As filed with the Securities and Exchange Commission on December 1, 2006

Registration No. 333-135584

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

AMENDMENT NO. 3
TO
Form S-1
REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

OCULUS INNOVATIVE SCIENCES, INC.

(Exact name of registrant as specified in its charter)

California (prior to reincorporation) **Delaware (after reincorporation)** *(State or other jurisdiction of incorporation or organization)*	**3841** *(Primary Standard Industrial Classification Code Number)*	**68-0423298** *(I.R.S. Employer Identification No.)*

1129 N. McDowell Blvd.
Petaluma, CA 94954
(707) 782-0792
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Hojabr Alimi
Chief Executive Officer and President
1129 N. McDowell Blvd.
Petaluma, CA 94954
(707) 782-0792
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

Sylvia K. Burks, Esq. **Gabriella A. Lombardi, Esq.** **Pillsbury Winthrop Shaw Pittman LLP** **2475 Hanover Street** **Palo Alto, CA 94304-1114** **(650) 233-4500** **(650) 233-4545 facsimile**	**Robert C. Funsten, Esq.** **Marc G. Alcser, Esq.** **Stradling Yocca Carlson & Rauth** **660 Newport Center Drive, Suite 1600** **Newport Beach, CA 92660-6422** **(949) 725-4000** **(949) 725-4100 facsimile**

Approximate date of commencement of proposed sale to the public: As soon as practicable after the effective date of this Registration Statement.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. ☐

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐

Calculation Of Registration Fee Chart

Title of each class of securities to be registered	Number of shares to be registered(1)	Proposed maximum offering price per share(2)	Proposed maximum aggregate offering price(2)	Amount of registration fee(3)
Common Stock, $0.0001 par value	3,538,461	$14.00	$49,538,454	$5,301

(1) Includes 461,538 shares of Common Stock that are being registered in connection with an over-allotment option granted to the underwriters.
(2) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(a) under the Securities Act of 1933.
(3) The Registrant previously paid $8,614 of the registration fee.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

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The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and we are not soliciting any offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED DECEMBER 1, 2006

PRELIMINARY PROSPECTUS

3,076,923 Shares

Oculus Innovative Sciences, Inc.

Common Stock

We are offering 3,076,923 shares of our common stock. This is our initial public offering, and no public market currently exists for our shares. We anticipate that the initial public offering price will be between $12.00 and $14.00 per share. We have applied for quotation of our common stock on the Nasdaq Global Market under the symbol "OCLS."

Investing in our common stock involves a high degree of risk. Before buying any shares, you should carefully consider the risk factors described in "Risk Factors" beginning on page 9 of this prospectus.

	Per Share	Total
Public offering price	$	$
Underwriting discount	$	$
Proceeds, before expenses, to Oculus Innovative Sciences, Inc.	$	$

The underwriters may also purchase up to an additional 461,538 shares from us at the public offering price, less the underwriting discount, within 30 days after the date of this prospectus to cover over-allotments. The underwriters will have the right to purchase from us, at a nominal price, warrants to purchase up to 7% of the total number of shares sold in this offering.

All information in this prospectus reflects a one-for-four reverse stock split of our common stock and our reincorporation in Delaware from California to be effected prior to the completion of this offering.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The underwriters expect to deliver the shares on or about , 2006.

ROTH CAPITAL PARTNERS

MAXIM GROUP LLC

BROOKSTREET SECURITIES CORPORATION

The date of this prospectus is , 2006

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You should rely only on the information contained in this prospectus. We have not, and the underwriters have not, authorized anyone to provide you with different information. We are not making an offer to sell these securities in any jurisdiction where the offer is not permitted. You should not assume that the information contained in this prospectus is accurate as of any date other than the respective dates as of which the information is given.

PROSPECTUS SUMMARY

Before you decide whether to invest in our common stock, you should carefully read this entire prospectus, including "Risk Factors" and the consolidated financial statements and related notes. In this prospectus, "we," "us," "our" and "Oculus" refer to Oculus Innovative Sciences, Inc. and its consolidated subsidiaries unless the context requires otherwise.

Oculus Innovative Sciences, Inc.

We have developed, and manufacture and market, a family of products intended to help prevent and treat infections in chronic and acute wounds. Infection is a serious potential complication in both chronic and acute wounds, and controlling infection is a critical step in wound healing. Our platform technology, called Microcyn, is a non-toxic, electrically charged, or super-oxidized, water-based solution that is designed to treat a wide range of organisms that cause disease, or pathogens, including viruses, fungi, spores and antibiotic resistant strains of bacteria, such as Methicillin-resistant *Staphylococcus aureus,* or MRSA, and Vancomycin-resistant *Enterococcus*, or VRE, in wounds. We do not have the necessary regulatory approvals to market Microcyn in the United States as a drug. However, in clinical testing and studies, our products were effective against a wide range of pathogens and were found to be non-toxic, easy to use and complementary to most existing treatment methods in wound care. Our experience and clinical data indicate that the use of Microcyn may shorten hospital stays, lower aggregate patient care costs and, in certain cases, reduce the need for system-wide or, systemic antibiotics. Microcyn also has potential applications in several other large markets, including respiratory, dermatology, dental and veterinary markets.

We believe Microcyn provides significant advantages over current methods of care in the treatment of a wide range of chronic and acute wounds throughout all stages of treatment. We believe that Microcyn is the first topical product that is effective against a broad range of bacteria and other infectious microbes, including antibiotic resistant strains, such as MRSA and VRE, without causing toxic side effects on, or irritation of, healthy tissue. Unlike most antibiotics, we believe Microcyn does not target specific strains of bacteria, a practice which has been shown to promote the development of resistant bacteria. In addition, our products are shelf stable, require no special preparation, and are easy to use.

Our products have received CE Mark, or European Union certification, for wound cleaning and reduction of microbial load, three U.S. Food and Drug Administration, or FDA, 510(k) clearances as a medical device in wound cleaning, or debridement, lubricating, moistening and dressing and have been granted approvals for use as an antiseptic, disinfectant and sterilant in Mexico, for use in cleaning and debriding in wound management in India and for moistening, irrigating, cleansing and debriding skin lesions in Canada. Physicians in several countries have conducted studies in which Microcyn was used to treat infection in a variety of wounds, including hard-to-treat wounds such as diabetic ulcers and burns, and, in some cases, reduced the need for systemic antibiotics. In July 2006, we completed a controlled clinical trial for pre-operative skin preparation. After completion of this trial, the FDA advised us that it is considering adopting new heightened performance requirements for evaluating efficacy of products designed to be used in pre-operative skin preparation such as ours. In discussions with the FDA, the FDA has not provided us with the definitive timing for, or parameters of, any such new requirements, and has informally stated that it is uncertain during what time frame it will be able to do so. We plan to continue our discussions with the FDA regarding the possible timing and parameters of any new guidelines for evaluating efficacy for pre-operative skin preparations. Depending on the ultimate position of the FDA regarding performance criteria for pre-operative skin preparations, we may reassess our priorities, clinical timelines and schedules for pursuing a pre-operative skin preparation indication or may decide not to pursue this indication.

We intend to conduct a pilot study in early 2007 to evaluate the effectiveness of Microcyn in patients with infections in open wounds. Following completion of the pilot study, we intend to establish a protocol for a Phase IIb clinical trial in a similar patient population, which we intend to begin in mid to late 2007. We anticipate this trial to last approximately 12 months.

We own one issued U.S. patent, 12 pending U.S. patent applications and 18 foreign pending patent applications relating to super-oxidized water, methods of using super-oxidized water-based solution, and aspects of the method and apparatus for manufacturing super-oxidized water.

We began selling our Microcyn-based product in July 2004 in Mexico, where we sell through a dedicated contract sales force, and in October 2004 in Europe, where we have a direct sales force and exclusive distribution agreements with distributors which we believe are experienced in supplying the wound care market. We began selling our products in the United States in June 2005 and have established a network of one national and five regional distributors, who are supported by our commercial team and clinical support staff. We began selling our product in India in July 2006 through a national distributor, and in Canada, we have entered into a distribution agreement under which distribution is expected to commence by late 2007.

The following is a list of the regulatory approvals and clearances that Microcyn-based products have received for our most significant or potentially significant markets:

Region	Approval or Clearance Type	Year of Approval or Clearance	Summary Indication
United States	510(k)	2005	Moistening and lubricating absorbent wound dressings for traumatic wounds.
	510(k)	2005	Moistening and debriding acute and chronic dermal lesions.
	510(k)	2006	Moistening absorbent wound dressings and cleaning minor cuts.
European Union	CE Mark	2004	Debriding, irrigating and moistening acute and chronic wounds in comprehensive wound treatment by reducing microbial load and creating moist environment.
Mexico	Product Registration	2003	Antiseptic disinfection solution for high level disinfection of medical instruments, and/or equipment and clean-rooms, areas of medical instruments, equipment and clean room areas.
	Product Registration	2004	Antiseptic treatment of wounds and infected areas.
Canada	Class II Medical Device	2004	Moistening, irrigating, cleansing and debriding acute and chronic dermal lesions, diabetic ulcers and post-surgical wounds.
India(1)	Drug License	2006	Cleaning and debriding in wound management.

(1) Drug license held by Indian distributor as required by Indian law.

If we successfully complete additional clinical studies and receive the necessary FDA regulatory approvals, we plan to market Microcyn in the United States as a drug.

Market Opportunity

According to Medtech Insight, a Division of Windhover Information, there were over 90 million incidents of wounds in the United States during 2004. Of these, over 6 million were chronic wounds, including arterial, diabetic, pressure and venous ulcers. The remaining 84 million incidents were acute wounds, which follow the normal process of healing and commonly include burns, traumatic wounds and approximately 67 million surgical incisions. Key trends in wound care include a large and increasing at-risk population, primarily of elderly, diabetic and obese people, increased emphasis on controlling the cost of patient care, technological product and treatment innovation, increased focus on improving the patient experience and advancements in combination treatment methods.

When infection is present in a wound, standard treatments include cleansing, debridement and systemic antibiotics. Although there are a number of topical antiseptics and antibiotics currently used to treat acute and chronic wounds, their overall effectiveness is limited. For example:

- many antiseptics, including Betadine, hydrogen peroxide and Dakin's solution, are toxic, can destroy human cells and tissue, may cause allergic reactions and can impede the wound healing process;
- silver-based products are expensive and require precise dosage and close monitoring by trained medical staff to minimize the potential for allergic reactions and bacterial resistance; and
- the increase in antibiotic resistant bacterial strains, such as MRSA and VRE, have compromised the efficacy of some widely used topical antibiotics, including Neosporin and Bacitracin.

Our Solution

We believe our products have the following key features:

- ***Efficacy.*** In both laboratory testing and physician clinical studies, our products were effective against a wide range of bacteria that cause infection in a variety of acute and chronic wounds. In addition, because of its mechanism of action, we believe that Microcyn does not target specific strains of bacteria, the practice of which has been shown to promote the development of resistant bacteria. In physician clinical studies where Microcyn was used both independent of and in conjunction with other wound care therapeutic products, data supported that patients generally experienced less pain, improved mobility and physical activity levels and better quality of life.
- ***Safety.*** Preclinical and clinical data shows that Microcyn is non-toxic. Throughout all our clinical trials and physician clinical studies to date and since commercialization in 2004, we have received no reports of serious adverse events related to the use of Microcyn products.
- ***Ease of Use.*** Our products require no preparation before use or at time of disposal, and caregivers can use our products without significant training. In addition, Microcyn can be stored at room temperature and does not require any specific handling procedures. Unlike other super-oxidized water solutions, which are typically stable for not more than 48 hours, our laboratory tests show that Microcyn has a shelf life ranging from one to two years, depending on the size and type of packaging. Our products are also complementary to most advanced technologies used to treat serious wounds, such as negative pressure wound therapy, jet lavage and tissue-engineered skin substitutes.
- ***Cost Effectiveness.*** The treatment of many wounds requires extended hospitalization and care, including the use of expensive systemic antibiotics. Infection prolongs the healing time and necessitates increased use of systemic antibiotics. We believe Microcyn has the potential to help treat infection, accelerate wound healing time and, in certain cases, may help reduce the need for systemic antibiotics, thereby lowering overall patient cost.

Our Strategy

Our goal is to become a worldwide leader in wound care by establishing Microcyn as the standard of care for helping to prevent and treat chronic and acute wounds. We also intend to leverage our expertise in wound care into additional market opportunities. The key elements of our strategy include the following:

- drive adoption of Microcyn as the standard of care in the wound care market to help prevent and treat infection;
- obtain additional regulatory approvals in the United States;
- expand our direct sales force and distribution networks;
- pursue opportunities to combine Microcyn with other treatments;
- develop strategic collaborations in the wound care market; and
- leverage our Microcyn platform to address additional markets.

Principal Risks

There are significant risks and challenges relating to our business and industry that may materially and adversely affect our ability to execute our strategy and achieve our objectives, including the following risks:

- we have a history of losses, expect to continue to incur losses and may never achieve profitability;
- all of our current products are based on our Microcyn platform technology;
- we do not have regulatory approval to market Microcyn as a drug in the United States;
- we are required to conduct lengthy and expensive clinical trials, which may not be successful or lead to regulatory approvals;
- even if our products receive regulatory approval, our products may not gain market acceptance;
- one of our Microcyn based products was recently found to be ineffective as a high level disinfectant in killing certain strains of pathogens under current U.S. Environmental Protection Agency testing protocols;
- we may be unable to protect our intellectual property and we may be subject to infringement claims from third parties; and
- in connection with their dismissal in April 2006, our former independent registered public accounting firm has notified us of a number of reportable events it deemed to constitute material weaknesses over financial reporting that could impact our ability to develop reliable financial statements in a timely manner.

Recent Developments

On September 14, 2006, we sold 84,539 units, consisting of 84,539 shares of our Series C convertible preferred stock and warrants to purchase 16,907 shares of our common stock at an exercise price of $18.00 per share, at a per unit price of $18.00 for aggregate gross proceeds of $1,521,702. On October 20, 2006, we sold 108,486 units, consisting of 108,486 shares of our Series C convertible preferred stock and warrants to purchase 21,697 shares of our common stock at an exercise price of $18.00 per share, at a per unit price of $18.00 for aggregate gross proceeds of $1,952,748. In connection with the first closing, we paid to Brookstreet Securities Corporation, or Brookstreet, as placement agent, an aggregate of $152,170 in commissions and issued to Brookstreet fully vested warrants to purchase an aggregate of 10,567 shares of our common stock at an exercise price of $18.00 per share. In connection with the second closing, we paid to Brookstreet, an aggregate of $195,274 in commissions and issued to Brookstreet fully vested warrants to purchase an aggregate of 13,560 shares of our common stock at an exercise price of $18.00 per share. We refer to these transactions collectively as the Series C Financing elsewhere in this prospectus.

On November 7, 2006, we signed a loan agreement with Robert Burlingame under which Mr. Burlingame advanced to us $4.0 million, which accrues interest at an annual rate of 7%. The principal and all accrued

interest under the loan agreement, which was funded on November 10, 2006, and is available to us as working capital, will become due and payable in full on the earlier of November 10, 2007 or five days after the completion of an initial public offering of our common stock resulting in gross proceeds to us of at least $30.0 million. The loan is secured by all of our assets, other than our intellectual property, but is subordinate to the security interest held by our secured lender. At the time the principal was advanced to us, Brookstreet was paid a fee in the amount of $50,000 and granted a warrant to purchase 25,000 shares of our common stock at an exercise price of $18.00 per share. We refer to this transaction as the Bridge Loan elsewhere in this prospectus. Mr. Burlingame was elected to our board of directors on November 7, 2006.

Corporate Information

We were incorporated in California in 1999 as Micromed Laboratories, Inc. In August 2001, we changed our name to Oculus Innovative Sciences, Inc. In connection with this offering, we intend to reincorporate in Delaware. Our principal executive offices are located at 1129 N. McDowell Blvd., Petaluma, California, 94954, and our telephone number is (707) 782-0792. We have two principal subsidiaries: Oculus Technologies of Mexico, S.A. de C.V., organized in Mexico, and Oculus Innovative Sciences Netherlands, B.V., organized in The Netherlands. Our website is *www.oculusis.com.* Information that is included on our website is not a part of this prospectus.

We use several trademarks in our business, including Microcyn, Dermacyn and Vetericyn. We own trademark registrations for these and other marks in the United States and in other countries, and we are currently seeking to register our Cidalcyn, Dentricyn and other marks in the United States and in other countries. All other trademarks, trade names or services marks appearing in this prospectus are the property of their respective owners.

Our human wound treatment product is marketed under the name Dermacyn in the United States, the European Union and Canada, under the name Microcyn60 in Mexico and under the name Oxum in India. We have agreed to cease marketing our product in Mexico under the name Microcyn60 by September 2007 as a result of the settlement of a trademark confusion claim in Mexico. All references in this prospectus to Microcyn as a product are to the products marketed under their respective names. Other references to Microcyn are to our platform technology used in producing our products for wound care and for other markets.

A glossary of technical, medical and industry terms appears on page 80.

The Offering

Common stock to be offered by us	3,076,923 shares
Common stock to be outstanding after the offering	11,476,132 shares
Assumed initial public offering price per share	$13.00
Use of proceeds	We intend to use the net proceeds from this offering to expand our sales and marketing capabilities, to fund clinical trials and related research, to repay the principal and interest of our Bridge Loan and for general corporate purposes, including working capital. See "Use of Proceeds."
Proposed Nasdaq Global Market symbol	OCLS

The number of shares of common stock that will be outstanding immediately after this offering:

- includes 4,222,731 shares of common stock outstanding as of September 30, 2006;
- includes the automatic conversion of all outstanding shares of our convertible preferred stock into 4,176,478 shares of our common stock;
- excludes 2,260,263 shares of our common stock issuable upon the exercise of outstanding stock options, options to be granted in connection with this offering and options to be granted to a new board member, at a weighted-average exercise price of $5.04 per share;
- excludes 1,098,301 shares of our common stock issuable upon the exercise of outstanding warrants, at a weighted average exercise price of $10.18 per share;
- excludes 215,385 shares of our common stock issuable upon the exercise of warrants to be issued to the underwriters in connection with this offering at an exercise price equal to 165% of the offering price; and
- excludes up to 1,250,000 additional shares of our common stock reserved for future grants under our 2006 Stock Incentive Plan.

Unless we indicate otherwise, all information in this prospectus:

- gives effect to the automatic conversion of all outstanding shares of our preferred stock into shares of our common stock upon the completion of this offering;
- does not reflect the exercise of outstanding warrants or options to purchase shares of our common stock;
- assumes that the underwriters do not exercise their over-allotment option to purchase up to 461,538 additional shares in this offering and related warrants to purchase up to 32,307 additional shares of our common stock are not issued;
- reflects a one-for-four reverse split of our common stock and preferred stock to be effected before completion of this offering;
- reflects our reincorporation in Delaware from California; and
- reflects the amendment of our certificate of incorporation in connection with this offering to, among other things, change the number of shares authorized for issuance.
- reflects the amendment to our bylaws in connection with this offering.

Summary Consolidated Financial Data

The following tables present our summary consolidated financial data. Our historical results are not necessarily indicative of the results that may be expected in the future. You should read this information together with our audited consolidated financial statements and related notes and the information under "Selected Consolidated Financial Data" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this prospectus.

The following tables present our summary consolidated financial data:

- on an actual basis;
- on a pro forma, as adjusted, basis to give effect to:
  - the conversion of all outstanding shares of our convertible preferred stock into 4,176,478 shares of our common stock upon closing of this offering;
  - the sale of 3,076,923 shares of common stock in this offering at an assumed initial public offering price of $13.00 per share, which is the midpoint of our expected offering range on the cover page of this prospectus, after deducting the estimated underwriting discounts and commissions and estimated offering expenses payable by us; and
  - the Bridge Loan, net of fees, resulting in proceeds to us of $3,950,000 and repayment of the Bridge Loan out of the net proceeds of this offering.

	Year Ended March 31,			Six Months Ended September 30,	
	2004	2005	2006	2005	2006
				(unaudited)	
	(In thousands, except per share data)				
Consolidated Statements of Operations Data:					
Revenues					
Product	$ 95	$ 473	$ 1,966	$ 807	$ 1,942
Service	807	883	618	275	388
Total revenues	902	1,356	2,584	1,082	2,330
Cost of revenues					
Product(1)	1,403	2,211	3,899	1,350	1,043
Service(1)	1,265	1,311	1,003	497	422
Total cost of revenues	2,668	3,522	4,902	1,847	1,465
Gross profit (loss)	(1,766)	(2,166)	(2,318)	(765)	865
Operating expenses					
Research and development(1)	1,413	1,654	2,600	965	1,595
Selling, general and administrative(1)	3,918	12,492	15,933	7,704	7,867
Total operating expenses	5,331	14,146	18,533	8,669	9,462
Loss from operations	(7,097)	(16,312)	(20,851)	(9,434)	(8,597)
Interest expense	(178)	(372)	(172)	(103)	(261)
Interest income	3	8	282	68	100
Other income (expense), net	(26)	146	(377)	(101)	92
Net loss from continuing operations	(7,298)	(16,530)	(21,118)	(9,570)	(8,666)
Loss on discontinued operations	—	—	(1,981)	(174)	—
Net loss	(7,298)	(16,530)	(23,099)	(9,744)	(8,666)
Preferred stock dividends	—	—	(121)	—	(242)
Net loss available to common stockholders	$ (7,298)	$ (16,530)	$ (23,220)	$ (9,744)	$ (8,908)
Net loss per common share: basic and diluted	$ (1.87)	$ (4.22)	$ (5.60)	$ (2.38)	$ (2.11)

	Year Ended March 31,			Six Months Ended September 30,	
	2004	2005	2006	2005	2006
				(unaudited)	
	(In thousands, except per share data)				
Weighted-average number of shares used in per common share calculations: basic and diluted	3,911	3,914	4,150	4,086	4,221
Pro forma net loss per common share: basic and diluted			$ (2.16)		$ (0.79)
Pro forma weighted-average number of shares used in per common share calculations: basic and diluted			10,759		11,283

(1) Includes the following stock-based compensation charges:

	Year Ended March 31,			Six Months Ended September 30,	
	2004	2005	2006	2005	2006
				(unaudited)	
	(In thousands)				
Cost of revenues					
Product	$ —	$ 2	$ 2	$ 1	$ —
Service	10	3	1	—	1
Operating expenses					
Research and development	56	5	52	12	40
Selling, general and administrative	358	2,339	542	253	229

	As of September 30, 2006	
	Actual	Pro Forma As Adjusted
		(unaudited)
	(In thousands, except per share data)	
Consolidated Balance Sheet Data:		
Cash and cash equivalents(1)	$ 2,269	$ 38,026
Working capital (deficiency)(1)	(797)	34,960
Total assets(1)	10,056	45,617
Total liabilities	9,082	9,082
Total stockholders' equity(1)	974	36,535

(1) A $1.00 increase or decrease in the assumed initial public offering price of $13.00 per share (the midpoint of our expected offering range on the cover of this prospectus) would increase or decrease, as applicable, this amount on a pro forma as adjusted basis by approximately $2,831 assuming the number of shares offered by us, as set forth on the cover page of this prospectus, remains the same and after deducting the estimated underwriting discounts and commissions and our estimated offering expenses.

RISK FACTORS

Investing in our common stock involves a high degree of risk. You should carefully consider the risks described below with all of the other information included in this prospectus before making an investment decision. If any of the following risks actually occur, our business, results of operations or financial condition would likely suffer. In that case, the market price of our common stock could decline and you could lose all or part of your investment in our common stock. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also impair our business operations.

Risks Related to Our Business

We have a history of losses, we expect to continue to incur losses and we may never achieve profitability.

We have incurred significant net losses in each fiscal year since our inception, including losses of $7.3 million, $16.5 million, $23.1 million and $8.7 million for the years ended March 31, 2004, 2005 and 2006 and the six months ended September 30, 2006, respectively. Our accumulated deficit as of September 30, 2006 was $59.3 million. We have yet to demonstrate that we can generate sufficient sales of our products to become profitable. The extent of our future operating losses and the timing of profitability are highly uncertain, and we may never achieve profitability. Even if we do generate significant revenues from our product sales, we expect that increased operating expenses will result in significant operating losses in the near term as we, among other things:

- expand our sales and marketing capabilities in the United States and internationally;
- conduct preclinical studies and clinical trials on our products and product candidates;
- seek FDA clearance to market Microcyn as a drug in the United States;
- increase our research and development efforts to enhance our existing products, commercialize new products and develop new product candidates; and
- establish additional and expand existing manufacturing facilities.

As a result of these activities, we will need to generate significant revenue in order to achieve profitability and may never become profitable. We must also maintain specified cash reserves in connection with our loan and security agreement which may limit our investment opportunities. Failure to maintain these reserves could result in our lender foreclosing against our assets or imposing significant restrictions on our operations. Even if we do achieve profitability, we may not be able to sustain or increase profitability on an ongoing basis.

We believe that the net proceeds from this offering, the Series C Financing and the Bridge Loan, together with our future revenues, cash and cash equivalent balances and interest we earn on these balances will be sufficient to meet our anticipated cash requirements through at least the next 12 months. Without completion of this offering, or the raise of capital through an alternate funding source, we would curtail certain operational activities in order to reduce costs. These activities may include clinical and regulatory trials, sales and marketing activities, and international operations. In the event that we are required to raise additional capital, we cannot provide any assurance that we will secure any commitments for new financing on acceptable terms, if at all.

Because all of our products are based on our Microcyn platform technology, we will need to generate sufficient revenues from the sale of Microcyn to execute our business plan.

All of our products are based on our Microcyn platform technology, and we do not have any non-Microcyn product candidates that will generate revenues in the foreseeable future. Accordingly, we expect to derive substantially all of our future revenues from sales of our current Microcyn products. We have only been selling our products since July 2004, and substantially all of our historical product revenues have been from sales of Microcyn in Mexico. Although we began selling in Europe in October 2004, in the United States in

June 2005, and in India in July 2006, our product revenues outside of Mexico were not significant prior to our last fiscal quarter. For example, product revenues from countries outside of Mexico were just 9.1% of our product revenues for the year ended March 31, 2006, but 45.5% of our product revenues for the six months ended September 30, 2006 were from countries outside Mexico. Microcyn has not been adopted as a standard of care for wound treatment in any country and may not gain acceptance among physicians, nurses, patients, third-party payors and the medical community. Existing protocols for wound care are well established within the medical community and tend to vary geographically, and healthcare providers may be reluctant to alter their protocols to include the use of Microcyn. If Microcyn does not achieve an adequate level of acceptance, we will not generate sufficient revenues to become profitable.

One of our non-commercialized products, when recently tested by the U.S. Environmental Protection Agency, or EPA, did not meet certain efficacy standards based on an EPA test protocol that used parameters that differed from those parameters previously used by us when we originally registered this product as an EPA registered disinfectant product. As a result, we have discontinued sampling, promotion and all distribution of this non-commercialized product.

In October 2004, after EPA review of our registration filing, including the results of disinfectant efficacy testing conducted by an independent laboratory retained by us, we obtained EPA authorization, or registration, for the distribution and sale of our Microcyn-based product, which we call Cidalcyn, as a hospital grade disinfectant. Although we have not commercialized Cidalcyn, we previously provided samples to potential marketing partners and other entities for product evaluation. Subsequently, in July 2006, we were informed by the EPA that in more recent tests conducted by the EPA, Cidalcyn did not meet efficacy standards when tested against three specified pathogens (*Pseudomonas aeruginosa*, *Staphylococcus aureus* and *Mycobacterium tuberculosis*) when used according to label directions. These new results prevent us from marketing Cidalcyn as a hospital grade disinfectant. We believe the EPA test protocol utilizes a bacterial culture to challenge a disinfectant in a test method which does not replicate a human wound environment and which is not used to evaluate the safety or efficacy of wound care products by the FDA or CE Mark. We believe the EPA test made use of a bacterial culture which contained a significantly higher concentration of pathogens than the culture used in the independent test, the results of which we submitted to the EPA for registration purposes. This increased concentration of bacteria might have overwhelmed our Cidalcyn product. Subsequent testing we have conducted appears to have confirmed the EPA's results against two of the three pathogens. Based on the EPA's own testing, the EPA strongly recommended that we immediately recall all Cidalcyn distributed on and after September 28, 2005. Accordingly, we promptly and voluntarily ceased all distribution of Cidalcyn to end users, and we are not providing the product to distributors or retailers for re-distribution to third parties or end users; we have ceased promoting Cidalcyn; and we have contacted the entities and small number of individuals in the United States who are not our employees, to whom the Cidalcyn product had been provided for evaluation purposes during the one-year period (the product's shelf-life) prior to our receipt of the EPA's recent notification to ensure they have been informed not to use any remaining quantities they might have in their possession. In August 2006, we received a "show cause" letter from the EPA stating that it was prepared to file a civil administrative complaint against us for violation of federal pesticide legislation in connection with the sale or distribution of a pesticide that did not meet the label's efficacy claims, and it gave us the opportunity to advise the EPA of any factors we believe the EPA should consider before issuing a civil complaint. We have engaged in discussions with the EPA since that time and are working cooperatively with the EPA to resolve this matter. We believe that any civil penalties that might be assessed against us in connection with such a civil complaint would not be in a material amount. Unless and until we provide new information to support the original label claims of Cidalcyn to the EPA, there will not be any sales or other distributions of the product in the United States as a hospital grade disinfectant.

We do not have the necessary regulatory approvals to market Microcyn as a drug in the United States.

We have obtained three 510(k) clearances in the United States that permit us to sell Microcyn as a medical device to clean, moisten and debride wounds. However, we do not have the necessary regulatory approvals to market Microcyn in the United States as a drug, which we will need to obtain in order to execute our business plan. Before we are permitted to sell Microcyn as a drug in the United States, we must, among

other things, successfully complete additional preclinical studies and well-controlled clinical trials, submit a New Drug Application, or NDA, to the FDA and obtain FDA approval. In July 2006, we completed a controlled clinical trial for pre-operative skin preparation. After completion of this trial, the FDA advised us that it is considering adopting new heightened performance requirements for evaluating efficacy of products designed to be used in pre-operative skin preparation such as ours. In discussions with the FDA, the FDA has not provided us with the definitive timing for, or parameters of, any such requirements, and has informally stated that it is uncertain during what time frame it will be able to do so. We plan to continue our discussions with the FDA regarding the possible timing and parameters of any new guidelines for evaluating efficacy for pre-operative skin preparations. Depending on the ultimate position of the FDA regarding performance criteria for pre-operative skin preparations, we may reassess our priorities, clinical timelines and schedules for pursuing a pre-operative skin preparation indication or may decide not to pursue this indication. We also intend to seek FDA approval for the use of Microcyn to treat infections in wounds.

We have sponsored the majority of physicians performing physician clinical studies of Microcyn and in some cases, the physicians who performed these studies also hold equity in our company. The physician clinical studies were performed in the United States, Mexico and Italy, and used various endpoints, methods and controls. These studies were not intended to be rigorously designed or controlled clinical trials and, as such, did not have all of the controls required for clinical trials used to support an NDA submission to the FDA in that they did not include blinding, randomization, predefined clinical endpoints, use of placebo and active control groups or U.S. good clinical practice requirements. Consequently, the results of these physician clinical studies may not be used by us to support an NDA submission for Microcyn to the FDA. In addition, any results obtained from clinical trials designed to support an NDA submission for Microcyn to the FDA may not be as favorable as results from such physician clinical studies and otherwise may not be sufficient to support an NDA submission or FDA approval of any Microcyn NDA.

The FDA approval process is expensive and uncertain, requires detailed and comprehensive scientific and other data and generally takes several years. Despite the time and expense exerted, approval is never guaranteed. We do not know whether we will obtain favorable results in our preclinical and clinical studies or whether we will obtain the necessary regulatory approvals to market Microcyn as a drug in the United States. We anticipate that obtaining approval for the use of Microcyn to treat infections in wounds in the United States will take several years. Even if we obtain FDA approval to sell Microcyn as a drug, we may not be able to successfully commercialize Microcyn as a drug in the United States and may never recover the substantial costs we have invested in the development of our Microcyn products.

Our inability to raise additional capital on acceptable terms in the future may cause us to curtail certain operational activities, including regulatory trials, sales and marketing, and international operations, in order to reduce costs and sustain the business, and would have a material adverse effect on our business, and financial condition.

We expect capital outlays and operating expenditures to increase over the next several years as we work to commercialize our products and expand our infrastructure and research and development activities. We have entered into debt financing arrangements which are secured by all of our assets. We may need to raise additional capital to, among other things:

- sustain commercialization of our current products or new products;
- increase our sales and marketing efforts to drive market adoption and address competitive developments;
- fund our clinical trials and preclinical studies;
- expand our research and development activities;
- expand our manufacturing capabilities;
- acquire or license technologies; and
- finance capital expenditures and our general and administrative expenses.

Our present and future funding requirements will depend on many factors, including:

- the progress and timing of our clinical trials;
- the level of research and development investment required to maintain and improve our technology position;
- cost of filing, prosecuting, defending and enforcing patent claims and other intellectual property rights;
- our efforts to acquire or license complementary technologies or acquire complementary businesses;
- changes in product development plans needed to address any difficulties in commercialization;
- competing technological and market developments; and
- changes in regulatory policies or laws that affect our operations.

If we raise additional funds by issuing equity securities, dilution to our stockholders could result. Any equity securities issued also may provide for rights, preferences or privileges senior to those of holders of our common stock. If we raise additional funds by issuing debt securities, these debt securities would have rights, preferences and privileges senior to those of holders of our common stock, and the terms of the debt securities issued could impose significant restrictions on our operations. If we raise additional funds through collaborations and licensing arrangements, we might be required to relinquish significant rights to our technologies or products, or grant licenses on terms that are not favorable to us. A failure to obtain adequate funds may cause us to curtail certain operational activities, including regulatory trials, sales and marketing, and international operations, in order to reduce costs and sustain the business, and would have a material adverse effect on our business and financial condition.

Delays or adverse results in clinical trials could result in increased costs to us and delay our ability to generate revenue.

Clinical trials can be long and expensive, and the outcome of clinical trials is uncertain and subject to delays. It may take several years to complete clinical trials, if at all, and a product candidate may fail at any stage of the clinical trial process. The length of time required varies substantially according to the type, complexity, novelty and intended use of the product candidate. Interim results of a preclinical study or clinical trial do not necessarily predict final results, and acceptable results in preclinical studies or early clinical trials may not be repeatable in later subsequent clinical trials. The commencement or completion of any of our clinical trials may be delayed or halted for a variety of reasons, including the following:

- FDA requirements for approval, including requirements for testing efficacy or safety, may change;
- the FDA or other regulatory authorities do not approve a clinical trial protocol;
- patients do not enroll in clinical trials at the rate we expect;
- delays in reaching agreement on acceptable clinical trial agreement terms with prospective sites;
- delays in obtaining institutional review board approval to conduct a study at a prospective site;
- third party clinical investigators do not perform our clinical trials on our anticipated schedule or consistent with the clinical trial protocol and good clinical practices, or the third party organizations do not perform data collection and analysis in a timely or accurate manner;
- governmental regulations or administrative actions are changed; and
- insufficient funds to continue our clinical trials.

We do not know whether our existing or any future clinical trials will demonstrate safety and efficacy sufficiently to result in additional FDA approvals. While a number of physicians have conducted clinical studies assessing the safety and efficacy of Microcyn for various indications, the data from these studies is not sufficient to support approval of Microcyn as a drug in the United States. We will be required to conduct additional clinical trials prior to seeking approval of Microcyn for additional indications. Our failure to

adequately demonstrate the safety and efficacy of our product candidates to the satisfaction of the FDA will prevent our receipt of FDA approval for additional indications and, ultimately, impact commercialization of our products in the United States. If we experience significant delays or adverse results in clinical trials, our financial results and the commercial prospects for products based on Microcyn will be harmed, our costs would increase and our ability to generate revenue would be delayed.

If we fail to obtain, or experience significant delays in obtaining additional regulatory clearances or approvals to market our current or future products, we may be unable to commercialize these products.

Developing, testing, manufacturing, marketing and selling of medical technology products are subject to extensive regulation by numerous governmental authorities in the United States and other countries. The process of obtaining regulatory clearance and approval of medical technology products is costly and time consuming. Even though the underlying product formulation may be the same or similar, our products are subject to different regulations and approval processes depending upon their intended use. In the United States, use of Microcyn to cleanse and debride a wound comes within the medical device regulation framework, while use of Microcyn to treat infections in wounds will require us to seek FDA approval of Microcyn as a drug in the United States.

To obtain regulatory approval of our products as drugs in the United States, we must first show that our products are safe and effective for target indications through preclinical studies (laboratory and animal testing) and clinical trials (human testing). The FDA generally clears marketing of a medical device through the 510(k) pre-market clearance process if it is demonstrated that the new product has the same intended use and the same or similar technological characteristics as another legally marketed Class II device, such as a device already cleared by the FDA through the 510(k) premarket notification process, and otherwise meets the FDA's requirements. Product modifications, including labeling the product for a new intended use, may require the submission of a new 510(k) clearance and FDA approval before the modified product can be marketed.

We do not know whether our products based on Microcyn will receive approval from the FDA as a drug. The data from clinical studies of Microcyn conducted by physicians to date will not satisfy the FDA's regulatory criteria for approval of an NDA. In order for us to seek approval for the use of Microcyn as a drug in the treatment of infections in wounds, we will be required to conduct additional preclinical and clinical trials and submit applications for approval to the FDA. For example, we are currently planning to conduct a pilot study of Microcyn for the treatment of wound infections, and we will need to conduct additional non-clinical and well-controlled clinical trials in order to generate data to support FDA approval of Microcyn for this indication.

The outcomes of clinical trials are inherently uncertain. In addition, we do not know whether the necessary approvals or clearances will be granted or delayed for future products. The FDA could request additional information or clinical testing that could adversely affect the time to market and sale of products as drugs. If we do not obtain the requisite regulatory clearances and approvals, we will be unable to commercialize our products as drugs or devices and may never recover any of the substantial costs we have invested in the development of Microcyn.

Distribution of our products outside the United States is subject to extensive government regulation. These regulations, including the requirements for approvals or clearance to market, the time required for regulatory review and the sanctions imposed for violations, vary from country to country. We do not know whether we will obtain regulatory approvals in such countries or that we will not be required to incur significant costs in obtaining or maintaining these regulatory approvals. In addition, the export by us of certain of our products that have not yet been cleared for domestic commercial distribution may be subject to FDA export restrictions. Failure to obtain necessary regulatory approvals, the restriction, suspension or revocation of existing approvals or any other failure to comply with regulatory requirements would have a material adverse effect on our future business, financial condition, and results of operations.

If our products do not gain market acceptance, our business will suffer because we might not be able to fund future operations.

A number of factors may affect the market acceptance of our products or any other products we develop or acquire, including, among others:

- the price of our products relative to other treatments for the same or similar treatments;
- the perception by patients, physicians and other members of the health care community of the effectiveness and safety of our products for their indicated applications and treatments;
- our ability to fund our sales and marketing efforts; and
- the effectiveness of our sales and marketing efforts.

If our products do not gain market acceptance, we may not be able to fund future operations, including developing, testing and obtaining regulatory approval for new product candidates and expanding our sales and marketing efforts for our approved products, which would cause our business to suffer.

We may incur significant liabilities in connection with our relationship with a former distributor in Mexico, and our results of operations may be negatively affected by the termination of this relationship.

On June 16, 2005, we entered into a series of agreements with Quimica Pasteur, or QP, a Mexico-based distributor of pharmaceutical products to hospitals and health care entities owned or operated by the Mexican Ministry of Health, or MOH. These agreements provided, among other things, for QP to act as our exclusive distributor of Microcyn to the MOH for a period of three years. We were granted an option to acquire all except a minority share of the equity of QP directly from its principals. In addition, two of our employees were appointed as officers of QP, which resulted in the establishment of financial control of QP by our company under applicable accounting literature.

As a result of our agreements, we were required to consolidate QP's operations with our financial results. In connection with our audit of QP's financial statements in late 2005, we were made aware of a number of facts that suggested that QP or its principals may have engaged in some form of tax avoidance practice prior to the execution of the agreements between our company and QP. We did not discover these facts prior to our execution of these agreements or for several months thereafter. Our prior independent auditors informed us that we did not have effective anti-fraud programs designed to detect the type of activities in which QP's principals engaged or the personnel to effectively evaluate and determine the appropriate accounting for non-routine or complex accounting transactions. Our audit committee engaged an outside law firm to conduct an investigation whose findings implicated QP's principals in a systemic tax avoidance practice prior to June 16, 2005. We estimate that QP's liability for taxes, interest and penalties related to these practices could amount to $7 million or more. Based on the results of this investigation, we terminated our agreements with QP effective March 26, 2006.

Although we do not believe that we are responsible for any tax avoidance practices of QP's principals prior to June 16, 2005, the Mexican taxing authority could make a claim against us or our Mexican subsidiary. We have been informed by counsel in Mexico that the statute of limitations, including for actions for fraud, is five years from the date of our last tax return, which was March 31, 2006. QP had a well-established relationship with the MOH. We lost the benefit of this relationship when we terminated our agreements with QP. Although we currently market Microcyn in Mexico through a dedicated contract sales force and continue to market Microcyn to the MOH, which has recently increased its purchases of Microcyn, we do not know whether our future sales in Mexico will decline as a result of the termination of our relationship with QP.

Our former independent registered public accounting firm has notified us of a number of reportable events constituting a material weakness over financial reporting which, if not successfully remedied, may among other things, impact our ability to develop reliable financial statements and comply with our reporting obligations as a public company.

