement) was sent to shareholders of record as of October 1, 2009, notifying them of the Proposal and the Special Meeting of Shareholders on November 23, 2009.

With the exception of a minimum share price, the Company believes it meets the criteria for listing on one of the national market exchanges. The Reverse Split is designed to enable the Company to meet the minimum share price requirement. If and when the Proposal is approved, the Company plans to seek a listing for its common stock on a national market. The Company believes the Reverse Split could enhance the appeal of its common stock to the financial community. The Company believes that a number of individual and institutional investors are reluctant or unable to invest in OTC Bulletin Board companies or companies with relatively low per share values. The reduction in the number of issued and outstanding shares of common stock effected by the Reverse Split, together with the anticipated increased stock price resulting from the Reverse Split, could promote a broader market for the Company s common stock than that which currently exists.

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Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Directors
of Derma Sciences, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Derma Sciences, Inc. and Subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of operations, shareholders equity and cash flows for each of the two years in the period ended December 31, 2008. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company s internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and 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 consolidated financial position of Derma Sciences, Inc. and Subsidiaries at December 31, 2008 and 2007, and the consolidated results of their operations and their cash flows for each of the two years in the period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania
March 31, 2009, except for the second paragraph
of Note 2, as to which the date is January 28, 2010

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DERMA SCIENCES, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

	December 31, 2008	2007
ASSETS		
Current Assets		
Cash and cash equivalents	$391,038	$577,096
Accounts receivable, net	3,892,523	3,667,119
Inventories	12,423,042	9,935,977
Prepaid expenses and other current assets	397,117	1,210,135
Total current assets	17,103,720	15,390,327
Cash restricted	2,014,422	
Equipment and improvements, net	3,977,853	4,909,049
Goodwill	7,119,726	9,524,305
Other intangible assets, net	5,310,129	5,537,653
Other assets, net	681,472	509,507
Total Assets	$36,207,322	$35,870,841
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Line of credit borrowings	3,446,605	1,219,197
Current maturities of long-term debt	1,298,207	1,288,532
Accounts payable	3,614,764	4,092,278
Accrued expenses and other current liabilities	2,004,493	3,421,282
Total current liabilities	10,364,069	10,021,289
Long-term debt	4,065,036	5,292,136
Other long-term liabilities	44,848	82,402
Deferred tax liability	340,871	420,059
Total Liabilities	14,814,824	15,815,886
Shareholders Equity		
Convertible preferred stock, $.01 par value; 1,468,750 shares authorized; issued and outstanding: 285,051 at December 31, 2008 and 2007 (liquidation preference of $4,210,231 at December 31, 2008)	2,851	2,851
Common stock, $.01 par value: authorized shares 18,750,000; issued and outstanding shares: 5,017,593 at December 31, 2008 and 4,228,719 at December 31, 2007	50,176	42,287
Additional paid-in capital	40,398,829	33,856,916
Accumulated other comprehensive income cumulative translation adjustments	604,465	1,854,787
Accumulated deficit	(19,663,823)	(15,701,886)
Total Shareholders Equity	21,392,498	20,054,955
Total Liabilities and Shareholders Equity	$36,207,322	$35,870,841

See accompanying consolidated notes.

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DERMA SCIENCES, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

	Year Ended December 31,	
	2008	2007
Net Sales	$ 50,199,428	$ 34,135,401
Cost of sales	35,289,684	22,530,986
Gross Profit	14,909,744	11,604,415
Operating expenses		
Selling, general and administrative	17,196,863	11,885,368
Research and development	653,326	993,069
Total operating expenses	17,850,189	12,878,437
Operating loss	(2,940,445)	(1,274,022)
Other expense, net:		
Interest expense	940,148	413,992
Loss on debt extinguishment		256,628
Other expense, net	22,529	77,929
Total other expense, net	962,677	748,549
Loss before provision for income taxes	(3,903,122)	(2,022,571)
Provision for income taxes	58,815	262,034
Net Loss	$ (3,961,937)	$ (2,284,605)
Net loss per common share basic and diluted	$ (0.82)	$ (0.69)
Shares used in computing loss per common share basic and diluted	4,825,847	3,315,443

See accompanying consolidated notes.

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DERMA SCIENCES, INC. AND SUBSIDIARIES

Consolidated Statements of Shareholders Equity

See accompanying consolidated notes.

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DERMA SCIENCES, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

	Year Ended December 31,	
	2008	2007
Operating Activities		
Net loss	$(3,961,937)	$(2,284,605)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation of equipment and improvements	855,609	773,280
Amortization of intangible assets	1,427,524	659,712
Amortization of deferred financing costs	129,519	119,807
Provision for bad debts	247,000	15,971
Allowance for sales adjustments	690,625	413,029
Provision for inventory obsolescence	349,303	131,151
Loss on disposal of equipment		3,164
Deferred rent expense	(60,115)	(28,191)
Compensation charge for employee stock options	773,136	604,592
Compensation charge for restricted stock	48,420	48,420
Non cash interest expense		93,821
Deferred tax provision	(5,008)	262,034
Changes in operating assets and liabilities:		
Accounts receivable	(476,106)	1,557,072
Inventories	(3,570,840)	(2,519,367)
Prepaid expenses and other current assets	7,724	(742,647)
Other assets	(46,291)	33,929
Accounts payable	(241,634)	1,301,925
Accrued expenses and other current liabilities	(910,896)	925,020
Net cash (used in) provided by operating activities	(4,743,967)	1,368,117
Investing Activities		
Acquisition of businesses		(13,000,000)
Costs of acquiring businesses	(120,484)	(737,665)
Refund of acquired business escrow funds	1,193,187	
Purchase of equipment and improvements	(471,357)	(491,212)
Proceeds from sale of equipment		2,271
Net cash provided by (used in) investing activities	601,346	(14,226,606)
Financing Activities		
U.S. term loan proceeds		6,000,000
Cash restricted	(2,014,422)	
Net change in bank line of credit	2,227,408	1,219,197
Deferred financing costs	(269,235)	(434,190)
Long-term debt repayments	(1,313,749)	(499,550)
Proceeds from issuance of common stock, net of costs	5,728,246	5,610,915

Net cash provided by financing activities	4,358,248	11,896,372
Effect of exchange rate changes on cash	(401,684)	253,270
Net decrease in cash and cash equivalents	(186,058)	(708,847)
Cash and cash equivalents		
Beginning of year	577,096	1,285,943
End of year	$391,038	$577,096
Supplemental disclosures of cash flow information:		
Equipment obtained with capital leases	$96,324	$163,745
Cash paid during the year for:		
Interest	$809,808	$488,184

See accompanying consolidated notes.

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DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Description of Business

Derma Sciences, Inc. and its subsidiaries (the Company) is a full line provider of wound care, wound closure and specialty securement devices and skin care products. The Company markets its products principally through independent distributors servicing the long-term care, home health and acute care markets in the United States, Canada and other select international markets. The Company s U.S. distribution facilities are located in St. Louis, Missouri, and Houston, Texas, while the Company s Canadian distribution facility is located in Toronto. The Company has manufacturing facilities in Toronto, Canada and Nantong, China.

The Company incurred net losses of $3,961,937 and $2,284,605 for the years ended December 31, 2008 and 2007, respectively, and has an accumulated deficit of $19,663,823 at December 31, 2008. During 2008 and 2007, the Company has primarily relied on external financing sources to provide the capital necessary to fund operations including the private sale of its common stock and debt financing through its revolving line of credit and U.S. term loan. At December 31, 2008, the Company had working capital of $6,739,651. Management believes the current available working capital and the available capacity on its revolving line of credit will be sufficient to support operations for all of 2009. The continued availability of the revolving line of credit is predicated on the Company s ability to meet restrictive loan covenants including minimum EBITDA levels and certain ratios of fixed charge coverage, senior debt leverage and total debt leverage for each quarter of 2009. Based on the actions taken during the latter part of 2008 including the curtailment of certain operating expenses and the transfer of production of FAD products from its facility in Houston, Texas to lower cost foreign suppliers, management believes it will comply with the restrictive loan covenants during 2009. Additionally, if necessary to comply with the loan covenants, the Company has the intent and ability to reduce spending in 2009 by further controlling costs that are within management s discretion. Such costs include certain sales and marketing expenses, salaries, research and development costs related to DSC 127 and certain other general and administrative expenses.

If the Company were unable to comply with the loan covenants during any quarter of 2009, the U.S. lender could declare all amounts under the revolving credit facility and the U.S. term loan as currently due and payable. If this were to occur, the Company would need to secure additional external financing to continue its operations. There is no assurance that the Company would be able to secure additional external financing under commercially reasonable terms, or at all.