In August 2006, our former independent registered public accounting firm, PricewaterhouseCoopers LLP, or PWC, notified us of a number of deficiencies it believes comprise reportable events that may, among other things, impact our ability to develop reliable financial statements. In its letter, PWC stated that it had advised our audit committee of the following:

- the absence of financial accounting personnel with sufficient skills and experience to effectively evaluate and determine the appropriate accounting for non-routine and/or complex accounting transactions consistent with accounting principles generally accepted in the United States, which resulted in a number of material audit adjustments to the financial statements during the course of audit procedures;
- the failure to maintain effective controls to ensure the identification of accounting issues related to and the proper accounting for stock options with the right of rescission that were granted under certain stock option plans that required registration or qualification under federal and state securities laws primarily due to insufficient oversight and lack of personnel in the accounting and finance organization with the appropriate level of accounting knowledge, experience and training;
- the failure to maintain an effective anti-fraud program designed to detect and prevent fraudulent activities in QP;
- the need to expand significantly the scope of the audit of QP to assess the impact of identified fraudulent activities on our financial statements, in which regard PWC advised our audit committee that the results of the fraud investigation may cause PWC to be unwilling to be associated with our financial statements;
- the "tone at the top" set by our senior management does not appear to encourage an attitude within our company that controls are important or that established controls cannot be circumvented;
- we did not have the appropriate financial management and reporting infrastructure in place to meet the demands that will be placed upon us as a public company, including the requirements of the Sarbanes-Oxley Act of 2002, and that we will be unable to report our financial results accurately or in a timely manner; and
- significant control deficiencies, when considered in the aggregate, constituted a material weakness over financial reporting.

We have filed a copy of the letter from PWC as an exhibit to the registration statement of which this prospectus forms a part. For additional information, please see "Change in Independent Registered Public Accounting Firm."

We have agreed to change the brand name of our product in Mexico, which may result in the loss of any brand recognition that we have established with users of our products.

In accordance with the settlement of a trademark infringement lawsuit filed against us in Mexico, we have agreed to stop using the name Microcyn60 in Mexico by September 2007. In addition, in May 2006, a complaint was filed against us for trademark confusion in connection with the same tradename, and we are in settlement negotiations concerning such claim. We have marketed our products in Mexico under the brand name of Microcyn60 since 2004. In the six months ended September 30, 2006, 54.5% of our product revenues were derived from Mexico. As a result of our agreement to change our product name, we may lose the benefit of the brand name recognition we have generated in the region and our product sales in Mexico could decline. In locations where we have distributed our products, we believe that the brand names of those products have developed name recognition among consumers who purchase them. Any change to the brand name of our other products may cause us to lose such name recognition, which may lead to confusion in the marketplace and a decline in sales of our products.

If our competitors develop products similar to Microcyn, we may need to modify or alter our business strategy, which may delay the achievement of our goals.

Competitors may develop products with similar characteristics as Microcyn. Such similar products marketed by larger competitors can hinder our efforts to penetrate the market. As a result, we may be forced to modify or alter our business and regulatory strategy and sales and marketing plans, as a response to changes in the market, competition and technology limitations, among others. Such modifications may pose additional delays in achieving our goals.

If we are unable to expand our direct domestic sales force, we may not be able to successfully sell our products in the United States.

We currently sell Microcyn in the United States through a network of one national and five regional distributors and our medical and clinical employees. We plan to sell directly into the United States markets and we plan to expand our domestic sales force. Developing a sales force is expensive and time consuming, and the lack of qualified sales personnel could delay or limit the success of our product launch. Our domestic sales force, if established, will be competing with the sales operations of our competitors, which are better funded and more experienced. We may not be able to develop domestic sales capacity on a timely basis or at all.

Our dependence on distributors for sales could limit or prevent us from selling our products and from realizing long-term revenue growth.

We currently depend on distributors to sell Microcyn in the United States, Europe and other countries and intend to continue to sell our products primarily through distributors in Europe and the United States for the foreseeable future. In addition, if we are unable to expand our direct sales force, we will continue to rely on distributors to sell Microcyn. Our existing distribution agreements are generally short-term in duration, and we may need to pursue alternate distributors if the other parties to these agreements terminate or elect not to renew their agreements. If we are unable to retain our current distributors for any reason, we must replace them with alternate distributors experienced in supplying the wound care market, which could be time-consuming and divert management's attention from other operational matters. In addition, we will need to attract additional distributors to expand the geographic areas in which we sell Microcyn. Distributors may not commit the necessary resources to market and sell our products to the level of our expectations, which could harm our ability to generate revenues. In addition, some of our distributors may also sell products that compete with ours. In some countries, regulatory licenses must be held by residents of the country. For example, the regulatory approval for one product in India is owned and held by our Indian distributor. If the licenses are not in our name or under our control, we might not have the power to ensure their ongoing effectiveness and use by us. If current or future distributors do not perform adequately, or we are unable to locate distributors in particular geographic areas, we may not realize long-term revenue growth.

We depend on a contract sales force to sell our products in Mexico.

We currently depend on a contract sales force to sell Microcyn in Mexico. Our existing agreement is short-term in duration and can be terminated by either party upon 30 days written notice. If we are unable to retain our current agreement for any reason, we may need to build our own internal sales force or find an alternate source for contract sales people. We may be unable to find an alternate source, or the alternate source's sales force may not generate sufficient revenue. If our current or future contract sales force does not perform adequately, we may not realize long-term revenue growth in Mexico.

We intend to license or collaborate with third parties in various potential markets, and events involving these strategic partners or any future collaborations could delay or prevent us from developing or commercializing products.

Our business strategy and our short- and long-term operating results will depend in part on our ability to execute on existing strategic collaborations and to license or partner with new strategic partners. We believe collaborations allow us to leverage our resources and technologies and to access markets that are compatible with our own core areas of expertise while avoiding the cost of establishing a direct sales force in each market.

To penetrate our target markets, we may need to enter into additional collaborative agreements to assist in the development and commercialization of future products. For example, depending upon our analysis of the time and expense involved in obtaining FDA approval to sell a product to treat open wounds, we may chose to license our technology to a third party as opposed to pursuing commercialization ourselves. Establishing strategic collaborations is difficult and time-consuming. Potential collaborators may reject collaborations based upon their assessment of our financial, regulatory or intellectual property position and our internal capabilities. Our discussions with potential collaborators may not lead to the establishment of new collaborations on favorable terms. We have limited control over the amount and timing of resources that our current collaborators or any future collaborators devote to our collaborations or potential products. These collaborators may breach or terminate their agreements with us or otherwise fail to conduct their collaborative activities successfully and in a timely manner. Further, our collaborators may not develop or commercialize products that arise out of our collaborative arrangements or devote sufficient resources to the development, manufacture, marketing or sale of these products. By entering into a collaboration, we may preclude opportunities to collaborate with other third parties who do not wish to associate with our existing third party strategic partners. Moreover, in the event of termination of a collaboration agreement, termination negotiations may result in less favorable terms.

If we fail to comply with ongoing regulatory requirements, or if we experience unanticipated problems with our products, these products could be subject to restrictions or withdrawal from the market.

Regulatory approvals or clearances that we currently have and that we may receive in the future are subject to limitations on the indicated uses for which the products may be marketed, and any future approvals could contain requirements for potentially costly post-marketing follow-up studies. If the FDA determines that our promotional materials or activities constitute promotion of an unapproved use or we otherwise fail to comply with FDA regulations, we may be subject to regulatory enforcement actions, including a warning letter, injunction, seizure, civil fine or criminal penalties. In addition, the manufacturing, labeling, packaging, adverse event reporting, storage, advertising, promotion, distribution and record-keeping for approved products are subject to extensive regulation. Our manufacturing facilities, processes and specifications are subject to periodic inspection by the FDA, European and other regulatory authorities and from time to time, we may receive notices of deficiencies from these agencies as a result of such inspections. Our failure to continue to meet regulatory standards or to remedy any deficiencies could result in restrictions being imposed on products or manufacturing processes, fines, suspension or loss of regulatory approvals or clearances, product recalls, termination of distribution or product seizures or the need to invest substantial resources to comply with various existing and new requirements. In the more egregious cases, criminal sanctions, civil penalties, disgorgement of profits or closure of our manufacturing facilities are possible. The subsequent discovery of previously unknown problems with Microcyn, including adverse events of unanticipated severity or frequency, may result in restrictions on the marketing of our products, and could include voluntary or mandatory recall or withdrawal of products from the market.

New government regulations may be enacted and changes in FDA policies and regulations, their interpretation and enforcement, could prevent or delay regulatory approval of our products. We cannot predict the likelihood, nature or extent of adverse government regulation that may arise from future legislation or administrative action, either in the United States or abroad. Therefore, we do not know whether we will be able to continue to comply with any regulations or that the costs of such compliance will not have a material adverse effect on our future business, financial condition, and results of operations. If we are not able to maintain regulatory compliance, we will not be permitted to market our products and our business would suffer.

We may experience difficulties in manufacturing Microcyn, which could prevent us from commercializing one or more of our products.

The machines used to manufacture our Microcyn-based products are complex, use complicated software and must be monitored by highly trained engineers. Slight deviations anywhere in our manufacturing process, including quality control, labeling and packaging, could lead to a failure to meet the specifications required by the FDA, the EPA, European notified bodies, Mexican regulatory agencies and other foreign regulatory bodies, which may result in lot failures or product recalls. In August 2006, we received a “show cause” letter form the

EPA, which stated that, in tests conducted by the EPA, Cidalcyn was found to be ineffective in killing specified pathogens when used according to label directions. We have begun gathering records for review to determine if there might have been any problems in production of the lot tested by the EPA. We have also quarantined all remaining quantities of the production lot in question. If we are unable to obtain quality internal and external components, mechanical and electrical parts, if our software contains defects or is corrupted, or if we are unable to attract and retain qualified technicians to manufacture our products, our manufacturing output of Microcyn, or any other product candidate based on our platform that we may develop, could fail to meet required standards, our regulatory approvals could be delayed, denied or revoked, and commercialization of one or more of our Microcyn-based products may be delayed or foregone. Manufacturing processes that are used to produce the smaller quantities of Microcyn needed for our clinical test and current commercial sales may not be successfully scaled up to allow production of significant commercial quantities. Any failure to manufacture our products to required standards on a commercial scale could result in reduced revenues, delays in generating revenue and increased costs.

Our competitive position depends on our ability to protect our intellectual property and our proprietary technologies.

Our ability to compete and to achieve and maintain profitability depends on our ability to protect our intellectual property and proprietary technologies. We currently rely on a combination of patents, patent applications, trademarks, trade secret laws, confidentiality agreements, license agreements and invention assignment agreements to protect our intellectual property rights. We also rely upon unpatented know-how and continuing technological innovation to develop and maintain our competitive position. These measures may not be adequate to safeguard our Microcyn technology. In addition, we granted a security interest in our assets under a loan and security agreement. The security interest extends to our intellectual property in the event we fail to maintain specified cash reserves under the loan. If we do not protect our rights adequately, third parties could use our technology, and our ability to compete in the market would be reduced.

Although we have filed U.S. and foreign patent applications related to our Microcyn based products, the manufacturing technology for making the products, and their uses, only one patent has been issued from these applications to date.

Our pending patent applications and any patent applications we may file in the future may not result in issued patents, and we do not know whether any of our in-licensed patents or any additional patents that might ultimately be issued by the U.S. Patent and Trademark Office or foreign regulatory body will protect our Microcyn technology. Any claims that issue may not be sufficiently broad to prevent third parties from producing competing substitutes and may be infringed, designed around, or invalidated by third parties. Even issued patents may later be found to be invalid, or may be modified or revoked in proceedings instituted by third parties before various patent offices or in courts.

The degree of future protection for our proprietary rights is more uncertain in part because legal means afford only limited protection and may not adequately protect our rights, and we will not be able to ensure that:

- we were the first to invent the inventions described in patent applications;
- we were the first to file patent applications for inventions;
- others will not independently develop similar or alternative technologies or duplicate our products without infringing our intellectual property rights;
- any patents licensed or issued to us will provide us with any competitive advantages;
- we will develop proprietary technologies that are patentable; or
- the patents of others will not have an adverse effect on our ability to do business.

The policies we use to protect our trade secrets may not be effective in preventing misappropriation of our trade secrets by others. In addition, confidentiality and invention assignment agreements executed by our employees, consultants and advisors may not be enforceable or may not provide meaningful protection for our

trade secrets or other proprietary information in the event of unauthorized use or disclosures. We cannot be certain that the steps we have taken will prevent the misappropriation and use of our intellectual property, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. For example, one of our former contract partners, Nofil Corporation, whom we relied upon to manufacture our proprietary machines had access to our proprietary information and we believe undertook the development and manufacture of the machines to be sold to third parties in violation of our agreement with such company. We have brought a claim against Nofil Corporation in the U.S. District Court for the Northern District of California. We believe that a former officer of our Mexico subsidiary collaborated in these acts, misappropriated our trade secrets, and is currently selling products in Mexico that are competitive with our products. In addition, we believe that, through the licensor of the patents that we in-license and who has also assigned patents to us, a company in Japan obtained one of our patent applications, translated it into Hangul and filed it under such company's and the licensor's name in South Korea. These and any other leak of confidential data into the public domain or to third parties could allow our competitors to learn our trade secrets.

We are in a dispute with the Japanese entity that licenses to us certain rights under Japanese patents, which could result in our losing such rights and may have a material adverse impact on our business opportunities in Japan.

In March 2003, we obtained an exclusive license to six issued Japanese patents and five Japanese published pending patent applications owned by Coherent Technologies. The issued Japanese patents and pending Japanese patent applications relate to an earlier generation of super-oxidized water product with an acidic pH and not the current commercialized Microcyn. The patents that cover the method and apparatus for the production of the earlier generation of super-oxidized water will expire between 2011 and 2014. In June 2006, we received written notice from Coherent Technologies advising us that the patent license was terminated, citing various reasons with which we disagree. Since that time we have engaged Coherent Technologies in discussions concerning the license agreement and our continued business relationship. Although we do not believe Coherent Technologies has grounds to terminate the license, we may have to take legal action to preserve our rights under the license and to enjoin Coherent Technologies from breaching its terms. We do not know whether we would prevail in any such action, which would be costly and time consuming, and we could lose our rights under the license, which could have a material adverse impact on our business opportunities in Japan. In addition, we could have to defend ourselves against infringement claims from Coherent Technologies in Japan based on their position on termination of the license.

We may face intellectual property infringement claims that could be time-consuming, costly to defend and could result in our loss of significant rights and, in the case of patent infringement claims, the assessment of treble damages.

From time to time, we may receive notices of claims of infringement, misappropriation or misuse of other parties' proprietary rights. We may have disputes regarding intellectual property rights with the parties that have licensed those rights to us. Some claims received from third parties may lead to litigation. We cannot assure you that we will prevail in these actions, or that other actions alleging misappropriation or misuse by us of third-party trade secrets, infringement by us of third-party patents and trademarks or the validity of our patents, will not be asserted or prosecuted against us. We may also initiate claims to defend our intellectual property. Intellectual property litigation, regardless of outcome, is expensive and time-consuming, could divert management's attention from our business and have a material negative effect on our business, operating results or financial condition. If there is a successful claim of infringement against us, we may be required to pay substantial damages (including treble damages if we were to be found to have willfully infringed a third party's patent) to the party claiming infringement, develop non-infringing technology, stop selling our products or using technology that contains the allegedly infringing intellectual property or enter into royalty or license agreements that may not be available on acceptable or commercially practical terms, if at all. Our failure to develop non-infringing technologies or license the proprietary rights on a timely basis could harm our business. In addition, modifying our products to include the non-infringing technologies could require us to seek re-approval or clearance from various regulatory bodies for our products, which would be costly and time

consuming. Also, we may be unaware of pending patent applications that relate to our technology. Parties making infringement claims on future issued patents may be able to obtain an injunction that would prevent us from selling our products or using technology that contains the allegedly infringing intellectual property, which could harm our business.

In September 2005, a complaint was filed against us in Mexico claiming trademark infringement with respect to our Microcyn60 mark. To settle this claim we have agreed to cease marketing our product in Mexico under the name Microcyn60 by September 2007. A second unrelated claim was filed against us in Mexico in May 2006, claiming trademark infringement with respect to our Microcyn60 mark in Mexico. We are in discussions with the claimant to settle the matter.

In addition to the infringement claims in Mexico, we are currently involved in several pending trademark opposition proceedings in connection with our applications to register the marks *Microcyn*, *Oculus Microcyn* and *Dermacyn* in the European Union, Argentina, Guatemala, Honduras, Nicaragua and Paraguay. If we are unable to settle these disputes or prevail in these opposition proceedings, we will not be able to obtain registrations for the *Microcyn*, *Oculus Microcyn* and *Dermacyn* marks in those countries, and that may impair our ability to enforce our trademark rights against infringers in those countries. Although no such legal proceedings have been brought or threats of such legal proceedings have been made, we cannot rule out the possibility that any of these opposing parties will also file a trademark infringement lawsuit seeking to prevent our use and seek monetary damages based on our use of the *Microcyn*, *Oculus Microcyn* and *Dermacyn* marks in the European Union, Argentina, Guatemala, Honduras, Nicaragua and Paraguay.

We have also entered into agreements with third parties to settle trademark opposition proceedings in which we have agreed to certain restrictions on our use and registration of certain marks. In March 2006, we entered into an agreement with an opposing party that places restrictions on the manner in which we can use and register our *Microcyn* and *Microcyn60* marks in countries where the opposing party has superior rights, including in Europe and Singapore. These restrictions include always using *Microcyn* along with the word "technology" and another distinctive trademark such as *Cidalcyn, Dermacyn* and *Vetericyn.* In addition, we have entered into an agreement with an opposing party in which we agreed to limit our use and registration of the *Microcyn* mark in Uruguay to disinfectant, antiseptic and sterilizing agents. Moreover, we have entered into an agreement with an opposing party in Europe in which we agreed to specifically exclude ophthalmologic products for our *Oculus Microc*yn application in the European Union.

Our ability to generate revenue will be diminished if we are unable to obtain acceptable prices or an adequate level of reimbursement from third-party payors of healthcare costs.

The continuing efforts of governmental and other third-party payors, including managed care organizations such as health maintenance organizations, or HMOs, to contain or reduce costs of health care may affect our future revenue and profitability, and the future revenue and profitability of our potential customers, suppliers and collaborative or license partners and the availability of capital. For example, in certain foreign markets, pricing or profitability of prescription pharmaceuticals is subject to government control. In the United States, governmental and private payors have limited the growth of health care costs through price regulation or controls, competitive pricing programs and drug rebate programs. Our ability to commercialize our products successfully will depend in part on the extent to which appropriate coverage and reimbursement levels for the cost of our Microcyn products and related treatment are obtained from governmental authorities, private health insurers and other organizations, such as HMOs.

There is significant uncertainty concerning third-party coverage and reimbursement of newly approved medical products and drugs. Third-party payors are increasingly challenging the prices charged for medical products and services. Also, the trend toward managed healthcare in the United States and the concurrent growth of organizations such as HMOs, as well as legislative proposals to reform healthcare or reduce government insurance programs, may result in lower prices for or rejection of our products. The cost containment measures that health care payors and providers are instituting and the effect of any health care reform could materially and adversely affect our ability to generate revenues.

In addition, given ongoing federal and state government initiatives directed at lowering the total cost of health care, the United States Congress and state legislatures will likely continue to focus on health care reform, the cost of prescription pharmaceuticals and the reform of the Medicare and Medicaid payment systems. While we cannot predict whether any proposed cost-containment measures will be adopted, the announcement or adoption of these proposals could reduce the price that we receive for our Microcyn products in the future.

We could be required to indemnify third parties for alleged infringement, which could cause us to incur significant costs.

Some of our distribution agreements contain commitments to indemnify our distributors against liability arising from infringement of third party intellectual property such as patents. We may be required to indemnify our customers for claims made against them or license fees they are required to pay. If we are forced to indemnify for claims or to pay license fees, our business and financial condition could be substantially harmed.

A significant part of our business is conducted outside of the United States, exposing us to additional risks that may not exist in the United States, which in turn could cause our business and operating results to suffer.

We have international operations in Mexico and Europe. For the fiscal years ended March 31, 2004, 2005 and 2006 and the six months ended September 30, 2006, approximately 10%, 35%, 75% and 81%, respectively, of our total revenue was generated from sales outside of the United States. Our business is highly regulated for the use, marketing and manufacturing of our Microcyn products both domestically and internationally. Our international operations are subject to risks, including:

- local political or economic instability;
- changes in governmental regulation;
- changes in import/export duties;
- trade restrictions;
- lack of experience in foreign markets;
- difficulties and costs of staffing and managing operations in certain foreign countries;
- work stoppages or other changes in labor conditions;
- difficulties in collecting accounts receivables on a timely basis or at all; and
- adverse tax consequences or overlapping tax structures.

We plan to continue to expand internationally to respond to customer requirements and market opportunities. We currently have international manufacturing facilities in Mexico and The Netherlands. Establishing operations in any foreign country or region presents risks such as those described above as well as risks specific to the particular country or region. In addition, until a payment history is established over time with customers in a new geography or region, the likelihood of collecting receivables generated by such operations could be less than our expectations. As a result, there is a greater risk that reserves set with respect to the collection of such receivables may be inadequate. If our international expansion efforts in any foreign country are unsuccessful, we could incur significant losses and we may not achieve profitability.

In addition, changes in policies or laws of the United States or foreign governments resulting in, among other things, changes in regulations and the approval process, higher taxation, currency conversion limitations, restrictions on fund transfers or the expropriation of private enterprises, could reduce the anticipated benefits of our international expansion. If we fail to realize the anticipated revenue growth of our future international operations, our business and operating results could suffer.

Our sales in international markets subject us to foreign currency exchange and other risks and costs which could harm our business.

A substantial portion of our revenues are derived from outside the United States, primarily from Mexico. We anticipate that revenues from international customers will continue to represent a substantial portion of our revenues for the foreseeable future. Because we generate revenues in foreign currencies, we are subject to the effects of exchange rate fluctuations. We incurred foreign currency exchange losses of $4,000, $283,000 and $119,000 for the fiscal years ended March 31, 2004 and 2006 and the six months ended September 30, 2006, respectively, and a gain of $134,000 for the fiscal year ended March 31, 2005. The functional currency of our Mexican subsidiary is the Mexican Peso, and the functional currency of our subsidiary in The Netherlands is the Euro. For the preparation of our consolidated financial statements, the financial results of our foreign subsidiaries are translated into U.S. dollars on average exchange rates during the applicable period. If the U.S. dollar appreciates against the Mexican Peso or the Euro, as applicable, the revenues we recognize from sales by our subsidiaries will be adversely impacted. Foreign exchange gains or losses as a result of exchange rate fluctuations in any given period could harm our operating results and negatively impact our revenues. Additionally, if the effective price of our products were to increase as a result of fluctuations in foreign currency exchange rates, demand for our products could decline and adversely affect our results of operations and financial condition.

The loss of key members of our senior management team, one of our directors or our inability to retain highly skilled scientists, technicians and salespeople could adversely affect our business.

Our success depends largely on the skills, experience and performance of key members of our executive management team, including Hojabr Alimi, our Chief Executive Officer, and Akihisa Akao, a member of our Board of Directors and one of our consultants. The efforts of these people will be critical to us as we continue to develop our products and attempt to commercialize products in the chronic and acute wound care market. If we were to lose one or more of these individuals, we may experience difficulties in competing effectively, developing our technologies and implementing our business strategies.

Our research and development programs depend on our ability to attract and retain highly skilled scientists and technicians. We may not be able to attract or retain qualified scientists and technicians in the future due to the intense competition for qualified personnel among medical technology businesses, particularly in the San Francisco Bay Area. We also face competition from universities and public and private research institutions in recruiting and retaining highly qualified personnel. In addition, our success depends on our ability to attract and retain salespeople with extensive experience in wound care and close relationships with the medical community, including physicians and other medical staff. We may have difficulties locating, recruiting or retaining qualified salespeople, which could cause a delay or decline in the rate of adoption of our products. If we are not able to attract and retain the necessary personnel to accomplish our business objectives, we may experience constraints that will adversely affect our ability to support our research, development and sales programs.

We maintain key-person life insurance only on Mr. Alimi. We may discontinue this insurance in the future, it may not continue to be available on commercially reasonable terms or, if continued, it may prove inadequate to compensate us for the loss of Mr. Alimi's services.

We may be unable to manage our future growth effectively, which would make it difficult to execute our business strategy.

We may experience periods of rapid growth as we expand our business, which will likely place a significant strain on our limited personnel and other resources. Any failure by us to manage our growth effectively could have an adverse effect on our ability to achieve our commercialization goals.

Furthermore, we conduct business in a number of geographic regions and are seeking to expand to other regions. We have not established a physical presence in many of the international regions in which we conduct or plan to conduct business, but rather we manage our business from our headquarters in Northern California. As a result, we conduct business at all times of the day and night with limited personnel. If we fail to

appropriately target and increase our presence in these geographic regions, we may not be able to effectively market and sell our Microcyn products in these locations or we may not meet our customers' needs in a timely manner, which could negatively affect our operating results.

Future growth will also impose significant added responsibilities on management, including the need to identify, recruit, train and integrate additional employees. In addition, rapid and significant growth will place strain on our administrative and operational infrastructure, including sales and marketing and clinical and regulatory personnel. Our ability to manage our operations and growth will require us to continue to improve our operational, financial and management controls, reporting systems and procedures. If we are unable to manage our growth effectively, it may be difficult for us to execute our business strategy.

The wound care industry is highly competitive and subject to rapid technological change. If our competitors are better able to develop and market products that are less expensive or more effective than any products that we may develop, our commercial opportunity will be reduced or eliminated.

The wound care industry is highly competitive and subject to rapid technological change. Our success depends, in part, upon our ability to stay at the forefront of technological change and maintain a competitive position.

We compete with large healthcare, pharmaceutical and biotechnology companies, along with smaller or early-stage companies that have collaborative arrangements with larger pharmaceutical companies, academic institutions, government agencies and other public and private research organizations. Many of our competitors have significantly greater financial resources and expertise in research and development, manufacturing, pre-clinical testing, conducting clinical trials, obtaining regulatory approvals and marketing approved products than we do. Our competitors may:

- develop and patent processes or products earlier than we will;
- develop and commercialize products that are less expensive or more efficient than any products that we may develop;
- obtain regulatory approvals for competing products more rapidly than we will; and
- improve upon existing technological approaches or develop new or different approaches that render our technology or products obsolete or non-competitive.

As a result, we may not be able to successfully commercialize any future products.

The success of our research and development efforts may depend on our ability to find suitable collaborators to fully exploit our capabilities. If we are unable to establish collaborations or if these future collaborations are unsuccessful, our research and development efforts may be unsuccessful, which could adversely affect our results of operations and financial condition.

An important element of our business strategy will be to enter into collaborative or license arrangements under which we license our Microcyn technology to other parties for development and commercialization. We expect that while we may initially seek to conduct initial clinical trials on our drug candidates, we may need to seek collaborators for a number of our potential products because of the expense, effort and expertise required to continue additional clinical trials and further develop those potential products candidates. Because collaboration arrangements are complex to negotiate, we may not be successful in our attempts to establish these arrangements. Also, we may not have products that are desirable to other parties, or we may be unwilling to license a potential product because the party interested in it is a competitor. The terms of any arrangements that we establish may not be favorable to us. Alternatively, potential collaborators may decide against entering into an agreement with us because of our financial, regulatory or intellectual property position or for scientific, commercial or other reasons. If we are not able to establish collaborative agreements, we may not be able to develop and commercialize new products, which would adversely affect our business and our revenues.

In order for any of these collaboration or license arrangements to be successful, we must first identify potential collaborators or licensees whose capabilities complement and integrate well with ours. We may rely

on these arrangements for, not only financial resources, but also for expertise or economies of scale that we expect to need in the future relating to clinical trials, manufacturing, sales and marketing, and for licenses to technology rights. However, it is likely that we will not be able to control the amount and timing of resources that our collaborators or licensees devote to our programs or potential products. If our collaborators or licensees prove difficult to work with, are less skilled than we originally expected, or do not devote adequate resources to the program, the relationship will not be successful. If a business combination, involving a collaborator or licensee and a third party were to occur, the effect could be to diminish, terminate or cause delays in development of a potential product.

We may acquire other businesses or form joint ventures that could harm our operating results, dilute your ownership of us, increase our debt or cause us to incur significant expense.

As part of our business strategy, we may pursue acquisitions of complementary businesses and assets, as well as technology licensing arrangements. We also intend to pursue strategic alliances that leverage our core technology and industry experience to expand our product offerings or distribution. We have no experience with respect to acquiring other companies and limited experience with respect to the formation of collaborations, strategic alliances and joint ventures. If we make any acquisitions, we may not be able to integrate these acquisitions successfully into our existing business, and we could assume unknown or contingent liabilities. Any future acquisitions by us also could result in significant write-offs or the incurrence of debt and contingent liabilities, any of which could harm our operating results. Integration of an acquired company also may require management resources that otherwise would be available for ongoing development of our existing business. We may not identify or complete these transactions in a timely manner, on a cost-effective basis, or at all, and we may not realize the anticipated benefits of any acquisition, technology license, strategic alliance or joint venture.

To finance any acquisitions, we may choose to issue shares of our common stock as consideration, which would dilute your ownership interest in us. If the price of our common stock is low or volatile, we may not be able to acquire other companies for stock. Alternatively, it may be necessary for us to raise additional funds for acquisitions through public or private financings. Additional funds may not be available on terms that are favorable to us, or at all.

If we are unable to comply with broad and complex federal and state fraud and abuse laws, including state and federal anti-kickback laws, we could face substantial penalties and our products could be excluded from government healthcare programs.

We are subject to various federal and state laws pertaining to healthcare fraud and abuse, which include, among other things, “anti-kickback” laws that prohibit payments to induce the referral of products and services, and “false claims” statutes that prohibit the fraudulent billing of federal healthcare programs. Our operations are subject to the federal anti-kickback statute, a criminal statute that, subject to certain statutory exceptions, prohibits any person from knowingly and willfully offering, paying, soliciting or receiving remuneration, directly or indirectly, to induce or reward a person either (i) for referring an individual for the furnishing of items or services for which payment may be made in whole or in part by a government healthcare program such as Medicare or Medicaid, or (ii) for purchasing, leasing, or ordering or arranging for or recommending the purchasing, leasing or ordering of an item or service for which payment may be made under a government healthcare program. Because of the breadth of the federal anti-kickback statute, the Office of Inspector General of the U.S. Department of Health and Human Services, or the OIG, was authorized to adopt regulations setting forth additional exceptions to the prohibitions of the statute commonly known as “safe harbors.” If all of the elements of an applicable safe harbor are fully satisfied, an arrangement will not be subject to prosecution under the federal anti-kickback statute.

We have agreements to pay compensation to our advisory board members and physicians who conduct clinical trials or provide other services for us. The agreements may be subject to challenge to the extent they do not fall within relevant safe harbors under federal and similar state anti-kickback laws. If our past or present operations, including, but not limited to, our consulting arrangements with our advisory board members or physicians conducting clinical trials on our behalf, or our promotional or discount programs, are found to be in violation of these laws, we or our officers may be subject to civil or criminal penalties,

including large monetary penalties, damages, fines, imprisonment and exclusion from government healthcare program participation, including Medicare and Medicaid.

In addition, if there is a change in law, regulation or administrative or judicial interpretations of these laws, we may have to change our business practices or our existing business practices could be challenged as unlawful, which could have a negative effect on our business, financial condition and results of operations.

Healthcare fraud and abuse laws are complex and even minor, inadvertent irregularities can potentially give rise to claims that a statute or regulation has been violated.

The frequency of suits to enforce these laws have increased significantly in recent years and have increased the risk that a healthcare company will have to defend a false claim action, pay fines or be excluded from the Medicare, Medicaid or other federal and state healthcare programs as a result of an investigation arising out of such action. We cannot assure you that we will not become subject to such litigation. Any violations of these laws, or any action against us for violation of these laws, even if we successfully defend against it, could harm our reputation, be costly to defend and divert management's attention from other aspects of our business. Similarly, if the physicians or other providers or entities with whom we do business are found to have violated abuse laws, they may be subject to sanctions, which could also have a negative impact on us.

Our efforts to discover and develop potential products may not lead to the discovery, development, commercialization or marketing of actual drug products.

We are currently engaged in a number of different approaches to discover and develop new product applications and product candidates. At the present time, we have one Microcyn-based drug candidate in clinical trials. We also have a non-Microcyn-based compound in the research and development phase. We believe this compound has potential applications in oncology. Discovery and development of potential drug candidates are expensive and time-consuming, and we do not know if our efforts will lead to discovery of any drug candidates that can be successfully developed and marketed. If our efforts do not lead to the discovery of a suitable drug candidate, we may be unable to grow our clinical pipeline or we may be unable to enter into agreements with collaborators who are willing to develop our drug candidates.

We must implement additional and expensive finance and accounting systems, procedures and controls as we grow our business and organization and to satisfy new reporting requirements, which will increase our costs and require additional management resources.

As a public reporting company, we will be required to comply with the Sarbanes-Oxley Act of 2002 and the related rules and regulations of the Securities and Exchange Commission, or the Commission, including expanded disclosures and accelerated reporting requirements and more complex accounting rules. Compliance with Section 404 of the Sarbanes-Oxley Act of 2002 and other requirements will increase our costs and require additional management resources. In a letter following their dismissal, our prior independent auditors informed us that we did not have the appropriate financial management and reporting structure in place to meet the demands of a public company and that our accounting and financial personnel lacked the appropriate level of accounting knowledge, experience and training. We recently have been upgrading our finance and accounting systems, procedures and controls and will need to continue to implement additional finance and accounting systems, procedures and controls as we grow our business and organization, enter into complex business transactions and take actions designed to satisfy new reporting requirements. Specifically, our experience with QP indicated that we need to better plan for complex transactions and the application of complex accounting principles relating to those transactions. If we are unable to complete the required Section 404 assessment as to the adequacy of our internal control over financial reporting, if we fail to maintain or implement adequate controls, or if our independent registered public accounting firm is unable to provide us with an unqualified report as to the effectiveness of our internal control over financial reporting as of the date of our first Annual Report on Form 10-K for which compliance is required and thereafter, our ability to obtain additional financing could be impaired. In addition, investors could lose confidence in the reliability of our internal control over financial reporting and in the accuracy of our periodic reports filed under the Securities Exchange Act of 1934. A lack of investor confidence in the reliability and accuracy of our public reporting could cause our stock price to decline.

We may not be able to maintain sufficient product liability insurance to cover claims against us.

Product liability insurance for the healthcare industry is generally expensive to the extent it is available at all. We may not be able to maintain such insurance on acceptable terms or be able to secure increased coverage if the commercialization of our products progresses, nor can we be sure that existing or future claims against us will be covered by our product liability insurance. Moreover, the existing coverage of our insurance policy or any rights of indemnification and contribution that we may have may not be sufficient to offset existing or future claims. A successful claim against us with respect to uninsured liabilities or in excess of insurance coverage and not subject to any indemnification or contribution could have a material adverse effect on our future business, financial condition, and results of operations.

Risks Related to Our Common Stock

Purchasers in this offering will experience immediate and substantial dilution in the book value of their investment.

The initial public offering price of our common stock is substantially higher than the net tangible book value per share of our common stock immediately after this offering. Therefore, if you purchase our common stock in this offering, you will incur an immediate dilution of $9.82 in net tangible book value per share from the price you paid, based on the assumed initial public offering price of $13.00 per share. The exercise of outstanding options will result in further dilution of your investment. For additional information, please see “Dilution.”

Our operating results may fluctuate, which could cause our stock price to decrease.

Fluctuations in our operating results may lead to fluctuations, including declines, in our share price. Our operating results and our share price may fluctuate from period to period due to a variety of factors, including:

- demand by physicians, other medical staff and patients for our Microcyn products;
- reimbursement decisions by third-party payors and announcements of those decisions;
- clinical trial results and publication of results in peer-reviewed journals or the presentation at medical conferences;
- the inclusion or exclusion of our Microcyn products in large clinical trials conducted by others;
- actual and anticipated fluctuations in our quarterly financial and operating results;
- developments or disputes concerning our intellectual property or other proprietary rights;
- issues in manufacturing our product candidates or products;
- new or less expensive products and services or new technology introduced or offered by our competitors or us;
- the development and commercialization of product enhancements;
- changes in the regulatory environment;
- delays in establishing new strategic relationships;
- introduction of technological innovations or new commercial products by us or our competitors;
- litigation or public concern about the safety of our product candidates or products;
- changes in recommendations of securities analysts or lack of analyst coverage;
- failure to meet analyst expectations regarding our operating results;
- additions or departures of key personnel; and
- general market conditions.

Variations in the timing of our future revenues and expenses could also cause significant fluctuations in our operating results from period to period and may result in unanticipated earning shortfalls or losses. In addition, the Nasdaq Global Market, in general, and the market for life sciences companies, in particular, have experienced significant price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies.

If an active, liquid trading market for our common stock does not develop, you may not be able to sell your shares quickly or at or above the initial offering price.

Prior to this offering, there has not been a public market for our common stock. Although we have applied to have our common stock listed on the Nasdaq Global Market, an active and liquid trading market for our common stock may not develop or be sustained following this offering. You may not be able to sell your shares quickly or at or above the initial offering price if trading in our stock is not active. The initial public offering price may not be indicative of prices that will prevail in the trading market. See "Underwriting" for more information regarding the factors that will be considered in determining the initial public offering price.

Future sales of shares by our stockholders could cause the market price of our common stock to drop significantly, even if our business is doing well.

After this offering, we will have 11,476,132 outstanding shares of common stock based on the number of shares outstanding at September 30, 2006. This includes the 3,076,923 shares we are selling in this offering, which (other than shares purchased by our affiliates) may be resold in the public market immediately. The remaining shares will become available for resale in the public market as shown in the chart below.

Number of Restricted Shares and % of Total Outstanding Following Offering	Date Available for Sale Into Public Market
229,025 shares, or 2%	Immediately
7,976,604 shares, or 70%	Immediately upon expiration of the 180-day lock up period
193,580 shares, or 2%	At some point after the expiration of the 180-day lock up period

We do not expect to pay dividends in the foreseeable future. As a result, you must rely on stock appreciation, if any, for a return on your investment.

We do not anticipate paying cash dividends on our common stock in the foreseeable future. Any payment of cash dividends will also depend on our financial condition, results of operations, capital requirements and other factors and will be at the discretion of our board of directors. Accordingly, you will have to rely on appreciation in the price of our common stock, if any, to earn a return on your investment in our common stock. Furthermore, we may in the future become subject to contractual restrictions on, or prohibitions against, the payment of dividends.

We may allocate net proceeds from this offering in ways with which you may not agree.

Our management will have broad discretion in using the proceeds from this offering and may use the proceeds in ways with which you may disagree. Because we are not required to allocate the net proceeds from this offering to any specific investment or transaction, you cannot determine at this time the value or propriety of our application of the proceeds. Moreover, you will not have the opportunity to evaluate the economic, financial or other information on which we base our decisions on how to use our proceeds. We may use the proceeds for corporate purposes that do not immediately enhance our prospects for the future or increase the value of your investment. As a result, you and other stockholders may not agree with our decisions.

Anti-takeover provisions in our charter, by-laws and Delaware law may make it more difficult for you to change our management and may also make a takeover difficult.

Our corporate documents and Delaware law contain provisions that limit the ability of stockholders to change our management and may also enable our management to resist a takeover. These provisions include:

- the ability of our board of directors to issue and designate the rights of, without stockholder approval, up to 5,000,000 shares of preferred stock, which rights could be senior to those of common stock;
- limitations on persons authorized to call a special meeting of stockholders; and
- advance notice procedures required for stockholders to make nominations of candidates for election as directors or to bring matters before an annual meeting of stockholders.

These provisions might discourage, delay or prevent a change of control or in our management. These provisions could also discourage proxy contests and make it more difficult for you and other stockholders to elect directors and cause us to take other corporate actions. In addition, the existence of these provisions, together with Delaware law, might hinder or delay an attempted takeover other than through negotiations with our board of directors.

Purchasers in this offering may experience substantial dilution in the value of their investment if we issue additional shares of our capital stock.

Our charter documents allow us to issue up to 100,000,000 shares of our common stock and to issue and designate the rights of, without stockholder approval, up to 5,000,000 shares of preferred stock. In the event we issue additional shares of our capital stock, dilution to our stockholders could result. In addition, if we issue and designate a class of preferred stock, these securities may provide for rights, preferences or privileges senior to those of holders of our common stock.

INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

This prospectus contains forward-looking statements that involve risks and uncertainties, such as statements about our plans, objectives, expectations, assumptions, and future events. In some cases, you can identify forward-looking statements by terminology such as "anticipate," "estimate," "plan," "project," "continue," "ongoing," "potential," "expect," "predict," "believe," "intend," "may," "will," "should," "could," "would," and similar expressions. These statements involve estimates, assumptions, known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from any future results, performances, or achievements expressed or implied by the forward-looking statements. Consequently, you should not place undue reliance on these forward-looking statements. We discuss many of these risks in greater detail under the heading "Risk Factors" above.

Forward-looking statements include, but are not limited to, statements about:

- the progress and timing of our development programs and regulatory approvals for our products;
- the benefits and effectiveness of our products;
- the development of protocols for clinical studies;
- enrollment in clinical studies;
- the progress and timing of clinical trials and physician studies;
- our expectations related to the use of our proceeds from this offering;
- our ability to manufacture sufficient amounts of our product candidates for clinical trials and products for commercialization activities;
- the outcome of discussions with the FDA and other regulatory agencies;
- the content and timing of submissions to, and decisions made by, the FDA and other regulatory agencies, including demonstrating to the satisfaction of the FDA the safety and efficacy of our products;
- the ability of our products to meet existing or future regulatory standards;
- the rate and causes of infection;
- the accuracy of our estimates of the size and characteristics of the markets which may be addressed by our products;
- our expectations and capabilities relating to the sales and marketing of our current products and our product candidates;
- the execution of distribution agreements;
- the expansion of our sales force and distribution network;
- the establishment of strategic partnerships for the development or sale of products;
- the timing of commercializing our products;
- our ability to protect our intellectual property and operate our business without infringing on the intellectual property of others;
- our ability to continue to expand our intellectual property portfolio;
- our expectations about the outcome of litigation and controversies with third parties;
- our ability to attract and retain qualified directors, officers, employees and advisory board members;
- our relationship with Quimica Pasteur;
- our ability to compete with other companies that are developing or selling products that are competitive with our products;
- the ability of our products to become the standard of care for controlling infection in chronic and acute wounds;
- our ability to expand to and commercialize products in markets outside the wound care market;
- our estimates regarding future operating performance, earnings and capital requirements;

- our expectations relating to the concentration of our revenue from international sales; and
- the impact of the Sarbanes-Oxley Act of 2002 and any future changes in accounting regulations or practices in general with respect to public companies.

The forward-looking statements speak only as of the date on which they are made, and, except as required by law, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

This prospectus contains market data that we obtained from industry sources. These sources do not guarantee the accuracy or completeness of the information. Although we believe that the industry sources are reliable, we have not independently verified the information.

USE OF PROCEEDS

We expect to receive net proceeds of approximately $34.0 million from this offering, based on an assumed initial public offering price of $13.00 per share, after deducting the estimated underwriting discounts and commissions and estimated offering expenses payable by us. If the underwriters exercise their over-allotment option in full, our estimated net proceeds will be approximately $42.4 million, after deducting the estimated underwriting discounts and commissions and estimated offering expenses payable by us. A $1.00 increase or decrease in the assumed initial public offering price of $13.00 per share (the midpoint of the range on the cover page of this prospectus) would increase or decrease, as applicable, the net proceeds to us by approximately $2.8 million, assuming the number of shares offered by us, as set forth on the cover page of this prospectus, remains the same and after deducting the estimated underwriting discounts and commissions and our estimated offering expenses.

We currently intend to use the proceeds of this offering as follows:

- approximately $12.6 million to expand our sales and marketing capabilities, including the expansion of our direct sales force in Europe and the United States;
- approximately $13.0 million to fund clinical trials and related research;
- repayment of the principal and interest at an annual rate of 7% of our $4.0 million Bridge Loan which funded on November 10, 2006 and which is due on the earlier of the date that is 5 business days after the completion of an initial public offering resulting in gross proceeds to us of at least $30.0 million or on November 10, 2007; and
- the remaining proceeds for general corporate purposes, including working capital.

While we have estimated the particular uses for the net proceeds to be received upon the completion of this offering, the actual amounts and timing of any expenditures will depend upon the rate of growth, if any, of our business, the amount of cash generated by our operations, status of our research and development efforts, competitive and technological developments and the amount of proceeds actually raised in this offering. A portion of the net proceeds may also be used to acquire or invest in complementary businesses, technologies, services or products, although we have no agreements with respect to any such transactions as of the date of this prospectus. Accordingly, our management will have significant flexibility in applying the net proceeds from this offering. Pending these uses described above, we intend to invest the net proceeds in short-term, investment grade securities.

We believe that the net proceeds from this offering, the Series C Financing and the Bridge Loan, together with our future revenues, cash and cash equivalent balances and interest we earn on these balances will be sufficient to meet our anticipated cash requirements through at least the next 12 months.

DIVIDEND POLICY

We have never declared or paid any cash dividends on our common stock. Upon the completion of this offering, we anticipate that any earnings will be retained for development and expansion of our business, and we do not anticipate paying any cash dividends on our common stock in the foreseeable future. Our board of directors has sole discretion to pay cash dividends based on our financial condition, results of operations, capital requirements, contractual obligations and other relevant factors. In the future, we may also obtain loans or other credit facilities that may restrict our ability to declare or pay dividends.

CAPITALIZATION

The following table describes our capitalization as of September 30, 2006:

- on an actual basis;
- on a pro forma, as adjusted, basis to give effect to:
  - the conversion of all outstanding shares of our convertible preferred stock into 4,176,478 shares of our common stock upon closing of this offering;
  - the sale of 3,076,923 shares of common stock in this offering at an assumed initial public offering price of $13.00 per share, which is the midpoint of our expected offering range on the cover page of this prospectus, after deducting the estimated underwriting discounts and commissions and estimated offering expenses payable by us; and
  - the Bridge Loan, net of fees, resulting in proceeds to us of $3,950,000 and repayment of the Bridge Loan out of the net proceeds of this offering.

You should read this table together with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and the related notes appearing elsewhere in this prospectus.

	As of September 30, 2006	
	Actual	Pro Forma As Adjusted
		(unaudited)
	(In thousands, except share and per share data)	
Short-term debt	$ 1,776	$ 1,776
Long-term debt, less current portion	$ 2,852	$ 2,852
Stockholders' equity (deficit):		
Convertible preferred stock, no par value; 7,500,000 shares authorized, 4,067,992 shares issued and outstanding, actual; no shares authorized, issued or outstanding, pro forma, as adjusted	51,760	—
Common Stock, no par value; 25,000,000 shares authorized, 4,222,731 shares issued and outstanding, actual; no shares authorized, issued or outstanding, pro forma, as adjusted	3,399	—
Preferred stock, $0.0001 par value; no shares authorized, issued and outstanding, actual; 5,000,000 shares authorized, no shares issued and outstanding, pro forma, as adjusted	—	—
Common stock, $0.0001 par value; 100,000,000 shares authorized, 11,476,132 shares issued and outstanding, pro forma, as adjusted	—	1
Additional paid-in capital(1)	5,163	95,932
Accumulated other comprehensive gain (loss)	(140)	(140)
Accumulated deficit	(59,208)	(59,258)
Total stockholders' equity(1)	974	36,535
Total capitalization(1)	$ 5,602	$ 41,163

(1) A $1.00 increase or decrease in the assumed initial public offering price of $13.00 per share (the midpoint of our expected offering range on the cover page of this prospectus) would increase or decrease, as applicable, this amount on a pro forma, as adjusted, basis by approximately $2,831, assuming the number of

shares offered by us, as set forth on the cover page of this prospectus, remains the same and after deducting the estimated underwriting discounts and commissions and our estimated offering expenses.

The information set forth in the table excludes as of September 30, 2006:

- 2,260,263 shares of our common stock issuable upon the exercise of outstanding stock options, options to be granted in connection with this offering and options to be granted to a new board member, at a weighted average exercise price of $5.04 per share;
- 1,098,301 shares of our common stock issuable upon the exercise of outstanding warrants, at a weighted average exercise price of $10.18 per share;
- 215,385 shares of our common stock issuable upon the exercise of warrants to be issued to the underwriters in connection with this offering at an exercise price equal to 165% of the offering price; and
- up to 1,250,000 additional shares of our common stock reserved for future grant under our 2006 Stock Incentive Plan.

DILUTION

Our historical net tangible book value as of September 30, 2006 was $974,000 or $0.23 per share of outstanding common stock. Historical net tangible book value per share represents the amount of our total tangible assets less total liabilities, divided by the number of outstanding shares of common stock on September 30, 2006. Our pro forma net tangible book value as of September 30, 2006 was $2,485,000 or $0.30 per share of common stock. Pro forma net tangible book value per share represents the amount of our total tangible assets less total liabilities, including the close of the Bridge Loan net of fees resulting in net proceeds of $3,950,000, divided by the number of shares of common stock which includes 4,222,731 shares of common stock outstanding as of September 30, 2006 and the conversion of all shares of our convertible preferred stock into 4,176,478 shares of our common stock upon the closing of this offering. Dilution of pro forma net tangible book value per share represents the difference between the amount per share paid by purchasers of shares of common stock in this offering and the pro forma as adjusted net tangible book value per share of common stock immediately after completion of this offering. After giving effect to the sale of 3,076,923 shares of common stock at an assumed initial public offering price of $13.00 per share, which is the midpoint of our expected offering range, and after deducting the estimated underwriting discounts and commissions and estimated offering expenses payable by us and the repayment of our Bridge Loan out of the net proceeds of this offering, our pro forma as adjusted net tangible book value as of September 30, 2006 would have been $36,535,000 or $3.18 per share of common stock. This represents an immediate increase in net tangible book value of $2.88 per share of common stock to existing common stockholders and an immediate dilution in pro forma as adjusted net tangible book value of $9.82 per share to new investors purchasing shares of common stock in this offering. The following table illustrates this per share dilution:

Assumed initial public offering price per share of common stock		$ 13.00
Historical net tangible book value per share at September 30, 2006	$ 0.23	
Increase in pro forma net tangible book value per share attributable to pro forma adjustments	$ 0.07	
Pro forma net tangible book value per share as of September 30, 2006	$ 0.30	
Increase in pro forma net tangible book value per share attributable to new investors	$ 2.88	
Pro forma net tangible book value per share after this offering		$ 3.18
Dilution in pro forma net tangible book value per share to new investors in this offering		$ 9.82

A $1.00 increase or decrease in the assumed initial public offering price of $13.00 per share (the midpoint of our expected offering range on the cover of this prospectus) would increase or decrease, as applicable, our pro forma as adjusted net tangible book value by $2.8 million, pro forma as adjusted net tangible book value per share by $0.25 per share and the dilution to investors in this offering by $0.75 per share, assuming the number of shares offered by us, as set forth on the cover page of this prospectus, remains the same and after deducting the estimated underwriting discounts and commissions and estimated offering expenses payable by us.

The following table summarizes, as of September 30, 2006, on the pro forma basis described above, the number of shares of common stock purchased from us, the total consideration paid and the average price per share paid to us by existing and new investors purchasing shares of common stock in this offering assuming an initial public offering price of $13.00 per share, which is the midpoint of our expected offering range, before deducting the estimated underwriting discounts and commissions and estimated offering expenses.

	Shares Purchased		Total Consideration		Average Price Per Share
	Number	Percent	Amount	Percent	
Existing stockholders	8,399,209	73%	$ 62,384,772	61%	$ 7.43
New investors	3,076,923	27%	40,000,000	39%	$ 13.00
Total	11,476,132	100.0%	102,384,772	100.0%	

A $1.00 increase or decrease in the assumed initial public offering price of $13.00 per share (the midpoint of our expected offering range on the cover of this prospectus) would increase or decrease, as applicable, total consideration paid by new investors and total consideration paid by all stockholders by $2.8 million, assuming the number of shares offered by us, as set forth on the cover of this prospectus, remains the same.

If the underwriters exercise their over-allotment option in full, our existing stockholders would own 70% and our new investors would own 30% of the total number of shares of our common stock outstanding after this offering.

The number of shares of our common stock referred to above that will be outstanding immediately after completion of this offering is based on 4,222,731 shares of our common stock outstanding as of September 30, 2006 and reflects the automatic conversion of our preferred stock into 4,176,478 shares of common stock and excludes:

- 2,260,263 shares of our common stock issuable upon the exercise of outstanding stock options and options to be granted in connection with this offering, and options to be granted to a new board member, at a weighted-average exercise price of $5.04 per share;
- 1,098,301 shares of our common stock issuable upon the exercise of outstanding warrants, at a weighted average exercise price of $10.18 per share;
- 215,385 shares of our common stock issuable upon the exercise of warrants to be issued to the underwriters in connection with this offering at an exercise price equal to 165% of the offering price; and
- up to 1,250,000 additional shares of our common stock reserved for issuance under our 2006 Stock Incentive Plan.

If all of our outstanding options and warrants as of September 30, 2006 were exercised, our pro forma, as adjusted, net tangible book value per share after this offering would be $4.23 per share, representing an increase attributable to new investors of $2.10 per share, and there would be an immediate dilution of $8.77 per share to new investors.

In addition, we may choose to raise additional capital due to market conditions or strategic considerations even if we believe we have sufficient funds for our current or future operating plans. To the extent that additional capital is raised through the sale of equity or convertible debt securities, the issuance of these securities could result in further dilution to our stockholders.

SELECTED CONSOLIDATED FINANCIAL DATA

You should read the following selected consolidated financial data together with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes included elsewhere in this prospectus. The selected consolidated statements of operations data for the six months ended September 30, 2005 and 2006 and the selected consolidated balance sheet data as of September 30, 2006 are derived from our unaudited consolidated financial statements and related notes included elsewhere in this prospectus. The selected consolidated statements of operations data for each of the years ended March 31, 2004, 2005 and 2006 and the selected consolidated balance sheet data as of March 31, 2005 and 2006 have been derived from our audited consolidated financial statements and related notes included elsewhere in this prospectus. The selected consolidated statements of operations data for the years ended March 31, 2002 and 2003 and the selected consolidated balance sheet data as of March 31, 2002, 2003 and 2004 have been derived from our consolidated financial statements and related notes not included in this prospectus. The selected consolidated statement of operations data for the year ended March 31, 2003 and the selected consolidated balance sheet data as of March 31, 2003 have not been audited. The unaudited financial statements include, in the opinion of management, all adjustments that management considers necessary for the fair presentation of the financial information set forth in those statements. Our historical results are not necessarily indicative of the results that may be expected in the future.

	Year Ended March 31,					Six Months Ended September 30,	
	2002	2003	2004	2005	2006	2005	2006
		(unaudited)				(unaudited)	
	(In thousands, except per share data)						
Consolidated Statements of Operations Data:							
Revenues							
Product	$ —	$ —	$ 95	$ 473	$ 1,966	$ 807	$ 1,942
Service	2,000	2,470	807	883	618	275	388
Total revenues	2,000	2,470	902	1,356	2,584	1,082	2,330
Cost of revenues							
Product[1]	—	—	1,403	2,211	3,899	1,350	1,043
Service[1]	815	1,768	1,265	1,311	1,003	497	422
Total cost of revenues	815	1,768	2,668	3,522	4,902	1,847	1,465
Gross profit (loss)	1,185	702	(1,766)	(2,166)	(2,318)	(765)	865
Operating expenses							
Research and development[1]	6	68	1,413	1,654	2,600	965	1,595
Selling, general and administrative[1]	1,326	2,102	3,918	12,492	15,933	7,704	7,867
Total operating expenses	1,332	2,170	5,331	14,146	18,533	8,669	9,462
Loss from operations	(147)	(1,468)	(7,097)	(16,312)	(20,851)	(9,434)	(8,597)
Interest expense	(24)	(123)	(178)	(372)	(172)	(103)	(261)
Interest income	—	—	3	8	282	68	100
Other income (expense), net	4	(4)	(26)	146	(377)	(101)	92
Net loss from continuing operations	(167)	(1,595)	(7,298)	(16,530)	(21,118)	(9,570)	(8,666)
Loss on discontinued operations	—	—	—	—	(1,981)	(174)	—
Net loss	(167)	(1,595)	(7,298)	(16,530)	(23,099)	(9,744)	(8,666)
Preferred stock dividends	—	—	—	—	(121)	—	(242)
Net loss available to common stockholders	$ (167)	$ (1,595)	$ (7,298)	$ (16,530)	$ (23,220)	$ (9,744)	$ (8,908)
Net loss per common share: basic and diluted[2]							
Continuing operations	(0.04)	(0.42)	(1.87)	(4.22)	(5.12)	(2.34)	(2.11)
Discontinued operations	—	—	—	—	(0.48)	(0.04)	—
	$ (0.04)	$ (0.42)	$ (1.87)	$ (4.22)	$ (5.60)	$ (2.38)	$ (2.11)
Weighted average number of shares used in per common share calculations: basic and diluted	3,795	3,827	3,911	3,914	4,150	4,086	4,221
Pro forma net loss per common share: basic and diluted					$ (2.16)		$ (0.79)
Pro forma weighted average number of shares used in per common share calculations: basic and diluted					10,759		11,283

(1) Includes the following stock-based compensation charges:

	Year Ended March 31,					Six Months Ended September 30,	
	2002	2003	2004	2005	2006	2005	2006
		(unaudited)				(unaudited)	
				(In thousands)			
Cost of revenues							
Product	$ —	$ —	$ —	$ 2	$ 2	$ 1	$ —
Service	—	55	10	3	1	—	1
Operating expenses							
Research and development	—	—	56	5	52	12	40
Selling, general and administrative	—	186	358	2,339	542	253	229

(2) See Note 1 to our consolidated financial statements for a description of the method used to compute basic and diluted net loss per share and number of shares used in computing historical basic and diluted net loss per share.

	As of March 31,					As of September 30,
	2002	2003	2004	2005	2006	2006
		(unaudited)				(unaudited)
				(In thousands)		
Consolidated Balance Sheet Data:						
Cash and cash equivalents	$ 764	$ 177	$ 869	$ 3,287	$ 7,448	$ 2,269
Working capital	889	(145)	(1,186)	663	5,127	(797)
Total assets	1,687	961	2,992	6,940	12,689	10,056
Total liabilities	747	1,040	3,374	4,738	5,351	9,082
Total stockholders' equity (deficit)	940	(79)	(382)	2,202	7,338	974

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

The following discussion of our financial condition and results of operations should be read together with our consolidated financial statements and related notes included elsewhere in this prospectus. This discussion contains forward-looking statements based upon current expectations that involve risks, uncertainties and assumptions. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under "Risk Factors," "Information Regarding Forward-looking Statements" and elsewhere in this prospectus.

Overview

We have developed and manufacture and market a family of products intended to help prevent and treat infections in chronic and acute wounds. Infection is a serious potential complication in both chronic and acute wounds, and controlling infection is a critical step in wound healing. Our platform technology, called Microcyn, is a non-toxic, super-oxidized water-based solution that is designed to treat a wide range of pathogens, including viruses, fungi, spores and antibiotic resistant strains of bacteria such as Methicillin-resistant *Staphylococcus aureus,* or MRSA, and Vancomycin-resistant *Enterococcus,* or VRE, in wounds. We do not have the necessary regulatory approvals to market Microcyn in the United States as a drug. However, in clinical testing and studies, our products were effective against a wide range of pathogens and were found to be non-toxic, easy to use and complementary to most existing treatment methods in wound care. Our experience and clinical data indicate that the use of Microcyn may shorten hospital stays, lower aggregate patient care costs and, in certain cases, reduce the need for systemic antibiotics. Microcyn also has potential applications in several other large markets, including respiratory, dermatology, dental and veterinary markets.

We believe that Microcyn may be the first topical product that is effective against a broad range of bacteria and other infectious microbes without causing toxic side effects on, or irritation of, healthy tissue. Unlike most antibiotics, including antibiotic resistant strains, such as MRSA and VRE, we believe Microcyn does not target specific strains of bacteria, a practice which has been shown to promote the development of resistant bacteria. In addition, our products are shelf stable, require no special preparation and are easy to use.

We currently sell Microcyn in the United States through a small commercial team and through one national and five regional distributors. In Europe, we have a small direct sales force and exclusive distribution agreements with four distributors, all of which are experienced suppliers to the wound care market, with an aggregate combined sales force of over 25 full-time equivalent salespeople. In Mexico, we sell through a dedicated contract sales force, including salespeople, nurses and clinical support staff, and a network of distributors to both the public and private sector. The MOH, which approves product selection and procurement for government hospitals and healthcare institutions, has approved reimbursement for Microcyn. In India we sell through a national distributor, and in Canada, we have entered into a distribution agreement under which distribution will commence upon required regulatory approvals. We plan to expand our direct sales force in the United States, Europe and Mexico to support our distribution network.

Our products have received CE Mark approval for wound cleaning and reduction of microbial loads, three U.S. FDA 510(k) clearances as a medical device in wound debridement, lubricating, moistening and dressing, approvals for use as an antiseptic, disinfectant and sterilant in Mexico, approval for use in cleaning and debriding in wound management in India, and approval for moistening, irrigating, cleansing and debriding skin lesions in Canada. Physicians in several countries have conducted studies in which Microcyn was used to treat infection in a variety of wounds, including hard-to-treat wounds such as diabetic ulcers and burns, and, in some cases, reduced the need for systemic antibiotics. In July 2006, we completed a controlled clinical trial for pre-operative skin preparation. After completion of this trial, the FDA advised us that it is considering adopting new heightened performance requirements for evaluating efficacy of products designed to be used in pre-operative skin preparation such as ours. In discussions with the FDA, the FDA has not provided us with the definitive timing for, or parameters of, any such new requirements, and has informally stated that it is uncertain during what time frame it will be able to do so. We plan to continue our discussions with the FDA regarding the possible timing and parameters of any new guidelines for evaluating efficacy for pre-operative skin preparations. Depending on the ultimate position of the FDA regarding the performance criteria for pre-

operative skin preparations, we may reassess our priorities, clinical timelines and schedules for pursuing a pre-operative skin preparation indication or may decide not to pursue this indication.

We intend to conduct a pilot study in early 2007 to evaluate the effectiveness of Microcyn in patients with open wounds. Following completion of the pilot study, we intend to establish a protocol for a Phase IIb clinical trial in a similar patient population, which we intend to begin in mid to late 2007. We anticipate this trial to last approximately 12 months. The Phase IIb clinical trial is expected to cost approximately $4.0 million and will be funded through proceeds from this offering. We anticipate this clinical trial to be completed in late 2008.

In the event we choose to pursue a partnering arrangement to commercialize products, we would expect a larger portion of our revenues would be derived from licensing as opposed to direct sales.

We also have a non-Microcyn based compound in the research and development phase. This compound has potential applications in oncology. We anticipate spending approximately $500,000 on further clinical studies on this compound, funded by proceeds from this offering. We expect these studies to be completed in 2008.

We have incurred significant net losses since our inception and had an accumulated deficit of $59.3 million as of September 30, 2006. We expect to incur significant expenses in the foreseeable future as we seek to commercialize our products, and we cannot be sure that we will achieve profitability.

Financial Operations Overview

Revenues

We derive our revenues from product sales and service arrangements. Product revenues are generated from the sale of Microcyn to hospitals, medical centers, doctors, pharmacies, distributors and strategic partners, and are generally recorded upon shipment following receipt of a purchase order or upon obtaining proof of sell-through by a distributor. Product sales are made either through direct sales personnel or distributors. Historically, a significant majority of our product sales have been in Mexico.

Service revenues are derived from consulting and testing contracts. Service revenues are generally recorded upon performance under the service contract. Revenues generated from testing contracts are recorded upon completion of the test and when the final report is sent to the customer. We have refocused our business efforts away from consulting and testing services toward the commercialization of Microcyn. As a result, we expect service revenues to continue to significantly decline in future periods.

Cost of Revenues

Cost of product revenues represents the costs associated with the manufacturing of our products, including expenses for our various facilities which are fixed, and related personnel cost and the cost of materials used to produce our products. Cost of service revenues consists primarily of personnel related expenses and supplies.

Research and Development Expense

Research and development expense consists of costs related to the research and development of Microcyn and our manufacturing process, the development of new products and new delivery systems for our products and to carry out preclinical studies and clinical trials to obtain various regulatory approvals. Research and development expense is charged as incurred.

Selling, General and Administrative Expense

Selling, general and administrative expense consists of personnel related costs, including salaries and sales commissions, and education and promotional expenses associated with Microcyn and costs related to administrative personnel and senior management. These expenses also include the costs of educating physicians and other healthcare professionals regarding our products and participating in industry conferences

and seminars. Selling, general and administrative expense also includes travel costs, outside consulting services, legal and accounting fees and other professional and administrative costs.

Stock-Based Compensation Expense

Prior to April 1, 2006, we accounted for stock-based employee compensation arrangements in accordance with the provisions of Accounting Principles Board Opinion No. 25, or APB No. 25, "Accounting for Stock Issued to Employees," and its interpretations and applied the disclosure requirements of SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure, an amendment of FASB Statement No. 123." We used the minimum value method to measure the fair value of awards issued prior to April 1, 2006 with respect to its application requirements under SFAS No. 123.

Effective April 1, 2006, we adopted SFAS No. 123(R) "Share Based Payment," or SFAS 123(R). This statement is a revision of SFAS Statement No. 123, "Accounting for Stock-Based Compensation" and supersedes APB Opinion No. 25, and its related implementation guidance. SFAS 123(R) addresses all forms of share-based payment, or SBP, awards including shares issued under employee stock purchase plans, stock options, restricted stock and stock appreciation rights. Under SFAS 123(R), SBP awards result in a cost that will be measured at fair value on the awards' grant date, based on the estimated number of awards that are expected to vest and will result in a charge to operations.

Under SFAS 123(R), nonpublic entities, including those that become public entities after June 15, 2005, that used the minimum value method of measuring equity share options and similar instruments for either recognition or pro forma disclosure purposes under Statement 123 are required to apply SFAS 123(R) prospectively to new awards and to awards modified, repurchased or cancelled after the date of adoption. In addition, SFAS 123(R) requires such entities to continue accounting for any portion of awards outstanding at the date of initial application using the accounting principles originally applied to those awards. Accordingly, we record stock-based compensation expense relating to awards granted prior to April 1, 2006 that are expected to vest in periods ending after April 1, 2006 in accordance with the provisions of APB No. 25 and related interpretive guidance.

We have adopted the prospective method with respect to accounting for our transition to SFAS 123(R). Accordingly, we recognized in salaries and related expense $104,000 of stock-based compensation expense in the six months ended September 30, 2006, which represents the intrinsic value of options granted prior to April 1, 2006 that we continue to account for using the recognition and measurement principles prescribed under APB No. 25.

Discontinued Operations

On June 16, 2005, we entered into a series of agreements with Quimica Pasteur, or QP, a Mexico-based distributor of pharmaceutical products to hospitals and health care entities owned and/or operated by the Mexican Ministry of Health, or MOH. These agreements provided, among other things, for QP to act as our exclusive distributor of Microcyn to the MOH for a period of three years.

In connection with these agreements, we were granted an option to acquire all except a minority share of the equity of QP directly from its principals in exchange for 150,000 shares of common stock, contingent upon QP's attainment of certain financial milestones. Two of our employees were appointed as officers of QP, which resulted in the establishment of financial control of QP by our company under applicable accounting literature. In addition, due to its liquidity circumstances, QP was unable to sustain operations without our financial and management support. Accordingly, QP was deemed to be a variable interest entity in accordance with FIN 46R and the results of QP were therefore consolidated with our financial statements for the period from June 16, 2005 through March 26, 2006, the effective termination date of the distribution and related agreements.

In connection with an audit of QP's financial statements in late 2005, we were made aware of a number of facts that suggested that QP or its principals may have engaged in some form of fraudulent tax avoidance practice prior to the execution of the agreements between our company and QP. We did not discover these facts prior to our execution of these agreements or for several months thereafter. Our prior independent

auditors informed us that we did not have effective anti-fraud programs designed to detect the activities in which QP's principals engaged or the personnel to effectively evaluate and determine the accounting for non-routine or complex accounting transactions. Our audit committee engaged an outside law firm to conduct an investigation whose findings implicated QP's principals in a systemic tax avoidance practice prior to June 16, 2005. Based on the results of this investigation, we terminated our agreements with QP on March 26, 2006. We estimate that QP's liability for taxes, interest and penalties related to these practices could amount to $7 million or more. QP had a well-established relationship with the MOH. Although we lost the benefit of this relationship when we terminated our agreements with QP, we continue to sell to the MOH through our dedicated direct sales force and through other distributors. As of September 30, 2006, our sales to the MOH were not negatively affected by the termination of our relationship with QP and we do not expect that it will have a significant effect on sales to the MOH in the future.

In accordance with SFAS 144, we have reported QP's results for the period of June 16, 2005 through March 26, 2006 as discontinued operations because the operations and cash flows of QP have been eliminated from our ongoing operations as a result of the termination of these agreements. We no longer have any continuing involvement with QP as of the date on which the agreements were terminated. Amounts associated with the loss upon the termination of the agreements with QP, which consisted of funds we advanced to QP to provide it with working capital, are presented separately from QP's operating results.

Critical Accounting Policies

The preparation of our consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to exercise its judgment. We exercise considerable judgment with respect to establishing sound accounting polices and in making estimates and assumptions that affect the reported amounts of our assets and liabilities, our recognition of revenues and expenses, and disclosure of commitments and contingencies at the date of the financial statements.

On an ongoing basis, we evaluate our estimates and judgments. Areas in which we exercise significant judgment include, but are not necessarily limited to, our valuation of accounts receivable, inventory, depreciation, amortization, recoverability of long-lived assets, income taxes, equity transactions (compensatory and financing) and contingencies. We have also adopted certain polices with respect to our recognition of revenue that we believe are consistent with the guidance provided under Securities and Exchange Commission Staff Accounting Bulletin No. 104.

We base our estimates and judgments on a variety of factors including our historical experience, knowledge of our business and industry, current and expected economic conditions, the attributes of our products, regulatory environment, and in certain cases, the results of outside appraisals. We periodically re-evaluate our estimates and assumptions with respect to these judgments and modify our approach when circumstances indicate that modifications are necessary.

While we believe that the factors we evaluate provide us with a meaningful basis for establishing and applying sound accounting policies, we cannot guarantee that the results will always be accurate. Since the determination of these estimates requires the exercise of judgment, actual results could differ from such estimates.

A description of significant accounting polices that require us to make estimates and assumptions in the preparation of our consolidated financial statements is as follows:

Revenue Recognition and Accounts Receivable

We generate product revenues from sales of our products to hospitals, medical centers, doctors, pharmacies, distributors and strategic partners. We sell our products directly to third parties and to distributors through various cancelable distribution agreements. We have also entered into an agreement to license our products.

We apply the revenue recognition principles set forth in Securities and Exchange Commission Staff Accounting Bulletin, or SAB, 104 "Revenue Recognition," with respect to all of our revenues. Accordingly, we

record revenues when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectability of the sale is reasonable assured.

We require all of our product sales to be supported by evidence of a sale transaction that clearly indicates the selling price to the customer, shipping terms and payment terms. Evidence of an arrangement generally consists of a contract or purchase order approved by the customer. We have ongoing relationships with certain customers from which we customarily accept orders by telephone in lieu of a purchase order.

We recognize revenues at the time in which we receive a confirmation that the goods were either tendered at their destination when shipped "FOB destination," or transferred to a shipping agent when shipped "FOB shipping point." Delivery to the customer is deemed to have occurred when the customer takes title to the product. Generally, title passes to the customer upon shipment, but could occur when the customer receives the product based on the terms of the agreement with the customer.

While we have a policy of investigating the creditworthiness of our customers, we have, under certain circumstances, shipped goods in the past and deferred the recognition of revenues when available information indicates that collection is in doubt. We establish allowances for doubtful accounts when available information causes us to believe that a credit loss is probable.

We market a substantial portion of our goods through distributors. In Europe, we defer recognition of distributor-generated revenues until the time we confirm that distributors have sold these goods. Although our terms provide for no right of return, our products have a finite shelf life and we may, at our discretion, accommodate distributors by accepting returns to avoid the distribution of expired goods.

Service revenues are recorded upon performance of the service contracts. Revenues generated from testing contracts are recorded when the test is completed and the final report is sent to the customer.

Inventory and Cost of Revenues

We state our inventory at the lower of cost, determined using the first-in, first-out method, or market, based on standard costs. Establishing standard manufacturing costs requires us to make estimates and assumptions as to the quantities and costs of materials, labor and overhead that are required to produce a finished good. Cost of service revenues is expensed when incurred.

Income Taxes

We are required to determine the aggregate amount of income tax expense or loss based upon tax statutes in jurisdictions in which we conduct business. In making these estimates, we adjust our results determined in accordance with generally accepted accounting principles for items that are treated differently by the applicable taxing authorities. Deferred tax assets and liabilities, as a result of these differences, are reflected on our balance sheet for temporary differences in loss and credit carryforwards that will reverse in subsequent years. We also establish a valuation allowance against deferred tax assets when it is more likely than not that some or all of the deferred tax assets will not be realized. Valuation allowances are based, in part, on predictions that management must make as to our results in future periods. The outcome of events could differ over time which would require that we make changes in our valuation allowance.

Equity Transactions

Under generally accepted accounting principles, we have the ability to choose between two alternative methods of accounting for employee stock based compensation: the intrinsic value method or the fair value method. Although we have adopted the intrinsic value method, the results we could derive under the fair value method could differ significantly. In addition, since our stock is not publicly traded, we must estimate its fair value. We have used outside valuation specialists that have relied upon information provided by management to determine value of our stock and have also made valuation estimates based on concurrent sales of equity securities for cash and other business related information.

Deferred Stock-Based Compensation Expense

Stock-based compensation expense, which is a non-cash charge, results from stock option grants at exercise prices that, for financial reporting purposes, are deemed to be below the fair value of the underlying common stock. We recognize stock-based compensation expense on a straight-line basis over the vesting period of the underlying option, which is generally five years. The amount of stock-based compensation expense expected to be amortized in future periods may decrease if unvested options for which deferred stock-based compensation expense has been recorded are subsequently cancelled or may increase if future option grants are made with exercise prices below the deemed fair value of the common stock on the date of measurement.

During the period from April 1, 2005 to March 31, 2006, we granted options to purchase a total of 787,000 shares of common stock with exercise prices ranging from $4.40 to $12.00 per share and at a weighted average exercise price of $9.20 per share. We obtained a contemporaneous valuation from an independent valuation specialist in July 2005. This valuation was used by our board of directors to establish the fair market value of our common stock with respect to the majority of options granted in the year ended March 31, 2006. Our other options were granted at fair market value as determined by our board of directors. Given the absence of an active market for our common stock and resulting lack of liquidity in the year ended March 31, 2006, our board of directors determined the estimated fair value of our common stock on the date of grant based on several factors, including the offering prices and liquidation preferences of our preferred stock, progress and milestones achieved in our business, our financial condition, equity market conditions, trading ranges of comparable public companies and the likelihood of achieving a liquidity event such as an initial public offering or a sale of the company given prevailing market conditions.

After receipt of the independent valuation in July 2005, our board of directors reassessed the value of our common stock. In reassessing the value of our common stock, we used a straight-line approach because we determined no single event supported incremental movement in the underlying stock. Further, we believe this approach is consistent with valuation methodologies applied by similar companies pursuing an initial public offering. Based upon this process, we determined that the reassessed fair value of options granted from August 7, 2003 through April 1, 2005 ranged from $3.28 to $9.12 per share. Accordingly, we recorded deferred stock-based compensation of $233,000, $2.8 million and $401,000 during the years ended March 31, 2004, 2005 and 2006, respectively, in accordance with Accounting Principles Board, or APB, Opinion 25. The deferred stock-based compensation is being amortized on a straight-line basis over the vesting period of the related awards, which is generally five years. For the years ended March 31, 2004, 2005 and 2006, we recorded employee stock-based compensation of $30,000, $2.3 million and $279,000, respectively. Stock-based compensation expense recorded during the year ended March 31, 2005 includes $1.7 million for the intrinsic value of options to purchase 1.2 million shares of common stock granted to our Chief Executive Officer.

The information regarding net loss as required by SFAS No. 123 presented in Note 13 to our consolidated financial statements, has been determined as if we had accounted for our employee stock options under the fair value method. The resulting effect on net loss pursuant to SFAS No. 123 is not likely to be representative of the effect on net loss pursuant to SFAS No. 123 in future years, since future years are likely to include additional grants and the impact of future years' vesting.

Comparison of Six Months Ended September 30, 2006 and September 30, 2005

Revenues

Revenues increased $1.2 million, or 116%, to $2.3 million for the six months ended September 30, 2006, from $1.1 million for the six months ended September 30, 2005. Product revenues increased $1.1 million, or 140%, to $1.9 million for the six months ended September 30, 2006, from $807,000 for the six months ended September 30, 2005. This increase was primarily due to $580,000 in sales to a new customer, Alkem Laboratories Limited, in India, during the six months ended September 30, 2006. Additionally, Microcyn product revenues in Europe and Mexico increased by $184,000 and $403,000, respectively, from the six months ended September 30, 2005, to the six months ended September 30, 2006, due to continued penetration

into the hospital markets in these regions by our distributors' sales forces in Europe, and our direct sales force in Mexico.

Service revenues increased $113,000, or 41%, to $388,000 for the six months ended September 30, 2006, from $275,000 for the six months ended September 30, 2005.

We expect that product revenues will continue to increase as we expand our sales and marketing efforts worldwide. As of September 30, 2006, sales of our product to the MOH were not negatively affected by the termination of our relationship with QP. We expect that our service revenues will significantly decline in future periods, as we continue to implement our strategy of focusing primarily on our Microcyn business.

Cost of Revenues

Cost of revenues decreased $381,000, or 21%, to $1.5 million for the six months ended September 30, 2006, from $1.8 million for the six months ended September 30, 2005. Cost of revenues from product sales principally include fixed costs associated with plant and labor and to a lesser extent variable costs associated with packaging and other raw materials. During the six months ended September 30, 2006, revenues from product sales exceeded cost of revenues from product sales as our sales volumes were sufficient to cover our fixed and variable cost components.

Cost of revenues from product sales decreased $307,000, or 23%, to $1.0 million for the six months ended September 30, 2006, from $1.4 million for the six months ended September 30, 2005. Cost of revenues from product sales in the U.S. decreased $612,000 for the six months ended September 30, 2006, as compared to the six months ended September 30, 2005. Beginning in April 2006, we shifted the focus of our United States facility from manufacturing to activities related to the research and development of new Microcyn products. As a result, we began classifying the expense associated with our United States facility as a research and development expense, and therefore our fixed cost of product revenues decreased accordingly. Cost of revenues from product sales in Europe increased $448,000 for the six months ended September 30, 2006 as compared to the six months ended September 30, 2005, as our European manufacturing center expanded production capacity and the associated fixed costs grew accordingly. Also during that time, cost of sales from product revenues in Mexico decreased by $110,000 as we closed a manufacturing facility in Morelia, Mexico in September 2005, and opened a new, lower fixed cost facility in Guadalajara, Mexico the following quarter.

Cost of revenues from services decreased $75,000, or 15%, to $422,000 for the six months ended September 30, 2006, from $497,000 for the six months ended September 30, 2005.

Gross margins increased $1.6 million to a gross profit of $865,000 for the six months ended September 30, 2006, from a gross loss of $765,000 for the six months ended September 30, 2005. Primarily this increase was due to the $1.1 million growth in product revenues, while the cost of product revenues decreased by $306,000.

We experienced positive gross margins during the six months ended September 30, 2006, and expect to experience positive gross margins in future periods as well. If we fail to increase our sales volume to sufficient levels in the future, we may have to examine strategies to reduce our recurring fixed costs of manufacturing. We expect that cost of revenues will continue to increase in absolute dollars as product sales increase in future periods.

Research and Development Expense

Research and development expense increased $631,000, or 65%, to $1.6 million for the six months ended September 30, 2006, from $965,000 for the six months ended September 30, 2005. This increase was primarily attributable to the U.S. manufacturing department shifting focus from product manufacturing to research and development in April 2006. As a result, we began classifying the expense associated with our U.S. facility as a research and development expense, and therefore our research and development expense increased accordingly. Additionally, $205,000 of this increase was attributable to higher salary and related expenses in the clinical and regulatory department. The expansion of our clinical and regulatory team was due to our increased focus

on medical education, clinical trials and the management of regulatory trials designed to obtain FDA drug approvals for our Microcyn products.

We expect that research and development expense will continue to increase substantially in future years as we seek additional regulatory approvals of our Microcyn products. We expect to expand the scope of our new product development, which may also result in substantial increases in research and development expense.

Selling, General and Administrative Expense

Selling, general and administrative expense increased $159,000, or 2%, to $7.9 million during the six months ended September 30, 2006, from $7.7 million during the six months ended September 30, 2005. This increase was partially due to a $345,000 increase in U.S. selling, general, and administrative expense, which was primarily the result of an increase of $167,000 in personnel expense during the six months ended September 30, 2006. Additionally, outside service fees for sales and marketing in the United States increased by $162,000. Selling, general, and administrative expense in Europe increased $456,000, primarily due to higher personnel expense as we hired additional sales representatives and other general support staff during the six months ended September 30, 2006. The increase in selling, general, and administrative expense was offset by a $642,000 decrease in selling, general, and administrative expense in Mexico in the six months ended September 30, 2006 as compared to the six months ended September 30, 2005. This decrease was primarily the result of lower personnel expense of $314,000 as we reduced our internal sales force and general and administrative personnel in Mexico during the six months ended September 30, 2005. In addition, outside professional fees associated with sales and marketing decreased by $180,000, and rent expense decreased by $112,000 as we moved to lower cost office space in September 2005.

We expect that selling, general and administrative expense will increase in the future as we increase sales and marketing personnel and expand our infrastructure to support the requirements of being a public company.

Interest Expense and Interest Income

Interest expense increased $157,000, or 152%, to $261,000 for the six months ended September 30, 2006 from $103,000 for the six months ended September 30, 2005. This increase was primarily the result of higher borrowings during the six months ended September 30, 2006. Interest income increased $31,000 or 45%, to $100,000 for the six months ended September 30, 2006, from $68,000 for the six months ended September 30, 2005. This increase was primarily the result of higher balances of interest-bearing instruments during the six months ended September 30, 2006.

Other Income (Expense), Net

Other income (expense), net was $92,000 net income for the six months ended September 30, 2006, compared with $101,000 net expense for the six months ended September 30, 2005. This change was primarily attributable to a $119,000 gain on foreign exchange translation for the six months ended September 30, 2006, as compared to loss of $102,000 for the six months ended September 30, 2005.

Discontinued Operations

Loss on the disposal of discontinued business was $174,000 for the six months ended September 30, 2005. This charge represents the net loss associated with the entity QP which were consolidated with our financial statements as required by FIN 46(R), and later deemed to be a discontinued operation. As no relationship existed with this entity following the year ended March 31, 2006, no charges were recognized during the six months ended September 30, 2006.