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.

Reverse Stock Split The accompanying financial statements reflect a 1-for-8 reverse stock split of the Company s common and preferred stock approved by the Board of Directors and stockholders of the Company and made effective by an amendment to the Company s articles of incorporation on January 28, 2010. All share and per share information

herein that relates to the Company s common and preferred stock has been retroactively restated to reflect the reverse stock split.

Use of Estimates In conformity with accounting principles generally accepted in the United States, the preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Although these estimates are based on knowledge of current events and actions which may be undertaken in the future, actual results may ultimately differ from these estimates.

Foreign Currency Translation Assets and liabilities are translated using the exchange rates in effect at the balance sheet date, while income and expenses are translated using average rates. Translation adjustments are reported as a component of shareholders equity in accumulated other comprehensive income. For the Company s Canadian subsidiary, whose functional currency is the Canadian dollar, exchange rate

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DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Summary of Significant Accounting Policies (continued)

fluctuations on foreign currency denominated assets and liabilities other than the functional currency resulted in $183,479 and $161,244 of expense for the years ended December 31, 2008 and 2007, respectively.

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.

Concentration of Credit Risk Financial instruments that subject the Company to a concentration of credit risk consist principally of cash and cash equivalents 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 (FDIC) up to $250,000. The Company has not experienced any losses in such accounts. The Company s accounts receivable balance is net of an allowance for doubtful 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.

Foreign Operations Risk The Company s future operations and earnings will depend to a large extent on the results of its operations in Canada and its ability to continue to maintain a continuous supply of basic wound care products from its own operation and/or its suppliers in China and Mexico. While the Company does not envision any adverse change to the manner in which operations in Canada, China and Mexico are presently being conducted, there can be no assurance that the Company will be able to successfully conduct such operations in the future, and a failure to do so may have a material adverse effect on the Company s consolidated financial position, results of operations and cash flows. Also, the success of the Company s operations will be subject to numerous contingencies, some of which are beyond management s control. These contingencies include general and regional economic conditions, foreign exchange prices for the Company s products, prices for materials and products purchased from suppliers, competition and changes in regulations.

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

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

Fair Value of Financial Instruments The carrying value of cash and cash equivalents, accounts receivable, prepaid expenses and other current assets, accounts payable and accrued expenses reported in the consolidated balance sheets equal or approximate fair value due to their short term nature. The fair value of the Company s long-term debt approximates book value as the debt is at market rates currently available to the Company.

Other Intangible Assets Patents and trademarks and other intangible assets with definite lives are stated on the basis of cost or fair value as determined as of the date of acquisition. Patent and trademarks are amortized over 12 to 17 years on a straight-line basis. Other intangible assets consisting of product rights, formulations and specifications, regulatory approvals, customer lists, non-compete and other agreements are amortized over 4 to 13 years on a straight-line basis.

Long Lived Assets In accordance with Statement of Financial Accounting Standards No. 144 (SFAS 144), Accounting for Impairment or Disposal of 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.

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DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Summary of Significant Accounting Policies (continued)

Goodwill The Company tests goodwill for impairment using the two-step process prescribed by Statement of Financial Accounting Standards No. 142 Goodwill and Other Intangible Assets (SFAS 142). 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 31 of each year, or more frequently if impairment indicators are present.

In connection with the acquisitions of certain assets of NutraMax Products, Inc. in 2007 (see Note 3), the Company recorded goodwill of $4,679,684, representing the excess of the purchase price over the fair value of identifiable assets acquired and liabilities assumed. For tax purposes, the goodwill is deductible and is being amortized over fifteen years.

Stock-Based Compensation Effective January 1, 2006 the Company adopted SFAS 123R which revises SFAS 123 Accounting for Stock-Based Compensation (SFAS 123) and supersedes Accounting Principles Board Opinion 25 Accounting for Stock Issued to Employees. SFAS 123R requires that new, modified and unvested share-based payment transactions with employees, such as grants of stock options and restricted stock, be recognized in the financial statements based on their fair value at the grant date and recognized as compensation expense over their vesting periods. The Company estimates the fair value of stock options as of the date of grant using the Black-Scholes or binomial/lattice pricing model (as applicable) and restricted stock based on the quoted market price.

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 their 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 Company measures and recognizes the tax implications of positions taken or expected to be taken in its tax returns on an ongoing basis. In 2008 and 2007, 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 does not expect that unrecognized tax benefits will increase within the next twelve months. The Company records interest and

penalties related to tax matters within other expense on the accompanying Consolidated Statements of Operations. 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 2004 are no longer subject to federal or state examination. The Company s State of New Jersey tax returns for the tax years 2002 through 2005 have been examined and there were no assessments. The Company s 2003 and 2002 Canadian tax returns were subject to examination and adjustment by the Canada Customs and Revenue Agency. These adjustments did not have a material impact on the Company s financial position, results of operations or cash flows. Tax years prior to 2004 are no longer subject to examination in Canada.

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DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Summary of Significant Accounting Policies (continued)

Revenue Recognition The Company operates in three segments: wound care, wound closure and specialty securement devices and skin care. 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 expensed as incurred and were $1,276,368 and $859,857 in 2008 and 2007, 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, 2008 and 2007 was $346,260 and $49,005, 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 common stock 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, 2008 and 2007 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,	
	2008	2007
Excluded dilutive shares:		
Preferred stock	285,051	285,051
Restricted common stock	21,875	21,875
Stock options	1,002,828	1,027,935
Warrants	1,093,157	1,039,095
Total dilutive shares	2,402,911	2,373,956

Recently Issued Accounting Pronouncements In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements, but does not require any new fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal

years. The Company adopted SFAS 157 as of January 1, 2008, as required. The adoption of SFAS 157 did not have a material effect on the Company s financial condition or results of operations for the year ended December 31, 2008.

In December 2007, the FASB issued SFAS No. 141 (revised), *Business Combinations* (SFAS 141(R)), which is intended to improve reporting by creating greater consistency in the accounting and financial reporting of business combinations. SFAS 141(R) requires that the acquiring entity in a business combination recognize all (and only) the assets and liabilities assumed in the transaction, establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed, and requires the acquirer to disclose to investors and other users all of the information that they need to evaluate and understand the nature and financial effect of the business combination. In addition, SFAS 141(R) impacts the accounting for transaction and restructuring costs. SFAS 141(R) is effective for business combinations for

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DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Summary of Significant Accounting Policies (continued)

which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. SFAS 141(R) will impact the accounting for acquisitions completed by the Company after December 31, 2008.

In June 2008, the FASB issued EITF 07-5, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity s Own Stock* (EITF 07-5). EITF 07-5 provides guidance in assessing whether an equity-linked financial instrument (or embedded feature) is indexed to an entity s own stock for purposes of determining whether the appropriate accounting treatment falls under the scope of SFAS 133, *Accounting For Derivative Instruments and Hedging Activities* and/or EITF 00-19, *Accounting For Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock*. EITF 07-5 is effective for financial statements issued for fiscal years beginning after December 15, 2008 and early application is not permitted. The Company has not yet determined what, if any, effect EITF 07-5 will have on the results of operations or financial condition.

3. Acquisitions

NutraMax Acquisition

On November 8, 2007, the Company acquired the NutraMax Products, Inc., (NutraMax) first aid division (FAD) for $13,000,000 cash and a $500,000 potential earn out bonus. The cash purchase price consisted of $10,250,000 paid to NutraMax, $2,000,000 deposited in a supply agreement escrow account and $750,000 deposited in an indemnification escrow account. In addition, the Company incurred $858,148 of capitalizable transaction costs related to the acquisition. On June 26, 2008 the Company and NutraMax reached an agreement on the disposition of the escrowed funds and settled other working capital items. In connection with the settlement the Company received payment of $1,193,187 in full satisfaction of all indemnification and contingent acquisition related matters which has been recorded as an adjustment to the purchase price. The purchased assets consisted of receivables, inventory, equipment, other amortizable intangible assets and goodwill. To fund the acquisition, the Company raised $5,610,915 (net of $389,079 in commission and other offering expenses) from the private sale of 1,071,427 shares of common stock at a price of $5.60 per share, together with 267,857 five-year warrants to purchase one share of common stock at a price of $6.16 per share. In addition, the Company entered into a new five-year credit and security agreement comprised of an $8,000,000 revolver and a $6,000,000 term loan. At closing, the Company applied the entirety of the $6,000,000 term loan and approximately $3,000,000 of the revolver in satisfaction of the Company s obligations under the purchase agreement and related obligations.

The FAD is a leading manufacturer and marketer of branded and private label adhesive strips and related first aid products to the medical, industrial and retail markets. The FAD s product line will serve to expand the Company s existing basic wound care line to new customers and markets, especially the retail market where the Company did not have a presence. The Company anticipates being able to leverage cross selling opportunities presented by the purchase to grow sales. In addition, the Company expects to be able to reduce FAD product costs by completing the transfer of

production of FAD products, initiated by NutraMax, to lower cost suppliers. The production transfer was completed in the fourth quarter of 2008.

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DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

3. Acquisitions (continued)

The acquisition has been accounted for as a purchase. Accordingly, the results of operations of FAD have been included in the consolidated financial statements commencing November 8, 2007. The allocation of the purchase price is outlined below:

Purchase Price:	
Cash paid, net of settlement	$11,806,813
Transaction costs	858,148
Total	$12,664,961
Allocation of Purchase Price:	
Trade receivables	$2,073,800
Inventory	2,343,732
Equipment	297,000
Goodwill	4,679,684
Identifiable intangible assets subject to amortization	4,200,000
Liabilities assumed	(929,255)
Total	$12,664,961

The allocation of the purchase price to the assets acquired and liabilities assumed as reflected in the consolidated financial statements is based on the finalized independent valuation study which established the fair market value of the assets, liabilities and the identifiable intangible assets and liabilities assumed. The intangible assets acquired consist primarily of customer lists, trademarks and other agreements.

Effective December 31, 2008, we made certain adjustments to our preliminary valuation of tangible and intangible assets acquired and liabilities assumed in connection with our November, 2007 acquisition of FAD. In so doing, we considered a valuation study prepared by an independent appraiser as well as information that became available after the acquisition. The responsibility for the valuation adjustments is entirely ours.

A reconciliation of the preliminary goodwill valuation of $7,084,263 identified in the December 31, 2007 financial statements to the final valuation is as follows:

Goodwill at December 31, 2007	$ 7,084,263
Less:	
Escrow account settlement	1,193,187
Increase in intangible assets	1,200,000
Increase in tangible assets	11,392
Goodwill at December 31, 2008	$ 4,679,684

The Company has retained certain NutraMax personnel to perform sales and marketing, manufacturing and distribution activities on a permanent and transitional basis. Manufacturing activities were completed in Houston in

the fourth quarter 2008. The Company entered into a lease for NutraMax s former facility in Houston, Texas through April, 2009. Under the terms of the lease, the Company will pay the landlord $18,750 per month and will be responsible for utilities and ongoing normal repair and maintenance costs.

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DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

3. Acquisitions (continued)

The unaudited pro forma information below presents combined results of operations as if the FAD acquisition had occurred on January 1, 2007 instead of November 8, 2007. The pro forma information is based on historical results 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.

	2007 (Unaudited)
Revenues	$48,548,377
Net loss	$(3,131,722)
Net loss per common share:	
Basic and diluted	$(0.94)

4. Accounts Receivable

Accounts receivable include the following:

	December 31, 2008	2007
Accounts receivable	$5,213,167	$4,070,658
Less:		
Allowance for doubtful accounts	(370,000)	(123,000)
Allowance for trade rebates	(709,244)	(213,550)
Allowance for cash discounts and returns	(241,400)	(66,989)
Accounts receivable, net	$3,892,523	$3,667,119

At December 31, 2008 and 2007 Derma Canada s net accounts receivable balance was a credit of $1,257,273 and $1,650,528, respectively. The credit balance was primarily attributable to the trade rebate allowance from its largest customer exceeding the underlying trade accounts receivables outstanding. The credit balance has been reclassed to accrued expenses and other current liabilities for financial statement presentation purposes (see Note 10).

5. Inventories

Inventories include the following:

	December 31, 2008	2007

Finished goods	$ 9,001,269	$ 6,660,454
Work in process	443,511	180,823
Packaging materials	700,948	1,152,268
Raw materials	2,277,314	1,942,432
Total inventory	$ 12,423,042	$ 9,935,977

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DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

6. Equipment and Improvements, net

Equipment and improvements include the following:

	December 31, 2008	2007
Machinery and equipment	$5,110,112	$5,527,923
Furniture and fixtures	569,617	455,737
Leasehold improvements	1,229,168	1,462,690
	6,908,897	7,446,350
Less: accumulated depreciation	(2,931,044)	(2,537,301)
Total equipment and improvements, net	$3,977,853	$4,909,049

Included in equipment and improvements at December 31, 2008 were leased machinery and equipment with a cost of $161,381 and accumulated amortization of $76,656 and furniture and fixtures with a cost of $260,069 and accumulated amortization of $66,301 attributable to leased equipment. Amortization of assets under capital leases is included in depreciation expense.

7. Other Intangible Assets, net

Other intangible assets, net include the following:

	December 31, 2008	2007
Patents and trademarks	$444,067	$444,067
Other intangible assets	7,842,797	6,642,797
	8,286,864	7,086,864
Less accumulated amortization	(2,976,735)	(1,549,211)
Other intangible assets, net	$5,310,129	$5,537,653

In connection with the various acquisitions of certain assets and assumption of trade payables during 2007 and 2006, the Company allocated $7,500,000 to identifiable intangible assets as outlined below:

	Fair Value	Annual Amortization	Amortization Period
Trademarks and trade names	$ 1,600,000	$ 135,000	10 13 years
Customer list	3,300,000	600,000	4 10 years
Non-compete agreement	1,200,000	240,000	5 years
Other agreements	1,200,000	300,000	4 years

Certification and product designs	200,000	40,000	5 years
Total	$ 7,500,000	$ 1,315,000	

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DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

7. Other Intangible Assets, net (continued)

The weighted average useful life of patent and trademarks and other intangibles as of December 31, 2008 and 2007 is 3.8 and 4.9 years, respectively. Actual amortization expense for 2008 and 2007 and estimated thereafter by year is outlined below:

	Patents and Trademarks	Other Intangibles	Total
Actual amortization expense for year ended December 31, 2008	$ 36,012	$ 1,391,511	$ 1,427,524
Actual amortization expense for year ended December 31, 2007	$ 41,201	$ 618,511	$ 659,712
Estimated amortization expense for years ending December 31,			
2009	$	$ 1,316,879	$ 1,316,879
2010		1,315,000	1,315,000
2011		1,051,250	1,051,250
2012		320,000	320,000
2013		285,000	285,000
Thereafter		1,022,000	1,022,000
Total	$	$ 5,310,129	$ 5,310,129

8. Other Assets, net

Other assets, net include the following:

	December 31,	
	2008	2007
Deferred financing costs, net	$ 559,212	$ 419,496
Deposits	122,260	90,011
Total other assets, net	$ 681,472	$ 509,507

Deferred financing costs related to the U.S. credit facility are being amortized over the five-year term of the related facility. Unamortized deferred financing costs in the amount of $56,628 associated with the $3,500,000 revolving line of credit agreement which was paid off in November, 2007 were written-off and included in Loss on Debt Extinguishment in the Consolidated Statement of Operations.

9. Line of Credit Borrowings

In November, 2007, the Company entered into a new five-year revolving credit agreement providing for maximum borrowings of $8,000,000 with a U.S. lender. Advances under the revolving credit agreement may be drawn, from time to time, up to the amount of 85% of eligible receivables (as defined) and 42% of eligible inventory (as defined). Interest on outstanding advances under the revolving credit agreement is payable at the LIBOR monthly rate (the Base Rate) plus 2.75% (the Base Rate Margin) (3.22% at December 31, 2008). In addition, the Company pays a monthly unused line fee of 0.5% per annum on the difference between the daily average amount of advances outstanding under the agreement and $6,500,000 ($8,000,000 less a reserve of $1,500,000) together with a monthly collateral management fee of $2,000. Outstanding balances under the agreement are secured by all of the Company s and its subsidiaries existing and after-acquired tangible and intangible assets located in the United States and Canada. At December 31, 2008 the Company had an outstanding balance of $3,446,605 under this agreement.

The revolving credit agreement is subject to financial covenants which require maintaining a minimum cumulative EBITDA level and certain ratios of fixed charge coverage, senior debt leverage and total debt leverage as defined in the agreement. Additional covenants governing permitted investments, indebtedness and

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DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

9. Line of Credit Borrowings (continued)

liens, together with payments of dividends and protection of collateral, are also included in the agreement. The revolving credit agreement contains a subjective acceleration provision whereby the lender can declare a default upon a material adverse change in the Company s business operations.