Comparison of Years Ended March 31, 2006 and March 31, 2005

Revenues

Revenues increased $1.2 million, or 91%, to $2.6 million for the year ended March 31, 2006, from $1.4 million for the year ended March 31, 2005. Product revenues increased $1.5 million, or 316%, to

$2.0 million for the year ended March 31, 2006, from $473,000 for the year ended March 31, 2005. This increase was primarily due to a $1.4 million increase in sales of Microcyn60 in Mexico following the expansion of our sales force in that country and the receipt of product reimbursement by the MOH.

The increase in product revenues was partially offset by a $265,000 decrease in service revenues during the year ended March 31, 2006, as compared to the prior year. The decrease in service revenues was a result of a shift in our focus from services to the development of our Microcyn products in fiscal 2006.

Cost of Revenues

Cost of revenues increased $1.4 million, or 39%, to $4.9 million for the year ended March 31, 2006, from $3.5 million for the year ended March 31, 2005. Cost of revenues from product sales principally include fixed costs associated with plant and labor and to a lesser extent variable costs associated with packaging and other raw materials. Cost of revenues from product sales increased $1.7 million, or 76%, to $3.9 million in the year ended March 31, 2006, from $2.2 million in the year ended March 31, 2005. This increase was due primarily to European product manufacturing beginning in the middle of the year ended March 31, 2005 as compared to a full year of costs in the year ended March 31, 2006. As such, total cost of product revenues in Europe increased $637,000 to $1.0 million for the year ended March 31, 2006 from $381,000 for the year ended March 31, 2005. Additionally, we incurred charges we believe to be non-recurring. We wrote off $1.0 million of inventory due to product labeling issues and expiring shelf life of products as a result of a one-time build-up of excess product inventory. We also relocated our manufacturing facility in Mexico and incurred approximately $200,000 of labor and severance charges related to the move. These increases were partially offset by a $308,000, or 23%, decrease in costs related to service revenues to $1.0 million in the year ended March 31, 2006, from $1.3 million in the year ended March 31, 2005. The lower cost of service revenues was related to our shift in focus to product development and the sale of our Microcyn products during fiscal 2006.

We experienced a gross loss of $2.3 million during the year ended March 31, 2006. This gross loss was primarily due to relatively high fixed costs associated with manufacturing our products and a sales volume that was not sufficient to cover these costs. Additionally, there were several charges that we believe to be non-recurring that were incurred during the year ended March 31, 2006 that increased our gross loss for the period. The most significant of these charges was the write off of inventory and the costs associated with the relocation of our Mexican manufacturing facility as described above.

Research and Development Expense

Research and development expense increased $946,000, or 57%, to $2.6 million in the year ended March 31, 2006, from $1.7 million in the year ended March 31, 2005. This increase was primarily attributable to the expansion of our regulatory team, which focused on EPA, FDA and KEMA approvals for Microcyn products during the period. Additionally, in September 2005, we commenced our pre-operative skin preparation pilot studies to support our application for an FDA drug clearance indicating microbial load reduction. Total spending on regulatory trials, other clinical studies, and related expenses increased $1.2 million, or 164%, to $1.9 million for the year ended March 31, 2006, from $735,000 during the year ended March 31, 2005. This increase was partially offset by a $418,000 decrease in spending on new product development to $497,000 in the year ended March 31, 2006, from $915,000 in the year ended March 31, 2005.

Selling, General and Administrative Expense

Selling, general and administrative expense increased $3.4 million, or 28%, to $15.9 million during the year ended March 31, 2006, from $12.5 million during the year ended March 31, 2005. This increase was partially due to a $1.8 million increase in United States selling, general and administrative expense primarily as a result of higher outside consulting and service fees during the year ended March 31, 2006. Specifically, outside accounting fees increased by $653,000 due to the preparation and completion of an audit of our last four fiscal years, legal fees increased by $507,000 due to expanded intellectual property and general legal support, and outside consulting and service fees increased by $294,000 due to consulting expenses related to the marketing of our products in Asia.

In addition, sales and marketing expense in Europe increased $429,000 due to the hiring of additional sales and marketing personnel during the year ended March 31, 2006.

Selling, general and administrative expense in Mexico increased $3.3 million in the year ended March 31, 2006 compared to the prior year primarily due to expanded sales and marketing efforts in Mexico, as well as non-recurring charges associated with the relocation of our Mexican subsidiary's facility. During the year ended March 31, 2006, we began utilizing 75 full-time, direct sales personnel in the major districts of Mexico, dedicated to the sale of Microcyn60 in the hospital and pharmacy markets in Mexico. As a result, sales and marketing expense in Mexico increased $2.7 million during the year ended March 31, 2006, compared to the prior year.

The increase in selling, general and administrative expense was offset by a $1.8 million decrease in non-cash stock compensation expense in the year ended March 31, 2006 compared to the prior year. Approximately $1.7 million of non-cash stock-based compensation expense incurred in the year ended March 31, 2005 was related to the grant of an option to purchase 1.2 million shares of common stock to our Chief Executive Officer.

Interest Expense and Interest Income

Interest expense decreased $200,000, or 54%, to $172,000 in the year ended March 31, 2006, from $372,000 in the year ended March 31, 2005. This decrease was primarily the result of lower borrowings during the year. Interest income increased $274,000, to $282,000 in the year ended March 31, 2006, from $8,000 in the year ended March 31, 2005. This increase was primarily the result of higher balances of interest-bearing instruments during the year ended March 31, 2006.

Other Income (Expense), Net

Other income (expense), net was $377,000 net expense in the year ended March 31, 2006, compared with $146,000 net income in the year ended March 31, 2005. This change was primarily attributable to a $283,000 loss on foreign exchange translation in the year ended March 31, 2006, as compared to a gain of $134,000 in the year ended March 31, 2005.

Discontinued Operations

Loss on discontinued operations was $2.0 million in the year ended March 31, 2006. This loss consisted of $818,000 classified as a loss from operations of discontinued business and $1.2 million of loss on the disposal of discontinued business. The loss from operations of discontinued business represents the net operating loss of QP, which was consolidated with our financial results as required by FIN 46(R). The relationship was terminated in the fourth quarter of the fiscal year ended March 31, 2006 and the loss was classified as a discontinued operation on our statements of operations. In addition, $1.2 million of net assets associated with this entity were written off and classified as a loss on disposal of discontinued business. As no relationship existed with this entity prior to the year ended March 31, 2006, no charges were recognized in prior years.

Comparison of Years Ended March 31, 2005 and March 31, 2004

Revenues

Revenues increased $454,000, or 50%, to $1.4 million for the year ended March 31, 2005, from $902,000 for the year ended March 31, 2004. Product revenues increased $378,000 to $473,000 for the year ended March 31, 2005, as compared to $95,000 in the prior year. This increase was primarily attributable to the hiring of new sales and marketing personnel in Mexico and an increased demand for Microcyn60 in the Mexican private hospital market.

Service revenues increased $76,000, or 9%, to $883,000 for the year ended March 31, 2005, as compared to $807,000 for the prior year. This increase was primarily the result of increased demand for our laboratory testing services.

Cost of Revenues

Cost of revenues increased $854,000, or 32%, to $3.5 million for the year ended March 31, 2005, from $2.7 million for the year ended March 31, 2004. Cost of product revenues increased $808,000 primarily due to the expansion of our manufacturing capacity in the United States and Europe and related costs, including operating expenses for new facilities and an increase in personnel.

Cost of service revenues was $1.3 million for both the years ended March 31, 2005 and 2004.

We experienced gross losses during the years ended March 31, 2005 and March 31, 2004 of $2.2 million and $1.8 million, respectively. These gross losses were primarily due to the relatively high fixed costs associated with manufacturing our products and a sales volume that was not sufficient to cover these costs. During these years we developed our manufacturing sites in the United States, Europe and Mexico, prior to significant sales in those countries.

Research and Development Expense

Research and development expense increased $241,000, or 17%, to $1.7 million for the year ended March 31, 2005, from $1.4 million for the year ended March 31, 2004. This increase was primarily related to a $194,000 increase in salary expense related to the expansion of our research and development and regulatory teams and a $102,000 increase in consulting services in the year ended March 31, 2005, as compared to the prior year.

Selling, General and Administrative Expense

Selling, general and administrative expense increased $8.6 million, or 219%, to $12.5 million for the year ended March 31, 2005, from $3.9 million for the year ended March 31, 2004. This increase was due in part to a $4.1 million increase in general and administrative expense, primarily personnel costs associated with hiring additional senior management, sales and marketing, operations and administrative personnel. Additionally, selling, general and administrative expense was higher due to a $2.0 million increase in non-cash stock compensation expense in the year ended March 31, 2005 compared to the prior year.

Interest Expense

Interest expense increased $194,000, or 109%, to $372,000 in the year ended March 31, 2005, from $178,000 in the year ended March 31, 2004. This increase was primarily due to an increase in non-cash interest expense charged on warrants issued in connection with debt financing transactions in the year ended March 31, 2005.

Other Income (Expense), net

Other income (expense), net was net income of $146,000 in the year ended March 31, 2005, compared to net expense of $26,000 in the year ended March 31, 2004. The change was primarily attributable to a gain of $134,000 on foreign exchange transactions in the year ended March 31, 2005, compared to a loss of $4,000 in the prior year.

Liquidity and Capital Resources

Since our inception, we have incurred significant losses and, as of September 30, 2006, we had an accumulated deficit of approximately $59.3 million. We have not yet achieved profitability. We expect that our research and development and selling, general and administrative expenses will continue to increase and, as a result, we will need to generate significant product revenues to achieve profitability. We may never achieve profitability.

Sources of Liquidity

Since our inception, substantially all of our operations have been financed through the sale of our common and preferred stock. Through September 30, 2006, we had received net proceeds of $3.5 million from the sale of common stock, $6.6 million from the sale of Series A convertible preferred stock, $43.7 million

from the sale of Series B convertible preferred stock and $304,000 from the issuance of common stock to employees, consultants and directors in connection with the exercise of stock options. We have received additional funding through loans and capital equipment leases, as described below. We have also used our revenues to date as a source of additional liquidity. As of September 30, 2006, we had cash and cash equivalents of $2.3 million and debt under our notes payable and equipment loans of $4.5 million.

In June 2006, we entered into a loan and security agreement with a financial institution to borrow a maximum of $5.0 million. The facility allows us to borrow a maximum of $2.7 million in working capital, $1.3 million in accounts receivable financing and $1.0 million in equipment financing, subject to certain conditions. In conjunction with this agreement, we issued warrants to purchase up to 75,000 shares of our Series B preferred stock at an exercise price of $18.00 per share. Warrants to purchase 53,750 shares were earned and exercisable at execution of the agreement, and warrants to purchase 21,250 shares will be earned on a pro rata basis upon our use of this facility. As of October 31, 2006, we had borrowed $4.2 million against this facility at an interest rate of 8.5%. Draws under this facility bear interest at prime plus one-half percent.

On September 14, 2006, we sold 84,539 units, consisting of 84,539 shares of our Series C convertible preferred stock and warrants to purchase 16,907 shares of our common stock at an exercise price of $18.00 per share, at a per unit price of $18.00 for aggregate gross proceeds of $1,521,702. In connection with this sale, we paid to Brookstreet, as placement agent, an aggregate of $152,170 in commissions and issued to Brookstreet fully vested warrants to purchase an aggregate of 10,567 shares of our common stock at an exercise price of $18.00 per share.

On October 20, 2006, we sold 108,486 units, consisting of 108,486 shares of our Series C convertible preferred stock and warrants to purchase 21,697 shares of our common stock at an exercise price of $18.00 per share, at a per unit price of $18.00 for aggregate gross proceeds of $1,952,748. In connection with this sale, we paid to Brookstreet, as placement agent, an aggregate of $195,274 in commissions and issued to Brookstreet fully vested warrants to purchase an aggregate of 13,560 shares of our common stock at an exercise price of $18.00 per share.

On November 7, 2006, we signed a loan agreement with Robert Burlingame, under which Mr. Burlingame advanced to us $4.0 million, which was funded on November 10, 2006, which accrues interest at an annual rate of 7%. The principal and all accrued interest under the loan agreement, and is available to us as working capital, will become due and payable in full on the earlier of November 10, 2007 or five days after the completion of an initial public offering of our common stock resulting in gross proceeds to us of at least $30.0 million. The loan is secured by all of our assets, other than our intellectual property, but is subordinate to the security interest held by our secured lender. Brookstreet was paid a fee in the amount of $50,000 and granted a warrant to purchase 25,000 shares of our common stock at an exercise price of $18.00 per share in connection with this loan.

Cash Flows

As of September 30, 2006, we had cash and cash equivalents of $2.3 million, compared to $7.4 million at March 31, 2006 and $3.3 million at March 31, 2005.

Net cash used in operating activities was $5.6 million, $13.5 million and $19.7 million in the years ended March 31, 2004, 2005 and 2006, respectively, and $8.7 million for the six months ended September 30, 2006. Net cash used in each of these periods primarily reflects net loss for these periods, offset in part by non-cash charges in operating assets and liabilities, non-cash stock-based compensation and depreciation.

Net cash used in investing activities was $1.0 million, $1.1 million and $419,000 for the years ended March 31, 2004, 2005 and 2006, respectively, and $587,000 for the six months ended September 30, 2006. Cash was used primarily to invest in fixed assets and other capital expenditures to support increased personnel and manufacturing facility expansion in Europe and Mexico during the years ended March 31, 2004 and 2005.

We expect to continue to make significant investments in the purchase of property and equipment to support our expanding operations.

Net cash provided by financing activities for the years ended March 31, 2004, 2005 and 2006 was $7.3 million, $17.2 million and $26.1 million, respectively, and $4.3 million for the six months ended September 30, 2006. The net cash provided by financing activities for the year end periods was primarily attributable to the sale of convertible preferred stock, which generated $6.6 million, $16.7 million and $27.0 million for the years ended March 31, 2004, 2005 and 2006, respectively. In addition, net proceeds from debt financing added $574,000, $1.2 million and $257,000 for the years ended March 31, 2004, 2005 and 2006, respectively, and $4.4 million for the six months ended September 30, 2006. Debt financing consisted primarily of notes payable to individuals and secured notes issued to finance the purchase of capital equipment, corporate insurance premiums and general operations.

Contractual Obligations

As of March 31, 2006, we had contractual obligations as follows (long-term debt and capital lease amounts include principal payments only):

	Payments Due by Period				
	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
			(in thousands)		
Long-term debt	$ 714	$ 504	$ 93	$ 117	$ —
Capital leases	69	21	42	6	—
Operating leases	878	341	340	197	—
Total	$ 1,661	$ 866	$ 475	$ 320	$ —

We have leases covering approximately 40,000 square feet of office and manufacturing space in Petaluma, California, expiring in 2007, and our monthly rent is $23,493. We also have leases covering approximately 19,000 square feet of office and manufacturing space in Sittard, The Netherlands expiring in 2009, and approximately 12,000 square feet of office and manufacturing space and 5,000 square feet of warehouse space in Zapopan, Mexico, expiring in 2011 and 2007, respectively.

In June 2006, we entered into a loan and security agreement with a financial institution to borrow a maximum of $5.0 million. The facility allows us to borrow a maximum of $2.7 million in working capital, $1.3 million in accounts receivable financing and $1.0 million in equipment financing, subject to certain conditions. As a result of our borrowings of $4.2 million under such agreement, as of September 30, 2006, our total debt has increased to $4.6 million as of September 30, 2006.

We do not have any off-balance sheet arrangements as such term is defined in rules promulgated by the SEC.

Operating Capital and Capital Expenditure Requirements

We expect to continue to incur substantial operating losses in the future and to make capital expenditures to support the expansion of our research and development programs and to expand our commercial operations. We anticipate using a portion of the proceeds from this offering to finance these activities. It may take several years to obtain the necessary regulatory approvals to commercialize Microcyn as a drug in the United States.

We expect to use the net proceeds from this offering to fund approximately $12.6 million in expenses related to the expansion of our sales and marketing capabilities, including the expansion of our direct sales forces in the United States and Europe, approximately $13.0 million in clinical trials and related research, the repayment of the principal and interest on our Bridge Loan and the remaining proceeds for general corporate purposes, including working capital. A portion of the net proceeds may also be used to acquire or invest in complementary businesses, technologies, services or products. The amount and timing of actual expenditures may vary significantly depending upon the rate of growth, if any, of our business, the amount of cash

generated by our operations, status of our research and development efforts, competitive and technological developments and the amount of proceeds actually raised in this offering.

We currently anticipate that the net proceeds from this offering, the Series C Financing and the Bridge Loan, together with our future revenues, cash and cash equivalent balances and interest we earn on these balances will be sufficient to meet our anticipated cash requirements through at least the next 12 months.

Our future funding requirements will depend on many factors, including:

- the scope, rate of progress and cost of our clinical trials and other research and development activities;
- future clinical trial results;
- the terms and timing of any collaborative, licensing and other arrangements that we may establish;
- the cost and timing of regulatory approvals;
- the cost and delays in product development as a result of any changes in regulatory oversight applicable to our products;
- the cost and timing of establishing sales, marketing and distribution capabilities;
- the effect of competing technological and market developments;
- the cost of filing, prosecuting, defending and enforcing any patent claims and other intellectual property rights; and
- the extent to which we acquire or invest in businesses, products and technologies.

If we are unable to generate a sufficient amount of revenue to finance our operations, research and development and regulatory plans, we may seek to raise additional funds through public or private equity offerings, debt financings, capital lease transactions, corporate collaborations or other means. We may seek to raise additional capital due to favorable market conditions or strategic considerations even if we have sufficient funds for planned operations. The sale of additional equity or convertible debt securities could result in dilution to our stockholders. To the extent that we raise additional funds through collaborative arrangements, it may be necessary to relinquish some rights to our technologies or grant licenses on terms that are not favorable to us. We do not know whether additional funding will be available on acceptable terms, or at all. A failure to secure additional funding when needed may require us to curtail certain operational activities, including regulatory trials, sales and marketing, and international operations and would have a material adverse effect on our future business and financial condition.

Recent Accounting Pronouncements

In Emerging Issues Task Force, or EITF, Issue No. 04-8, “The Effect of Contingently Convertible Instruments on Diluted Earnings per Share,” the EITF reached a consensus that contingently convertible instruments, such as contingently convertible debt, contingently convertible preferred stock and other such securities should be included in diluted earnings per share (if dilutive) regardless of whether the market price trigger has been met. The consensus became effective for reporting periods ending after December 15, 2004. The adoption of this pronouncement did not have material effect on our financial statements.

In May 2005, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards No. 154, “Accounting Changes and Error Corrections — a replacement of APB Opinion No. 20 and FASB Statement No. 3”, or SFAS 154. This Statement replaces APB Opinion No. 20, “Accounting Changes”, and FASB Statement No. 3, “Reporting Accounting Changes in Interim Financial Statements”, and changes the requirements for the accounting for and reporting of a change in accounting principle. This Statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed.

APB Opinion No. 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. This Statement requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. When it is impracticable to determine the period-specific effects of an accounting change on one or more individual prior periods presented, this Statement requires that the new accounting principle be applied to the balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable and that a corresponding adjustment be made to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that period rather than being reported in an income statement. When it is impracticable to determine the cumulative effect of applying a change in accounting principle to all prior periods, this Statement requires that the new accounting principle be applied as if it were adopted prospectively from the earliest date practicable. This Statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. We do not believe that the adoption of SFAS 154 will have a significant effect on our financial statements.

On June 29, 2005, the EITF ratified Issue No. 05-2, "The Meaning of 'Conventional Convertible Debt Instrument' in EITF Issue No. 00-19, 'Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock." EITF Issue 05-2 provides guidance on determining whether a convertible debt instrument is "conventional" for the purpose of determining when an issuer is required to bifurcate a conversion option that is embedded in convertible debt in accordance with SFAS 133. Issue No. 05-2 is effective for new instruments entered into and instruments modified in reporting periods beginning after June 29, 2005. We do not believe that the adoption of this pronouncement will have a significant effect on our financial statements.

In September 2005, the EITF ratified Issue No. 05-4, "The Effect of a Liquidated Damages Clause on a Freestanding Financial Instrument Subject to EITF Issue No. 00-19, 'Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock'." EITF 05-4 provides guidance to issuers as to how to account for registration rights agreements that require an issuer to use its "best efforts" to file a registration statement for the resale of equity instruments and have it declared effective by the end of a specified grace period and, if applicable, maintain the effectiveness of the registration statement for a period of time or pay a liquidated damage penalty to the investor. We are currently in the process of evaluating the effect that the adoption of this pronouncement may have on our financial statements.

In September 2005, the FASB ratified the EITF Issue No. 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues," which addresses whether a modification to a conversion option that changes its fair value affects the recognition of interest expense for the associated debt instrument after the modification and whether a borrower should recognize a beneficial conversion feature, not a debt extinguishment if a debt modification increases the intrinsic value of the debt (for example, the modification reduces the conversion price of the debt). This issue is effective for future modifications of debt instruments beginning in the first interim or annual reporting period beginning after December 15, 2005. We do not believe that the adoption of this pronouncement will have a significant effect on our financial statements.

In September 2005, the FASB also ratified the EITF's Issue No. 05-8, "Income Tax Consequences of Issuing Convertible Debt with a Beneficial Conversion Feature," which discusses whether the issuance of convertible debt with a beneficial conversion feature results in a basis difference arising from the intrinsic value of the beneficial conversion feature on the commitment date, which is treated and recorded in the shareholder's equity for book purposes, but as a liability for income tax purposes, and, if so, whether that basis difference is a temporary difference under FASB Statement No. 109, "Accounting for Income Taxes." This Issue should be applied by retrospective application pursuant to Statement 154 to all instruments with a beneficial conversion feature accounted for under Issue 00-27 included in financial statements for reporting periods beginning after December 15, 2005. We do not believe that the adoption of this pronouncement will have a significant effect on our financial statements.

In February 2006, the FASB issued SFAS No. 155 "Accounting for Certain Hybrid Financial Instruments-an amendment of FASB Statements No. 133 and 140", or FAS 155. FAS 155 addresses the following: a) permits fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation; b) clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133; c) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation; d) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and e) amends Statement 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. FAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. We are currently evaluating the requirements of FAS 155, but do not expect that the adoption of this pronouncement will have a material effect on our financial statements.

In March 2006, the FASB issued SFAS 156 "Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140," or SFAS 156. SFAS 156 is effective for the first fiscal year beginning after September 15, 2006. SFAS 156 changes the way entities account for servicing assets and obligations associated with financial assets acquired or disposed of. We have not yet completed our evaluation of the impact of adopting SFAS 156 on our results of operations or financial position, but do not expect that the adoption of SFAS 156 will have a material impact.

In September 2006, the FASB issued SFAS No. 157, "Accounting for Fair Value Measurements", or SFAS 157. SFAS 157 defines fair value, and establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosure about fair value measurements. SFAS 157 is effective for financial statements issued subsequent to November 15, 2007. We do not expect the new standard to have any material impact on our financial position, results of operations or cash flows.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on our consolidated financial statements upon adoption.

Income Taxes

Since inception, we have incurred operating losses and, accordingly, have not recorded a provision for income taxes for any of the periods presented. As of March 31, 2006, we had net operating loss carryforwards for federal, state and foreign income tax purposes of approximately $28.8 million, $25.9 million and $17.4 million, respectively. The carryforwards expire beginning 2020, 2010 and 2014, respectively. We also had, as of March 31, 2006, federal and state research credit carryforwards of approximately $104,000 and $108,000, respectively. The federal credits expire beginning 2026, and the state credits have no expiration.

We have experienced substantial ownership changes in connection with financing transactions completed through the year ended March 31, 2006. Accordingly, our utilization of net operating loss and tax credit carryforwards against taxable income in future periods, if any, is subject to substantial limitations under the Change in Ownership rules of Section 382 of the Internal Revenue Code. After considering all available evidence, we have fully reserved for these and other deferred tax assets since it is more likely than not such benefits will not be realized in future periods. We will continue to evaluate our deferred tax assets to determine whether any changes in circumstances could affect the realization of their future benefit. If it is determined in future periods that portions of our deferred income tax assets satisfy the realization standard of SFAS No. 109, the valuation allowance will be reduced accordingly.

Quantitative and Qualitative Disclosures About Market Risk

Market risk represents the risk of changes in the value of market risk sensitive instruments caused by fluctuations in interest rates, foreign exchange rates and commodity prices. Changes in these factors could cause fluctuations in our results of operations and cash flows.

Our exposure to interest rate risk is confined to our excess cash in highly liquid money market funds. The primary objective of our investment activities is to preserve our capital to fund operations. We also seek to maximize income from our investments without assuming significant risk. We do not use derivative financial instruments in our investment portfolio. Our cash and investments policy emphasizes liquidity and preservation of principal over other portfolio considerations.

We have operated primarily in the United States; however we do have two significant subsidiaries, one each in Europe and Mexico. In order to mitigate our exposure to foreign currency rate fluctuations, we maintain minimal cash balances in the foreign subsidiaries. However, if we are successful in our efforts to grow internationally, our exposure to foreign currency rate fluctuations, primarily the Euro and Mexican Peso, may increase. We are exposed to foreign currency risk related to the Euro denominated and Mexican Peso denominated intercompany receivables. Because our intercompany receivables are accounted for in Euros and Mexican Pesos, any appreciation or devaluation of the Euro or Mexican Peso will result in a gain or loss to the consolidated statements of operations.

BUSINESS

Overview

We have developed and manufacture and market, a family of products intended to help prevent and treat infections in chronic and acute wounds. Infection is a serious potential complication in both chronic and acute wounds, and controlling infection is a critical step in wound healing. Our platform technology, called Microcyn, is a non-toxic, electronically charged, or super-oxidized, water-based solution that is designed to treat a wide range of organisms that cause disease, or pathogens, including viruses, fungi, spores and antibiotic resistant strains of bacteria such as Methicillin-resistant *Staphylococcus aureus,* or MRSA, and Vancomycin-resistant *Enterococcus*, or VRE, in wounds. We do not have the necessary regulatory approvals to market Microcyn in the United States as a drug. However, in clinical testing and studies, our products were effective against a wide range of pathogens and were found to be non-toxic, easy to use and complementary to most existing treatment methods in wound care. Microcyn-based products have also received three U.S. 510(k) regulatory clearances and approvals in Canada, Mexico and India. Our experience and clinical data indicate that the use of Microcyn has the potential to shorten hospital stays, lower aggregate patient care costs and, in certain cases, reduce the need for system-wide, or systemic, antibiotics. Microcyn also has potential applications in several other large markets, including respiratory, dermatology, dental and veterinary markets.

In 2004, chronic and acute wound care represented an aggregate of $9.6 billion in global product sales, of which $3.3 billion was spent for the treatment of skin ulcers, $1.6 billion to treat burns and $4.7 billion for the treatment of surgical and trauma wounds, according to Kalorama Information, a life sciences market research firm. Common methods of controlling infection, including topical antiseptics and antibiotics, have proven to be only moderately effective in combating infection in the wound bed. However, topical antiseptics tend to inhibit the healing process due to their toxicity and may require specialized preparation or handling. Antibiotics can lead to the emergence of resistant bacteria, such as MRSA and VRE. Systemic antibiotics may not be effective in controlling infection in patients with disorders affecting circulation, such as diabetes, which are commonly associated with chronic wounds. As a result, no single treatment is used across all types of wounds and stages of healing.

We believe Microcyn provides significant advantages over current methods of care in the treatment of a wide range of chronic and acute wounds throughout all stages of treatment. These stages include cleaning, or debridement, prevention and treatment of infections and wound moistening. We believe that Microcyn may be the first topical product that is effective against a broad range of bacteria and other infectious microbes including antibiotic resistant strains such as MRSA and VRE, without causing toxic side effects on healthy tissue. Unlike most antibiotics, we believe Microcyn does not target specific strains of bacteria, a practice which has been shown to promote the development of resistant bacteria. In addition, our products are shelf stable, require no special preparation, and are easy to use.

Our goal is to become a worldwide leader in wound care by establishing Microcyn as the standard of care for helping to prevent and treat infections in chronic and acute wounds. We currently have, and intend to seek additional regulatory clearances and approvals to market Microcyn worldwide. In July 2004, we began selling Microcyn in Mexico after receiving approval from the Mexican Ministry of Health, or MOH, for the use of Microcyn as an antiseptic, disinfectant and sterilant. Since then, physicians in the United States, Europe and Mexico have conducted twelve physician clinical studies assessing Microcyn's use in the treatment of infections in a variety of wounds, including hard-to-treat wounds such as diabetic ulcers and burns. We used the data generated from some of these studies to support our application for the CE Mark, or European Union certification, for wound cleaning and reduction of infection. We received the CE Mark in November 2004 and additional international approvals in Canada, Mexico and India. Microcyn has also received three FDA 510(k) clearances for use as a medical device in wound cleaning, or debridement, lubricating, moistening and dressing, including traumatic wounds and acute and chronic dermal lesions.

In July 2006, we completed a controlled clinical trial for pre-operative skin preparation. After completion of this trial, the FDA advised us that it is considering adopting new heightened performance requirements for evaluating efficacy of products designed to be used in pre-operative skin preparation such as ours. In

discussions with the FDA, the FDA has not provided us with the definitive timing for, or parameters of, any such new requirements, and has informally stated that it is uncertain during what time frame it will be able to do so. We plan to continue our discussions with the FDA regarding the possible timing and parameters of any new guidelines for evaluating efficacy for pre-operative skin preparations. Depending on the ultimate position of the FDA regarding performance criteria for pre-operative skin preparations, we may reassess our priorities, clinical timelines and schedules for pursuing a pre-operative skin preparation indication or may decide not to pursue this indication.

We intend to conduct a pilot study in early 2007 to evaluate the effectiveness of Microcyn in patients with infections in open wounds. Following completion of the pilot study, we intend to establish a protocol for a Phase IIb clinical trial in a similar patient population, which we hope to begin in mid to late 2007. We anticipate this trial to last approximately 12 months.

We currently sell Microcyn in the United States through one national and five regional distributors who are supported by our commercial team and clinical support staff. In October 2006, we initiated a focused U.S.-based sales effort to increase the awareness of Microcyn at selected wound treatment centers in a major metropolitan area, and, if this strategy is successful, we intend to target other metropolitan areas in 2007 and 2008. In Europe, we sell Microcyn through exclusive distribution agreements with distributors, all of which, we believe, are experienced suppliers to the wound care market, supported by our direct sales force. In Mexico, we sell Microcyn through a network of distributors and through a contract sales force, including salespeople, nurses and clinical support staff. We plan to continue to expand our sales and marketing force to support our distribution network. In India we sell through a national distributor and in Canada, we have entered into a distribution agreement under which distribution will commence upon required regulatory approvals.

Our goal is to achieve the following milestones through 2009:

2007

- Initiate and complete pilot study for Microcyn in the treatment of infections in open wounds
- Initiate enrollment for Phase IIb clinical trial for Microcyn in the treatment of infections in open wounds
- Initiate several physician-sponsored studies in the United States, Europe and India
- Initiate 510(k) clearance process for next generation Microcyn product formulation
- Execute distribution agreements for Microcyn in select European, Asian and South American countries
- Expand U.S. sales force to cover additional major U.S. metropolitan areas

2008

- Receive 510(k) marketing clearance for next generation Microcyn product formulation

2009

- Data expected from Phase IIb clinical trial for Microcyn in the treatment of infections in open wounds
- Initiate strategic partner discussions for Microcyn in the treatment of infections in open wounds

We cannot guarantee that we will obtain on timely basis, if at all, the necessary FDA approval to market Microcyn in the United States for the treatment of infection in open wounds. A number of factors can delay or prevent completion of human clinical trials, particularly patient recruitment. Moreover, many drug candidates fail to successfully complete clinical trials. After an NDA is filed with the FDA, the FDA commences an in-depth review of the NDA that takes ten months to a year to complete but may take longer. In addition, we cannot guarantee that we will obtain on a timely basis, or at all, the necessary 510(k) clearances for the next generation Microcyn product formulation. The milestones described above assume that we complete our clinical trials for the treatment of infection in open wounds and that the results from these clinical trials support an NDA filing and that our products will be commercially viable. We cannot guarantee that we will

find appropriate distribution or strategic partners, generate revenue sufficient to fund our cash flow needs or that we will meet any of the milestones described above in a timely manner or at all.

Industry Background

Wound Care Industry Overview

According to Medtech Insight, a Division of Windhover Information, there were over 90 million incidents of wounds in the United States during 2004. Of these, over six million were chronic wounds, including arterial, diabetic, pressure and venous ulcers. The remaining 84 million were acute wounds, which follow the normal process of healing and commonly include burns, traumatic wounds, and approximately 67 million surgical incisions.

Key trends in wound care include:

- large and increasing elderly, diabetic and obese populations, each of which is vulnerable to developing a variety of difficult-to-heal ulcers;
- increased emphasis on controlling the cost of patient care in hospitals, wound care centers and in private practice;
- technological innovation, which has expanded treatment options from traditional ointments and gauze to include advanced treatments, such as vacuum devices, silver dressings, ultrasound and skin grafts;
- increased focus on improving the patient experience, including reduction of pain and accelerated healing time; and
- adjunctive nature of the market where multiple treatment methods are employed, either simultaneously or sequentially, depending on the type and stage of the wound.

Wound care is complex, and controlling infection is a critical step in wound healing. Difficult-to-heal wounds can result from traumatic injury, diabetes, peripheral vascular disease, complications following surgery, rheumatoid arthritis, congestive heart failure, arterial or venous ulcers and many other conditions which compromise circulation. Without proper medical intervention and control of infection, these types of wounds typically remain open and chronically infected.

Chronic Wounds

Chronic wounds are wounds that do not heal within a normally expected time frame under standard care. The most frequently occurring chronic wounds are venous, arterial, pressure and diabetic foot ulcers. According to Medtech Insight, in 2004, the incidence of chronic wounds in the United States was approximately 6.1 million, comprised of 2.0 million pressure ulcers, 1.7 million arterial ulcers, 1.6 million venous ulcers and 800,000 diabetic foot ulcers. In addition to being expensive to treat, chronic wounds are debilitating, painful and can result in amputations and other serious consequences. Clinical studies suggest that, depending on the severity of the wound, up to 43% of patients with diabetic foot ulcers undergo an amputation. Furthermore, the five year survival rate for patients undergoing amputations as a result of diabetic foot ulcers is 27%.

The increasing prevalence of chronic wounds is driven by the large and growing elderly, diabetic and obese populations.

Aging. People aged 65 and over are more susceptible to wounds that become chronic than the overall population. In 2006, there were more than 37 million people in the United States over 65, representing more than 12% of the population. By 2030, this group is expected to comprise more than 19% of the total population of the United States, according to U.S. Census Bureau projections. Additionally, according to Medtech Insight, 70% of pressure ulcers occur in people age 70 years or older and 25% of patients in nursing homes suffer from pressure ulcers.

Diabetes. Diabetics are particularly vulnerable to chronic wounds as a result of the debilitating effect of diabetes on the circulatory system. According to the Centers for Disease Control and Prevention, CDC, one

out of three children born in 2000 in the United States will develop diabetes. There are currently approximately 14.7 million diabetic Americans, representing 5% of the total population, up from 2.7% in 1990. Furthermore, according to the CDC the incidence of diabetes is significantly higher in people over 65: in 2004, 16% of people over 65 were diabetic compared to 7.5% of the total population.

Obesity. Obesity is a leading cause of Type II, or "adult onset," diabetes, making the obese population more likely to eventually sustain chronic wounds. Obesity in the United States is a growing problem. According to the National Institute of Diabetes and Digestive and Kidney Diseases in 2000, more than 30% of the United States adult population was obese, up from 13% in 1960.

Acute Wounds

Acute wounds are typically caused by traumatic injury or surgical incision and are broadly categorized as those that can be expected to heal within a definable timeframe. However, the healing process may be affected by complicating factors such as infection, leading to chronic wounds.

All acute wounds have the potential for infection and may require prophylactic treatment to prevent infection. According to Medtech Insight, in 2004, about 16.2 million traumatic wounds were treated, including 8.7 million open wounds. Also according to Medtech Insight, in 2004, approximately 67 million surgical wounds were reported in the United States, including 36 million completed under anesthesia. Despite modern infection control procedures, and technologies at hospitals and surgery centers, every time the skin is opened there is a risk of infection. We believe that there is a higher likelihood of infection in surgeries involving anesthesia because of the length of time the wound is open. In a clinical study on surgical infections, it was shown that infection rates vary with the time required to complete the surgery. For example, infection rates varied from about 3.6% for surgeries taking less than 30 minutes to about 16.4% for those longer than 5 hours.

Critical Steps for Wound Treatment

Infection Control

According to the Committee to Reduce Infection Deaths, or RID, one out of every 20 patients contracts an infection while in the hospital. Certain infections are increasingly dangerous because they cannot be effectively controlled by commonly used antibiotics. In addition, the RID estimates that each year in the United States, approximately two million patients contract infections while in hospitals and, of those, an estimated 100,000 die as a result. According to a recent study, patients with surgical site infections incur almost triple the average hospital costs of other patients. Surgical site infections account for approximately 500,000 hospital acquired infections in the United States each year, according to the CDC.

Staphylococcus aureus, or *Staph*, is one of the most common hospital acquired infections. One of the deadliest forms of *Staph* infection is MRSA. According to data from the CDC, in 2003, 57% of the *Staph* infections reported were MRSA, up from 22% in 1995 and 2% in 1974. Patients who do survive MRSA often spend months in the hospital and endure repeated surgeries to remove infected tissue.

When infection is present in a wound, standard treatments can include cleansing, debridement and systemic antibiotics. Many cleansing agents can harm tissue, causing irritation and sensitization and impeding the wound healing process. Some forms of debridement may increase scar tissue and complicate skin grafting. Systemic antibiotics may be ineffective if the patient's metabolic state is compromised. Additionally, the effectiveness of oral or systemic antibiotics in diabetic foot ulcer patients may be diminished due to the patient's poor circulation, limiting delivery of the antibiotics to the wound site.

Because there is a risk of infection with many surgical procedures, clinicians perform several procedures before and after surgery designed to prevent infection. Pre-operative procedures generally involve preparing the surgical site with an anti-bacterial agent, such as Betadine. Post-operative procedures can include an anti-infective irrigation, a therapeutic body cavity cleansing and the use of systemic antibiotics.

Wound Healing and Closure

Wound healing is a cascade process comprised of inflammation, proliferation and maturation. The first stage of the wound healing process is the inflammatory phase, which is associated with swelling, redness and heat, and involves the migration of healthy cells to the wound bed. Removing dead tissue or debris from the wound prepares the wound bed for regeneration of new tissue. The second phase is the proliferative phase, which involves collagen and blood vessel formation and tissue growth. The final phase, maturation, occurs as the wound begins to take on its permanent form as collagen is reconstituted, forming new skin. None of these phases, however, will progress normally in the presence of infection.

Advanced Technologies

Techniques and devices have been developed to treat complex and hard-to-treat wounds, ranging from specialized devices to antimicrobial dressings. Negative pressure wound therapy, high pressure oxygen chambers and localized devices, sophisticated water-based tissue removal devices, oxygenated mist devices and tissue engineered skin substitutes are some of the most advanced devices available to the wound care specialist. Although relatively effective, many of these treatments have limitations or drawbacks in that they cannot be used on certain types of wounds or are expensive and complex to use. Despite these advanced technologies, treatment of challenging wounds continues to be multi-pronged, with a number of associated therapies employed in an attempt to achieve wound closure.

Market Opportunity — Key Limitations of Existing Treatments

Commonly used topical antiseptics and antibiotics have limitations and side effects that may constrain their usage. For example:

- many antiseptics, including Betadine, hydrogen peroxide and Dakin's solution, are toxic, can destroy human cells and tissue, may cause allergic reactions and can impede the wound healing process;
- silver-based products are expensive and require precise dosage and close monitoring by trained medical staff to minimize the potential for tissue toxicity allergic reactions and bacterial resistance; and
- the increase in antibiotic resistant bacterial strains, such as MRSA and VRE, have compromised the effectiveness of some widely used topical antibiotics including Neosporin and Bacitracin.

Our Solution

We believe Microcyn has potential advantages over current methods of care in the treatment of chronic and acute wounds, including the following:

- ***Efficacy.*** In both laboratory testing and physician clinical studies, our products were effective against a wide range of bacteria that cause infection in a variety of acute and chronic wounds. In addition, because of its mechanism of action, we believe Microcyn does not target specific strains of bacteria, the practice of which has been shown to promote the development of resistant bacteria. In physician clinical studies where Microcyn was used both independent of and in conjunction with other wound care therapeutic products, data supported that patients generally experienced less pain, improved mobility and physical activity levels and better quality of life.
- ***Safety.*** Preclinical and clinical data shows that Microcyn is non-toxic. Throughout all our clinical trials and physician clinical studies to date and since commercialization in 2004, we have received no reports of serious adverse events related to the use of Microcyn products.
- ***Ease of Use.*** Our products require no preparation before use or at time of disposal, and caregivers can use our products without significant training. In addition, Microcyn can be stored at room temperature and does not require any specific handling procedures. Unlike other super-oxidized water solutions, which are typically stable for not more than 48 hours, our laboratory tests show that Microcyn has a shelf life ranging from one to two years depending on the size and type of packaging.

Our products are also complementary to most advanced technologies to treat serious wounds, such as negative pressure wound therapy, jet lavage and tissue-engineered skin substitutes.