On March 31, 2009, the Company s U.S. lender agreed to amend the credit and security agreement to allow the Company to enter into a forbearance agreement with Western Medical to postpone payment of its promissory note due April 18, 2009 and to allow subsequent payments on the subordinated debt beginning in April 2010 provided the Company achieves predetermined liquidity and free cash flow (as defined) objectives and provided Western Medical further extends for one year the payment of the principal balance, if any, remaining on the promissory note after giving effect to the April, 2010 payment. In return for the amendment, the Company agreed to change its base rate for interest charged to a three month LIBOR rate from a one month LIBOR rate. Further, the base rate margin was increased 150 basis points on the revolving line of credit from 2.75% to 4.25%, on the term loan from 4.25% to 5.75% and on the portion of the term loan secured by restricted cash from 2.25% to 3.75%. In addition, the Company is obligated to increase the revolving loan availability on its revolving line of credit to a minimum of $3,000,000 by December 31, 2009. Failure to achieve the minimum revolving loan availability amount will result in the base rate changing to the greater of 3.00% or the actual rate in effect. In addition, the Company is responsible for the U.S. lender s reasonable legal fees relative to the third amendment to the credit and security agreement.

Effective August 13, 2008, the Company s lender agreed to waive all prior financial and reporting covenant defaults and amend the existing minimum EBITDA, fixed charge coverage, senior debt leverage and total debt leverage covenants to allow the Company to continue to implement its growth strategy in line with the lender s minimum liquidity terms. Amendment of the covenants was predicated upon the Company segregating $2,000,000 in a restricted account the use of which is subject to the approval of the lender. The Company s maximum revolver borrowing capacity remained unchanged. The Company incurred fees of $25,000 associated with the granting of the covenant amendment.

Effective March 28, 2008, the Company s U.S. lender agreed to waive all prior financial and reporting covenant defaults and amend the existing minimum EBITDA, fixed charge coverage, senior debt leverage and total debt leverage covenants, to be measured on a quarterly basis, to allow the Company to implement its growth strategy. Amendment of the covenants was predicated upon the Company s commitment to raise a minimum of $3,000,000 by May 1, 2008 from the sale of equity and agreement to limit its maximum revolver borrowing to the lesser of (a) the revolver loan commitment ($8,000,000) or (b) the borrowing base (as defined), less $1,500,000. Not less than $3,000,000 of the equity infusion was required to be applied to the then existing revolver balance which amount will be credited as a component of EBITDA for covenant compliance purposes. The Company incurred fees of $250,000 associated with the granting of the covenant amendment, together with related expenses of $10,829 which are included as additions to deferred financing costs. In March, 2008 the equity infusion requirement was met (see Note 12).

10. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities include the following:

	December 31,	
	2008	2007
Accrued Canadian sales rebate, net (see notes 3 and 16)	$ 1,257,273	$ 1,650,528
USC License Fee (see note 16)		839,348
Accrued compensation and related taxes	177,133	520,185
Accrued sales incentives and administrative fees	347,841	249,262
Other	222,246	161,959
Total accrued expenses and other current liabilities	$ 2,004,493	$ 3,421,282

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DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

10. Accrued Expenses and Other Current Liabilities (continued)

At December 31, 2008 and 2007, the value of the Canadian accrued sales rebate and other reserves exceeded the value 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.

11. Long-Term Debt

Long-term debt and capital leases includes the following:

	December 31,	
	2008	2007
U.S. term loan	$ 4,700,000	$ 5,900,000
Promissory note	500,000	500,000
Capital lease obligations	163,243	180,668
Total debt	5,363,243	6,580,668
Less: current maturities	1,298,207	1,288,532
Long-term debt	$ 4,065,036	$ 5,292,136

The following are term loan and promissory note maturities over the next five years:

Year Ending December 31,	Term Loan and Promissory Note
2009	$ 1,200,000
2010	1,700,000
2011	1,200,000
2012	1,100,000
2013	$
Total term loan obligations	5,200,000
Less: current maturities	1,200,000
Long-term loan obligations	$ 4,000,000

U.S. Term Loan

In November, 2007, the Company entered into a five-year $6,000,000 term loan agreement with a U.S. lender. Interest on the term loan is payable at the LIBOR monthly rate plus 4.25%, (4.72% at December 31, 2008). Monthly payments of principal in the amount of $100,000 together with interest are due under the agreement. The agreement is secured by all of the Company s and its subsidiaries existing and after-acquired tangible and intangible assets located in the

United States and Canada.

The term loan agreement is subject to financial covenants which require maintaining a minimum cumulative EBITDA level and certain ratios of fixed charge coverage, senior debt leverage and total debt leverage as defined in the agreement. Additional covenants governing permitted investments, indebtedness and liens, together with payments of dividends and protection of collateral, are also included in the agreement. The term loan agreement contains a subjective acceleration provision whereby the lender can declare a default upon a material adverse change in the Company s business operations.

Effective August 13, 2008 and March 28, 2008, the foregoing financial covenants were amended as described in the third and fourth paragraphs under the heading Line of Credit Borrowings (see Note 9).

Promissory Note

In connection with the acquisition of Western Medical in April 2006, a portion of the purchase price was paid via a three-year unsecured promissory note issued to the seller. The principal amount of the promissory

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DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. Long-Term Debt (continued)

note, together with simple interest of 12%, is payable in 11 quarterly installments of interest only in the amount of $15,000 and a final payment of accrued interest of $15,000 and the principal balance of $500,000 on April 18, 2009. The promissory note may be prepaid in part or in full at any time without penalty.

On March 31, 2009, the Company entered into a Forbearance Agreement (the Agreement) with Western Medical to postpone payment of its $500,000 promissory note due April 18, 2009. The Company will continue to make interest payments when due and a final payment of the principal plus accrued interest through the date of payment on April 14, 2010. In consideration for the postponement, the Company agreed to grant Western Medical warrants to purchase 50,000 shares of the Company s common stock at the market price on the date of execution of the Agreement and agreed to pay Western Medical s legal fees associated with the preparation and subsequent enforcement of the Agreement.

Capital Lease Obligations

The Company has three capital lease obligations for certain office furniture and distribution equipment totaling $163,243 as of December 31, 2008. The capital lease obligations bear interest at annual rates ranging from 6.8% to 9.6% expiring through February 2011.

The future minimum lease payments required under the capital leases and the present value of the minimum lease payments as of December 31, 2008 are as follows:

Year Ending December 31	Capital Lease Obligations
2009	$ 107,676
2010	61,463
2011	5,901
Total minimum lease payments	175,040
Less: Amount representing interest	11,797
Present value of capital lease obligations	163,243
Less: Current maturities of capital lease obligations	98,207
Long-term capital lease obligations	$ 65,036

12. Shareholders Equity

Preferred Stock

There are 18,750 shares of series A convertible preferred stock outstanding at December 31, 2008. The series A preferred stock is convertible into common stock on a one-for-one basis, bears no dividend, maintains a liquidation preference of $32.00 per share, votes as a class on matters affecting the series A preferred stock and maintains voting rights identical to the common stock on all other matters.

There are 55,000 shares of series B convertible preferred stock outstanding at December 31, 2008. The series B preferred stock is convertible into common stock on a one-for-one basis, bears no dividend, maintains a liquidation preference of $48.00 per share, votes as a class on matters affecting the series B preferred stock and maintains voting rights identical to the common stock on all other matters.

There are 77,382 shares of series C convertible preferred stock outstanding at December 31, 2008. The series C preferred stock is convertible into common stock on a one-for-one basis, bears no dividend, maintains a liquidation preference averaging $5.60 per share, votes as a class on matters affecting the series C preferred stock and maintains voting rights identical to the common stock on all other matters.

There are 133,918 shares of series D convertible preferred stock outstanding at December 31, 2008. The series D preferred stock is convertible into common stock on a one-for-one basis, bears no dividend, maintains

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DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

12. Shareholders Equity (continued)

a liquidation preference averaging $4.00 per share, votes as a class on matters affecting the series D preferred stock and maintains voting rights identical to the common stock on all other matters.

Common Stock

In March 2008, the Company raised $5,610,871 (net of $489,129 in commission and other offering expenses) from the private sale of 762,500 shares of common stock at a price of $8.00 per share, together with 381,250 five-year warrants to purchase one share of common stock at a price of $9.60 per share. In addition, the placement agent for the shares sold received 17,812 five-year warrants to purchase one share of common stock at $9.60 per share. The proceeds were used to meet the minimum equity infusion requirements associated with the Company s March 28, 2008 amended bank covenants, support the Company s strategic growth initiatives and increase working capital.

In January 2008, the Company issued 26,374 shares of common stock as follows: (a) 12,500 shares in consideration of $105,000 upon exercise of series G warrants, (b) 2,475 shares in consideration of $12,375 upon exercise of 2,475 stock options, and (c) 11,399 shares upon cashless exercise of 22,275 stock options.

On December 28, 2007 the Company amended its articles of incorporation to increase the number of authorized shares of common stock from 6,250,000 to 18,750,000.