- ***Cost-Effectiveness.*** The treatment of many wounds requires extended hospitalization and care, including the use of expensive systemic antibiotics. Infection prolongs the healing time and necessitates increased use of systemic antibiotics. We believe that Microcyn has the potential to help treat infection, accelerate healing time and, in certain cases, may help reduce the need for systemic antibiotics, thereby lowering overall patient cost.

Our Strategy

Our goal is to become a worldwide leader in wound care by establishing Microcyn as the standard of care for helping to prevent and treat infections in chronic and acute wounds. We also intend to leverage our expertise in wound care into additional market opportunities. The key elements of our strategy include the following:

- ***Drive adoption of Microcyn as the standard of care in the wound care market to help prevent and treat infection***

We believe our products are well positioned to become the standard of care in helping to prevent and treat infection. We seek to drive adoption of Microcyn as the standard of care in the wound care market through data from physician clinical studies, our own clinical trials and key opinion leader programs. We intend to continue to maintain a marketing presence in key medical communities throughout the world through targeted direct marketing and sponsorships of physician presentations at medical conferences and seminars.

- ***Obtain additional regulatory approvals in the United States***

We intend to seek additional regulatory clearances and approvals, which we believe will allow us to accelerate adoption of our products by wound care specialists worldwide. Our current focus is on developing a well-defined, well-controlled clinical protocol for a Phase IIb trial. To increase our probability of success in the trial, we intend to conduct a pilot study in early 2007 to evaluate the effectiveness of Microcyn in subjects with infections in open wounds. Following completion of the pilot study, we intend to establish a Phase IIb clinical trial in a similar patient population.

- ***Expand our direct sales force and distribution networks***

We intend to expand our direct sales force and distribution networks in the United States, Europe and the rest of the world. In the United States, Europe and Mexico, we sell our products through distribution networks supported by our direct sales force. We also have distribution agreements for our products in India, Southeast Asia and the Middle East. We select distributors based on their demonstrated expertise in selling to wound care professionals and facilities. In the United States we are initiating a series of focused, intense product roll-outs in large metropolitan areas to increase the awareness of Dermacyn among healthcare providers. We will continue to expand the number of metropolitan areas included in this roll-out as we expand our U.S.-based sales force.

- ***Pursue opportunities to combine Microcyn with other treatments***

We believe our products are compatible with and may potentially enhance the efficacy of a variety of existing wound care treatment methods including negative pressure wound therapy, pulse and jet lavage and tissue engineered skin substitutes. Combining Microcyn with these therapies has been and continues to be evaluated in physician clinical studies. We believe combination therapies to treat open wounds are gaining acceptance by wound care professionals and may prove to be clinically and commercially attractive.

- ***Develop strategic collaborations in the wound care market***

We intend to pursue strategic relationships with respect to both product development and distribution. To accelerate adoption of our products, we may enter into strategic relationships with healthcare companies that have product lines or distribution channels that are complementary to ours. We believe

collaborations allow us to leverage our resources and technology. These relationships may take the form of co-development, co-promotion or distribution agreements. In addition, we may expand our offerings of new products or technologies through acquisitions or licensing agreements.

- ***Leverage our Microcyn platform to address additional markets***

We believe our products have potential applications in several other large markets, including the respiratory, dermatology, dental and veterinary markets. We intend to pursue access to these markets through strategic partnerships.

Microcyn Platform Technology

Mechanism of Action

We believe Microcyn's ability to treat and help prevent infection and its sterilant properties are based on its uniquely engineered chemistry. As a result of our proprietary manufacturing process, Microcyn contains a wide array of reactive chemicals that, among other things, interact and inactivate surface proteins on microorganisms and viruses. The function of these proteins are varied and play significant roles in cell communication, nutrient and waste transport and other required functions for cell viability. Once Microcyn surrounds single cell microorganisms, it damages these proteins, causing cell membrane rupture, leading to cell death. This destruction of the cell appears to occur through a fundamentally different process than that which occurs as a result of contact with a bleach-based solution because experiments have demonstrated that Microcyn kills bleach-resistant bacteria. However, the solution remains non-toxic to animals and human tissues because human cells are interlocked and prevent Microcyn from targeting and surrounding single cells topically on the body.

In laboratory tests, Microcyn has been shown to eliminate certain biofilms. A biofilm is a complex cluster of microorganisms or bacteria marked by the formation of a protective shell, allowing the bacteria to collect and proliferate. It is estimated that over 65% of microbial infections in the body involve bacteria growing as a biofilm. Bacteria living in a biofilm typically have significantly different properties from free-floating bacteria of the same species. One result of this film environment is increased resistance to antibiotics and to the body's immune system. In chronic wounds, biofilms interfere with the normal healing process and halt or slow wound closure. In our laboratory studies, Microcyn was shown to destroy two common biofilms after five minutes of exposure.

It is widely accepted that reducing inflammation surrounding an injury or wound is beneficial to wound healing. Our independent laboratory research indicates that Microcyn may inhibit certain inflammatory responses from allergy-producing, or mast, cells. These reactions are critical components of the body's natural inflammatory response to injury or wounds. Our laboratory research suggests that Microcyn's interference with these cells is selective to only the inflammation response and does not interfere with other functions of these cells. Additionally, physician clinical studies suggest that Microcyn only inhibits this response in tissue that is directly exposed to the solution.

Microcyn has demonstrated antimicrobial activity against numerous bacterial, viral and fungal pathogens, including antibiotic-resistant strains, as evidenced by passing results in numerous standardized laboratory microbiology tests conducted on Microcyn by a variety of certified independent testing laboratories. Some of the pathogens against which Microcyn has demonstrated antimicrobial activity are listed below:

Pathogen
Antibiotic-Resistant Bacteria
Vancomycin Resistant *Enterococcus faecalis* (VRE)
Methicillin resistant *Staphylococcus aureus* (MRSA)
Other Bacteria
Acinetobacter baumanii
Aspergillus niger
Clostridium difficile
Escherichia coli
Escherichia coli O157:H7
Mycobacterium bovis
Pseudomonas aeruginosa
Salmonella typhi
Viruses
Human Coronavirus
Human Immunodeficiency Virus Type 1 — HIV
Influenza A
Rhinovirus Type 37
Fungi
Candida albicans
Trichophyton mentagrophytes

In addition to the above mentioned independent laboratory microbiology tests, a study was completed and published in the Journal of Hospital Infection in 2005, which was co-authored by our Director of Medical Affairs, Andres Gutiérrez, M.D., Ph.D., that showed that Microcyn exerts a wide range of antimicrobial activity (Landa-Solis, González-Espinosa D, Guzman B, Snyder M, Reyes-Terán G, Torres K and Gutiérrez AA. Microcyn: a novel super-oxidized water with neutral pH and disinfectant activity. J Hosp Infect (UK) 61: 291-299).

Current Regulatory Approvals and Clearances

All our current products are based on our Microcyn platform technology. We are able to modify the chemistry of Microcyn by changing the oxidation-reduction potential, pH-level and concentrations of specific ions or chemicals, which allows us to manufacture a variety of solutions, each specifically designed for maximum efficacy and safety by indication. The indications for our products vary from country to country due to different regulatory requirements and standards from jurisdiction to jurisdiction. The indications below are summaries of the indications approved by the regulatory authority or authorities in the listed jurisdiction. The similarly named products have similar formulations; however, they may not have identical specifications due to varying requirements in different jurisdictions' regulatory agencies. The following is a list of the regulatory approvals and clearances that Microcyn-based products have received for its most significant or potentially significant markets:

Region	Approval or Clearance Type	Year of Approval or Clearance	Summary Indication
United States	510(k)	2005	Moistening and lubricating absorbent wound dressings for traumatic wounds.
	510(k)	2005	Moistening and debriding acute and chronic dermal lesions.
	510(k)	2006	Moistening absorbent wound dressings and cleaning minor cuts.

Region	Approval or Clearance Type	Year of Approval or Clearance	Summary Indication
European Union	CE Mark	2004	Debriding, irrigating and moistening acute and chronic wounds in comprehensive wound treatment by reducing microbial load and creating moist environment.
Mexico	Product Registration	2004	Antiseptic treatment of wounds and infected areas.
	Product Registration	2003	Antiseptic disinfection solution for high level disinfection of medical instruments, and/or equipment and clean-rooms, areas of medical instruments, equipment and clean room areas.
Canada	Class II Medical Device	2004	Moistening, irrigating, cleansing and debriding acute and chronic dermal lesions, diabetic ulcers and post-surgical wounds.
India(1)	Drug License	2006	Cleaning and debriding in wound management.

(1) Drug license held by Indian distributor as required by Indian law.

Clinical Trials

In July 2006, we completed a controlled clinical trial for the use of Microcyn as a pre-operative skin preparation. In this study, the application of Microcyn, a commonly used skin disinfectant called Hibiclens, or sterile saline was randomized so that each subject had two of the three alternatives on a possible four sites per person. The amount of bacteria per square centimeter was measured initially to determine the baseline level. Subsequently, the amount of bacteria on the groin and abdominal sites were measured after 30 seconds, 10 minutes and six hours. The trial was conducted by a third party laboratory that has completed numerous similar studies with other pre-operative skin preparation products. The trial was completed in July 2006. The results from this trial showed that Microcyn produces an average reduction in bacterial count that was statistically comparable to Hibiclens.

After completion of this trial, the FDA advised us that it is considering adopting new heightened performance requirements for evaluating efficacy of products designed to be used in pre-operative skin preparation such as ours. In discussions with the FDA, the FDA has not provided us with the definitive timing for, or parameters of, any such new requirements, and has informally stated that it is uncertain during what time frame it will be able to do so. We plan to continue our discussions with the FDA regarding the possible timing and parameters of any new guidelines for evaluating efficacy for pre-operative skin preparations. Depending on the ultimate position of the FDA regarding the performance criteria for pre-operative skin preparations, we may reassess our priorities, clinical timelines and schedules for pursuing a pre-operative skin preparation indication or may decide not to pursue this indication.

We intend to develop Microcyn as a topical antimicrobial to treat infected wounds and to obtain the necessary clearances and/or approvals to commercialize this product. We intend to conduct a pilot study in early 2007 to evaluate the effectiveness of Microcyn in patients with infections in open wounds. Following completion of the pilot study, we intend to establish a protocol for a Phase IIb clinical trial in a similar patient population, which we intend to begin in mid to late 2007. We expect to have data available from the trial in 2009. Assuming the results of the Phase IIb trial supports further development of our product for treatment of open wounds, the results of this Phase IIb trial will be used to determine the design and sample sizes for subsequent Phase III trials. These Phase IIb and Phase III clinical trials are intended to provide the clinical basis for submission to the FDA of an NDA for the treatment of open wounds.

Physician Clinical Studies

In addition to our clinical trials, several physicians have conducted twelve clinical studies of Microcyn generating data supporting that Microcyn is safe, reduces microbial load, shortens treatment time and may have the potential to reduce costs to healthcare providers and patients. We have sponsored the majority of physicians performing these studies by supplying Microcyn, unrestricted research grants and paying expenses and honoraria. In some cases, the physicians who performed these studies also hold equity in our company. The studies were performed in the United States, Mexico and Italy, and used various endpoints, methods and controls (for example, saline, antiseptics and antibiotics). These studies were not intended to be rigorously designed or controlled clinical trials and, as such, did not have all of the controls required for clinical trials used to support an NDA submission to the FDA in that they did not include blinding, randomization, predefined clinical endpoints, use of placebo and active control groups or U.S. good clinical practice requirements.

In many cases the physicians who led these studies have published articles on their studies and results. The following table lists a selection of articles and publications from physicians who have completed studies on the use of Microcyn for wound care and wound irrigation.

Physician	Country	Number of Patients	Publication
David E. Allie, M.D.(1)	U.S.	40	Allie D. Super-Oxidized Dermacyn in Lower-Extremity Wounds. *Wounds*, 2006, Jan (Suppl), 3-6
Tom Wolvos, M.D.(2)	U.S.	26	Wolvos TA. Advanced Wound Care with Stable, Super-Oxidized Water. A look at how combination therapy can optimize wound healing. *Wounds*, 2006, Jan (Suppl), 11-13
Cheryl Bongiovanni, Ph.D.(3)	U.S.	8	Bongiovanni CM. Superoxidized Water Improves Wound Care Outcomes in Diabetic Patients. *Diabetic Microvascular Complications Today,* 2006, May-Jun: 11-14
Luca Dalla Paola, M.D.(4)	Italy	218	Dalla Paola L, Brocco E, Senesi, A, Merico M, De Vido D, Assaloni R, DaRos R. Super-Oxidized Solution (SOS) Therapy for Infected Diabetic Foot Ulcers. *Wounds*, 2006, vol. 18: 262-270 Dalla Paola, L. Treating diabetic foot ulcers with super-oxidized water. *Wounds*, 2006, Jan (Suppl), 14-16
Ariel Miranda, M.D.(5)	Mexico	64	Miranda-Altamirano A. Reducing Bacterial Infectious Complications from Burn Wounds. A look at the use of Oculus Microcyn60 to treat wounds in Mexico. *Wounds*, 2006, Jan (Suppl), 17-19

Notes

(1) indicates that the physician is a member of our Medical and Business Advisory Board, a paid consultant, an investor and received research grants, expense payments, honorarium and Microcyn to complete the study

(2) indicates that the physician is a paid consultant and a warrant holder

(3) indicates that the doctor received Microcyn to complete the study

(4) indicates that the physician is a member of our Medical and Business Advisory Board and received expense payments and Microcyn to complete the study

(5) indicates that the physician received payments, expense payments and Microcyn to complete the study

In addition to the above articles and publications, several additional journal articles have been submitted for peer review and publication. There are also several ongoing and planned physician clinical studies in the United States, Europe and India to assess Microcyn's effectiveness in helping to prevent and treat infections in wounds. For example, we are supporting a study by Dr. David Armstrong of the Scholl College of Podiatric Medicine in Chicago, Illinois and Dr. Andrew Boulton, Head of the Manchester Diabetes Center at the Manchester Royal Infirmary in the United Kingdom. This is a study of diabetic foot ulcers using the VersaJet, and aggressive debridement system, in two groups of 20 patients each, one utilizing Microcyn and the other utilizing saline. The endpoints are microbial load reduction and time to complete wound healing.

Dr. Dalla Paola is conducting a second study, in addition to the above publication, involving 100 patients comparing Microcyn to another antimicrobial agent in the treatment of diabetic foot necrobiosis, with time to wound healing the primary endpoint. We have given Dr. Tom Wolvos, a board certified surgeon who is the Medical Director at the Scottsdale Healthcare Wound Management Center in Arizona, an unrestricted research grant to conduct a 40-patient study comparing Microcyn to saline solution with the VAC, a negative pressure wound therapy system, in the treatment of a variety of wounds. Lastly, Cheryl Bongiovanni, Ph.D., Director of the Lake Wound Clinics in Lakeview, Oregon, is conducting two patient studies, one focusing on the potential cost savings from the use of Microcyn in treating a variety of wounds, and one 20-patient study comparing Microcyn with saline solution in the treatment of leg ulcers. We provided each of these doctors with Microcyn and may pay their expenses, including travel, hotels and meals, to attend medical conferences to present their findings. We have also paid consulting fees and expenses to Dr. Wolvos in connection with corporate development and licensing evaluations.

Sales and Marketing

We are developing distribution and sales networks to market our products domestically and in a number of countries outside the United States. We expect to expand our existing sales force in the United States, Europe and Mexico as we obtain additional regulatory claims. Our products are purchased by hospitals, physicians, nurses and other healthcare practitioners who are the primary caregivers to patients being treated for acute or chronic wounds, as well as those patients undergoing surgical procedures.

Our strategy is to enter into agreements with established regional distributors, provide ongoing sales support and utilize clinical studies and key opinion leader programs to accelerate product adoption. Implementation of our strategy includes the development of relationships with wound care specialists through targeted direct marketing and communications programs and through sponsorship of physician presentations at medical conferences and seminars.

In the United States, we currently distribute our products through one national and five regional distributors who are supported by our commercial team and clinical support staff. In addition to our distributors, we employ medical and clinical professionals, with marketing contacts in leading wound care clinics, hospitals and health care agencies that provide wound care services. Our U.S. commercial team is initiating a focused sales strategy that will allow us to increase the awareness of Microcyn to healthcare providers. This strategy involves sampling and customer education efforts in a major metropolitan area. Based on the success of this initial roll-out, we intend to target other metropolitan areas in 2007 and 2008. We intend to hire additional salespeople in the United States in the event we receive FDA approval of our product for additional indications.

In Europe, we have arrangements with distributors in Germany, Italy, Sweden and the Czech Republic who are supported by our sales team. We are actively pursuing additional distribution arrangements in other European countries. We currently have a small direct sales force in our European regional sales office in The Netherlands, and intend to hire additional direct sales people to support our distributors.

In Mexico, we market our products through our established distribution network and direct sales organization. We have a dedicated contract sales force, including salespeople, nurses and clinical support staff responsible for selling Microcyn to private and public hospitals and to retail independent pharmacies.

We have established distribution channels for our disinfectant and wound care products in India, Bangladesh, Pakistan, Singapore, United Arab Emirates and Saudi Arabia. In December 2005, we entered into an agreement with Alkem Laboratories, a large pharmaceutical company in India, which employs more than 800 salespeople servicing the Indian healthcare market. We commenced sales to Alkem Laboratories in April 2006.

Other Market Opportunities

We believe our products have potential applications in several other large markets and intend to pursue access to these markets through strategic partnerships. We have entered into distribution or license agreements in some of these markets; however, we have not generated meaningful revenue from any of these agreements. In addition, we plan to develop new applications of our products in the respiratory, dermatology and oral care market through strategic partnerships. Some of these market opportunities include:

Respiratory

Our nasal product candidate is an anti-microbial solution designed to be self-administered into a patient's nasal cavity for the treatment of chronic rhinosinusitis, or inflammation of the nasal sinuses. In animal studies, Microcyn has been shown to kill the bacteria that causes rhinosinusitis. We are currently conducting pre-clinical animal studies seeking to support the efficacy and safety of this product candidate.

Rhinosinusitis affects an estimated 35 million people in the United States. There is no FDA-approved therapy for chronic rhinosinusitis. Most treatment methods have focused on the symptoms of the disease and include the use of antibiotics, antihistamines, corticosteroids and sinus surgery.

Dermatology

We believe that our Microcyn technology can be used to develop products to treat various fungal and bacterial skin infections. Laboratory and clinical test data support that our technology may be effective in treating these bacterial and fungal infections.

Dental and Oral Care

Based on data from the Freedonia Group, the United States market for mouthwash and dental rinse products was $600 million in 2003. We believe that our Microcyn technology may be used both as a mouthwash and a dental rinse, and that early data from physician studies support its safe use in oral surgery.

Veterinary Medicine

Our animal wound care product based on Microcyn technology, Vetericyn, was launched in late 2004 and is currently available for purchase by veterinarians through MWI Veterinary Supply, Inc., a distributor of animal health products. Vetericyn has uses in a variety of applications, including, the treatment of hard-to-heal wounds in horses. We believe a non-toxic wound spray that is safe for use in animals has wide application for use in companion animals. According to the American Veterinary Medical Association, as of December 31, 2005, there were more than 54,000 veterinarians in private practice in more than 27,000 veterinary practices nationwide.

Research and Product Development

The main goals of our research and product development program are to design, develop and produce products to treat acute and chronic wounds, and to identify new applications for our technology. Our research and product development efforts with our Microcyn-based products are divided into three areas: science, new product development and engineering.

Our scientists work to continually improve our product performance by evaluating variations of the formulations and chemical structures of our products. For example, we are evaluating alterations to Microcyn to increase the speed at which it kills certain bacteria and viruses.

The focus of our current development efforts is new formulations, applications and delivery systems for Microcyn, including the following:

- an intravenous bag and spikeable bottle for use with compatible wound care systems;
- various formulations and delivery systems that extend the stability of the product;
- a surgical irrigant to control infections during and after surgery; and
- a fine mist to treat chronic rhinosinusitis.

Our engineers seek to optimize our manufacturing process by reducing costs and increasing yield. For example, we have significantly decreased the waste product resulting from our manufacturing process, and we continue to experiment to find ways of decreasing it further.

Our technology may have application in other non-medical markets. We intend to pursue opportunities in these markets with third parties. Our director of research and development coordinates all research and product development activities. We plan to increase our research and product development staff in the future to address market demands identified in our market research and commercial practice.

Manufacturing

We manufacture Microcyn through a proprietary electrolysis process within a multi-chamber system. We are able to control the passage of ions through proprietary membranes, yielding electrolyzed water with only trace amounts of chlorine. This process is fundamentally different from the processes for manufacturing hydrogen peroxide and bleach and is the basis for our technology's efficacy and safety. Our manufacturing process produces very little waste, which is disposed of as water after a simple non-toxic chemical treatment.

We manufacture our products in Petaluma, California, Sittard, The Netherlands and Zapopan, Mexico. We have developed an automated manufacturing process and conduct quality assurance testing on each production batch in accordance with current U.S. Good Manufacturing Practices, or cGMP. Our facilities are required to meet and maintain regulatory standards applicable to the manufacture pharmaceutical and medical device products. Our United States and Netherlands facilities are certified and comply with cGMP medical device Quality Systems Regulation or QSR, and International Organization for Standardization, or ISO, guidelines. Our Mexico facility has been approved by the MOH.

Our machines are subjected to a series of tests, which is part of a validation protocol mandated by cGMP, QSR and ISO requirements. This validation is designed to ensure that the final product is consistently manufactured in accordance with product specifications at all manufacturing sites. Certain materials and components used in manufacturing our machines are proprietary to us.

We believe we have a sufficient number of machines to produce an adequate amount of Microcyn to meet anticipated future requirements for at least the next two years. As we expand into new geographic markets, we may establish additional manufacturing facilities to better serve those new markets.

Intellectual Property

Our success depends in part on our ability to obtain and maintain proprietary protection for our product technology and know-how, to operate without infringing proprietary rights of others, and to prevent others from infringing our proprietary rights. We seek to protect our proprietary position by, among other methods, filing, when possible, U.S. and foreign patent applications relating to our technology, inventions and improvements that are important to our business. We also rely on trade secrets, know-how, continuing technological innovation, and in-licensing opportunities to develop and maintain our proprietary position.

As of October 30, 2006, we own one issued U.S. patent, 12 pending U.S. patent applications and 18 foreign pending patent applications generally relating to super-oxidized water. These applications include three U.S. provisional applications for which the one-year period to file a non-provisional application has not yet expired as well as three international PCT applications that have not yet reached the deadline to file counterpart phase applications. We filed the provisional U.S. patent applications as a way of deferring the

payment of U.S. and foreign patent office fees while we decide whether the invention merits a full examination based on the development of the market for the product. In addition, a provisional patent application gives us the opportunity to continue to develop the inventive concepts further before filing further U.S. and foreign patent applications that are subject to examination. Our portfolio of pending applications can be divided into two groups. The first group includes one U.S. issued patent and three pending U.S. patent applications and seven foreign patent applications that relate to early generation super-oxidized water product, methods of using super-oxidized water, and aspects of the method and apparatus for manufacturing super-oxidized water. The second group includes nine pending U.S. patent applications, including three provisional applications, and 11 foreign patent applications that relate to Microcyn, the method and apparatus for manufacturing Microcyn, and its uses.

In March 2003, we obtained an exclusive license to six issued Japanese patents and five Japanese published pending patent applications owned by Coherent Technologies, or Coherent. The issued Japanese patents and pending Japanese patent applications relate to an early generation of unstable, super-oxidized water product and aspects of the method and apparatus for producing super-oxidized water and will expire between 2011 and 2014. In June 2006, we received written notice via email from Coherent advising us that the patent license was terminated, citing various reasons with which we disagree. Although we do not believe Coherent has grounds to terminate the license, we may have to take legal action to preserve our rights under the license and to enjoin Coherent from breaching its terms. We do not know whether we would prevail in any such action, which would be costly and time consuming, and we could lose our rights under the license, which could have a material adverse impact on our business opportunities in Japan. In addition, we may have to defend ourselves against infringement claims from Coherent in Japan based on their position on termination of the license. We do not believe the Japanese patents disclose or cover certain innovations in our products, which we developed independently and are the subject of our own patent applications. Neither party has sought legal remedy to this issue. In fact, we maintain an ongoing dialogue with Coherent. To date, we have not commercialized any products or generated any revenue in Japan.

Although we work to protect our technology, we cannot assure you that any patent will issue from currently pending patent applications or from future patent applications. We also cannot assure you that the scope of any patent protection will exclude competitors or provide competitive advantages to us, that any of our patents will be held valid if subsequently challenged, or that others will not claim rights in or ownership of our patents and proprietary rights. Furthermore, we cannot assure you that others have not developed or will develop similar products, duplicate any of our products or design around our patents.

We have also filed for trademark protection for marks used with our Microcyn products in each of the United States, Europe, certain countries in Central and South America, including Mexico and Brazil, Latin America, certain countries in Asia, including Japan, China and the Republic of Korea, and Australia.

In addition to patents and trademarks, we rely on trade secret and other intellectual property laws, nondisclosure agreements and other measures to protect our intellectual property rights. We believe that in order to have a competitive advantage, we must develop and maintain the proprietary aspects of our technologies. We require our employees, consultants and advisors to execute confidentiality agreements in connection with their employment, consulting or advisory relationship with us. We also require our employees, consultants and advisors who we expect to work on our products to agree to disclose and assign to us all inventions made in the course of our working relationship with them, while using our property or which relate to our business. Despite any measures taken to protect our intellectual property, unauthorized parties may attempt to copy aspects of our products or to wrongfully obtain or use information that we regard as proprietary. For more information, please see “Risk Factors,” “Our competitive position depends on our ability to protect our intellectual property and our proprietary technologies.”

Competition

We believe the principal competitive factors in our target market include improved patient outcomes, such as time in the hospital, healing time, adverse events, safety of products, ease of use, stability, spore killing and cost effectiveness. The medical device industry, and in particular the wound care market, is highly competitive.

We compete with a number of large well-established and well-funded companies that sell a broad range of wound care products, including topical anti-infectives and antibiotics, as well as some advanced wound technologies, such as skin substitutes, growth factors and sophisticated delayed release silver-based dressings.

Our products compete with a variety of products used for wound cleaning, debriding and moistening, including sterile saline, and chlorhexadine-based products, and they also compete with a large number of prescription and over-the-counter products for the prevention and treatment of infections, including topical anti-infectives, such as Betadine, silver sulfadiazine, hydrogen peroxide, Dakin's solution and hypochlorous acid, and topical antibiotics, such as Neosporine and Bacitracin. Currently, no single anti-infective product dominates the chronic or acute wound markets because many of the products have serious limitations or tend to inhibit the wound healing process.

Our products can also replace the use of sterile saline for debriding and moistening a dressing as well as for use as a complementary product with many advanced wound care technologies, such as the VAC from Kinetic Concepts Inc., skin substitute products from Smith & Nephew, Integra Life Sciences, Life Cell, Organogenesis and Ortec International, and ultrasound from Celleration. We believe that Microcyn can enhance the effectiveness of many of these advanced wound care technologies. Because Microcyn is competitive with some of the large wound care companies' products and complementary to others, we may compete with such companies in some product lines and complement other product lines.

While many companies are able to produce oxidized water, their products, unlike ours, typically become unstable after 48 hours, and we believe they have a much higher chlorine content that may not be suitable for treatment of infections in wounds. One such company, PuriCore, sells electrolysis machines used to manufacture brine-based oxidized water primarily as a sterilant.

Some of our competitors enjoy several competitive advantages, including:

- significantly greater name recognition;
- established relationships with healthcare professionals, patients and third party payors;
- established distribution networks;
- additional product lines and the ability to offer rebates or bundle products to offer discounts or incentives;
- greater experience in conducting research and development, manufacturing, obtaining regulatory approval for products and marketing; and
- greater financial and human resources for product development, sales and marketing and patient support.

Government Regulation

Government authorities in the United States at the federal, state and local levels and foreign countries extensively regulate, among other things, the research, development, testing, manufacture, labeling, promotion, advertising, distribution, sampling, marketing, and import and export of pharmaceutical products, biologics and medical devices. All of our products in development will require regulatory approval by government agencies prior to commercialization. In particular, human therapeutic products are subject to rigorous pre-clinical and clinical trials and other approval procedures of the FDA and similar regulatory authorities in foreign countries. Various federal, state, local and foreign statutes and regulations also govern testing, manufacturing, safety, labeling, storage, distribution and record-keeping related to such products and their marketing. The process of obtaining these approvals and the subsequent process of maintaining substantial compliance with appropriate federal, state, local, and foreign statutes and regulations require the expenditure of substantial time and financial resources. In addition, statutes, rules, regulations and policies may change and new legislation or regulations may be issued that could delay such approvals.

Medical Device Regulation

New medical devices, such as Microcyn, are subject to FDA approval and extensive regulation under the Federal Food Drug and Cosmetic Act, or FDCA. Under the FDCA, medical devices are classified into one of three classes: Class I, Class II or Class III. The classification of a device into one of these three classes generally depends on the degree of risk associated with the medical device and the extent of control needed to ensure safety and effectiveness.

Class I devices are those for which safety and effectiveness can be assured by adherence to a set of general controls. These general controls include compliance with the applicable portions of the FDA's Quality System Regulation, which sets forth good manufacturing practice requirements; facility registration, device listing and product reporting of adverse medical events; truthful and non-misleading labeling; and promotion of the device only for its cleared or approved intended uses. Class II devices are also subject to these general controls, and any other special controls as deemed necessary by the FDA to ensure the safety and effectiveness of the device. Review and clearance by the FDA for these devices is typically accomplished through the so-called 510(k) pre-market notification procedure. When 510(k) clearance is sought, a sponsor must submit a pre-market notification demonstrating that the proposed device is substantially equivalent to a legally marketed Class II device (for example, a device previously cleared through the 510(k) premarket notification process). If the FDA agrees that the proposed device is substantially equivalent to the predicate device, then 510(k) clearance to market will be granted. After a device receives 510(k) clearance, any modification that could significantly affect its safety or effectiveness, or that would constitute a major change in its intended use, requires a new 510(k) clearance or could require pre-market approval, or PMA.

Clinical trials are almost always required to support a PMA application and are sometimes required for a 510(k) pre-market notification. These trials generally require submission of an application for an investigational device exemption, or IDE. An IDE must be supported by pre-clinical data, such as animal and laboratory testing results, which show that the device is safe to test in humans and that the study protocols are scientifically sound. The IDE must be approved in advance by the FDA for a specified number of patients, unless the product is deemed a non-significant risk device and is eligible for more abbreviated investigational device exemption requirements.

Both before and after a medical device is commercially distributed, manufacturers and marketers of the device have ongoing responsibilities under FDA regulations. The FDA reviews design and manufacturing practices, labeling and record keeping, and manufacturers' required reports of adverse experiences and other information to identify potential problems with marketed medical devices. Device manufacturers are subject to periodic and unannounced inspection by the FDA for compliance with the Quality System Regulation, which sets forth the current good manufacturing practice requirements that govern the methods used in, and the facilities and controls used for, the design, manufacture, packaging, servicing, labeling, storage, installation and distribution of all finished medical devices intended for human use.

FDA regulations prohibit the advertising and promotion of a medical device for any use outside the scope of a 510(k) clearance or PMA approval or for unsupported safety or effectiveness claims. Although the FDA does not regulate physicians' practice of medicine, the FDA does regulate manufacturer communications with respect to off-label use.

If the FDA finds that a manufacturer has failed to comply with FDA laws and regulations or that a medical device is ineffective or poses an unreasonable health risk, it can institute or seek a wide variety of enforcement actions and remedies, ranging from a public warning letter to more severe actions such as:

- fines, injunctions and civil penalties;
- recall or seizure of products;
- operating restrictions, partial suspension or total shutdown of production;
- refusing requests for 510(k) clearance or PMA approval of new products;

- withdrawing 510(k) clearance or PMA approvals already granted; and
- criminal prosecution.

The FDA also has the authority to require repair, replacement or refund of the cost of any medical device.

The FDA also administers certain controls over the export of medical devices from the United States, as international sales of medical devices that have not received FDA approval are subject to FDA export requirements. Additionally, each foreign country subjects such medical devices to its own regulatory requirements. In the European Union, a single regulatory approval process has been created, and approval is represented by the CE Mark.

Pharmaceutical Product Regulation

In the United States, the FDA regulates drugs under the FDCA and implementing regulations that are adopted under the FDCA. In the case of biologics, the FDA regulates such products under the Public Health Service Act. If we fail to comply with the applicable requirements under these laws and regulations at any time during the product development process, approval process, or after approval, we may become subject to administrative or judicial sanctions. These sanctions could include the FDA's refusal to approve pending applications, withdrawals of approvals, clinical holds, warning letters, product recalls, product seizures, total or partial suspension of our operations, injunctions, fines, civil penalties or criminal prosecution. Any agency enforcement action could have a material adverse effect on us. The FDA also administers certain controls over the export of drugs and biologics from the United States.

Under the United States regulatory scheme, the development process for new pharmaceutical products can be divided into three distinct phases:

- *Pre-Clinical Phase.* The pre-clinical phase involves the discovery, characterization, product formulation and animal testing necessary to prepare an Investigational New Drug application, or IND, for submission to the FDA. The IND must be accepted by the FDA before the drug can be tested in humans.
- *Clinical Phase.* The clinical phase of development follows a successful IND submission and involves the activities necessary to demonstrate the safety, tolerability, efficacy, and dosage of the substance in humans, as well as the ability to produce the substance in accordance with cGMP requirements. Data from these activities are compiled in a New Drug Application, or NDA, or for biologic products a Biologics License Application, or BLA, for submission to the FDA requesting approval to market the drug.
- *Post-Approval Phase.* The post-approval phase follows FDA approval of the NDA or BLA, and involves the production and continued analytical and clinical monitoring of the product. The post- approval phase may also involve the development and regulatory approval of product modifications and line extensions, including improved dosage forms, of the approved product, as well as for generic versions of the approved drug, as the product approaches expiration of patent or other exclusivity protection.

Each of these three phases is discussed further below.

Pre-Clinical Phase. The development of a new pharmaceutical agent begins with the discovery or synthesis of a new molecule. These agents are screened for pharmacological activity using various animal and tissue models, with the goal of selecting a lead agent for further development. Additional studies are conducted to confirm pharmacological activity, to generate safety data, and to evaluate prototype dosage forms for appropriate release and activity characteristics. Once the pharmaceutically active molecule is fully characterized, an initial purity profile of the agent is established. During this and subsequent stages of development, the agent is analyzed to confirm the integrity and quality of material produced. In addition, development and optimization of the initial dosage forms to be used in clinical trials are completed, together with analytical models to determine product stability and degradation. A bulk supply of the active ingredient to support the

necessary dosing in initial clinical trials must be secured. Upon successful completion of pre-clinical safety and efficacy studies in animals, an IND submission is prepared and provided to the FDA for review prior to commencement of human clinical trials. The IND consists of the initial chemistry, analytical, formulation, and animal testing data generated during the pre-clinical phase. The review period for an IND submission is 30 days, after which, if no comments are made by the FDA, the product candidate can be studied in Phase I clinical trials.

Clinical Phase. Following successful submission of an IND, the sponsor is permitted to conduct clinical trials involving the administration of the investigational product candidate to human subjects under the supervision of qualified investigators in accordance with good clinical practice. Clinical trials are conducted under protocols detailing, among other things, the objectives of the study and the parameters to be used in assessing the safety and the efficacy of the drug. Each protocol must be submitted to the FDA as part of the IND prior to beginning the trial. Each trial must be reviewed, approved and conducted under the auspices of an independent Institutional Review Board, and each trial, with limited exceptions, must include the patient's informed consent. Typically, clinical evaluation involves the following time-consuming and costly three-phase sequential process:

- *Phase I.* Phase I human clinical trials are conducted in a limited number of healthy individuals to determine the drug's safety and tolerability and include biological analyses to determine the availability and metabolization of the active ingredient following administration. The total number of subjects and patients included in Phase I clinical trials varies, but is generally in the range of 20 to 80 people.
- *Phase II.* Phase II clinical trials involve administering the drug to individuals who suffer from the target disease or condition to determine the drug's potential efficacy and ideal dose. These clinical trials are typically well controlled, closely monitored, and conducted in a relatively small number of patients, usually involving no more than several hundred subjects. These trials require scale up for manufacture of increasingly larger batches of bulk chemical. These batches require validation analysis to confirm the consistent composition of the product.
- *Phase III.* Phase III clinical trials are performed after preliminary evidence suggesting effectiveness of a drug has been obtained and safety (toxicity), tolerability, and an ideal dosing regimen have been established. Phase III clinical trials are intended to gather additional information about the effectiveness and safety that is needed to evaluate the overall benefit-risk relationship of the drug and to complete the information needed to provide adequate instructions for the use of the drug. Phase III trials usually include from several hundred to several thousand subjects.

Throughout the clinical phase, samples of the product made in different batches are tested for stability to establish shelf life constraints. In addition, large-scale production protocols and written standard operating procedures for each aspect of commercial manufacture and testing must be developed.

Phase I, II, and III testing may not be completed successfully within any specified time period, if at all. The FDA closely monitors the progress of each of the three phases of clinical trials that are conducted under an IND and may, at its discretion, reevaluate, alter, suspend, or terminate the testing based upon the data accumulated to that point and the FDA's assessment of the risk/benefit ratio to the patient. Clinical investigators, or IRBs, and companies may be subject to pre-approval, routine, or "for cause" inspections by the FDA for compliance with Good Clinical Practices, or GCPs, and FDA regulations governing clinical investigations. The FDA may suspend or terminate clinical trials, or a clinical investigator's participation in a clinical trial, at any time for various reasons, including a finding that the subjects or patients are being exposed to an unacceptable health risk. The FDA can also request additional clinical trials be conducted as a condition to product approval. Additionally, new government requirements may be established that could delay or prevent regulatory approval of our products under development. Furthermore, institutional review boards, which are independent entities constituted to protect human subjects in the institutions in which clinical trials are being conducted, have the authority to suspend clinical trials in their respective institutions at any time for a variety of reasons, including safety issues.

Post-Approval Phase. After approval, we are still subject to continuing regulation by the FDA, including, but not limited to, record keeping requirements, submitting periodic reports to the FDA, reporting of any adverse experiences with the product, and complying with drug sampling and distribution requirements. In addition, we are required to maintain and provide updated safety and efficacy information to the FDA. We are also required to comply with requirements concerning advertising and promotional labeling. In that regard, our advertising and promotional materials must be truthful and not misleading. We are also prohibited from promoting any non-FDA approved or "off-label" indications of products. Failure to comply with those requirements could result in significant enforcement action by the FDA, including warning letters, orders to pull the promotional materials, and substantial fines. Also, quality control and manufacturing procedures must continue to conform to cGMP after approval.

Drug and biologics manufacturers and their subcontractors are required to register their facilities and products manufactured annually with the FDA and certain state agencies and are subject to periodic routine and unannounced inspections by the FDA to assess compliance with cGMP regulations. Facilities may also be subject to inspections by other federal, foreign, state, or local agencies. In addition, approved biological drug products may be subject to lot-by-lot release testing by the FDA before these products can be commercially distributed. Accordingly, manufacturers must continue to expend time, money, and effort in the area of production and quality control to maintain compliance with cGMP and other aspects of regulatory compliance. Future FDA inspections may identify compliance issues at our facilities or at the facilities that may disrupt production or distribution, or require substantial resources to correct.

In addition, following FDA approval of a product, discovery of problems with a product or the failure to comply with requirements may result in restrictions on a product, manufacturer, or holder of an approved marketing application, including withdrawal or recall of the product from the market or other voluntary or FDA-initiated action that could delay further marketing. Newly discovered or developed safety or effectiveness data may require changes to a product's approved labeling, including the addition of new warnings and contraindications. Also, the FDA may require post-market testing and surveillance to monitor the product's safety or efficacy, including additional clinical studies, known as Phase IV trials, to evaluate long-term effects.

Regulation of Disinfectants

In the United States, the EPA regulates disinfectants as antimicrobial pesticides under the Federal Insecticide, Fungicide and Rodenticide Act, or FIFRA, and the implementing regulations that the EPA has adopted under FIFRA. Before marketing a disinfectant in the United States, we must satisfy the EPA's pesticide registration requirements. That registration process requires us to demonstrate the disinfectant's efficacy and to determine the potential human and ecological risks associated with use of the disinfectant. The testing and registration process could be lengthy and could be expensive. There is no assurance, however, that we will be able to satisfy all of the pesticide registration requirements for a particular proposed new disinfectant product. Once we satisfy the FIFRA registration requirements for an individual disinfectant, additional FIFRA regulations will apply to our various business activities, including marketing, related to that EPA-registered product.

Failure to comply with FIFRA's requirements could expose us to various enforcement actions. FIFRA empowers the EPA to seek administrative or judicial sanctions against those who violate FIFRA. Among the potential FIFRA penalties are civil administrative penalties, stop sale orders, cancellation of our registration, seizures, injunctions and criminal sanctions. If EPA were to initiate a FIFRA enforcement action against us, it could have a material adverse effect on us.

Other Regulation in the United States

Health Care Coverage and Reimbursement by Third-Party Payors

Commercial success in marketing and selling our products depends, in part, on the availability of adequate coverage and reimbursement from third-party health care payors, such as government and private health insurers and managed care organizations. Third-party payers are increasingly challenging the pricing of medical products and services. Government and private sector initiatives to limit the growth of health care

costs, including price regulation, competitive pricing, and managed-care arrangements, are continuing in many countries where we do business, including the United States. These changes are causing the marketplace to be more cost-conscious and focused on the delivery of more cost-effective medical products. Government programs, including Medicare and Medicaid, private health care insurance companies, and managed-care plans control costs by limiting coverage and the amount of reimbursement for particular procedures or treatments. This has created an increasing level of price sensitivity among customers for our products. Some third-party payors also require that a favorable coverage determination be made for new or innovative medical devices or therapies before they will provide reimbursement of those medical devices or therapies. Even though a new medical product may have been cleared or approved for commercial distribution, we may find limited demand for the product until adequate coverage and reimbursement have been obtained from governmental and other third-party payors.