In November 2007, the Company raised $5,610,915 (net of $389,079 in commission and other offering expenses) from the private sale to two institutional investors of 1,071,427 shares of the Company s common stock at the price of $5.60 per share, together with 267,857 five-year warrants to purchase one share of common stock at the price of $6.16. The funds were used for the acquisition of FAD.

In accordance with the series F warrant agreement, effective January 4, 2007, the warrant holders effected a cashless exercise of all issued and outstanding series F warrants comprising 163,680 warrants with an exercise price of $4.56 per warrant. Based on the thirty day trailing average closing price of $6.24 per share, the warrants had a calculated value of $1.68 each ($6.24 $4.56), or $274,983 in the aggregate, and were exchanged for 44,022 shares of common stock.

Stock Purchase Warrants

At December 31, 2008, the Company had warrants outstanding to purchase 1,039,157 shares of the Company s common stock as outlined below:

Series	Number of Warrants	Exercise Price	Expiration Date

H	331,887	$ 8.00	April 30, 2011
I	94,351	$ 5.76	April 30, 2011
J	267,857	$ 6.16	May 31, 2013
K	399,062	$ 9.60	April 1, 2013
Total	1,039,157		

On December 31, 2008 the remaining Series G warrants of 332,500 expired unexercised.

Stock Options

The Company has a stock option plan under which options to purchase a maximum of 1,250,000 shares of common stock may be issued. The plan permits the granting of both incentive stock options and nonqualified stock options to employees and directors of the Company and certain outside consultants and advisors to 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. Under the plan, service based options to purchase 45,000 and 235,000 shares of common stock were granted to officers, directors, agents and employees in 2008 and 2007, respectively, with exercise prices

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DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

12. Shareholders Equity (continued)

ranging from $4.80 to $8.88 per share. Market based options to purchase 87,500 shares of common stock were granted to officers in 2007. In 2008 and 2007, 20,625 and zero plan options were forfeited and 2,500 and 3,625 expired, respectively. In 2008, 24,750 options were exercised. As of December 31, 2008, options to purchase 766,203 shares of the Company s common stock were issued and outstanding under the plan.

The Company has previously granted nonqualified stock options to officers, directors, agents and employees outside of the stock option plan (non-plan options). All non-plan options were granted at the fair market value at the date of grant. As of December 31, 2008, non-plan options to purchase 236,625 shares of the Company s common stock were issued and outstanding. In 2008 and 2007, 5,000 and zero non-plan options were forfeited and 17,232 and 20,725 options expired, respectively.

For the years ended December 31, 2008 and 2007 the fair value of each service based 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, 2008 and 2007 were as follows:

	2008	2007
Risk-free interest rate	3.08 %	4.28 %
Volatility factor	118 %	118 %
Dividend yield	0 %	0 %
Expected option life (years)	6.25	6.25
Contractual life (years)	10	10

In both 2008 and 2007, the risk-free rate utilized represents the U.S. Treasury yield curve rate which approximates the risk-free rate for the expected option life at the time of grant. In 2008 and 2007, the volatility factor was calculated based on the seventy-five month-end closing prices of the Company s common stock preceding the month of stock option grant. The Company uses a seventy-five month volatility period to coincide with the expected stock option life. Based on guidance from Staff Accounting Bulletin 107 and 110, a stock option life of 6.25 years was utilized under the simplified method. The dividend yield is 0% since the Company does not anticipate paying dividends in the near future. Based on the Company s historical experience of options that expired or are cancelled before becoming fully vested, the Company has assumed an annualized forfeiture rate of 1.0% for all options. Under the true-up provision of SFAS 123R, 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.

For the year ended December 31, 2008 no market based options were awarded. For the year ended December 31, 2007 the fair value of each market based option award was estimated at the date of grant using the binomial/lattice option pricing model. The weighted-average assumptions for the year ended December 31, 2007 were as follows:

	2007

Risk-free interest rate	3.97 %
Volatility factor	99.3 %
Dividend yield	0 %
Expected option life (years)	8.5
Contractual life (years)	10

The risk-free rate utilized represents the U.S. Treasury yield curve rate which approximates the risk-free rate for the expected option life at the time of grant. The volatility factor was calculated based on the seventy-five month-end closing prices of the Company s common stock preceding the month of stock option grant, respectively. A one hundred and twenty month volatility period to coincide with the contractual stock option life was utilized. The dividend yield is 0% since the Company does not anticipate paying dividends in

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

12. Shareholders Equity (continued)

the near future. Based on the Company s historical experience for market based options that cancel before becoming fully vested, the Company has assumed an annualized forfeiture rate of 0% for all options.

A summary of the Company s stock option activity and related information for the years ended December 31, 2008 and 2007 follows:

	2008		2007	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding beginning of year	1,027,935	$ 6.24	729,785	$ 7.52
Granted	45,000	$ 7.36	322,500	$ 5.44
Forfeited	(25,625)	$ 6.64		
Expired	(19,732)	$ 46.48	(24,350)	$ 32.64
Exercised	(24,750)	$ 5.04		
Outstanding end of year	1,002,828	$ 5.60	1,027,935	$ 6.24
Exercisable at end of year	795,328	$ 5.60	735,748	$ 6.56

The weighted average fair value per share of options granted during 2008 and 2007 was $6.40 and $5.76, respectively. The fair value of options vested during 2008 and 2007 was $493,075 and $421,325, respectively.

The following table summarizes information related to stock options outstanding and exercisable at December 31, 2008:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding at 12/31/08	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable at 12/31/08	Weighted-Average Exercise Price
$2.96 $4.00	270,141	4.9	$ 3.60	270,141	$ 3.60
$4.08 $6.00	433,500	6.7	$ 5.04	281,937	$ 5.12
$6.40 $9.60	250,625	6.5	$ 6.96	197,969	$ 7.04
$12.40 $13.60	42,687	4.8	$ 13.04	42,687	$ 13.04
$22.40 $48.00	5,875	7.0	$ 28.96	2,594	$ 37.20
	1,002,828	6.08		795,328	

For the years ended December 31, 2008 and 2007, no income tax benefit was recognized related to stock option activity.

During the year ended December 31, 2008 and 2007, stock option compensation expense was recorded using the fair value method under SFAS 123R as follows:

	2008	2007
Cost of sales	$ 58,328	$ 23,825
Selling, general and administrative expenses	714,808	580,767
Total stock option compensation expense	$ 773,136	$ 604,592

As of December 31, 2008, there was $922,664 of unrecognized compensation cost related to nonvested service based awards and $423,500 related to nonvested market based awards granted under the plan. That cost is expected to be recognized over the options remaining weighted average vesting period of 1.45 years for service based options and 1.0 year for market based options.

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DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

12. Shareholders Equity (continued)

Restricted Common Stock

On May 11, 2006, the Company adopted a restricted common stock plan and reserved 312,500 shares of common stock for issuance.

On May 12, 2006, 21,875 shares of restricted common stock were granted to non-employee members of the Company s board of directors and will vest three years from the date of the grant. The fair market value at the date of grant, determined by the quoted market price, was $145,250 or $6.64 per share. The fair market value of the grant is being recognized to compensation expense over the three-year service period. For the years ended December 31, 2008 and 2007, $48,420 for each period was recorded in selling, general and administrative expense for these grants.

Shares Reserved for Future Issuance

At December 31, 2008, the Company had reserved the following shares of common stock for future issuance:

Convertible preferred shares (series A D)	285,051
Common stock options available for grant	483,797
Common stock options outstanding	1,002,828
Common stock warrants outstanding (series H K)	1,093,157
Restricted common stock available for grant	290,625
Restricted common stock grants	21,875
Total common stock shares reserved	3,177,333

Securities Registration Obligations

The Company closed on private syndications of its securities on April 18, 2006, August 3, 2006, November 8, 2007 and April 2, 2008. In connection with each such syndication, the Company agreed with purchasers both to register the securities for public sale and to use its best efforts to maintain the effectiveness of such registration statements. The Company has satisfied its obligations to register the securities issued in each of the aforementioned syndications and has maintained the effectiveness of such registrations through the date hereof.

The securities registration provisions applicable to the April 18, 2006 and August 3, 2006 syndications do not specify liquidated damages for failure to maintain the effectiveness of the subject registration statements. The registration statements relative to these syndications, and the Company s obligations thereunder, expire on October 20 and November 27, 2009, respectively.

The securities registration provisions applicable to the November, 2007 and April, 2008 syndications require that if the Securities and Exchange Commission suspends the effectiveness of the subject registration statements prior to all registered securities either having been sold or becoming eligible for unrestricted sale pursuant to Rule 144(b)(1)(i) under the Securities Act of 1933, an event not now anticipated, the Company must pay purchasers one thirtieth of one percent of the purchase price of the securities for each day the registration statement is not effective up to a maximum of ten percent of the purchase price.