Fraud and Abuse Laws

In the United States, we are subject to various federal and state laws pertaining to healthcare fraud and abuse, which, among other things, prohibit the offer or acceptance of remuneration intended to induce or in exchange for the purchase of products or services reimbursed under a federal healthcare program and the submission of false or fraudulent claims with the government. These laws include the federal Anti-Kickback Statute, the False Claim Act and comparable state laws. These laws regulate the activities of entities involved in the healthcare industry, such as us, by limiting the kinds of financial arrangements such entities may have with healthcare providers who use or recommend the use of medical products (including for example, sales and marketing programs, advisory boards and research and educational grants). In addition, in order to ensure that healthcare entities comply with healthcare laws, the Office of Inspector General, or OIG, of the U.S. Department of Health and Human Services recommends that healthcare entities institute effective compliance programs. To assist in the development of effective compliance programs, the OIG has issued model Compliance Program Guidance, or CPG, materials for a variety of healthcare entities which, among other things, identify practices to avoid that may implicate the federal Anti-Kickback Statute and other relevant laws and describes elements of an effective compliance program. While compliance with the CPG materials is voluntary, a recent California law requires pharmaceutical and devices manufacturers to initiate compliance programs that incorporate the CPG and the July 2002 Pharmaceuticals Research and Manufacturers of America Code on Interactions with Healthcare Professionals.

Due to the scope and breadth of the provisions of some of these laws, it is possible that some of our practices might be challenged by the government under one or more of these laws in the future. Violations of these laws, which are discussed more fully below, can lead to civil and criminal penalties, damages, imprisonment, fines, exclusion from participation in Medicare, Medicaid and other federal health care programs, and the curtailment or restructuring of our operations. Any such violations could have a material adverse effect on our business, financial condition, results of operations or cash flows.

Anti-Kickback Laws. Our operations are subject to federal and state anti-kickback laws. The federal Anti-Kickback Statute prohibits persons from knowingly and willfully soliciting, receiving, offering or providing remuneration directly or indirectly to induce either the referral of an individual for a good or service reimbursed under a federal healthcare program, or the furnishing, recommending, or arranging of a good or service, for which payment may be made under a federal healthcare program, such as Medicare or Medicaid. The definition of "remuneration" has been broadly interpreted to include anything of value, including such items as gifts, discounts, the furnishing of supplies or equipment, waiver of co-payments, and providing anything at less than its fair market value. Because the Anti-Kickback Statute makes illegal a wide variety of common (even beneficial) business arrangements, the OIG was tasked with issuing regulations, commonly known as "safe harbors," that describe arrangements where the risk of illegal remuneration is minimal. As long as all of the requirements of a particular safe harbor are strictly met, the entity engaging in that activity will not be prosecuted under the federal Anti-Kickback Statute. The failure of a transaction or arrangement to fit precisely within one or more safe harbors does not necessarily mean that it is illegal or that prosecution will be pursued. However, business arrangements that do not fully satisfy an applicable safe harbor may result in increased scrutiny by government enforcement authorities, such as the OIG. Our agreements to pay

compensation to our advisory board members and physicians who conduct clinical trials or provide other services for us may be subject to challenge to the extent they do not fall within relevant safe harbors under state and federal anti-kickback laws. In addition, many states have adopted laws similar to the federal Anti-Kickback Statute which apply to the referral of patients for healthcare services reimbursed by Medicaid, and some have adopted such laws with respect to private insurance. Violations of the Anti-Kickback Statute are subject to significant fines and penalties and may lead to a company being excluded from participating in federal health care programs.

False Claims Laws. The federal False Claims Act prohibits knowingly filing a false claim, knowingly causing the filing of a false claim, or knowingly using false statements to obtain payment from the federal government. Under the False Claims Act, such suits are known as "qui tam" actions, and those who bring such suits. Individuals may file suit on behalf of the government share in any amounts received by the government pursuant to a settlement. In addition, certain states have enacted laws modeled after the federal False Claims Act under the Deficit Reduction Act of 2005, the federal government created financial incentives for states to enact false claims laws consistent with the federal False Claims Act. As more states enact such laws, we expect the number of qui tam lawsuits to increase. Qui tam actions have increased significantly in recent years, causing greater numbers of healthcare companies to have to defend a false claims action, pay fines or be excluded from Medicare, Medicaid or other federal or state government healthcare programs as a result of investigations arising out of such actions.

HIPAA. Two federal crimes were created under the Health Insurance Portability and Accountability Act of 1996, or HIPAA: healthcare fraud and false statements relating to healthcare matters. The healthcare fraud statute prohibits knowingly and willfully executing a scheme to defraud any healthcare benefit program, including private payors. The false statements statute prohibits knowingly and willfully falsifying, concealing or covering up a material fact or making any materially false, fictitious or fraudulent statement in connection with the delivery of or payment for healthcare benefits, items or services.

Health Information Privacy and Security

Individually identifiable health information is subject to an array of federal and state regulation. Federal rules promulgated pursuant to HIPAA regulate the use and disclosure of health information by "covered entities." Covered entities include individual and institutional health care providers from which we may receive individually identifiable health information. These regulations govern, among other things, the use and disclosure of health information for research purposes, and require the covered entity to obtain the written authorization of the individual before using or disclosing health information for research. Failure of the covered entity to obtain such authorization could subject the covered entity to civil and criminal penalties. We may experience delays and complex negotiations as we deal with each entity's differing interpretation of the regulations and what is required for compliance. Also, where our customers or contractors are covered entities, including hospitals, universities, physicians or clinics, we may be required by the HIPAA regulations to enter into "business associate" agreements that subject us to certain privacy and security requirements. In addition, many states have laws that apply to the use and disclosure of health information, and these laws could also affect the manner in which we conduct our research and other aspects of our business. Such state laws are not preempted by the federal privacy law where they afford greater privacy protection to the individual. While activities to assure compliance with health information privacy laws are a routine business practice, we are unable to predict the extent to which our resources may be diverted in the event of an investigation or enforcement action with respect to such laws.

Foreign Regulation

Whether or not we obtain FDA approval for a product, we must obtain approval of a product by the applicable regulatory authorities of foreign countries before we can commence clinical trials or marketing of the product in those countries. The approval process varies from country to country, and the time may be longer or shorter than that required for FDA approval. The requirements governing the conduct of clinical trials, product licensing, pricing, and reimbursement also vary greatly from country to country. Although governed by the applicable country, clinical trials conducted outside of the United States typically are

administered under a three-phase sequential process similar to that discussed above for pharmaceutical products.

European Union Regulation

Medical Device Regulation. Our Microcyn products are classified as medical devices in the European Union. In order to sell our medical device products within the European Union, we are required to comply with the requirements of the Medical Devices Directive, or MDD, and its national implementations, including affixing CE Marks on our products. In order to comply with the MDD, we must meet certain requirements relating to the safety and performance of our products and, prior to marketing our products, we must successfully undergo verification of our product's regulatory compliance, or conformity assessment.

Medical devices are divided into three regulatory classes: Class I, Class IIb and Class III. The nature of the conformity assessment procedures depends on the regulatory class of the product. We executed the conformity assessment for production quality assurance for Class IIb products for Dermacyn Wound Care. Compliance with production quality assurance is audited every year by a private entity certified by government regulators. In order to comply with the examination, we completed, among other things, a risk analysis and presented clinical data, which demonstrated that our products met the performance specifications claimed by us, provided sufficient evidence of adequate assessment of unwanted side effects and demonstrated that the benefits to the patient outweigh the risks associated with the device. We will be subject to continued supervision and will be required to report any serious adverse incidents to the appropriate authorities. We will also be required to comply with additional national requirements that are beyond the scope of the MDD.

We received our CE certificate for Dermacyn Wound Care as a Class IIb medical device in February 2005. There can be no assurance that we will be able to maintain the requirements established for CE Marks for any or all of our products or that we will be able to produce these products in a timely and profitable manner while complying with the requirements of the MDD and other regulatory requirements.

Marketing Authorizations for Drugs. In order to obtain marketing approval of any of our drug products in Europe, we must submit for review an application similar to a U.S. NDA to the relevant authority. In contrast to the United States, where the FDA is the only authority that administers and approves NDAs, in Europe there are multiple authorities that administer and approve these applications. Marketing authorizations in Europe expire after five years but may be renewed.

We believe that our Microcyn based drugs will be reviewed by the Committee for Medicinal Products for Human Use, or CHMP, on behalf of the European Medicines Agency, or EMEA. Based upon the review of the CHMP, the EMEA provides an opinion to the European Commission on the safety, quality and efficacy of the drug. The decision to grant or refuse an authorization is made by the European Commission.

Approval of applications can take several months to several years, or may be denied. This approval process can be affected by many of the same factors relating to safety, quality and efficacy as in the approval process for NDAs in the United States. As in the United States, European drug regulatory authorities can require us to perform additional non-clinical studies and clinical trials. The need for such studies or trials, if imposed, may delay marketing approval and involve unanticipated costs. Inspection of clinical investigation sites by a competent authority may also be required as part of the regulatory approval procedure. In addition, as a condition of marketing approval, regulatory agencies in Europe may require post-marketing surveillance to monitor for adverse effects, or other additional studies as deemed appropriate. The terms of any approval, including labeling content, may be more restrictive than expected and could affect the marketability of a product. In addition, after approval for the initial indication, further clinical studies are usually necessary to gain approval for any additional indications.

European GMP. In the European Union, the manufacture of pharmaceutical products and clinical trial supplies is subject to good manufacturing practice, or GMP, as set forth in the relevant laws and guidelines. Compliance with GMP is generally assessed by the competent regulatory authorities. They may conduct inspections of relevant facilities, and review manufacturing procedures, operating systems and personnel

qualifications. In addition to obtaining approval for each product, in many cases each drug manufacturing facility must be approved. Further inspections may occur over the life of the product.

Mexico

The MOH is the authority in charge of sanitary controls in Mexico. Sanitary controls are a group of practices related to the orientation, education, testing, verification and application of security measures and sanctions exercised by the MOH. The MOH acts by virtue of the Federal Commission for the Protection against Sanitary Risks, or COFEPRIS, a decentralized entity of the MOH whose mission is to protect the population against sanitary risks, by means of centralized sanitary regulations, controls and by raising public awareness.

The MOH is responsible for the issuance of Official Mexican Standards and specifications for drugs subject to the provisions of the General Health Law, which govern the process and specifications of drugs, including the obtaining, preparation, manufacturing, maintenance, mixture, conditioning, packaging, handling, transport, distribution, storage and supply of products to the public at large. In addition, a medical device is defined as a device that may contain antiseptics or germicides used in surgical practice or in the treatment of continuity solutions, skin injuries or its attachments.

Regulations applicable to medical devices and drugs are divided into two sections: the business that manufacture the medical device or drug and the product itself.

Manufacturing a Medical Device or Drug. Under the General Health Law, a business that manufactures drugs is either required to obtain a Sanitary Authorization or to file an Operating Notice. Our Mexico subsidiary is considered a business that manufactures medical devices and therefore is not subject to a Sanitary Authorization, but rather only an Operating Notice.

In addition to its Operating Notice, our Mexico subsidiary has obtained a “Good Processing Practices Certificate” issued by COFEPRIS, which demonstrates that the manufacturing of Microcyn at the facility located in Zapopan, Mexico, operates in accordance with the applicable official standards.

Commercialization of Drugs and Medical Devices. Drugs and medical devices should be commercialized in appropriate packaging containing labels printed in accordance with specific official standards. For medical devices, there are no specific standards or regulations related to the labeling of the product, but rather only a general standard related to the labeling for all types of products to be commercialized in Mexico. Advertising of medical devices is regulated in the General Health Law and in the specific regulations of the General Health Law related to advertising. Generally, the advertising of medical devices is subject to a permit only in the case that such advertising is directed to the general public.

Medical Devices and Drugs as a Product. To produce, sell or distribute medical devices, a Sanitary Registry is required in accordance with the General Health Law and the Regulation for Drugs. Such registry is granted for a term of five years, and this term may be extended. The Sanitary Registry may be revoked if the interested party does not request the extension in the term or the product or the manufacturer or the raw material is changed without the permission of the MOH.

The MOH classifies the medical devices in three classes:

- Class I. Devices for which safety and effectiveness have been duly proved and are generally not used inside the body;
- Class II. Devices that may vary with respect to the material used for its fabrication or in its concentration and generally used in the inside of the body for a period no greater than 30 days; and
- Class III. New devices or recently approved devices in the medical practice or those used inside the body and which shall remain inside the body for a period greater than 30 days.

Violation of these regulations may result in the revocation of the registrations or approvals, and, in addition, economic fines. In some cases, such violations may constitute criminal actions.

In addition, regulatory approval of prices is required in most countries other than the United States, which could result in lengthy negotiations delaying our ability to commercialize our products. We face the risk that the prices which result from the regulatory approval process would be insufficient to generate an acceptable return.

Employees

As of September 30, 2006, we had 76 full-time employees, including 19 in manufacturing, eight in research and development, five in regulatory and clinical, 17 in sales and marketing and 13 in executive or administrative functions in the U.S., four in administrative functions in Europe, eight in administrative functions in Mexico, and two in information technology function. In early 2007, we plan to add additional sales and marketing personnel to support our various markets and opportunities. We also plan to hire additional clinical support personnel to work with key opinion leaders, and to provide educational services and technical support our distribution channels. None of our employees is covered by collective bargaining arrangements, and we consider our relationship with our employees to be good.

Properties

We currently lease approximately 12,000 square feet of office, research and manufacturing space in Petaluma, California, which serves as our principal executive offices. We also lease approximately 28,000 square feet of office space in an adjacent building for manufacturing and research and development. Both leases expire in September 2007.

We lease approximately 4,000 square feet of office space and approximately 14,000 square feet of manufacturing and warehouse space in Zapopan, Mexico, under a lease that expires in April 2011. We lease approximately 5,000 square feet of office space and approximately 14,000 square feet of manufacturing and warehouse space in Sittard, The Netherlands, under leases that expire in January 2009. As we expand, we may need to establish manufacturing facilities in other countries.

We believe our properties are adequate to meet our needs through September 2007.

Legal Proceedings

In March 2006, we filed suit in the U.S. District Court for the Northern District of California against Nofil Corporation and Naoshi Kono, its Chief Executive Officer, for breach of contract, misappropriation of trade secrets and trademark infringement. We believe that Nofil Corporation violated key terms of both an exclusive purchase agreement and non-disclosure agreement by contacting and working with a potential competitor in Mexico. In the complaint, we seek damages of $3.5 million and immediate injunctive relief. No trial date has been set.

In September 2005, a complaint was filed against us in Mexico claiming trademark infringement with respect to our Microcyn60 mark. To settle this claim we have agreed to cease marketing our product in Mexico under the name Microcyn60 in Mexico by September 2007. A second unrelated claim was filed against us in Mexico in May 2006, claiming trademark infringement with respect to our Microcyn60 mark in Mexico. We are in discussions with the claimant to settle the matter.

In September 2006, a consulting firm in Mexico City contacted us threatening legal action in Mexico, alleging breach of contract and claiming damages of $225,000. A formal complaint has not been served and no trial date has been set. We are currently in settlement negotiations with the plaintiff. If these negotiations are not successful, we intend to vigorously defend this action. If the claims are litigated, we may incur considerable litigation costs.

In April 2005, a former director and Chief Operating Officer of our company filed an action in the Superior Court of the State of California, Sonoma County, alleging breach of employment contract. In the complaint, the plaintiff claims $300,000 and the right to purchase approximately 150,000 shares of our common stock at $3.00 per share. We entered into a settlement agreement with the plaintiff in November 2006

which provides for the payment of $250,000 and the issuance of a warrant to purchase 50,000 shares of our common stock exercisable at $3.00 per share. The issuance of warrants is subject to our obtaining appropriate waivers from our preferred stockholders and the cash payment is subject to the closing of an equity financing resulting in gross proceeds to us of $10 million or more on the completion of our initial public offering. The estimated expense of $550,000 will be recorded as a general and administrative expense in the period the warrants are issued. Under the terms of the agreement, the plaintiff has agreed to dismiss his claim and waived any other previous claims against us. If the claims are litigated, we may incur considerable litigation costs. We expect our insurance carrier to cover a portion of the claim.

Except for the foregoing, we are not a party to any material legal proceedings, and, except as set forth above, management is not aware of any threatened legal proceedings that it believes could cause a material adverse impact on our business, financial condition or results of operations. From time to time, we may be party to lawsuits in the ordinary course of business.

GLOSSARY OF TECHNICAL, MEDICAL AND INDUSTRY TERMS

The following technical, medical, and industry-specific terms used in this prospectus have the following meanings:

Anti-infective	Capable of killing infectious agents or of preventing them from spreading and causing infection.
Antimicrobial	Capable of destroying or inhibiting the growth of micro-organisms.
Antiseptic	A germicide used on skin or living tissue for the purpose of inhibiting or destroying microorganisms (for example, alcohol, chlorhexidine, chlorine, hexachlorophene, iodine, chloroxylenol PCMX, quaternary ammonium compounds, and triclosan).
Disinfection	Destruction of pathogenic and other kinds of microorganisms by physical or chemical means. Disinfection is less lethal than sterilization, because it destroys the majority of recognized pathogenic microorganisms, but not necessarily all microbial forms (for example, bacterial spores). Disinfection does not ensure the degree of safety associated with sterilization processes.
Germicide	An agent that destroys microorganisms, especially pathogenic organisms. Terms with the same suffix (e.g., virucide, fungicide, bactericide, tuberculocide, and sporicide) indicate agents that destroy the specific microorganism identified by the prefix. Germicides can be used to inactivate microorganisms in or on living tissue (antiseptics), or on environmental surfaces (disinfectants).
Microbial load	Number of viable organisms in or on an object or surface or organic material on a surface or object before decontamination or sterilization.
Pathogen	A specific causative agent of disease, such as a bacteria, virus or fungus.
Spore	A small, usually single-celled reproductive body that is highly resistant to desiccation and heat and is capable of growing into a new organism, produced especially by certain bacteria, fungi, algae, and nonflowering plants. A dormant nonreproductive body formed by certain bacteria in response to adverse environmental conditions.
Wound debridement	Surgical removal of dead, devitalized or contaminated tissue and removal of foreign matter from a wound.

MANAGEMENT

Executive Officers, Key Employees and Directors

The following table shows information about our executive officers, key employees and directors as of October 31, 2006:

Name	Age	Position(s)
Hojabr Alimi	46	Chief Executive Officer, President and Chairman of the Board
Michael Wokasch	55	Chief Operating Officer
Robert Miller	64	Chief Financial Officer
James Schutz	43	Vice President of Corporate Development, General Counsel, Corporate Secretary and Director
Theresa Mitchell(1)	56	Vice President of Regulatory, Clinical Affairs, Quality Assurance and Research and Development
Bruce Thornton	42	Vice President of International Operations and Sales
Robert Northey, Ph.D.	49	Director of Research and Development
Andres Gutiérrez, M.D., Ph.D.	45	Director of Medical Affairs
Gerard de Nies	42	Director of Marketing and Sales-Europe, Middle East and Africa of Oculus Innovative Sciences Netherlands
Sergio Caleti	41	Commercial Director of Oculus Technologies of Mexico
Akihisa Akao	52	Director
Edward Brown(4)	42	Director
Robert Burlingame	72	Director
Richard Conley(2)(3)(4)	56	Director
Gregory French(2)(3)(4)	45	Director

(1) Resignation tendered effective January 2, 2007, at which time we anticipate that Ms. Mitchell will transition to a consulting role with us, the terms of which are yet to be determined.

(2) Member of the audit committee

(3) Member of the compensation committee

(4) Member of the nominating and corporate governance committee

Hojabr Alimi, one of our founders, has served as our Chief Executive Officer, President and director since 1999 and was appointed as Chairman of the board of directors in June 2006. Prior to co-founding our company with his spouse in 1999, Mr. Alimi was a Corporate Microbiologist for Arterial Vascular Engineering. Mr. Alimi received a B.A. in biology from Sonoma State University.

Michael Wokasch has served as our Chief Operating Officer since June 2006. From July 2004 to May 2006, Mr. Wokasch served as Senior Vice President Global Commercial Operations for the Biopharmaceuticals division of Chiron Corporation, a biotechnology company. He served as Chief Operating Officer of Impax Laboratories, a pharmaceutical company, from January 2003 to June 2004. Prior to Impax, Mr. Wokasch served as President of PanVera Corporation and then Aurora Biosciences Corporation, both drug discovery subsidiary companies of Vertex Pharmaceuticals, from July 2001 to December 2002, and as Chief Executive Officer of Gala Design, a biotechnology company, from June 2000 to July 2001. Prior to this, Mr. Wokasch also served as a President and Corporate Senior Vice President at Covance from 1997 to 1999, a contract research organization. In this capacity, Mr. Wokasch managed the global Early Development operations at Covance responsible for providing drug development services including preclinical toxicology, bioanalytical chemistry, regulatory, and Phase I clinical services to pharmaceutical and biotechnology companies. Prior to

this, he held sales and marketing positions at Abbott Laboratories, Merck & Co., and Miles Inc. Mr. Wokasch received a B.S. from the University of Minnesota, College of Pharmacy.

Robert Miller has served as our Chief Financial Officer since June 2004 and was a consultant to us from March 2003 to May 2004. Mr. Miller has served as a director of Scanis, Inc. since 1998 and served as acting Chief Financial Officer from 1998 to June 2006. He was a Chief Financial Officer consultant to Evit Labs from June 2003 to December 2004, Wildlife International Network from October 2002 to December 2005, Endoscopic Technologies from November 2002 to March 2004, Biolog from January 2000 to December 2002 and Webware from August 2000 to August 2002. Prior to this, Mr. Miller was the Chief Financial Officer for GAF Corporation, Penwest Ltd. and Bugle Boy and Treasurer of Mead Corporation. He received a B.A. in economics from Stanford University and an M.B.A. in finance from Columbia University.

James Schutz has served as our Vice President of Corporate Development and General Counsel since August 2003, as a director since May 2004 and Corporate Secretary since June 2006. From August 2001 to August 2003, Mr. Schutz served as General Counsel at Jomed (formerly EndoSonic Corp.), an international medical device company. From 1999 to July 2001, Mr. Schutz served as in-house counsel at Urban Media Communications Corporation, an Internet/telecom company based in Palo Alto, California. Mr. Schutz received a B.A. in economics from the University of California, San Diego and a J.D. from the University of San Francisco School of Law.

Theresa Mitchell has served as our Vice President of Regulatory, Clinical Affairs, Quality Assurance and Research and Development since March 2005. Ms. Mitchell has tendered her resignation effective January 2, 2007, at which time we anticipate that she will transition to a consulting role with us on terms that are not yet determined. Prior to joining us, Ms. Mitchell took a sabbatical following her service as Vice President, Regulatory and Clinical Affairs and Quality Assurance at Oratec Interventions, Inc., a medical device company, from December 1998 to December 2003. She has held senior regulatory and clinical positions at Target Therapeutics, Fidus Medical, General Surgical Innovations and Advanced Cardiovascular Systems. Ms. Mitchell received a B.A. in experimental psychology/biostatistics and an M.A. in liberal arts from California State University, San Francisco.

Bruce Thornton has served as our Vice President of International Operations and Sales since June 2005. Mr. Thornton served as our General Manager for U.S. Operations from March 2004 to July 2005. He served as Vice President of Operations for Jomed (formerly EndoSonic Corp.) from January 1999 to September 2003, and as Vice President of Manufacturing for Volcano Therapeutics, an international medical device company, following its acquisition of Jomed, until March 2004. Mr. Thornton received a B.S. in aeronautical science from Embry-Riddle Aeronautical University and an M.B.A. from National University.

Robert Northey, Ph.D. has served as our Director of Research and Development since July 2005. Dr. Northey served as a consultant to us from May 2001 to June 2005. From August 1998 until June 2005, he was an Assistant Professor in the Paper Science and Engineering Department at the University of Washington. Dr. Northey received a B.S. in wood and fiber science and a Ph.D. in wood chemistry, each from the University of Washington.

Andres Gutiérrez, M.D., Ph.D. has served as our Director of Medical Affairs since August 2005. Dr. Gutiérrez served as a consultant to us from April 2003 to July 2005. He served as the Head of the Cell Therapy Unit at the National Institute of Rehabilitation in Mexico City from September 2000 to July 2005 and as a consulting physician with the Department of Medicine at Hospital Angeles del Pederegal in Mexico City from 1996 to July 2005. He received an M.D. with a specialty in internal medicine, and a Ph.D. in biomedical sciences, each from the National University of Mexico in Mexico City.

Gerard de Nies has served as Director of Marketing and Sales - Europe, Middle East and Africa of our Netherlands subsidiary, since August 2005. Mr. de Nies held a similar position in Kimberly-Clark for the Scientific & Industrial division, where he was responsible for sales and marketing in Europe from July 1999 through August 2005. He was the Sales Manager in the Ethicon Endo-Surgery division of Johnson & Johnson from June 1993 to July 1999. Mr. de Nies received a Bachelor of nursing and of healthcare management, each from the University of Amsterdam, The Netherlands.

Sergio Caleti has served as Commercial Director for our Mexican subsidiary since February 2005. Mr. Caleti served as the Mexico National Sales Manager of Darier Laboratories, a dermatological laboratory, from July 2003 to January 2005. He served as the Regional Sales Manager, Hospital Products Division for the central region for Abbott Laboratories from 1999 until June 2003. Mr. Caleti received an engineering degree from the Engineering School of Universidad Iberoamericana, Mexico.

Akihisa Akao has served as a director since 1999 and as a consultant since October 2005. Mr. Akao has served as President for White Moon Medical, Inc., a consulting company that provides advice to early-stage companies seeking to enter the Japanese medical products market. He served as the general manager in Japan at PowerMedical Interventions Inc., a medical device company, from January 2001 to September 2005. He also served as President of E-Med Japan, an application service provider for medical professionals and consumers, from 1999 to July 2000. Mr. Akao received a B.A. in electronic engineering from Doshisha University, Kyoto, Japan.

Edward Brown has served as a director since September 2005. Mr. Brown is co-founder of Healthcare Investment Partners, or HIP, a private equity buyout fund focused exclusively on healthcare, and has served as a Managing Director of HIP since June 2004. Before joining HIP, Mr. Brown was a Managing Director in the Healthcare Group of Credit Suisse First Boston, where he led the firm's West Coast healthcare effort and was one of the senior partners responsible for the firm's global life sciences practice, from August 2000 to June 2004. Mr. Brown serves on the board of directors of Angiotech Pharmaceuticals, Inc. Mr. Brown received an A.B. in English from Middlebury College.

Robert Burlingame has served as a director since November 2006. Mr. Burlingame is the Chief Executive Officer and Chairman of the Board of Burlingame Industries, Inc., a manufacturer of automated equipment specializing in the concrete rooftile industry, which he founded in 1969. He has held various senior management positions at several rooftile companies, including California Tile and Lifetile Corporation. Mr. Burlingame received a B.S. in business from Michigan State University and was a pilot in the U.S. Navy.

Richard Conley has served as a director since 1999, and served as our Secretary from July 2002 to June 2006. Since April 2001, Mr. Conley has served as Executive Vice President and Chief Operating Officer at Don Sebastiani & Sons International Wine Negociants, a branded wine marketing company. From 1994 to March 2001, he served as Senior Vice President and Chief Operating Officer at Sebastiani Vineyards, a California wine producer, where he was originally hired as Chief Financial Officer in 1994. Mr. Conley received a B.S. in finance and accounting from Western Carolina University and an M.B.A. from St. Mary's University.

Gregory French has served as a director since 2000. Mr. French is owner and Chairman of the Board of G&C Enterprises LLC, a real estate and investment company, which he founded in 1999. He held various engineering and senior management positions at several medical device companies, including Advanced Cardiovascular Systems, Peripheral Systems Group and Arterial Vascular Engineering. Mr. French received a B.S.I.E. from the California State Polytechnic University, San Luis Obispo.

Board of Directors

Our board of directors currently consists of seven members. We are actively seeking two additional independent board members, in order to achieve a majority of independent directors on our board of directors. All directors are elected to hold office until their successors have been elected and qualified or until the earlier of death, resignation or removal. The authorized number of directors may be changed by resolution duly adopted by the board of directors. Vacancies on the board can be filled by resolution of the board of directors. Each of Messrs. Brown, Conley and French are independent directors as defined by Rule 4200(a)(15) of the National Association of Securities Dealers listing standards.

Board Committees

Our board of directors currently has an audit committee, compensation committee and nominating and corporate governance committee, which have the composition and responsibilities described below. As of the

completion of this offering, we expect that all of the members of our committees will be independent directors under the rules of the SEC and the Nasdaq Stock Market.

Audit Committee. The audit committee provides assistance to the board of directors in fulfilling its legal and fiduciary obligations in matters involving our accounting, auditing, financial reporting, internal control and legal compliance functions by:

- appointing, retaining, determining compensation and overseeing our independent accountants;
- ensuring that our accountants are independent from management;
- approving the services performed by our independent accountants;
- reviewing our independent accountants' reports regarding our accounting policies and systems of internal controls;
- reviewing compliance with legal and regulatory requirements; and
- ensuring the integrity of our financial statements.

Our audit committee presently consists of Messrs. Conley and French. Following this offering, we expect that our audit committee will consist of Messrs. Conley and French and one additional independent director, with Mr. Conley serving as Chairman of the Committee. Each member of the audit committee is able to read and understand fundamental financial statements, including our balance sheet, income statement and cash flow statements. Our board of directors has determined that Mr. Conley is an audit committee financial expert as currently defined under the rules of the SEC. We believe that the composition of our audit committee meets the criteria for independence under, and the functioning of our audit committee complies with the requirements of, the Sarbanes Oxley Act of 2002, the rules of the Nasdaq Stock Market and SEC rules and regulations. Our board of directors has approved and adopted a written charter for the audit committee.

Compensation Committee. The compensation committee performs the following functions, among others, as set forth in its committee charter:

- determining our general compensation policies and the compensation of our directors and officers;
- reviewing and approving bonuses for our officers and other employees;
- reviewing and determining equity based compensation for our directors, officers, employees and consultants;
- administering our stock option plans and employee stock purchase plans;
- reviewing corporate goals and objectives relative to executive compensation; and
- evaluating our chief executive officer's performance and setting our chief executive officer's compensation.

The compensation committee historically has established our chief executive officer compensation. Our compensation committee presently consists of Messrs. Conley and French. Following this offering, we expect that our compensation committee will be comprised of Messrs. Conley and French and one additional independent director, with Mr. French serving as Chairman of the Committee. Each member is and will be an outside director as currently defined in Section 162(m) of the Internal Revenue Code of 1986 and a non-employee director within the current meaning of Rule 16b-3 as promulgated under the Securities Exchange Act of 1934. We believe that the composition of our compensation committee meets the criteria for independence under, and the functioning of our compensation committee complies with the applicable requirements of, the Nasdaq Stock Market.

Nominating and Corporate Governance Committee. The nominating and corporate governance committee performs the following functions, among others, as set forth in its committee charter:

- evaluating and recommending to the full board of directors candidates for directorship and the size and composition of the board;

- recommending members of the board of directors to serve on the various committees of the board of directors;
- overseeing our corporate governance guidelines;
- developing plans for chief executive officer succession; and
- reporting and making recommendations to the board concerning corporate governance matters and recommending a code of conduct for our directors, officers and employees.

Our nominating and corporate governance committee consists of Messrs. Brown, Conley and French, with Mr. Brown serving as Chairman of the Committee. We believe that the composition of our nominating and corporate governance committee meets the criteria for independence under the rules of the Nasdaq Stock Market and SEC rules and regulations.

Compensation Committee Interlocks and Insider Participation

None of the members of our compensation committee is presently nor at any time has been one of our executive officers or employees. Mr. Conley served as our Secretary from July 2002 until June 2006 but he was not compensated for such service, other than as a member of our board of directors. No interlocking relationship exists, or has existed in the past, between our board or compensation committee and the board or compensation committee of any company other than with a wholly owned subsidiary.

Director Compensation

We have agreements with each of our directors, including our employee directors, which provide for the grant of stock options as compensation for service on our board of directors. Pursuant to our agreements with each of Messrs. Alimi, Akao, Conley and French, we granted to each of these directors an option to purchase 19,570 shares of our common stock, which represented 0.5% of the then outstanding shares of our common stock, and granted Mr. Schutz an option to purchase 6,250 shares of our common stock, each with an exercise price of $3.00 per share. We granted an option to purchase 50,000 shares of our common stock to Mr. Brown pursuant to his agreement with an exercise price of $10.16 per share. All unvested shares underlying the options mentioned above will vest in full upon completion of this offering. We also granted Messrs. Alimi and Schutz options to purchase 12,500 shares and 6,250 shares, respectively, of our common stock with an exercise price of $10.16 per share. The director options granted to Messrs. Alimi and Schutz vest as to 20% of the shares on each of the first five anniversaries of the grant date. In addition, we reimburse our non-employee directors for reasonable out-of-pocket expenses incurred on our behalf. Mr. Brown's option vests as to 20% of the shares on the first anniversary of the grant date and as to $^1/_{60}$ each month thereafter until fully vested. We also granted an option to purchase 75,000 shares of our common stock to Mr. Burlingame, with an exercise price of $13.00 per share, which was fully vested upon grant.

Executive Compensation

The following table summarizes all compensation paid to our chief executive officer and to our four other most highly compensated executive officers whose total annual salary and bonus exceeded $100,000 for all services rendered in all capacities to us during the fiscal year ended March 31, 2006. We refer to these individuals as our named executive officers. The compensation described in this table does not include medical, group life insurance or other benefits which are generally available to all of our salaried employees.

Summary Compensation Table

	Annual Compensation		Long-Term Compensation	
Name and Position(s)	**Salary ($)**	**Bonus ($)**	**Shares Underlying Options (#)**	**All Other Compensation ($)**
Hojabr Alimi President and Chief Executive Officer	$262,885	$ 26,250	12,500	$ 4,517(1)
Robert Miller Chief Financial Officer	183,038	1,250	6,250	—
James Schutz Vice President of Corporate Development, General Counsel and Corporate Secretary	185,961	1,250	6,250	6,246(2)
Theresa Mitchell Vice President of Regulatory, Clinical Affairs, Quality Assurance and Research and Development	170,077	6,250	100,624	—
Bruce Thornton Vice President of International Operations and Sales	171,851	1,250	90,624	5,042(3)

(1) Consists of $350 for IRA contributions and $4,167 for life insurance premiums.

(2) Consists of $5,486 for IRA contributions and $760 for life insurance premiums.

(3) Consists of IRA contributions.

(4) Resignation tendered effective January 2, 2007, at which time it is anticipated that Ms. Mitchell will transition to a consulting role with us on terms which are not yet determined.

Options/SAR Grants Table

The following table set forth certain information for the year ended March 31, 2006 with respect to stock options granted to our named executive officers. The percentage of total options granted is based on an aggregate of 629,498 options granted to employees in the year ended March 31, 2006.

	Individual Grants				Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term(4)	
Name	Number of Shares Underlying Options Granted(1)	% of Total Options Granted to Employees in 2006	Exercise Price Per Share(2)	Expiration Date(3)	5% ($)	10% ($)
Hojabr Alimi	12,500	2.0%	$ 10.16	10/1/2015	$131,437	$ 275,236
Robert Miller	6,250	1.0	10.16	10/1/2015	65,719	137,618
James Schutz	6,250	1.0	10.16	10/1/2015	65,719	137,618
Theresa Mitchell	50,000	7.9	4.40	4/1/2015	788,768	1,313,867
	50,624	8.0	10.16	10/1/2015	532,310	1,114,683
Bruce Thornton	20,000	3.2	4.40	5/6/2015	317,399	531,180
	70,624	11.2	10.16	10/1/2015	742,609	1,555,061

(1) The options become exercisable as to 20% of the shares on each of the first five anniversaries of the grant date.

(2) The exercise price is the fair market value of our common stock on the date of grant, as determined by our board of directors.

(3) The options have a term of ten years, subject to earlier termination upon the occurrence of certain events related to termination of service or employment. Vesting of the options is subject to acceleration under certain circumstances described under “Director Compensation” and “Employment, Severance and Change of Control Arrangements.”

(4) The 5% and 10% assumed rates of appreciation are required by the rules of the SEC and do not represent our estimate or projection of the future common stock price. There can be no assurance that any of the values reflected in the table will be achieved.

Aggregated Option/SAR Exercises in Last Fiscal Year and Fiscal Year-End Option/SAR Values

The following table shows information concerning the number and value of unexercised options held by each of the named executive officers at March 31, 2006. There was no public trading market for our common stock as of March 31, 2006. Accordingly, as permitted by the rules of the Commission, we have calculated the value of unexercised in-the-money options at fiscal year-end assuming that the fair market value of our common stock as of March 31, 2006 was equal to the initial public offering price of $13.00, which is the midpoint of the range set forth on the cover of the prospectus, less the aggregate exercise price.

Name	Shares Acquired on Exercise	Value Realized	Number of Securities Underlying Unexercised Options at Fiscal Year-End (#)		Value of Unexercised In-the-Money Options/SARs at Fiscal Year-End ($)	
			Exercisable	Unexercisable	Exercisable	Unexercisable
Hojabr Alimi	—	—	414,828	27,242	$ 5,287,230	$ 182,920
Robert Miller	60,000	—	73,814	6,250	738,140	17,750
James Schutz	—	—	48,750	101,250	487,500	967,750
Theresa Mitchell	—	—	10,000	90,624	86,000	487,772
Bruce Thornton	—	—	4,000	96,624	40,000	432,572

Employment, Severance and Change of Control Arrangements

We have entered into employment agreements with each of Hojabr Alimi, Michael Wokasch, Robert Miller, James Schutz, Theresa Mitchell and Bruce Thornton. In the event Mr. Alimi, Mr. Wokasch, Mr. Miller or Mr. Schutz is terminated without cause or resigns for good reason, upon satisfaction of certain requirements, including executing a general release of claims against us, the officer is entitled to accrued but unpaid salary (including vacation pay), reimbursement of any outstanding business expenses, a lump severance payment equal to 12 times in the case of Mr. Wokasch, 18 times in the case of Mr. Miller and Mr. Schutz, or 24 times in the case of Mr. Alimi, the average monthly base salary paid to the officer over the preceding 12 months (or for the term of the officer's employment if less than 12 months), automatic vesting of all unvested options and other equity awards, the extension of exercisability of all options and other equity awards to at least 12 months following the date the officer terminates employment or, if earlier, until the option expires, up to one year reimbursement for health care premiums and a full gross up of any excise taxes payable by the officer under Section 4999 of the Internal Revenue Code because of the foregoing payments and acceleration (including the reimbursement of any additional federal, state and local taxes payable as a result of the gross up). If any officer terminates his or her employment for any reason, he or she must give us at least 30 days', or in the case of Mr. Alimi, at least 60 days' prior written notice.

Hojabr Alimi. Our agreement with Mr. Alimi, dated January 1, 2004, provides for an annual salary of $225,000, which amount may be increased by our board of directors. Separately, we granted Mr. Alimi an option to purchase 19,570 shares of our common stock for service as a director at an exercise price of $3.00 per share, which vests at a rate of 20% per year from the date of grant with accelerated vesting in full upon completion of this offering.

Michael Wokasch. Our agreement with Mr. Wokasch, dated June 10, 2006, provides for an annual salary of $200,000. In connection with Mr. Wokasch's agreement, we granted him an option to purchase 125,000 shares of our common stock on July 27, 2006, at an exercise price of $12.00 per share, which will vest over five years from the date of grant. We will also grant Mr. Wokasch an annual bonus of $100,000 upon meeting certain milestones. Separate from this agreement, we paid Mr. Wokasch a one-time signing bonus of $25,000.

Robert Miller. Our agreement with Mr. Miller, dated June 1, 2004, provides for an annual salary of $165,000. In connection with this agreement, we granted Mr. Miller an option to purchase 94,633 shares of our common stock, which vested immediately based on Mr. Miller's prior consultant work for us, and an option to purchase an additional 39,181 shares of our common stock, which vests based on Mr. Miller's hours

of service. Upon completion of this offering, we will grant Mr. Miller an additional fully-vested option to purchase 60,000 shares of our common stock. All of these options have, or will have, an exercise price of $3.00 per share.

James Schutz. Our agreement with Mr. Schutz, dated January 1, 2004, provides for an annual salary of $165,000, which amount may be increased by our board of directors, and an option to purchase 37,500 shares of our common stock at an exercise price of $3.00 per share, which vests in five equal annual installments from the date of grant. Separately, we granted Mr. Schutz an option to purchase 6,250 shares of our common stock for service as a director, at an exercise price of $3.00 per share, which vests at a rate of 20% per year from the date of grant with accelerated vesting in full upon completion of this offering.

Theresa Mitchell. Our agreement with Ms. Mitchell, dated March 23, 2005, provides for a salary of $165,000, which amount may be increased by our board of directors. In connection with Ms. Mitchell's agreement, we also granted her an option to purchase 50,000 shares of our common stock, at an exercise price of $4.40 per share, which vests in five equal annual installments from the date of grant. We must provide her with 12 months' notice if she is terminated without cause. During this 12-month period, we may provide Ms. Mitchell with continued salary payments as severance. In the event of a change of control of Oculus, if Ms. Mitchell is terminated, she is entitled to a lump sum severance payment equal to 12 months of her then base salary and all unvested options and other equity awards will immediately vest in full and remain exercisable for at least 12 months following her termination or, if earlier, the date the option or other equity award expires. Ms. Mitchell's agreement also provides her a full gross up of any excise taxes payable by Ms. Mitchell under Section 4999 of the Internal Revenue Code because of the foregoing payments and acceleration (including the reimbursement of any additional federal, state and local taxes payable as a result of the gross up). Ms. Mitchell has tendered her resignation effective January 2, 2007, at which time we anticipate she will assume a consulting role with us on terms not yet determined.