The securities purchased in the November, 2007 and April, 2008 syndications are all eligible for unrestricted sale under Rule 144(b)(1)(i) with the exception of securities purchased by a single institutional investor in the total amount of $6,500,000. The Company s maximum potential liability to the subject investor under the foregoing registration provisions would be $650,000. The Company s securities registration obligations relative to the November, 2007 and April, 2008 syndications expire on January 2, 2011 and August 29, 2011, respectively.

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DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

13. Operating Segments

The Company consists of three operating segments: wound care, wound closure and specialty securement devices and skin care. Products in the wound care segment consist of basic and advanced dressings, ointments and sprays and adhesive bandages. Wound closure and specialty securement device products include wound closure strips, nasal tube fasteners and a variety of catheter fasteners. The skin care segment consists of antibacterial skin cleansers, hair and body soaps, lotions and moisturizers.

Products in all three operating segments are marketed to long-term care facilities, hospitals, physicians, clinics, home health care agencies and other healthcare institutions. Basic and advanced wound care products are manufactured both internally and outsourced, while the manufacture of skin care products is completely outsourced. Wound closure-specialty securement devices are significantly manufactured in-house. Internally, the segments are managed at the gross profit level. The aggregation or allocation of other costs by segment is not practical.

Segment sales, gross profit and other related information for 2008 and 2007 are as follows:

	Year Ended December 31, 2008				
	Wound Care	Wound Closure-Specialty Securement Devices	Skin Care	Other	Total Company
Net sales	$ 47,641,194	$ 1,799,256	$ 758,978		$ 50,199,428
Gross profit	14,059,556	975,357	221,091		15,256,004
Total expenses					(19,217,941)
Net loss					$ (3,961,937)
Net long-lived assets	$ 15,686,129	$ 130,729	$ 41,463	$ 549,388	$ 16,407,708

	Year Ended December 31, 2007				
	Wound Care	Wound Closure-Specialty Securement Devices	Skin Care	Other	Total Company
Net sales	$ 30,983,191	$ 2,260,735	$ 891,475		$ 34,135,401
Gross profit	10,043,756	1,318,148	242,511		11,604,415
Total expenses				$ (13,889,020)	(13,889,020)
Net loss					$ (2,284,605)
Net long-lived assets	$ 19,345,496	$ 146,768	$ 52,350	$ 426,393	$ 19,971,007

Long-lived assets consist of equipment and improvements, other intangible assets and goodwill. Wound care long-lived assets consist principally of Derma Sciences Canada Inc. equipment and improvements, other identifiable intangible assets and goodwill. Corporate headquarters and the Company s U.S. distribution center equipment and improvements are included in the Other column since they service all three operating segments.

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DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

13. Operating Segments (continued)

A geographical breakdown of the Company s sales, gross profit and long-lived assets is outlined below:

	United States	Canada	Other	Total
2008				
Net sales	$35,369,182	$12,091,858	$2,743,388	$50,199,428
Gross profit	$10,585,004	$3,364,554	$960,186	$14,909,744
Net long-lived assets	$13,323,238	$2,627,922	$456,548	$16,407,708
2007				
Net sales	$20,119,160	$12,324,111	$1,692,130	$34,135,401
Gross profit	$7,560,253	$3,451,907	$592,246	$11,604,415
Net long-lived assets	$15,835,701	$3,775,581	$359,725	$19,971,007

Other sales and gross profit relate principally to wound care and wound closure and specialty securement devices sales in Europe and are invoiced by the United States operation.

For the year ended December 31, 2008, the Company has a major U.S. customer comprising 10% of U.S. sales and 11% of U.S. operations trade accounts receivable at December 31, 2008. The Company s wholly owned Canadian subsidiary sells to one customer who serves as its exclusive third party distributor and comprises 100% of Canada operations trade accounts receivable at December 31, 2008.

14. Income Taxes

Income (loss) before provision for income taxes consists of the following components:

	2008	2007
Domestic	$(4,060,199)	$(2,588,667)
Foreign	157,077	566,096
Loss before provision for income taxes	$(3,903,122)	$(2,022,571)

The components of the provision for income taxes are as follows:

	2008	2007
Current:		
Federal	$	$
State		
Foreign	63,823	
Total current	63,823	

Deferred:		
Federal		
State		
Foreign	(5,008)	262,034
Total deferred	(5,008)	262,034
Total provision for income taxes	$ 58,815	$ 262,034

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DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

14. Income Taxes (continued)

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

	December 31, 2008	2007
Deferred tax liabilities:		
Prepaids	$(28,915)	$(32,444)
Intangible amortization	(299,658)	(127,402)
Deductible acquisition costs	(110,779)	(113,345)
Depreciation	(280,089)	(435,394)
Total deferred tax liabilities	(719,440)	(708,585)
Deferred tax assets:		
Net operating loss carryforwards U.S.	3,580,429	3,900,236
Net operating loss carryforwards foreign		22,145
Equity based compensation	127,564	111,468
Allowance for sales deductions	512,306	149,063
Amortization of intangibles	948,133	649,882
Inventory adjustments	439,768	197,481
Other	50,466	27,931
Gross deferred tax assets	5,658,667	5,058,206
Valuation allowance	(5,275,646)	(4,765,541)
Total deferred tax assets	383,021	292,665
Net deferred tax liabilities	$(336,419)	$(415,920)

The net deferred tax liability relates to the Company s Canadian operation and consists of a deferred tax asset current of $4,452 and a net deferred tax liability long term of $340,871 as of December 31, 2008. The deferred tax asset current is included in prepaid expenses and other current assets in the consolidated balance sheet. The remaining valuation allowance relates to the U.S. The timing in which the Company can utilize its U.S. federal net operating loss carryforwards in any year or in total may be 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 U.S. net operating loss carryforwards and net deferred tax assets, a full valuation allowance has been provided as of December 31, 2008 and 2007.

The reconciliation of income tax computed at the U.S. federal statutory tax rates to income tax expense is:

	December 31, 2008	2007
Tax expense at federal statutory rate	$(1,327,062)	$(687,674)
State tax, net of federal benefit	(146,334)	(110,442)

Nondeductible expenses	298,277	187,713
Other	704,232	93,253
Total	(470,887)	(517,150)
Change in valuation allowance	529,702	779,184
Provision for income taxes	$ 58,815	$ 262,034

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DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

14. Income Taxes (continued)

At December 31, 2008, the Company has net operating loss carryforwards of approximately $9,864,000 for federal income tax purposes that begin to expire in years 2017 through 2028. For state income tax purposes, the Company has net operating loss carryforwards in a number of jurisdictions in varying amounts and with varying expiration dates. The most significant state net operating loss carryforward is approximately $2,425,000 in New Jersey, the site of the Company s headquarters. New Jersey currently allows the deduction of net operating losses up to 100% of net income. The state has a seven year carryforward period but such period is extended where an otherwise deductible net operating loss was disallowed in full or in part because of previous limitations. The New Jersey carryforwards begin to expire in years 2009 through 2015.

15. 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 of 50% on the first 6% of each participant s annual earnings contributed to the plan. Company contributions to the plan for the years ended December 31, 2008 and 2007 were $53,270 and $50,347, 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 of 50% of an employee s contribution to a maximum of 3% of annual gross earnings. Employee contribution limits to the group retirement savings plan are set by the Canada Customs and Revenue Agency. The Company s Canadian subsidiary s contributions to the plan for the year ended December 31, 2008 and 2007 were $60,360 and $54,939, respectively.

16. Commitments

Operating Leases

The Company has operating lease agreements for its facilities and equipment expiring in various years through 2012. Rent expense under non-cancelable operating agreements amounted to $1,468,289 and $1,280,654 in 2008 and 2007, respectively. The leases provide for increases in future minimum annual rental payments based on specified conditions over the life of the lease and/or annual inflationary increases tied to a published price index. The leases provide for renewal options consistent with the terms of the current lease. It is expected that these leases will be renewed or replaced by leases on other properties.

Net minimum future rental payments under these operating leases as of December 31, 2008 are:

Minimum Future Rental Payments

Year Ending December 31,	Amount
2009	$ 1,390,682
2010	1,432,739
2011	1,216,264
2012	591,325
2013	24,286
Thereafter	
Net minimum future rental payments	$ 4,655,296

Minimum rental payments associated with the U.S. distribution lease range from $11,000 per month in year one to $21,600 in year five of the lease term. The Company is recording lease expense monthly at $16,300, the weighted average monthly lease expense over the life of the lease. The difference between the monthly lease expense being recorded and the amount paid is being recorded as deferred rent expense on the balance sheet. At December 31, 2008, $10,872 of deferred rent expense was recorded.

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DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

16. Commitments (continued)

Comvita Licensing, Manufacturing and Sales Agreement

On February 13, 2006 the Company entered into an exclusive five year licensing, manufacturing and sales agreement (the Agreement) with Comvita New Zealand Limited, whereby the Company will manufacture and sell a line of Manuka Honey based wound care products developed by Comvita. These products are supported by proprietary intellectual property that will serve to provide a competitive advantage in the market place. Access to this technology and these products represents a significant milestone in the Company s strategy to build a larger presence in the advanced wound care market segment. Under the Agreement, the Company receives exclusive rights to manufacture and sell its branded products throughout North and South America within the professional medical-surgical marketplace (i.e. extended care, acute care, home care, etc.) and non-exclusive rights within the consumer marketplace. Comvita retains the right to these products in the consumer marketplace and has the option to purchase its branded consumer product requirements from the Company at agreed upon pricing.

In accordance with the Agreement, the Company will purchase its requirements for active honey from Comvita at agreed upon pricing. As consideration for the grant of the license, the Company will pay Comvita a royalty based on sales. The Agreement calls for the Company to spend a minimum of either $200,000 or 8% of sales per year on advertising and promotion in support of these products. Further, the Agreement calls for minimum sales achievement targets beginning in the second year of the Agreement and each year thereafter to maintain exclusivity. The Agreement commenced upon the receipt of regulatory approval of the first product which occurred during the fourth quarter of 2007. The Company achieved its minimum sales objective in the first year of the Agreement. In 2008 and 2007, the Company purchased $347,935 and $51,436 of active honey and incurred $113,203 and $8,472 of royalties under the Agreement, respectively.

Quick-Med Technologies, Inc. License Agreement

On March 23, 2007, the Company entered into a patent and technology license agreement (the Agreement) with Quick-Med Technologies, Inc. (QMT) relating to QMT s proprietary anti-microbial technology (the Technology). The Company anticipates utilizing the Technology in a series of wound care products, including conforming gauze, gauze sponges, gauze bandage rolls, gauze packing strips, oil emulsion acetate and Unna boot dressings. Initiation of the marketing and sale of products incorporating the Technology is dependent upon the grant by the FDA of approval for use of the Technology in primary and secondary wound dressings.

The initial term of the Agreement extends from March 23, 2007 (the Effective Date) for a period equal to the shorter of five years from the first commercial sale of products under the Agreement or seven years from the Effective Date. Under the Agreement, QMT granted to the Company an exclusive, royalty-bearing right and license to make, use and sell products incorporating the Technology in the United States and Canada (with the exception of sales to the United States government and agencies thereof in which case the license will be non-exclusive).

In consideration for the license to the Technology, the Company paid QMT a license fee in the amount of $125,000. The total non-refundable license and advance royalty payments of $125,000 was charged to research and development expense in 2007 in the consolidated statement of operations. The foregoing advance royalty payments are creditable against future royalties that become due under the Agreement.

Royalties are payable upon the Company s net sales of products utilizing the Technology for sales within exclusive and non-exclusive territories at specified rates. The Agreement provides for escalating minimum royalty payments for each contract year. In the event for a given contract year the Company fails to make the required minimum royalty payments, QMT s exclusive remedies (depending on the magnitude of the failure) would be either termination of the Company s exclusive rights to the Technology or termination of the Agreement.

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DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

16. Commitments (continued)

QMT received clearance from the FDA for use of the Technology in February 2009. The Company is in the process of initiating the actions necessary to launch the first product utilizing this technology in June 2009.

USC License Agreement

On November 2, 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 49 United States 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 a topical application 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 of $839,348 during the first quarter of 2008. The initial license fee was charged to research and development expense in 2007. Additionally, the Company will pay USC royalties relative to sales of products employing the Angiotensin Analog Technology at specified rates in respect of revenues less than $100 million and revenues equal to or greater than $100 million, respectively. In addition, the Company will make milestone payments to USC of up to $9,625,000 predicated upon obtaining approval of the FDA of various indications for the Angiotensin Analog Products as well as the attainment of various sales objectives. Further, the Company is obligated to spend at least $1,250,000 on direct marketing of the initial Angiotensin Analog Product within twelve months of the FDA s approval thereof.

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 I, phase II and phase III studies.

The compound has successfully undergone pre-clinical and phase I clinical studies. The phase II clinical studies commenced in 2008 and are expected to be concluded by mid 2010. If the phase II clinical studies are successful, phase III clinical studies are expected to begin in July, 2010 and, barring unforeseen events, are expected to be completed by mid 2013. In the event the phase III clinical studies are successful, evaluation of the clinical studies by the FDA is expected to be completed by mid 2014.

The Company s costs incident to conducting phase II and phase III clinical studies relative to the compound are expected to aggregate approximately $1.6 million and $10.0 million, respectively. The Company is under no obligation to undertake or complete phase II or phase III studies. Should it elect not to do so, the Company may either sublicense the Angiotensin Analog Technology to one or more pharmaceutical concerns or release the Technology to USC. In this latter event, USC would reimburse the Company for certain of its costs incident to clinical studies that have theretofore been performed.

Canadian Distribution Agreement

The Company has a five-year agreement expiring May 1, 2010 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 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. The agreement automatically renews after five-years for consecutive periods of one year each on the same terms and conditions unless either party gives notice of its intent not to renew 180 days prior to expiry. 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

DERMA SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

16. Commitments (continued)

by breach by the distributor, the distributor will be entitled on notice to the Company to return saleable inventory (as defined) to the Company. In the event sales returns are expected, they will be reserved for 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 will place 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 will pay the distributor an agreed upon distribution fee and a specified incentive for growth (as achieved). The Company will reimburse 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. Further, the agreement requires the distributor to meet specified minimum regular sales growth targets in the first four years and achieve a minimum annual private label product purchase target. The agreement is cancellable by the Company if the distributor does not meet its annual purchase requirements.

Clinical Services Agreement

In January 2008, the Company entered into an agreement with a clinical services company to provide phase II clinical studies for the angiotensin analog technology compound licensed from USC in November 2007.

Costs under the agreement include services fees of approximately $23,000 per month from January 2008 to January 2010 and reimbursement of sterile manufacturing, toxicology and statistician support services estimated in the amount of $470,000. The foregoing costs represent an estimate of the Company s costs under the agreement; however, actual costs could exceed these estimates. The agreement may be terminated upon termination of the USC license agreement. The Company incurred $572,083 in connection with this agreement in 2008 which is included as a component of research and development costs.

Derma Sciences, Inc.

1,500,000 Shares of Common Stock

PROSPECTUS

Rodman & Renshaw, LLC

Until , all dealers that effect transactions in these securities, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the dealers obligation to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

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PART II

INFORMATION NOT REQUIRED IN PROSPECTUS

Item 13. Other Expenses of Issuance and Distribution.

The following table sets forth expenses (estimated except for the registration fee) in connection with the offering described in the registration statement:

SEC registration fee	$ 617
Underwriting discount and commission	565,500
Underwriter s expense allowance	143,500
Accounting fees and expenses	100,000
Legal fees and expenses	150,000
Printing expenses	25,000
NASDAQ listing fee	55,000
Miscellaneous	100,383
Total	$ 1,140,000

Item 14. Indemnification of Directors and Officers.

Sections 1741 and 1742 of the Pennsylvania Business Corporation Law of 1988 empower us, and our bylaws provide that we shall have the power, to 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 by reason of the fact that he is or was our director, officer, employee or agent, or is or was serving at our request as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses, judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with such action, suit or proceeding if he acted in good faith and in a manner he reasonably believed to be in, or in the case of actions undertaken other than in his official capacity, not opposed to, our best interest, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful; except that, in the case of an action or suit by or in our right, no indemnification may be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable for negligence or misconduct in the performance of his duty to us unless and only to the extent that the court in which such action or suit was brought shall determine that such person is fairly and reasonably entitled to indemnity for proper expenses.

Item 15. Recent Sales of Unregistered Securities.

Offering of April 18, 2006

On April 18, 2006 we privately sold 2,655,098 units (the Units"), at $2.40 per Unit, each Unit consisting of four shares of our common stock, $0.01 par value (the Common Stock"), and one five-year warrant to purchase one share of Common Stock at the price of $1.00 (the Warrants"). Initially, neither the Units nor the Common Stock component of the Units nor the Common Stock issuable upon exercise of the Warrants (the latter, collectively, the Underlying Common Stock") were registered under the Securities Act of 1933 (the Act") and were offered pursuant to the

exemptions from registration set forth in section 4(2) of the Act and Regulation D, Rules 501-503 and 506 promulgated thereunder. The Units were offered exclusively to accredited investors" as this term is defined in Rule 501(a) of Regulation D. The Common Stock and Underlying Common Stock were subsequently registered pursuant to our registration statement on Form S-3 effective October 20, 2006.