Bruce Thornton. Our agreement with Mr. Thornton, entered in June 2005, provides an annual salary of $160,000, which amount may be increased by our board of directors. In connection with his agreement, we also granted him an option to purchase 20,000 shares of our common stock, at an exercise price of $4.40 per share, which vests ratably over five years from the date of grant. We must provide him with six months' notice if he is terminated without cause. During this six-month period, we may provide Mr. Thornton with continued salary payments as severance. In the event of a change of control of Oculus, if Mr. Thornton is terminated, he is entitled to a lump sum severance payment equal to 12 months of his then base salary, and all unvested options and other equity awards will immediately vest in full and remain exercisable for at least 12 months following his termination or, if earlier, the date the option or other equity award expires. Mr. Thornton's agreement also provides him a full gross up of any excise taxes payable by Mr. Thornton under Section 4999 of the Internal Revenue Code because of the foregoing payments and acceleration (including the reimbursement of any additional federal, state and local taxes payable as a result of the gross up).

Equity Compensation Plans

1999 Stock Plan

General. Our 1999 stock plan was adopted by our board of directors and approved by our shareholders in May 1999.

Administration. The compensation committee of our board of directors administers the 1999 stock plan. The 1999 stock plan provides for the granting of incentive stock options within the meaning of Section 422 of the Internal Revenue Code of 1986, or Section 422, to employees, officers and employee directors and the granting of nonstatutory stock options and stock purchase rights to employees, officers, directors (including non-employee directors) and consultants. The administrator determines to whom to grant options or stock purchase rights, the number of shares under the options or stock purchase rights, the exercise or purchase price, the fair market value of our common stock, the term of options, which is prohibited from exceeding 10 years (five years in the case of an incentive stock option granted to a shareholder holding more than 10% of the voting shares of our company, or 10% holders) and other terms and conditions. Under our 1999 stock plan, incentive stock options must be granted with an exercise price of at least 100% of the fair market value of our common stock on the date of grant, and

nonstatutory options must be granted with an exercise price of at least 85% of the fair market value of our common stock on the date of grant. Incentive stock options and nonstatutory stock options granted to 10% holders must have an exercise price of at least 110% of the fair market value of our common stock on the date of grant. To the extent an optionee would have the right in any calendar year to exercise for the first time one or more incentive stock options for shares having an aggregate fair market value in excess of $100,000, any such excess options would be treated as nonstatutory stock options.

Authorized Shares. Under our 1999 Plan, we reserved 1,151,250 shares of our common stock for issuance. As of September 30, 2006, 473,650 shares of common stock remained available for future issuance under our 1999 stock plan. As of September 30, 2006, options to purchase a total of 418,500 shares of common stock were outstanding under the 1999 stock plan at a weighted average exercise price of $0.44 per share. In June 2006, our board determined that no additional grants would be made under our 1999 stock plan.

Plan Features. Options granted under the 1999 stock plan generally vest at the rate of 20% of the total number of shares subject to the options on each anniversary of the vesting commencement date. No option may be transferred by the optionee other than by will or the laws of descent or distribution. Each option may be exercised during the lifetime of the optionee only by such optionee. Generally, options granted under the 1999 stock plan remain exercisable for 12 months following the termination of service of an optionee by reason of death or disability and remain exercisable for 3 months upon a termination of service for any other reason. The 1999 stock plan provides that in the event of a recapitalization, stock split or similar capital transaction, we will make appropriate adjustments in order to preserve the benefits of options outstanding under the plan. If we are involved in a merger or consolidation, options granted under the 1999 stock plan will fully vest immediately prior to the effective date of such transaction, unless the surviving or acquiring company assumes or substitutes an equivalent option or right for them.

2000 Stock Plan

General. Our 2000 stock plan was adopted by our board of directors in March 2000 and was subsequently approved by our shareholders in June 2000.

Administration. The compensation committee of our board of directors administers the 2000 stock plan. The 2000 stock plan provides for the granting of incentive stock options within the meaning of Section 422 to employees, officers and employee directors and the granting of nonstatutory stock options and stock purchase rights to employees, officers, directors (including non-employee directors) and consultants. The administrator determines to whom to grant options or stock purchase rights, the number of shares under the options or stock purchase rights, the exercise or purchase price, the fair market value of our common stock, the term of options, which is prohibited from exceeding 10 years (five years in the case of an incentive stock option granted to 10% holders) and other terms and conditions. Under our 2000 stock plan, incentive stock options must be granted with an exercise price of at least 100% of the fair market value of our common stock on the date of grant, and nonstatutory options must be granted with an exercise price of at least 85% of the fair market value of our common stock on the date of grant. Incentive stock options and nonstatutory stock options granted to 10% holders must have an exercise price of at least 110% of the fair market value of our common stock on the date of grant. To the extent an optionee would have the right in any calendar year to exercise for the first time one or more incentive stock options for shares having an aggregate fair market value in excess of $100,000, any such excess options would be treated as nonstatutory stock options.

Authorized Shares. Under our 2000 stock plan, we reserved 348,750 shares of our common stock for issuance. As of September 30, 2006, 305,950 shares of common stock remained available for future issuance under our 2000 stock plan. As of September 30, 2006, options to purchase a total of 39,500 shares of common stock were outstanding under the 2000 stock plan at a weighted average exercise price of $2.50 per share. In June 2006, our board determined that no additional grants would be made under our 2000 stock plan.

Plan Features. Options granted under the 2000 stock plan generally vest at the rate of 20% of the total number of shares subject to the options on each anniversary of the vesting commencement date. No option may be transferred by the optionee other than by will or the laws of descent or distribution. Each option may be exercised during the lifetime of the optionee only by such optionee. Generally, options granted under the

2000 stock plan remain exercisable for 12 months following the termination of service of an optionee by reason of death or disability and remain exercisable for 3 months upon a termination of service for any other reason. The 2000 stock plan provides that in the event of a recapitalization, stock split or similar capital transaction, we will make appropriate adjustments in order to preserve the benefits of options outstanding under the plan. If we are involved in a merger or consolidation, options granted under the 2000 stock plan will fully vest immediately prior to the effective date of such transaction, unless the surviving or acquiring company assumes or substitutes an equivalent option or right for them.

2003 Stock Plan

General. Our 2003 stock plan was adopted by our board of directors and approved by our shareholders in July 2003.

Administration. The compensation committee of our board of directors administers the 2003 stock plan. The 2003 stock plan provides for the granting of incentive stock options within the meaning of Section 422 to employees, officers and employee directors and the granting of nonstatutory stock options and stock purchase rights to employees, officers, directors (including non-employee directors) and consultants. The administrator determines to whom to grant options or stock purchase rights, the number of shares under the options or stock purchase rights, the exercise or purchase price, the fair market value of our common stock, the term of options, which is prohibited from exceeding 10 years (five years in the case of an incentive stock option granted to 10% holders) and other terms and conditions. Under our 2003 stock plan, incentive stock options must be granted with an exercise price of at least 100% of the fair market value of our common stock on the date of grant, and nonstatutory options must be granted with an exercise price of at least 85% of the fair market value of our common stock on the date of grant. Incentive stock options and nonstatutory stock options granted to 10% holders must have an exercise price of at least 110% of the fair market value of our common stock on the date of grant. To the extent an optionee would have the right in any calendar year to exercise for the first time one or more incentive stock options for shares having an aggregate fair market value in excess of $100,000, any such excess options would be treated as nonstatutory stock options.

Authorized Shares. Under our 2003 stock plan, we have reserved 1,000,000 shares of our common stock for issuance. As of September 30, 2006, 656,720 shares of common stock remained available for future issuance under our 2003 stock plan. As of September 30, 2006, options to purchase a total of 321,452 shares of common stock were outstanding under the 2003 stock plan at a weighted average exercise price of $3.00 per share. In June 2006, our board determined that no additional grants would be made under our 2003 stock plan.

Plan Features. Options granted under the 2003 stock plan generally vest at the rate of 20% of the total number of shares subject to the options on each anniversary of the vesting commencement date. No option may be transferred by the optionee other than by will or the laws of descent or distribution. Each option may be exercised during the lifetime of the optionee only by such optionee. Generally, options granted under the 2003 stock plan remain exercisable for 12 months following the termination of service of an optionee by reason of death or disability and remain exercisable for 3 months upon a termination of service for any other reason. The 2003 stock plan provides that in the event of a recapitalization, stock split or similar capital transaction, we will make appropriate adjustments in order to preserve the benefits of options outstanding under the plan. If we are involved in a merger or consolidation, options granted under the 2003 stock plan will fully vest immediately prior to the effective date of such transaction, unless the surviving or acquiring company assumes or substitutes an equivalent option or right for them.

2004 Stock Plan

General. Our 2004 stock plan was adopted by our board of directors and approved by our shareholders in July 2004.

Administration. The compensation committee of our board of directors administers the 2004 stock plan. The 2004 stock plan provides for the granting of incentive stock options within the meaning of Section 422 to employees, officers and employee directors and the granting of nonstatutory stock options to employees, officers, directors (including non-employee directors) and consultants. The administrator determines to whom

to grant options, the number of shares under the options, the fair market value of our common stock, the term of options, which is prohibited from exceeding 10 years (five years in the case of an incentive stock option granted to 10% holders) and other terms and conditions. Under our 2004 stock plan, incentive stock options must be granted with an exercise price of at least 100% of the fair market value of our common stock on the date of grant, and nonstatutory options must be granted with an exercise price of at least 85% of the fair market value of our common stock on the date of grant. Incentive stock options and nonstatutory stock options granted to 10% holders must have an exercise price of at least 110% of the fair market value of our common stock on the date of grant. No incentive stock option can be granted to an employee if as a result of the grant, the employee would have the right in any calendar year to exercise for the first time one or more incentive stock options for shares having an aggregate fair market value in excess of $100,000.

Authorized Shares. Under our 2004 stock plan, we reserved 1,500,000 shares of our common stock for issuance. As of September 30, 2006, 394,189 shares of common stock remained available for future issuance under our 2004 stock plan. As of September 30, 2006, options to purchase a total of 1,045,811 shares of common stock were outstanding under the 2004 stock plan at a weighted average exercise price of $8.54 per share. Our board determined that no additional grants under the 2004 stock plan will be made following the completion of this offering.

Plan Features. Options granted under the 2004 stock plan generally vest at the rate of 20% of the total number of shares subject to the options on each anniversary of the vesting commencement date. No option may be transferred by the optionee other than by will or the laws of descent or distribution. Each option may be exercised during the lifetime of the optionee only by such optionee. Generally, options granted under the 2004 stock plan remain exercisable for 6 months following the termination of service of an optionee by reason of death or disability and remain exercisable for between 30 days and 3 months upon a termination of service for any other reason. The exercise period for nonstatutory stock options may be extended for 6 months. An optionee must execute a shareholders agreement with us prior to the receipt of shares pursuant to the exercise of options granted under our 2004 stock plan. The 2004 stock plan provides that in the event of a recapitalization, stock split or similar capital transaction, we will make appropriate adjustments in order to preserve the benefits of options outstanding under the plan. If we are involved in a merger or consolidation, options granted under the 2004 stock plan will fully vest immediately prior to the effective date of such transaction, unless the surviving or acquiring company assumes or substitutes an equivalent option for them.

2006 Stock Incentive Plan

General. Our 2006 stock incentive plan was adopted by our board of directors in August 2006, subject to stockholder approval, and will become effective upon the completion of this offering.

The 2006 stock plan provides for the granting of incentive stock options within the meaning of Section 422 to employees and the granting of nonstatutory stock options to employees, non-employee directors, advisors, and consultants. The 2006 stock incentive plan also provides for grants of restricted stock, stock appreciation rights and stock units awards to employees, non-employee directors, advisors and consultants.

- *Stock Options.* The compensation committee, a plan administrator, determines to whom to grant awards, the number of shares under the awards, the fair market value of our common stock, the term of options, which is prohibited from exceeding 10 years (five years in the case of an incentive stock option granted to 10% holders) and other terms and conditions. Under our 2006 stock plan, incentive stock options must be granted with an exercise price of at least 100% of the fair market value of our common stock on the date of grant, and nonstatutory options must be granted with an exercise price of at least 85% of the fair market value of our common stock on the date of grant. Incentive stock options and nonstatutory stock options granted 10% holders must have an exercise price of at least 110% of the fair market value of our common stock on the date of grant. No incentive stock option can be granted to an employee if as a result of the grant, the employee would have the right in any calendar year to exercise for the first time one or more incentive stock options for shares having an aggregate fair market value in excess of $100,000. The exercise price for the shares of common stock subject to option grants made under our 2006 stock plan may be paid in cash or in shares of our common stock held by the optionee. The option may be exercised through a same-day sale program without any cash outlay by the optionee. In addition, the administrator may provide

financial assistance to an optionee, provided such optionee is not an executive officer or board member, in the exercise of the optionee's outstanding options by allowing such individual to deliver a full-recourse, interest-bearing promissory note in payment of the exercise price and any associated withholding taxes incurred in connection with such exercise.

- *Restricted Stock.* Participants who are granted restricted stock awards generally have all of the rights of a stockholder with respect to such stock. Restricted stock may generally be subject to a repurchase right by us in the event the recipient ceases to be employed. Restricted stock may be issued for consideration determined by the compensation committee, including cash, promissory notes and past or future services. Restricted stock may be subject to vesting over time or upon achievement of milestones.
- *Stock Units.* Stock units are denominated in unit equivalent of shares of our common stock. They are typically awarded to participants without payment of consideration, but are subject to vesting conditions based upon a vesting schedule or performance criteria established by the plan administrator. Unlike restricted stock, the stock underlying stock units will not be issued until the stock units have vested, and recipients of stock units generally will have no voting or dividend rights prior to the time the vesting conditions are satisfied.
- *Stock Appreciation Rights.* Stock appreciation rights may be granted independently or in consideration of a reduction in the recipient's compensation. Stock appreciation rights typically will provide for payments to the holder based upon increases in the price of our common stock over the exercise price of the related option. The exercise price of a stock appreciation right will be determined by the committee and may vary in accordance with a predetermined formula while the stock appreciation right is outstanding. The plan administrator may elect to pay stock appreciation rights in cash or in common stock or in a combination of cash and common stock.

Administration. The compensation committee of our board of directors will administer the 2006 stock plan. Our board of directors may appoint one or more separate committees of our board of directors, each consisting of one or more members of our board of directors, to administer our 2006 stock plan with respect to participants other than employees who are subject to Section 16 of the Exchange Act. Our board of directors may also authorize one or more officers to designate employees, other than employees who are subject to Section 16 of the Exchange Act, to receive awards under our 2006 stock plan and/or to determine the number of such awards to be received by such employees subject to limits specified by our board of directors.

Authorized Shares. Under our 2006 stock plan, 1,250,000 shares of our common stock have been authorized for issuance. Shares subject to awards that expire unexercised or are forfeited or terminated will again become available for issuance under the 2006 stock plan. No participant in the 2006 stock plan can receive option grants, restricted shares, stock appreciation rights or stock units for more than 750,000 shares in the aggregate in any calendar year.

Plan Features. Under the 2006 stock plan:

- Generally, if we merge with or into another corporation, we may accelerate the vesting or exercisability of outstanding options and terminate any unexercised options unless they are assumed or substituted for by any surviving entity or a parent or subsidiary of the surviving entity.
- The administrator may permit or require a participant to have cash otherwise payable to a participant on exercise of a stock appreciation right or settlement of stock units credited to a deferred compensation account, have shares that would otherwise be deliverable to a participant on exercise of an option or stock appreciation right converted into an equal number of stock units or have shares otherwise deliverable upon exercise of an option or stock appreciation right or settlement of stock units converted into amounts credited to a deferred compensation account.
- Awards under our 2006 stock plan may provide that the number of shares of our common stock or other benefits granted, issued, retained or vested under the award are subject to the attainment of performance criteria including cash flow, earnings per share, earnings before interest, taxes and amortization, return on equity, total stockholder return, share price performance, return on capital, return on assets or net assets, revenue, income or net income, operating income or net operating income, operating profit or net operating profit, operating margin or profit shares. The administrator

may structure such awards to be qualified performance-based compensation under Section 162(m) of the Code.

- The 2006 stock plan terminates ten years after its initial adoption, unless terminated earlier by the board. The board of directors may amend or terminate the plan at any time, subject to stockholder approval where required by applicable law. Any amendment or termination may not impair the rights of holders of outstanding awards without their consent.

SIMPLE IRA Plan

We sponsor a SIMPLE IRA plan under which employees may choose to make salary reduction contributions, and we make matching contributions up to 3% of the employee's compensation for the year. All contributions are made directly to an individual retirement account established for each employee.

Indemnification Agreements

We intend to enter into agreements to indemnify our directors and executive officers following our reincorporation in Delaware. We believe that these agreements are necessary to attract and retain qualified persons as directors and executive officers. Our certificate of incorporation and our bylaws contain provisions that limit the liability of our directors and executive officers to the fullest extent permitted by Delaware law. A description of these provisions is contained under the heading "Description of Common Stock — Limitation of Liability and Indemnification Matters."

We have an insurance policy covering our directors and officers with respect to specified liabilities, including liabilities arising under the Securities Act, or otherwise. Insofar as indemnification for liabilities arising under the Securities Act may be permitted to cover directors, officers and persons controlling us pursuant to the foregoing provisions, we have been informed that in the opinion of the SEC, this indemnification is against public policy as expressed in the Securities Act and is therefore unenforceable.

Advisory Boards

We have two advisory boards: Medical and Business Advisory Board and Clinical Investigational Board. We rely extensively on our physician advisors to advise on marketing and research and development efforts and provide information and data on the clinical use of our products. At least once per year we meet with each advisory board and each member is available to us as needed.

Our Medical and Business Advisory Board assists us in the following:

- prioritizing medical markets in terms of where our product can be the most effective, the speed with which they can be introduced and the scope of the problem in the market;
- prioritizing physician clinical studies;
- identifying clinical studies to be pursued;
- providing introductions to wound care specialists in the United States and Europe;
- advising regarding the success of our products in various market segments;
- reviewing and commenting on the specific protocols being considered;
- providing guidance on how best to educate and encourage the medical community to adopt our product as the standard of care in wound management;
- providing input to potential collaborators on the application and effectiveness of our products; and
- participating in physician clinical studies and presenting the results to other physicians.

Our Medical and Business Advisory Board is currently comprised of the following individuals:

Name	Specialty	Position
Don C. Wukasch, M.D.	Cardiovascular Surgery	Fellow, American College of Surgeons and American College of Cardiology
Barnett L. Cline, M.D. M.P.H., Ph.D.	Tropical Medicine	Tulane University Professor of Tropical Medicine, Emeritus; member, Armed Forces Epidemiological Board
Paul L. Schnur, M.D.	Plastic and Reconstructive Surgery	Consultant, Plastic Surgery Division, Mayo Clinic Scottsdale; Associate Professor, University of Arizona, College of Medicine
Bruce C. Wilson, M.D., F.A.C.C.	Cardiology	Fellow, American College of Cardiology; Chairman, Heart Hospital of Milwaukee; Assistant Professor of Medicine, Medical College of Wisconsin
Gerald L. Woolam, M.D.	General Surgery	Professor of Surgery, Texas Tech University
Philip J. Kearney	Legal	Assistant United States Attorney
David E. Allie, M.D.	Cardiothoracic and Endovascular Surgery	Chief of Cardiothoracic and Endovascular Surgery, Cardiovascular Institute of the South Lafayette; Director, Vascular Surgery and Noninvasive Vascular Labs Houma
Luca Dalla Paola, M.D.	Endocrinologist and Surgery	Chief of the Diabetic Foot Unit of Presidio Ospedaliero Abano Terme Hospital; Professor, Bologna University School of Medicine

Our Clinical Investigational Board assists us by introducing us to practicing physicians and key opinion leaders in our target markets and reviewing physician clinical studies. The Clinical Investigational Board is currently comprised of the following individuals:

Name	Specialty	Position
Gerald Keusch, M.D.	Infectious Disease	Associate Dean of Global Health, Professor of Medicine, Boston University
Richard Marks, M.D.	Foot and Ankle Surgery	Associate Professor of Orthopedic Surgery, Medical College of Wisconsin
Akito Ohmura, M.D., Ph.D.	Anesthesiology	Head of Medical ISO Committee Japan; Dean, Teikyo University School of Medicine

All of our physician advisors serve one or five-year terms. All of our physician advisors are employed by employers other than us and may have commitments or consulting arrangements with other companies, including our competitors, that may limit their availability to consult for us. Although these advisors may contribute significantly to our affairs, we generally do not expect them to devote more than a small portion of their time to us.

Advisory Board Compensation

In consideration of the services provided, we pay each of the members on the Medical and Business Advisory Board a quarterly stipend, except for Dr. Allie and Mr. Kearney. Drs. Cline, Schnur, Woolam, Dalla Paola and Wilson each receive $3,000 per quarter and Dr. Wukasch receives $6,000 per quarter. We also have a consulting agreement with Dr. Wilson and pay him an additional $12,000 per quarter pursuant to this agreement. Although Dr. Allie does not receive a quarterly stipend, we paid Dr. Allie $10,000 and issued him 12,500 shares of our common stock as payment for our participation in the 2005 New Cardiovascular Horizons Conference, of which Dr. Allie served as conference co-chairman. In addition, we granted each of our

physician advisors, except for Dr. Dalla Paola, warrants to purchase shares of our common stock with a conversion price of $18.00 per share. Dr. Allie has a warrant to purchase 2,500 shares, Drs. Cline, Schnur, Wilson and Woolam each have a warrant to purchase 3,750 shares, and Dr. Wukasch has a warrant to purchase 6,250 shares. We also compensate our Medical Advisory Board members for physician clinical studies they conduct for us.

We do not provide cash compensation to members of our Clinical Investigation Board. However, we granted Drs. Keusch and Marks each a warrant to purchase 2,500 shares with a conversion price of $18.00 per share. We also granted Dr. Ohmura an option to purchase 2,500 shares of our common stock with an exercise price of $3.00 per share. This option will not vest fully until October 2008.

RELATED PARTY TRANSACTIONS

We issued promissory notes to Akihisa Akao, one of our directors, in May 1999, December 1999 and February 2003 in the amount of $15,000 bearing interest at a rate of 8% per annum, $200,000 bearing interest at a rate of 8% per annum, and $40,000 bearing interest at a rate of 10% per annum, respectively. These obligations were repaid in October 2004.

We entered into a consulting agreement with White Moon Medical, a company formed under the laws of Japan, in October 2005, which was renewed for an additional one-year term expiring in October 2007. Mr. Akihisa Akao is the sole stockholder of White Moon Medical. Under the terms of the agreement, White Moon Medical provides us with merger and acquisition strategy and technology support in Asia, particularly in Japan. We have agreed to pay White Moon Medical an annual consulting fee of $146,000, and White Moon Medical is also eligible for additional bonuses. This agreement may be terminated by either party upon 30 days' written notice. Payments to White Moon Medical through September 30, 2006 amounted to $146,000.

We entered into a consulting agreement with Mr. Robert Burlingame, one of our directors, in November 2006. Under the terms of the agreement, Mr. Burlingame provides us with consulting services relating to global planning and implementation of key performance indicators to track progress of company-wide projects. In return for his services, we have issued to Mr. Burlingame a warrant to purchase 75,000 shares of our common stock at an exercise price of $13.00 per share.

We issued a promissory note to Richard Conley, one of our directors, in February 2003 in the amount of $40,000 bearing interest at a rate of 10% per annum. This note was convertible at any time by Mr. Conley into 10,000 shares of either our common stock or Series A preferred stock. On June 30, 2005, Mr. Conley converted this note into an aggregate of 10,000 shares of our Series A preferred stock at a conversion price of $4.00 per share.

We issued a promissory note to Mr. Burlingame, one of our directors, in November 2006 in the amount of $4.0 million, bearing interest at a rate of 7% per annum. This obligation matures on the earlier of November 10, 2007 or five days after the consummation of our initial public offering resulting in gross proceeds to us of at least $30.0 million. The loan is secured by all of our assets, other than our intellectual property, but is subordinate to the security interest held by our secured lender.

In accordance with the terms of the underlying option agreements, the vesting of options to purchase 85,062 shares of our common stock granted to our directors will be accelerated upon completion of this offering. Please see "Management — Director Compensation" for information on options granted to our directors.

In connection with the termination of Robert Miller's prior consulting agreement, we have agreed to grant him a fully-vested option to purchase 60,000 shares of our common stock at $3.00 per share upon completion of this offering. Assuming an initial public offering price of $13.00, we would recognize approximately $600,000 of stock-based compensation expense related to this option grant.

Brookstreet also acted as managing dealer in the sale of our Series A convertible preferred stock and our Series B convertible preferred stock. In connection with the Series A convertible preferred stock offering, we paid Brookstreet $1,123,746 in commissions and issued Brookstreet and its affiliates warrants to purchase an aggregate of 433,774 shares of our common stock, at an exercise price of $3.00 per share. In connection with the Series B convertible preferred stock offering, we paid Brookstreet $3,413,818 in commissions and issued Brookstreet and its affiliates warrants to purchase an aggregate of 329,471 shares of our common stock at an exercise price of $18.00 per share.

We entered into a managing dealer agreement, as amended, with Brookstreet, a holder of more than 5% of our voting securities in May 2006, pursuant to which Brookstreet acted as managing dealer, on a best-efforts basis, for the sale of units of our securities. Each unit consisted of one share of our Series C convertible preferred stock, and a warrant to purchase that number of shares of our common stock equal to one-fifth of the number of Series C shares underlying the unit, at an exercise price of $18.00 per share. In connection with

the Series C Financing, we paid to Brookstreet $347,444 in commissions and issued to Brookstreet fully vested warrants to purchase an aggregate of 24,127 shares of our common stock, at an exercise price of $18.00 per share. In addition, we paid Brookstreet $10,000 upon the execution of a term sheet regarding the terms of this offering, and an additional $10,000 on May 31, 2006, to defray the costs associated with the solicitation of stockholder approval.

Brookstreet also acted as a finder in connection with the Bridge Loan, which we entered into in November 2006. At the time the principal was advanced to us in November 2006, Brookstreet was paid a fee in the amount of $50,000 and was granted a warrant to purchase 25,000 shares of our common stock at an exercise price of $18.00 per share.

Please see "Management — Executive Compensation" for additional information on compensation of our executive officers and "Management — Employment, Severance and Change of Control Arrangements" for additional information regarding employment arrangements with our executive officers.

Our certificate of incorporation provides that we will indemnify our directors and officers to the fullest extent permitted by Delaware law. In addition, we intend to enter into indemnification agreements with our directors and executive officers following our reincorporation in Delaware. Please see "Description of Common Stock — Limitations of Liability and Indemnification Matters" for further details.

PRINCIPAL STOCKHOLDERS

The following table sets forth information as of November 30, 2006 regarding the number of shares and the percentage of common stock beneficially owned before and after the completion of this offering by:

- each of our directors and named executive officers listed above in the summary compensation table; and
- all of our directors and executive officers as a group.

We are not aware of any owners of more than 5% of our common stock other than Messrs. Alimi and Akao and Brookstreet Securities Corporation. We have determined beneficial ownership in accordance with the rules of the SEC. Except as indicated by the footnotes below, we believe, based on the information furnished to us, that the persons and entities named in the table below have sole voting and investment power with respect to all shares of common stock that they beneficially own, subject to applicable community property laws.

For purposes of the table below, we have 8,399,209 shares of common stock issued and outstanding prior to the completion of this offering, assuming the conversion of all outstanding shares of preferred stock into 4,176,478 shares of common stock, and 11,476,132 shares of common stock issued and outstanding upon completion of this offering. In computing the number of shares of common stock beneficially owned by a person and the percentage ownership of that person, we deemed outstanding shares of common stock subject to all derivative securities held by that person that are currently exercisable or exercisable within 60 days of November 30, 2006 and shares of common stock subject to options that vest upon completion of this offering. We did not deem these shares outstanding, however, for the purpose of computing the percentage ownership of any other person.

Name of Beneficial Owner(1)	Number of Shares Beneficially Owned	Percentage of Shares Outstanding	
		Before the Offering	After the Offering
5% Stockholders:			
Brookstreet Securities Corporation and related parties(2)	812,372	9.7%	7.1%
Executive Officers and Directors:			
Hojabr Alimi(3)	1,439,445	16.3%	12.1%
Robert Miller(4)	195,376	2.3%	1.7%
James Schutz(5)	82,812	1.0	*
Theresa Mitchell(6)	22,656	*	*
Bruce Thornton(7)	28,322	*	*
Akihisa Akao(8)	541,320	6.4%	4.7%
Robert Burlingame(9)	216,666	2.5%	1.9%
Edward Brown(10)	50,000	*	*
Richard Conley(11)	188,820	2.2%	1.6%
Gregory French(12)	75,382	*	*
All directors and executive officers as a group (10 persons) (13)	2,840,799	29.9%	22.6%

* Represents beneficial ownership of less than 1%.

(1) Unless otherwise noted, the address of each beneficial owner listed in the table is: c/o Oculus Innovative Sciences, Inc., 1129 N. McDowell Boulevard, Petaluma, California 94954.

(2) Principal address is 2361 Campus Drive, Suite 210, Irvine, California 92612. Consists of shares issuable under warrants that are immediately exercisable. Stan Brooks, trustee of the Brooks Family Trust, has voting or investment power for the shares held by Brookstreet Securities Corporation.

(3) Includes 422,867 shares issuable upon exercise of options that are exercisable within 60 days of November 30, 2006 and 7,828 shares issuable upon exercise of options that will become exercisable upon completion of this offering.

(4) Includes 75,376 shares issuable upon exercise of options that are exercisable within 60 days of November 30, 2006, 60,000 shares issuable upon exercise of options to be granted upon completion of this offering and 50,000 shares held by The Miller 2005 Grandchildren's Trust, for which Mr. Miller is a trustee.

(5) Includes 79,062 shares issuable upon exercise of options that are exercisable within 60 days of November 30, 2006 and 3,750 shares issuable upon exercise of options that will become exercisable upon completion of this offering.

(6) Includes 22,656 shares issuable upon exercise of options that are exercisable within 60 days of November 30, 2006.

(7) Includes 28,322 shares issuable upon exercise of options that are exercisable within 60 days of November 30, 2006.

(8) Includes 11,078 shares issuable upon exercise of options that are exercisable within 60 days of November 30, 2006 and 7,828 shares issuable upon exercise of options that will become exercisable upon completion of this offering.

(9) Includes 75,000 shares issuable upon exercise of options that are exercisable within 60 days of November 30, 2006 and 75,000 shares issuable upon exercise of warrants that are exercisable within 60 days of November 30, 2006.

(10) Includes 10,000 shares issuable upon exercise of options that are exercisable within 60 days of November 30, 2006, and 40,000 shares issued upon exercise of options that will become exercisable upon completion of this offering.

(11) Includes 140,992 shares issuable upon exercise of options that are exercisable within 60 days of November 30, 2006 and 7,828 shares issuable upon exercise of options that will become exercisable upon completion of this offering.

(12) Includes 31,890 shares issuable upon exercise of options that are exercisable within 60 days of November 30, 2006 and 7,828 shares issuable upon exercise of options that will become exercisable upon completion of this offering.

(13) Includes 972,243 shares issuable upon exercise of options and warrants that are exercisable within 60 days of November 30, 2006 and 135,062 shares issuable upon exercise of options that will become exercisable upon completion of this offering.

DESCRIPTION OF CAPITAL STOCK

General

The following describes our common stock and preferred stock and certain provisions of our certificate of incorporation and our bylaws as will be in effect upon the completion of this offering and assumes our reincorporation in Delaware. This description is only a summary. You should also refer to the certificate of incorporation and bylaws, which have been filed as exhibits to our registration statement, of which this prospectus forms a part. Upon completion of this offering, our authorized capital stock will consist of 100,000,000 shares of common stock, $0.0001 par value per share, and 5,000,000 shares of preferred stock, $0.0001 par value per share.

Common Stock

As of November 30, 2006, there were 8,399,209 shares of common stock outstanding held by approximately 623 stockholders of record, assuming the automatic conversion of each outstanding share of preferred stock upon the closing of this offering.

Each holder of common stock is entitled to one vote for each share of common stock held on all matters submitted to a vote of stockholders. We have not provided for cumulative voting for the election of directors in our certificate of incorporation. This means that the holders of a majority of the shares voted can elect all of the directors then standing for election. Subject to preferences that may apply to shares of preferred stock outstanding at the time, the holders of outstanding shares of our common stock are entitled to receive dividends out of assets legally available at the times and in the amounts that our board of directors may determine from time to time.

Holders of common stock have no preemptive subscription, redemption or conversion rights or other subscription rights. Upon our liquidation, dissolution or winding-up, the holders of common stock are entitled to share in all assets remaining after payment of all liabilities and the liquidation preferences of any outstanding preferred stock. Each outstanding share of common stock is, and all shares of common stock to be issued in this offering, when they are paid for will be, fully paid and nonassessable.

Preferred Stock

At the closing of this offering, each share of our preferred stock issued and outstanding will convert into one share of our common stock, for an aggregate of 4,176,478 shares of common stock. As a result, upon the closing of this offering, there will be no shares of preferred stock outstanding.

At the closing of this offering, our certificate of incorporation will be amended to delete all reference to the prior series of preferred stock and our board of directors will be authorized, subject to limitations imposed by Delaware law, to issue up to a total of 5,000,000 shares of preferred stock in one or more series, without stockholder approval. Our board is authorized to establish from time to time the number of shares to be included in each series, and to fix the rights, preferences and privileges of the shares of each wholly unissued series and any of its qualifications, limitations or restrictions. Our board can also increase or decrease the number of shares of any series, but not below the number of shares of that series then outstanding, without any further vote or action by the stockholders.

The board may authorize the issuance of preferred stock with voting or conversion rights that could harm the voting power or other rights of the holders of the common stock. The issuance of preferred stock, while providing flexibility in connection with possible acquisitions and other corporate purposes, could, among other things, have the effect of delaying, deferring or preventing a change in control of us and might harm the market price of our common stock and the voting and other rights of the holders of common stock. We have no current plans to issue any shares of preferred stock.

Registration Rights

In accordance with the terms of the Amended and Restated Investors Rights Agreement, or the Investors Rights Agreement, effective as of September 14, 2006, among us and certain stockholders referred to in the Investors Rights Agreement, upon completion of this offering, the holders of 4,176,478 shares of common stock issued upon conversion of the preferred stock will be entitled to contractual rights to require us to register those shares under the Securities Act. If we propose to register any of our securities under the Securities Act for our own account or the account of a security holder, other than on a Form S-8, holders of those shares are entitled to include their shares in our registration, provided, among other conditions, that the underwriters of any such offering have the right to limit the number of shares included in the registration. Six months after the effective date of the registration statement of which this prospectus is a part, and subject to limitations and conditions specified in the investor rights agreement with the holders, holders of a majority of the shares of common stock issued upon conversion of the preferred stock may require us to prepare and file a registration statement under the Securities Act at our expense covering those shares. We are not obligated to effect more than one of these stockholder-initiated registrations.

In accordance with the terms of our Investors Rights Agreement to which we and each of the holders of preferred stock are a party, upon completion of this offering, the holders of 88,200 shares of common stock issued upon conversion of the preferred stock issued pursuant to the exercise of warrants will be entitled to contractual rights to require us to register those shares under the Securities Act. If we propose to register any of our securities under the Securities Act for our own account or the account of a security holder, other than on a Form S-8, on a form in which the common stock issued upon conversion of the preferred stock may be included, holders of those shares are entitled to include their shares in our registration, provided, among other conditions, that the underwriters of any such offering have the right to limit the number of shares included in the registration. Six months after the effective date of the registration statement of which this prospectus is a part, and subject to limitations and conditions specified in the investor rights agreement or managing dealer warrant agreement with the holders, holders of a majority of the shares of common stock issued upon conversion of the preferred stock issued pursuant to the exercise of warrants may require us to prepare and file a registration statement under the Securities Act at our expense covering those shares. We are not obligated to effect more than one of these stockholder-initiated registrations.

In accordance with the terms of the Investors Rights Agreement, upon completion of this offering, the holders of 871,594 shares of common stock issued upon the exercise of warrants will be entitled to contractual rights to require us to register those shares under the Securities Act. If we propose to register any of our securities under the Securities Act for our own account, holders of those shares are entitled to include their shares in our registration, provided, among other conditions, that the underwriters of any such offering have the right to limit the number of shares included in the registration.

Anti-Takeover Effects of Certain Provisions of Delaware Law and Our Certificate of Incorporation and Bylaws

Certain provisions of Delaware law, our certificate of incorporation and our bylaws described below may have the effect of delaying, deferring or discouraging another party from acquiring control of us.

Delaware Law

We will be subject to the provisions of Section 203 of the Delaware General Corporation Law, or Delaware law, regulating corporate takeovers. In general, these provisions prohibit a Delaware corporation from engaging in any business combination with any interested stockholder for a period of three years following the date that the stockholder became an interested stockholder, unless:

- either the business combination or the transaction that resulted in the stockholder becoming an interested stockholder is approved by our board of directors before the date the interested stockholder attained that status;

- upon consummation of the transaction that resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced, excluding for purposes of determining the voting stock outstanding (but not the outstanding voting stock owned by the interested stockholder) those shares owned (i) by persons who are directors and also officers and (ii) employee stock plans in which employee participants do not have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or exchange offer; or
- on or after that date, the business combination is approved by our board of directors and authorized at a meeting of stockholders, and not by written consent, by at least two-thirds of the outstanding voting stock that is not owned by the interested stockholder.

Section 203 defines "business combination" to include the following:

- any merger or consolidation involving the corporation and the interested stockholder;
- any sale, transfer, pledge or other disposition of 10% or more of the assets of the corporation involving the interested stockholder;
- subject to certain exceptions, any transaction that results in the issuance or transfer by the corporation of any stock of the corporation to the interested stockholder:
- any transaction involving the corporation that has the effect of increasing the proportionate share of the stock of any class or series of the corporation beneficially owned by the interested stockholder; or
- the receipt by the interested stockholder of the benefit of any loans, advances, guarantees, pledges or other financial benefits provided by or through the corporation.

In general, Section 203 defines an interested stockholder as any entity or person beneficially owning 15% or more of the outstanding voting stock of the corporation and any entity or person affiliated with or controlling or controlled by any of these entities or persons.

A Delaware corporation may opt out of this provision either with an express provision in its original certificate of incorporation or in an amendment to its certificate of incorporation or bylaws approved by its stockholders. However, we have not opted out of this provision. The statute could prohibit or delay mergers or other takeover or change in control attempts and, accordingly, may discourage attempts to acquire us.

Certificate of Incorporation and Bylaws

Following the completion of this offering, our certificate of incorporation and bylaws will provide that:

- no action can be taken by stockholders except at an annual or special meeting of the stockholders called in accordance with our bylaws, and stockholders may not act by written consent;
- our board of directors will be expressly authorized to make, alter or repeal our bylaws;
- except as otherwise required by law, special meetings of the stockholders may only be called by the Chairman of the Board, the Chief Executive Officer or by majority of the board of directors;
- except as otherwise provided for in the certificate of incorporation with respect to any series of preferred stock, vacancies on the board of directors may only be filled by a majority of the board of directors then in office;
- stockholders will need to comply with advanced notice procedures to make nominations of candidates for election as directors or to bring matters before an annual stockholder meeting;
- our board of directors will be authorized to issue preferred stock without stockholder approval; and
- we will indemnify officers and directors against losses that they may incur in investigations and legal proceedings resulting from their services to us, which may include services in connection with takeover defense measures.

Limitation of Liability and Indemnification Matters

Our certificate of incorporation and bylaws limit the liability of our directors for monetary damages for breach of their fiduciary duty as directors, except for liability that cannot be eliminated under Delaware law. Under Delaware law, our directors have a fiduciary duty to us which will not be eliminated by this provision in our certificate of incorporation. In addition, each of our directors will continue to be subject to liability under Delaware law for breach of the director's duty of loyalty to us for acts or omissions which are found by a court of competent jurisdiction to be not in good faith or which involve intentional misconduct or knowing violations of law for actions leading to improper personal benefit to the director and for payment of dividends or approval of stock repurchases or redemptions that are prohibited by Delaware law. This provision does not affect the directors' responsibilities under any other laws, such as the Federal securities laws.

Delaware law permits a corporation to not hold its directors personally liable for monetary damages for breach of their fiduciary duty as directors, except for liability for the following:

- any breach of the director's duty of loyalty to the corporation or its stockholders;
- acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law;
- voting for or assenting to unlawful payment of dividends or unlawful stock repurchases or redemptions; or
- any transaction from which the director derived an improper personal benefit.

This limitation of liability does not apply to liabilities arising under the federal or state securities laws and does not affect the availability of equitable remedies such as injunctive relief or rescission. Any amendment or repeal of these provisions requires the approval of the holders of shares representing at least two-thirds of our shares entitled to vote in the election of directors, voting as one class.