Proceeds of the sale of the Units of $6,372,236, less commissions and other offering expenses of $568,932, were applied to our acquisition of substantially all of the assets of Western Medical, Inc. as well as the payment of acquisition related expenses.

We paid commissions to registered broker-dealers (Placement Agents") incident to the sale of the Units in amounts of up to 8% of the purchase price thereof, together with five-year warrants to purchase our Common Stock equal to 10% of the Common Stock sold in the offering and exercisable at $0.72 per share (Placement Agent Warrants"). Placement agents included Taglich Brothers, Inc., Oppenheimer & Co., Inc. and Beaufort International Associates, Ltd.

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Offering of August 3, 2006

On August 3, 2006 we privately sold 2,000,000 shares of our common stock, $0.01 par value (the Common Stock"), at $0.75 per share for a total purchase price of $1.5 million, to Comvita New Zealand Limited, a corporation organized under the laws of New Zealand and headquartered in Paengaroa, New Zealand (Comvita"). Initially, the Common Stock was not registered under the Securities Act of 1933 (the Act") and was offered and sold pursuant to the exemptions from registration set forth in section 4(2) of the Act and Regulation D, Rules 501-503 and 506 promulgated thereunder. Comvita is an accredited investor" as this term is defined in Rule 501(a) of Regulation D. The Common Stock was subsequently registered pursuant to our registration statement on Form S-3 effective November 27, 2006.

We did not pay sales commissions or other compensation relative to the sale of the Common Stock. It utilized $500,000 of the purchase price for the Common Stock to reduce its term loan obligations. The balance of the $1.0 million purchase price was utilized both to reduce debt obligations and for general working capital purposes.

Offering of November 8, 2007

On November 8, 2007 we privately sold 8,571,420 shares of our common stock (the Common Stock") at a price of $0.70 per share, together with 2,142,855 five-year warrants to purchase one share of Common Stock at the price of $0.77 (the Warrant(s)"), to two institutional purchasers. The Common Stock and the Warrants were bundled" with each purchaser receiving one Warrant for every four shares of Common Stock purchased. Initially, neither the Common Stock nor common stock issuable upon exercise of the Warrants (the Underlying Common Stock") were registered under the Securities Act of 1933 (the Act") and were offered pursuant to the exemptions from registration set forth in section 4(2) of the Act and Regulation D, Rules 501-503 and 506 promulgated thereunder. The purchasers are accredited investors" as this term is defined in Rule 501(a) of Regulation D. The Common Stock was subsequently registered pursuant to our registration statement on Form S-3 effective January 2, 2008.

We paid commissions to Oppenheimer & Co, Inc., a registered broker dealer, incident to the sale of the Common Stock and Warrants of 6% of the purchase price thereof, i.e. $360,000.

Proceeds from the sale of the Common Stock and Warrants of $5,999,994, less commissions and other offering expenses of $389,079, were applied to our acquisition of substantially all of the assets of the first aid division of NutraMax Products, Inc. as well as the payment of acquisition related expenses.

Offering of April 2, 2008

On April 2, 2008 we privately sold 6,100,000 shares of our common stock (the Common Stock") at a price of $1.00 per share, together with 3,050,000 five-year warrants to purchase one share of Common Stock at the price of $1.20 (the Warrant(s)"), to eight institutional purchasers (the Offering"). The Common Stock and the Warrants were bundled" with each purchaser receiving one Warrant for every two shares of Common Stock purchased. The purchasers are accredited investors" as this term is defined in Rule 501(a) of Regulation D (discussed below).

Neither the Common Stock nor common stock issuable upon exercise of the Warrants (the Underlying Common Stock") were registered under the Securities Act of 1933 (the Act") and were offered pursuant to the exemptions from registration set forth in section 4(2) of the Act and Regulation D, Rules 501-503 and 506 promulgated thereunder.

We paid the following consideration to Oppenheimer & Co, Inc., a registered broker dealer, incident to the sale of the Common Stock and Warrants: (i) commissions in the amount of $394,500, (ii) reimbursed expenses in the amount of

$4,678, and (iii) Warrants to purchase 142,500 shares of Common Stock.

Proceeds from the Offering of $6,100,000, less commissions and other offering expenses of $489,129, have been initially applied to reduce indebtedness under our revolving credit facility. We utilized net proceeds from the Offering to expand our sales force and for general working capital purposes.

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Item 16. Exhibits.

Exhibit Number	Description
4	Form of Securities Underwriting Agreement
5	Opinion of Hedger & Hedger regarding the legality of the securities being registered
23.1	Consent of Ernst & Young LLP
23.2	Consent of Hedger & Hedger (included in its opinion filed as Exhibit 5)

Item 17. Undertakings.

The undersigned Registrant undertakes:

(l) To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement:

(i) To include any prospectus required by Section 10(a)(3) of the Securities Act of 1933;

(ii) To reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement; notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of the securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than a 20 percent change in the maximum aggregate offering price set forth in the Calculation of Registration Fee table in the effective registration statement; and

(iii) To include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement; provided, however, that paragraphs (l)(i) and (l)(ii) do not apply if the registration statement is on Form S-3 or Form S-8, and the information required to be included in a post-effective amendment by those paragraphs is contained in periodic reports filed by the registrant pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 that are incorporated by reference in the registration statement.

(2) That, for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(3) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering.

(4) That, for the purpose of determining liability under the Securities Act of 1933 to any purchaser:

(i) If the Registrant is relying on Rule 430B:

(A) Each prospectus filed by the Registrant pursuant to Rule 424(b)(3) shall be deemed to be part of the registration statement as of the date the filed prospectus was deemed part of and included in the registration statement; and

(B) Each prospectus required to be filed pursuant to Rule 424(b)(2), (b)(5) or (b)(7) as part of a registration statement in reliance on Rule 430B relating to an offering made pursuant to Rule 415(a)(1)(i), (vii) or (x) for the purpose of providing the information required by Section 10(a) of the Securities Act of 1933 shall be deemed to be part of and included in the registration statement as of the earlier of the date such form of prospectus is first used after effectiveness or the date of the first contract of sale of securities in the offering described in the prospectus. As provided in Rule 430B, for liability purposes of the issuer and any person that is at that date an underwriter, such date shall be deemed to be a new effective date of the registration statement relating to the securities in the registration statement to which that prospectus relates, and the offering of such

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securities at that time shall be deemed to be the initial bona fide offering thereof. Provided, however, that no statement made in a registration statement or prospectus that is part of the registration statement or made in a document incorporated or deemed incorporated by reference into the registration statement or prospectus that is part of the registration statement will, as to a purchaser with a time of contract of sale prior to such effective date, supersede or modify any statement that was made in the registration statement or prospectus that was part of the registration statement or made in any such document immediately prior to such date of first use.

(5) That, for purposes of determining any liability under the Securities Act of 1933 each filing of the Registrant's annual report pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 that is incorporated by reference in the registration statement shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the Registrant pursuant to the provisions described under Item 15 above, or otherwise, the Registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the Registrant of expenses incurred or paid by a director, officer or controlling person of the Registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the Registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issue.

[Signatures on next page]

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SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, the Registrant has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized in the city of Princeton, New Jersey, on the 5th day of February, 2010.

DERMA SCIENCES, INC.
By:

/s/ Edward J. Quilty
Edward J. Quilty
President and Chief Executive Officer

Pursuant to the requirements of the Securities Act of 1933, this registration statement has been signed below by the following persons in the capacities and on the dates indicated.

Signature	Capacity in Which Signed	Date
/s/ Edward J. Quilty Edward J. Quilty	President, Chief Executive Officer and Chairman of the Board of Directors (Principal Executive Officer)	February 5, 2010
/s/ John E. Yetter, CPA John E. Yetter, CPA	Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	February 5, 2010
* Srini Conjeevaram	Director	February 5, 2010
* Stephen T. Wills, CPA, MST	Director	February 5, 2010
* James T. O Brien	Director	February 5, 2010
* C. Richard Stafford, Esq.	Director	February 5, 2010
* Richard J. Keim	Director	February 5, 2010
* Robert J. Moussa	Director	February 5, 2010
* Bruce F. Wesson	Director	February 5, 2010

*By:

/s/ Edward J. Quilty
Edward J. Quilty
Attorney-in-Fact

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