Delaware law provides that the indemnification permitted thereunder shall not be deemed exclusive of any other rights to which the directors and officers may be entitled under our bylaws, any agreement, and a vote of stockholders or otherwise. Our certificate of incorporation and bylaws eliminate the personal liability of directors to the maximum extent permitted by Delaware law. In addition, our certificate of incorporation and bylaws provide that we may fully indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding (whether civil, criminal, administrative or investigative) by reason of the fact that such person is or was one of our directors, officers, employees or other agents, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by such person in connection with such action, suit or proceeding.

We are entering into separate indemnification agreements with our directors and executive officers following our reincorporation in Delaware that could require us, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors and to advance their expenses incurred as a result of any proceeding against them as to which they could be indemnified. We believe that the limitation of liability provision in our certificate of incorporation and the indemnification agreements will facilitate our ability to continue to attract and retain qualified individuals to serve as directors and officers. Our bylaws also permit us to secure insurance on behalf of any officer, director, employee or other agent for any liability arising out of his or her actions, regardless of whether Delaware law would permit indemnification. We have purchased liability insurance for our officers and directors.

At present, there is no pending litigation or proceeding involving any director, officer, employee or agent as to which indemnification will be required or permitted under our certificate of incorporation. We are not aware of any threatened litigation or proceeding that may result in a claim for such indemnification.

Nasdaq Symbol

We have applied for quotation of our common stock on the Nasdaq Global Market under the symbol "OCLS."

Transfer Agent and Registrar

The transfer agent and registrar for our common stock is Mellon Investor Services LLC.

SHARES ELIGIBLE FOR FUTURE SALE

Prior to this offering, there has been no public market for our common stock. We cannot predict the effect, if any, that market sales of shares or the availability of shares for sale will have on the market price prevailing from time to time. As described below, only a limited number of shares will be available for sale shortly after this offering due to contractual and legal restrictions on resale. Nevertheless, sales of our common stock in the public market after the restrictions lapse, or the perception that those sales may occur, could cause the prevailing market price to decrease or to be lower than it might be in the absence of those sales of perceptions and could impair our ability to obtain future capital.

Sale of Restricted Shares

Upon completion of this offering, we will have outstanding 11,476,132 shares of common stock, assuming outstanding options or warrants are not exercised prior to the completion of this offering. Of these outstanding shares, all of the 3,076,923 shares of common stock being sold in this offering will be freely tradable, other than by any of our "affiliates" as defined in Rule 144(a) under the Securities Act, without restriction or registration under the Securities Act. All of the remaining shares were issued and sold by us in private transactions and are eligible for public sale only if registered under the Securities Act or sold in accordance with Rule 144 or Rule 701 under the Securities Act. These remaining shares are "restricted shares" within the meaning of Rule 144 under the Securities Act and will also be subject to the 180-day lock-up period described below.

Lock-Up Agreements

We expect that our directors and executive officers and certain of our other stockholders, option holders and warrant holders who collectively hold at least 90% of our outstanding common stock, in the aggregate and on a fully diluted basis, will agree that they will not sell, offer, contract or grant any option to sell, pledge, transfer, establish an open put equivalent position or otherwise dispose of, any shares of our common stock, securities convertible into or exercisable or exchangeable for shares of our common stock or any interest therein, or any capital stock of our subsidiaries owned by them without the prior written consent of Roth Capital Partners for a period of at least 180 days after the date of this prospectus. Roth Capital Partners may, in its sole discretion, at any time and without notice, release for sale in the public market all or any portion of the shares subject to the lock-up agreements. To the extent shares are released before the expiration of the lock-up period and these shares are sold into the market, the market price of our common stock could decline. As a result of the lock-up agreements described above and the provisions of Rules 144, 144(k) and 701, the restricted shares will be available for sale in the public market as follows:

• 229,025 shares will be eligible for sale immediately following the date of this prospectus;

• 7,976,604 shares will be eligible for sale upon the expiration of the lock-up agreements, described above, beginning 180 days after the date of this prospectus; and

• 193,580 shares will be eligible for sale upon the exercise of vested options, beginning 180 days after the date of this prospectus.

Rule 144

In general, under Rule 144 as currently in effect, beginning 90 days after the date of this prospectus, a person who beneficially owns shares for at least one year, unless Rule 144(k) is available as described below, would be entitled to sell within any three-month period a number of shares that does not exceed the greater of:

- 1% of the then outstanding shares of common stock, or approximately 80,101 shares immediately after this offering, assuming no exercise of the underwriters' over-allotment option; and
- the average weekly trading volume of the common stock on the Nasdaq Global Market during the four calendar weeks preceding the date on which notice of the sale on Form 144 is filed with the SEC.

Sales under Rule 144, however, are subject to specific manner of sale provisions, notice requirements and the availability of current public information about our company. We cannot estimate the number of shares of common stock our existing stockholders will sell under Rule 144 as this will depend on the market price of our common stock, the personal circumstances of the stockholders and other factors.

Rule 144(k)

Under Rule 144(k), in general, a stockholder who has beneficially owned shares of our common stock for at least two years and who is not deemed to have been an affiliate of our company at any time during the immediately preceding 90 days may sell shares without complying with the manner of sale provisions, notice requirements, public information requirements or volume limitations of Rule 144.

Rule 701

Subject to various limitations on the aggregate offering price of a transaction and other conditions, Rule 701 may be relied upon with respect to the resale of securities originally purchased from us by our employees, directors, officers, consultants or advisers prior to the completion of this offering, pursuant to written compensatory benefit plans or written contracts relating to the compensation of such persons. In addition, the SEC has indicated that Rule 701 will apply to stock options granted by us before this offering, along with the shares acquired upon exercise of those options. Securities issued in reliance on Rule 701 are deemed to be restricted shares and, beginning 90 days after the date of this prospectus, unless subject to the contractual restrictions described above, shares may be sold by such persons other than affiliates, subject only to the manner of sale provisions of Rule 144; however, no shares may be sold by affiliates under Rule 144 without compliance with the one-year minimum holding period requirements.

Stock Options

We intend to file a registration statement on Form S-8 under the Securities Act covering approximately 1,250,000 shares of common stock reserved for issuance under our 2006 Stock Incentive Plan. Accordingly, the shares of common stock registered under this registration statement will be available for sale in the open market upon exercise by the holders, unless those shares are subject to vesting restrictions with us or the contractual restrictions described above.

Registration Rights

In addition, in accordance with the terms of the Amended and Restated Investors Rights Agreement, upon completion of this offering, the holders of approximately 4,176,478 shares of common stock and warrants to purchase 227,525 shares of our common stock or preferred stock will be entitled to cause us to register the sale of those shares under the Securities Act. Registration of these shares under the Securities Act would result in these shares, other than shares purchased by our affiliates, becoming freely tradable without restriction under the Securities Act immediately upon the effectiveness of the registration. See “Description of Capital Stock — Registration Rights.”

UNDERWRITING

Subject to the terms and conditions of the underwriting agreement among us and the underwriters, each underwriter has agreed to purchase from us the following respective number of shares of common stock at the offering price less the underwriting discount set forth on the cover page of this prospectus.

Underwriter	Shares
Roth Capital Partners	
Brookstreet Securities Corporation	
Maxim Group LLC	
Total	

The underwriting agreement provides that the obligations of the underwriters are subject to certain conditions precedent and that the underwriters will purchase all such shares of common stock if any of these shares are purchased. The underwriters are obligated to take and pay for all of the shares of common stock offered hereby, other than those covered by the over-allotment option described below, if any are taken.

The underwriters have advised us that they propose to offer the shares of common stock to the public at the offering price set forth on the cover page of this prospectus and to certain dealers at such price less a concession not in excess of $ per share. The underwriters may allow, and such dealers may re-allow, a concession not in excess of $ per share to certain other dealers. If all of the shares are not sold at the initial offering price, the underwriters may change the offering price and other selling terms.

Pursuant to the underwriting agreement, we have granted to the underwriters an option, exercisable for 30 days after the date of this prospectus, to purchase up to an aggregate of 461,539 additional shares of common stock from us, at the offering price, less the underwriting discount set forth on the cover page of this prospectus, solely to cover over-allotments.

To the extent that the underwriters exercise such option, the underwriters will become obligated, subject to certain conditions, to purchase approximately the same percentage of such additional shares as the number set forth next to the underwriter's name in the preceding table bears to the total number of shares in the table, and we will be obligated, pursuant to the option, to sell such shares to the underwriters.

The following table summarizes the discounts and commissions to be paid to the underwriters by us in connection with this offering. These amounts are shown assuming both no exercise and full exercise of the underwriters' option to purchase additional shares of common stock.

	Total	
	No Exercise	Full Exercise
Per Share	$	$
Total	$	$

We expect to incur expenses, exclusive of the underwriting discount and commission, of approximately $3.2 million in connection with this offering. We have agreed to pay to Roth Capital Partners and Brookstreet Securities Corporation a non-accountable expense allowance equal to 1% of the gross proceeds to us in the offering. An electronic prospectus is available on the websites maintained by the underwriters and may also be made available on websites maintained by selected dealers and selling group members participating in this offering. No form of prospectus other than print and electronic forms, which will be printable, will be used in connection with this offering.

In connection with the offering, we have agreed to sell to the underwriters, for nominal consideration, underwriter warrants entitling the underwriters, or their assigns, to purchase up to an aggregate of 7% of the total number of shares sold in this offering at a price equal to 165% of the public offering price per share. The underwriter warrants will be exercisable for five years from the closing date of the offering and will contain cashless exercise provisions and customary anti-dilution provisions. The underwriter warrants grant the

underwriters, or their assigns, "piggyback" registration rights with respect to the common stock issuable upon exercise of the underwriter warrants for the five-year period during which the underwriter warrants are exercisable.

In addition, within 180 days prior to the effective date of this offering, we have issued to Brookstreet Securities Corporation warrants to purchase an aggregate of 24,127 shares of our common stock, at an exercise price of $18.00 per share, for its services as the managing dealer in connection with our Series C Financing and warrants to purchase 25,000 shares of our common stock, at an exercise price of $18.00 per share, for its services as a finder in connection with our Bridge Loan.

The underwriter warrants and the warrants issued to Brookstreet in connection with our Series C Financing and Bridge Loan are deemed compensation by the National Association of Securities Dealers, or NASD, and may not be sold, transferred, pledged, hypothecated or assigned for a period of 180-days following the effective date of the offering pursuant to Rule 2710(g)(1) of the NASD Conduct Rules.

We, our directors and executive officers and certain of our other stockholders, option holders and warrant holders have agreed, or, we expect will agree, that during the 180-day period after the date of this prospectus, subject to limited exceptions, we and they will not, without prior written consent, directly or indirectly, issue, sell, offer, agree to sell, grant any option or contract for the sale of, pledge, make any short sale of, maintain any short position with respect to, establish or maintain a "put equivalent option" (within the meaning of Rule 16a-1(h) under the Exchange Act) with respect to, enter into any swap, derivative transaction or other arrangement (whether any such transaction is to be settled by delivery of common stock, other securities, cash or other consideration) that transfers to another, in whole or in part, any of the economic consequences of ownership, or otherwise dispose of, any shares of our common stock, or any securities convertible into, exercisable or exchangeable for, our common stock or any interest therein or any capital stock of our subsidiaries). These lock-up agreements will cover approximately 90% of our outstanding common stock in the aggregate and on a fully-diluted basis. The managing underwriter may, in its sole discretion, allow any of these parties to dispose of common stock or other securities prior to the expiration of the 180-day period; no agreements between the managing underwriter and the parties that would allow them to do so as of the date of this prospectus.

The 180-day restricted period described above is subject to extension such that, in the event that either (1) during the last 17 days of the 180-day period, we issue an earnings release or material news or a material event relating to us occurs or (2) prior to the expiration of the 180-day restricted period, we announce that we will release earnings results during the 16-day period beginning on the last day of the 180-day period, the "lock-up" restrictions described above will, subject to limited exceptions, continue to apply until the date that is 15 calendar days plus three business days after the date of issuance of the earnings release or the occurrence of the material news or material event.

Prior to the offering, there has been no public market for the common stock. The initial public offering price for the shares of common stock included in this offering will be determined by negotiation among us and Roth Capital Partners. Among the factors considered in determining the price will be:

- the history of and prospects for our business and the industry in which we operate;
- an assessment of our management;
- our past and present revenues and earnings;
- the prospects for growth of our revenues and earnings; and
- currently prevailing conditions in the securities markets, including current market valuations of publicly traded companies which are comparable to us.

Each of the underwriters has advised us that it does not intend to confirm sales to any account over which it exercises discretionary authority.

We have agreed to indemnify the underwriters against certain liabilities, including liabilities under the Securities Act.

Until the distribution of the common stock is completed, rules of the Commission may limit the ability of the underwriters and certain selling group members to bid for and purchase the common stock. As an exception to these rules, the underwriters are permitted to engage in certain transactions that stabilize, maintain or otherwise affect the price of the common stock.

In connection with this offering, the underwriters may engage in stabilizing transactions, over-allotment transactions, syndicate covering transactions and penalty bids in accordance with Regulation M under the Exchange Act.

- Stabilizing transactions permit bids to purchase the underlying security so long as the stabilizing bids do not exceed a specified maximum.
- Over-allotment transactions involve sales by the underwriters of the shares of common stock in excess of the number of shares the underwriters are obligated to purchase, which creates a syndicate short position. The short position may be either a covered short position or a naked short position. In a covered short position, the number of shares over-allotted by the underwriters is not greater than the number of shares they may purchase in the over-allotment option. In a naked short position, the number of shares involved is greater than the number of shares in the over-allotment. The underwriters may close out any short position by exercising their over-allotment option and/or purchasing shares of common stock in the open market.
- Syndicate covering transactions involve purchases of the shares of common stock in the open market after the distribution has been completed in order to cover syndicate short positions. In determining the source of the shares of common stock to close out the short position, the underwriters will consider, among other things, the price of shares of common stock available for purchase in the open market as compared to the price at which they may purchase shares of common stock through the over-allotment option. If the underwriters sell more shares of common stock than could be covered by the over-allotment option, a naked short position, the position can only be closed out by buying shares of common stock in the open market. A naked short position is more likely to be created if the underwriters are concerned that there could be downward pressure on the price of the shares of common stock in the open market after pricing that could adversely affect investors who purchase in the offering.
- Penalty bids permit representatives to reclaim a selling concession from a syndicate member when the shares of common stock originally sold by the syndicate member are purchased in a stabilizing or syndicate covering transaction to cover syndicate short positions.

Similar to other purchase transactions, the underwriters' purchases to cover the syndicate short sales may have the effect of raising or maintaining the market price of the shares of common stock or preventing or retarding a decline in the market price of the shares of common stock. As a result, the price of the shares of common stock may be higher than the price that might otherwise exist in the open market.

The underwriters will deliver a prospectus to all purchasers of shares of common stock in the short sales. The purchases of shares of common stock in short sales are entitled to the same remedies under the federal securities laws as any other purchaser of shares of common stock covered by this prospectus.

Passive market making may stabilize or maintain the market price of our common stock at a level above that which might otherwise prevail and, if commenced, may be discontinued at any time.

The underwriters are not obligated to engage in any of the transactions described above. If they do engage in any of these transactions, they may discontinue them at any time.

We have applied to list the common stock on the Nasdaq Global Market under the symbol "OCLS."

From time to time in the ordinary course of their respective businesses, the underwriters and their affiliates may in the future engage in commercial banking or investment banking transactions with our affiliates and us.

Selling Restrictions

The distribution of this document and the offering and sale of shares in certain non-US jurisdictions may be restricted by law and therefore persons into whose possession this document comes should inform themselves about and observe any such restrictions. Any failure to comply with these restrictions may constitute a violation of securities law of any such jurisdiction.

Purchasers of the shares offered by this prospectus may be required to pay stamp taxes and other charges in accordance with the laws and practices of the country of purchase in addition to the offering price on the cover page of this prospectus.

LEGAL MATTERS

The validity of the shares of our common stock offered by this prospectus will be passed upon for us by Pillsbury Winthrop Shaw Pittman LLP, Palo Alto, California. Selected legal matters relating to the offering will be passed upon for the underwriters by Stradling Yocca Carlson & Rauth, a professional corporation, Newport Beach, California.

EXPERTS

Our consolidated financial statements as of March 31, 2005 and 2006 and for each of the three years in the period ended March 31, 2006 included in this prospectus have been so included in reliance on the report of Marcum & Kliegman LLP, independent registered public accounting firm, given on the authority of said firm as experts in auditing and accounting. Valuation Research Corporation issued our July 2005 and June 2006 valuation reports.

CHANGE IN INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

On April 12, 2006, the Audit Committee of our board of directors approved the dismissal of PricewaterhouseCoopers LLP, or PWC, as our independent registered public accounting firm and subsequently appointed Marcum & Kliegman LLP, or M&K, effective April 12, 2006. We did not consult with M&K on any accounting or financial reporting matters prior to M&K's appointment.

We engaged PWC on June 14, 2005, to perform an audit of our financial statements for our fiscal years ended March 31, 2003, 2004 and 2005. PWC did not issue a report on our financial statements for the years ended March 31, 2004 or 2005, or through April 12, 2006. For the years ended March 31, 2003, 2004 and 2005, and through April 12, 2006, there were no disagreements with PWC on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure, which disagreements, if not resolved to PWC's satisfaction, would have caused PWC to make reference thereto in their report on the financial statements for such years if they had delivered a report. In March 2006, and prior to its dismissal, PWC advised our Audit Committee orally of the following:

- the absence of financial accounting personnel with sufficient skills and experience to effectively evaluate and determine the appropriate accounting for non-routine and/or complex accounting transactions consistent with accounting principles generally accepted in the United States, which resulted in a number of material audit adjustments to the financial statements during the course of audit procedures;
- the failure to maintain effective controls to ensure the identification of accounting issues related to and the proper accounting for stock options with the right of rescission that were granted under certain stock option plans that required registration or qualification under federal and state securities laws primarily due to insufficient oversight and lack of personnel in the accounting and finance organization with the appropriate level of accounting knowledge, experience and training;
- the failure to maintain an effective anti-fraud program designed to detect and prevent fraudulent activities in QP;
- the need to expand significantly the scope of the audit of QP to assess the impact of identified fraudulent activities on the our financial statements, in which regard PWC advised our audit committee that the results of the fraud investigation may cause PWC to be unwilling to be associated with our financial statements;
- the "tone at the top" set by our senior management does not appear to encourage an attitude within our company that controls are important and that established controls cannot be circumvented;
- we did not have the appropriate financial management and reporting infrastructure in place to meet the demands that will be placed upon us as a public company, including the requirements of the Sarbanes-Oxley Act of 2002, and that we will be unable to report our financial results accurately or in a timely manner; and
- significant control deficiencies, when considered in the aggregate, constituted a material weakness over financial reporting.

We have authorized PWC to respond fully to the inquiries of M&K concerning the foregoing. We have taken the following steps designed to address PWC's concerns and to implement the recommendations made by our special counsel to our audit committee in connection with its investigation of QP:

- we have implemented a training program to continue to educate our finance personnel on accounting developments and the application of accounting principles to complex transactions, emerging and higher-risk areas and the application of significant accounting policies and judgments;
- we have implemented programs so that all employees in finance responsible for overseeing the consolidation of financial results of any subsidiary, foreign or domestic, have the requisite knowledge to understand the potential issues that are peculiarly important in dealing with our operations, including the potential for fraud;
- we will continue engaging outside consultants to provide accounting, tax and Sarbanes-Oxley advice to our finance personnel;
- with regard to any future material acquisition or partnership that does not involve a well-known entity, management will present a written report to our board of directors concerning the proposed transaction, including a vetting of the management team or practices of the third party;
- we are continuing our efforts to streamline our monthly closing and reporting processes and have implemented financial statement review procedures with the Audit Committee;
- we have adopted a code of ethics for all directors, employees and advisors in compliance with Nasdaq regulations;
- we have adopted a whistleblower policy and are implementing procedures that will allow for anonymous reporting of any potential violations of law; and
- we have hired an experienced Chief Operating Officer to oversee our day-to-day operations, further strengthening our commitment to ensure accurate financial reporting, as well as compliance with laws and regulations.

Under the oversight of our audit committee, we are continuing to review our processes and procedures to strengthen and improve our internal controls, with the goals of ensuring accurate financial reporting and complying with laws and regulations applicable to us.

WHERE YOU CAN FIND ADDITIONAL INFORMATION

We have filed with the Commission a registration statement under the Securities Act with respect to the common stock offered by this prospectus. This prospectus, which constitutes a part of the registration statement, does not contain all of the information set forth in the registration statement and the exhibits and schedules to the registration statement. Please refer to the registration statement, exhibits and schedules for further information with respect to the common stock offered by this prospectus. Statements contained in this prospectus regarding the contents of any contract or other documents are not necessarily complete. With respect to any contract or document filed as an exhibit to the registration statement, you should refer to the exhibit for a copy of the contract or document, and each statement in this prospectus regarding that contract or document is qualified by reference to the exhibit. A copy of the registration statement and its exhibits and schedules may be inspected without charge at the Commission's public reference room, located at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-202-551-8090 for further information on the public reference room. Our Commission filings, including the registration statement, are also available to the public on the Commission's website at www.sec.gov.

Upon completion of this offering, we will be subject to the information and reporting requirements of the Exchange Act and, in accordance therewith, will file periodic reports, proxy statements and other information with the Commission. Such periodic reports, proxy statements and other information will be available for inspection at the public reference room and website of the Commission referred to above.

OCULUS INNOVATIVE SCIENCES, INC. AND SUBSIDIARIES

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After the effectiveness of the reverse stock split and execution of the firm commitment described in the last paragraph of (Note 18) to the financial statements of Oculus Innovative Sciences, Inc., we expect to be in a position to render the following audit report.

/s/ Marcum & Kliegman llp

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of
Oculus Innovative Sciences, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Oculus Innovative Sciences, Inc. and Subsidiaries (the "Company") as of March 31, 2005 and 2006, and the related consolidated statements of operations, stockholders' equity (deficit) and cash flows for each of the three years in the period ended March 31, 2006. 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit 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, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Oculus Innovative Sciences, Inc. and Subsidiaries, as of March 31, 2005 and 2006, and the consolidated results of its operations and its cash flows for each of the three years in the period ended March 31, 2006 in conformity with United States generally accepted accounting principles.

New York, New York
June 21, 2006, except for
Note 18, as to which the date is ,2006

OCULUS INNOVATIVE SCIENCES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)

	March 31, 2005	March 31, 2006	September 30, 2006 (unaudited)
ASSETS			
Current assets:			
Cash and cash equivalents	$ 3,287	$ 7,448	$ 2,269
Accounts receivable, net	227	1,076	1,701
Inventories	868	317	355
Prepaid expenses and other current assets	499	1,386	1,108
Total current assets	4,881	10,227	5,433
Property and equipment, net	1,959	1,940	2,224
Notes receivable	55	—	—
Restricted cash	45	44	46
Deferred offering costs	—	478	1,405
Debt issue costs	—	—	948
Total assets	$ 6,940	$ 12,689	$ 10,056
LIABILITIES			
Current liabilities:			
Accounts payable	$ 906	$ 2,774	$ 2,286
Accrued expenses and other current liabilities	2,335	1,686	1,805
Dividend payable	—	121	363
Current portion of long-term debt	950	504	1,760
Current portion of capital lease obligations	27	15	16
Total current liabilities	4,218	5,100	6,230
Long-term debt, less current portion	460	210	2,818
Capital lease obligations, less current portion	60	41	34
Total liabilities	4,738	5,351	9,082
Commitments, Contingencies and Other Matters			
Stockholders' Equity			
Convertible preferred stock, no par value; 7,500,000 shares authorized,			
Series A 1,337,709 shares issued and outstanding at March 31, 2005 and 1,347,709 shares issued and outstanding at March 31, 2006 and September 30, 2006 (unaudited)	6,628	6,668	6,668
Series B 1,014,093 shares issued and outstanding at March 31, 2005 and 2,635,744 shares issued and outstanding at March 31, 2006 and September 30, 2006 (unaudited)	16,696	43,722	43,722
Series C 84,539 shares issued and outstanding at September 30, 2006 (unaudited)	—	—	1,370
Common stock, no par value; 25,000,000 shares authorized, 3,914,653 and 4,218,981 and 4,222,731 shares issued and outstanding at March 31, 2005 and 2006 and September 30, 2006 (unaudited), respectively	3,101	3,399	3,399
Additional paid-in capital	3,674	4,644	5,163
Deferred compensation	(676)	(798)	—
Accumulated other comprehensive (loss) income	(141)	3	(140)
Accumulated deficit	(27,080)	(50,300)	(59,208)
Total stockholders' equity	2,202	7,338	974
Total liabilities and stockholders' equity	$ 6,940	$ 12,689	$ 10,056

The accompanying footnotes are an integral part of these consolidated financial statements.

OCULUS INNOVATIVE SCIENCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)

	Year Ended March 31,			Six Months Ended September 30,	
	2004	2005	2006	2005	2006
				(unaudited)	
Revenues					
Product	$ 95	$ 473	$ 1,966	$ 807	$ 1,942
Service	807	883	618	275	388
Total revenues	902	1,356	2,584	1,082	2,330
Cost of revenues					
Product	1,403	2,211	3,899	1,350	1,043
Service	1,265	1,311	1,003	497	422
Total cost of revenues	2,668	3,522	4,902	1,847	1,465
Gross profit (loss)	(1,766)	(2,166)	(2,318)	(765)	865
Operating expenses					
Research and development	1,413	1,654	2,600	965	1,595
Selling, general and administrative	3,918	12,492	15,933	7,704	7,867
Total operating expenses	5,331	14,146	18,533	8,669	9,462
Loss from operations	(7,097)	(16,312)	(20,851)	(9,434)	(8,597)
Interest expense	(178)	(372)	(172)	(103)	(261)
Interest income	3	8	282	68	100
Other income (expense), net	(26)	146	(377)	(101)	92
Net loss from continuing operations	(7,298)	(16,530)	(21,118)	(9,570)	(8,666)
Discontinued operations					
Loss from operations of discontinued business	—	—	(818)	(174)	—
Loss on disposal of discontinued business	—	—	(1,163)	—	—
Loss on discontinued operations	—	—	(1,981)	(174)	—
Net loss	(7,298)	(16,530)	(23,099)	(9,744)	(8,666)
Preferred stock dividends	—	—	(121)	—	(242)
Net loss available to common stockholders	$ (7,298)	$ (16,530)	$ (23,220)	$ (9,744)	$ (8,908)
Net loss per common share: basic and diluted					
Continuing operations	$ (1.87)	$ (4.22)	$ (5.12)	$ (2.34)	$ (2.11)
Discontinued operations	—	—	(0.48)	(0.04)	—
	$ (1.87)	$ (4.22)	$ (5.60)	$ (2.38)	$ (2.11)
Weighted-average number of shares used in per common share calculations:					
Basic and diluted	3,911	3,914	4,150	4,086	4,221
Other comprehensive loss, net of tax					
Net loss	$ (7,298)	$ (16,530)	$ (23,099)	$ (9,744)	$ (8,965)
Foreign currency translation adjustments	(14)	(127)	144	22	(143)
Comprehensive loss	$ (7,312)	$ (16,657)	$ (22,955)	$ (9,722)	$ (9,108)

The accompanying footnotes are an integral part of these consolidated financial statements.

OCULUS INNOVATIVE SCIENCES, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
(In thousands, except share amounts)

	Convertible Preferred Stock												
	Series A		Series B		Series C		Common Stock		Additional Paid in Capital	Deferred Stock-Based Compen-sation	Accumu-lated Other Compre-hensive Income	Accum-ulated Deficit	Total
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount					
Balance, April 1, 2003	—	—	—	—	—	—	3,858,778	$ 2,892	$ 286	$ (5)	—	$ (3,252)	$ (79)
Issuance of common stock, net of offering costs	—	—	—	—	—	—	25,375	203	—		—	—	203
Issuance of common stock upon exercise of stock options	—	—	—	—	—	—	30,500	6			—	—	6
Deferred stock-based compensation	—	—	—	—	—	—	—	—	233	(233)	—	—	—
Amortization of stock-based compensation	—	—	—	—	—	—	—	—	—	30	—	—	30
Non-employee stock-based compensation	—	—	—	—	—	—	—	—	7	—	—	—	7
Issuance of common stock warrants in exchange for services	—	—	—	—	—	—	—	—	44	—	—	—	44
Reclassification of options subject to cash settlement	—	—	—	—	—	—	—	—	3	—	—	—	3
Issuance of common stock warrants in connection with debt financing	—	—	—	—	—	—	—	—	88	—	—	—	88
Issuance of Series A convertible preferred stock, net of offering costs	1,337,709	$ 6,628	—	—	—	—	—	—	—	—	—	—	6,628
Translation adjustment	—	—	—	—	—	—	—	—	—	—	(14)	—	(14)
Net loss	—	—	—	—	—	—	—	—	—	—	—	(7,298)	(7,298)
Balance, March 31, 2004	1,337,709	6,628			—	—	3,914,653	3,101	661	(208)	(14)	(10,550)	(382)
Issuance of common stock upon exercise of stock options	—	—	—	—	—	—		—	—	—	—	—	
Deferred stock-based compensation	—	—	—	—	—	—	—	—	2,765	(2,765)	—	—	—
Amortization of stock-based compensation	—	—	—	—	—	—	—	—	—	2,297	—	—	2,297
Non-employee stock-based compensation	—	—	—	—	—	—	—	—	30	—	—	—	30

	Convertible Preferred Stock												
	Series A		Series B		Series C		Common Stock		Additional Paid in Capital	Deferred Stock-Based Compen-sation	Accumu-lated Other Compre-hensive Income	Accum-ulated Deficit	Total
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount					
Reclassification of options subject to cash settlement	—	—	—	—	—	—	—	—	113	—	—	—	113
Issuance of common stock warrants in connection with debt financing	—	—	—	—	—	—	—	—	28	—	—	—	28
Issuance of Series A convertible preferred stock warrants in connection with debt financing	—	—	—		—	—	—	—	77	—	—	—	77

OCULUS INNOVATIVE SCIENCES, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
(In thousands, except share amounts)

	Convertible Preferred Stock												
	Series A		Series B		Series C		Common Stock		Additional Paid in Capital	Deferred Stock-Based Compen-sation	Accumu-lated Other Compre-hensive Income	Accum-ulated Deficit	Total
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount					
Issuance of Series B convertible preferred stock, net of offering costs	—	—	1,014,093	16,696	—	—	—	—	—	—	—	—	16,696
Translation adjustment	—	—	—	—	—	—	—	—	—	—	(127)	—	(127)
Net loss	—	—	—	—	—	—	—	—	—	—	—	(16,530)	(16,530)
Balances, March 31, 2005	1,337,709	$ 6,628	1,014,093	$16,696	—	—	3,914,653	$ 3,101	$ 3,674	$ (676)	$ (141)	$(27,080)	$ 2,202
Issuance of common stock upon exercise of stock options	—	—	—	—	—	—	291,828	298	—	—	—	—	298
Deferred stock-based compensation	—	—	—	—	—	—	—	—	401	(401)	—	—	—
Amortization of stock-based compensation	—	—	—	—	—	—	—	—	—	279	—	—	279
Non-employee stock-based compensation	—	—	—	—	—	—	—	—	32	—	—	—	32
Fair value adjustment related to common stock warrants with service conditions	—	—	—	—	—	—	—	—	153	—	—	—	153
Issuance of common stock in exchange for services	—	—	—	—	—	—	12,500	—	127	—	—	—	127
Reclassification of options subject to cash settlement	—	—	—	—	—	—	—	—	257	—	—	—	257
Issuance of Series B convertible preferred stock, net of offering costs	—	—	1,621,651	27,026	—	—	—	—	—	—	—	—	27,026

	Convertible Preferred Stock												
	Series A		Series B		Series C		Common Stock		Additional Paid in Capital	Deferred Stock-Based Compen-sation	Accumu-lated Other Compre-hensive Income	Accum-ulated Deficit	Total
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount					
Issuance of Series A convertible preferred stock in connections with convertible debt	10,000	40	—	—	—	—	—	—	—	—	—	—	40
Dividend payable to Series A preferred stockholders	—	—	—	—	—	—	—	—	—	—	—	(121)	(121)
Translation adjustment	—	—	—	—	—	—	—	—	—	—	144	—	144
Net loss	—	—	—	—	—	—	—	—	—	—	—	(23,099)	(23,099)
Balance, March 31, 2006	1,347,709	$ 6,668	2,635,744	$43,722	—	—	4,218,981	$ 3,399	$ 4,644	$ (798)	$ 3	$(50,300)	$7,338

The accompanying footnotes are an integral part of these consolidated financial statements.

OCULUS INNOVATIVE SCIENCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
(In thousands, except share amounts)

	Convertible Preferred Stock												
	Series A		Series B		Series C		Common Stock		Additional Paid in Capital	Deferred Stock-Based Compensation	Accumulated Other Comprehensive Income	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount					
Balance, March 31, 2006	1,347,709	$ 6,668	2,635,744	$ 43,722	—	—	4,218,981	$ 3,399	$ 4,644	$ (798)	$ 3	$ (50,300)	$ 7,338
Deferred stock-based compensation	—	—	—	—	—	—	—	—	(96)	96	—	—	—
Amortization of stock-based compensation	—	—	—	—	—	—	—	—	—	104	—	—	104
Non-employee stock-based compensation	—	—	—	—	—	—	—	—	11	—	—	—	11
Fair value related to common warrant adjustment with services conditions	—	—	—	—	—	—	—	—	70	—	—	—	70
Issuance of common stock in exchange for services	—	—	—	—	—	—	3,750	—	43	—	—	—	43
Issuance of common warrants in connection with line of credit	—	—	—	—	—	—	—	—	1,047	—	—	—	1,047
Issuance of Series C convertible preferred stock net of offering costs	—	—	—	—	84,539	$ 1,370	—	—	—	—	—	—	1,370
Employee stock-based compensation expense recognized under SFAS No. 123R, net of forfeitures	—	—	—	—	—	—	—	—	42	—	—	—	42
Dividend payable to Series A preferred stockholders	—	—	—	—	—	—	—	—	—	—	—	(242)	(242)
Reclassification of deferred stock based compensation									(598)	598			
Translation adjustment	—	—	—	—	—	—	—	—	—	—	(143)	—	(143)
Net loss	—	—	—	—	—	—	—	—	—	—	—	(8,666)	(8,666)
Balance, September 30, 2006 (unaudited)	1,347,709	$ 6,668	2,635,744	$ 43,722	84,539	$ 1,370	4,222,731	$ 3,399	$ 5,163	$ —	$ (140)	$ (59,208)	$ 974

The accompanying footnotes are an integral part of these consolidated financial statements.

OCULUS INNOVATIVE SCIENCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended March 31,			Six Months Ended September 30,	
	2004	2005	2006	2005	2006
				(unaudited)	
Cash flows from operating activities:					
Net loss from continuing operations	$ (7,298)	$ (16,530)	$ (21,118)	$ (9,570)	$(8,666)
Adjustments to reconcile net loss from continuing operations to net cash used in operating activities:					
Depreciation and amortization	163	434	651	307	328
Stock-based compensation	424	2,349	597	266	270
Non-cash interest expense	37	131	21	21	125
Loss on disposal of assets	10	2	113	—	—
Changes in operating assets and liabilities					
Accounts receivable, net of doubtful accounts	(195)	217	(849)	(119)	(617)
Inventory	(119)	(748)	551	(81)	(27)
Prepaid expenses and other current assets	(163)	(278)	(887)	(585)	262
Accounts payable	857	(165)	1,868	1,028	(494)
Accrued expenses and other current liabilities	726	1,055	(649)	(828)	106
Net cash used in operating activities	(5,558)	(13,533)	(19,702)	(9,561)	(8,713)
Cash flows from investing activities:					
Purchases of property and equipment	(982)	(1,042)	(475)	(166)	(585)
Issuance of note receivable	—	(55)	55	(2)	—
Changes in restricted cash	(25)	(21)	1	—	(2)
Net cash used in investing activities	(1,007)	(1,118)	(419)	(168)	(587)
Cash flows from financing activities:					
Proceeds from the issuance of common stock	203	—	—	—	—
Deferred offering costs	—	—	(478)	(342)	(926)
Issuance of common stock upon exercise of stock options	6	—	298	298	—
Proceeds from the issuance of preferred stock	6,628	16,696	27,026	25,744	1,370
Debt issue costs	—	—	—	—	(20)
Proceeds from issued debt	574	1,205	257	79	4,379
Principal payments on debt	(106)	(664)	(953)	(694)	(515)
Payments on capital leases	(34)	(41)	(31)	(9)	(7)
Net cash provided by financing activities	7,271	17,196	26,119	25,076	4,281
Cash flows from discontinued operations					
Operating cash flows	—	—	(818)	(174)	—
Investing cash flows	—	—	(1,163)	(970)	—
Net cash used in discontinued operations	—	—	(1,981)	(1,144)	—
Effect of exchange rates on cash and cash equivalents	(14)	(127)	144	22	(160)
Net increase (decrease) in cash and cash equivalents	692	2,418	4,161	14,225	(5,179)
Cash and equivalents, beginning of period	177	869	3,287	3,287	7,448
Cash and equivalents, end of period	$ 869	$ 3,287	$ 7,448	$ 17,512	$ 2,269
Supplemental disclosure of cash flow information:					
Cash paid for interest	$ 134	$ 221	$ 125	$ 78	$ 136
Equipment purchased under capital leases	$ 40	$ 37	$ —	$ —	$ —
Conversion of note into Series A preferred stock	$ —	$ —	$ 40	$ 40	$ —
Fair value of warrants issued with line of credit	$ —	$ —	$ —	$ —	$ 1,047

The accompanying footnotes are an integral part of these consolidated financial statements.

OCULUS INNOVATIVE SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(INFORMATION AS OF SEPTEMBER 30, 2006 AND FOR THE SIX MONTHS ENDED SEPTEMBER 30, 2005 AND 2006 IS UNAUDITED)

NOTE 1 — The Company

Oculus Innovative Sciences, Inc. (the "Company") was incorporated under the laws of the State of California in April 1999. The Company's principal office is located in Petaluma, California. The Company has developed and manufactures and markets a family of products intended to help prevent and treat infection in acute and chronic wounds. The Company's platform technology, Microcyn, is a non-toxic, super-oxidized water-based solution that is designed to treat a wide range of pathogens, including viruses, fungi, spores and antibiotic resistant strains of bacteria, such as MRSA and VRE, in wounds. The Company conducts its business world-wide, with its principal subsidiaries in Europe and Mexico.

As discussed in Note 2, the Company's amended articles of incorporation were amended on August 28, 2006, authorizing it to issue up to 875,000 of Series C convertible preferred stock.

Stock Split

In November 2006, the board of directors of the Company approved a reverse split within a range of 1 for 4 and 1 for 6 of the Company's outstanding shares and subsequently narrowed the range to 1 for 3.7 to 1 for 5. Pursuant to delegation of authority by the board of directors, the pricing committee approved a 1 for 4 reverse split on December 1, 2006. The reverse stock split will be effected by filing an amended and restated certificate of incorporation of the Company prior to the Company's initial public offering. All common and preferred shares and per share amounts contained in the consolidated financial statements have been retroactively adjusted to reflect a 1 for 4 reverse stock split.

NOTE 2 — Liquidity and Financial Condition

The Company incurred net losses of $7,298,000, $16,530,000 and $23,099,000 for the years ended March 31, 2004, 2005 and 2006, respectively, and $8,666,000 for the six months ended September 30, 2006. At March 31, 2006 and September 30, 2006, the Company's accumulated deficit amounted to $50,300,000 and $59,208,000, respectively.

During the years ended March 31, 2004, 2005 and 2006, the Company raised, net of offering costs, an aggregate of $6,837,000, $16,696,000 and $27,324,000, respectively in various equity financing transactions that, together with the proceeds of certain debt financing transactions, enabled it to sustain operations while attempting to execute its business plan. The Company had $5,127,000 of working capital as of March 31, 2006 and a working capital deficiency of $(797,000) as of September 30, 2006. In addition, in June 2006, the Company entered into a $5,000,000 credit facility from which it drew $4,182,000, to fund its operations, and invest in new equipment (Note 9). In addition, on November 7, 2006, the Company entered into a $4.0 million loan agreement which will be repaid within twelve months or within 5 days after the close of the Company's initial public offering of its common stock,

The Company's ability to continue its operations is dependent upon its ability to raise additional capital and generate revenue and operating cash flow through the execution of its business plan. The Company is also in the process of effectuating an initial public offering ("IPO") of its equity securities. The Company's Board of Directors and stockholders also approved an amendment to the Articles of Incorporation (that became effective on August 28, 2006) to authorize the issuance of up to 875,000 shares of Series C convertible preferred stock. On September 14, 2006, the Company sold 84,539 units, consisting of 84,539 shares of Series C convertible preferred stock and warrants to purchase 16,907 shares of the Company's common stock, for gross proceeds of $1,521,702 ($1,369,532 net of offering costs). On October 20, 2006, the Company sold 108,486 units, consisting of 108,486 shares of Series C convertible preferred stock and warrants to purchase 21,697 shares of the Company's common stock, for gross proceeds of $1,952,478 ($1,757,230 net of offering

costs). The Company cannot provide any assurance that it will successfully raise any additional capital under this offering as a result of the authorization to issue these shares.

Management believes the Company's current level of working capital, the $4.0 million raised in the note offering described in Note 18, as well as funds the Company expects to generate from operations and raise through an initial public offering, will sustain the business through September 30, 2007. However, the Company cannot provide any assurance that it will raise capital through this initial public offering or an alternative funding source. Without completion of this offering, or the raise of capital through an alternative funding source, the Company may curtail certain operational activities in order to reduce costs. These activities may include clinical and regulatory trials, sales and marketing activities, and international operations. In the event that the Company is required to raise additional capital, the Company cannot provide any assurance that it will secure any commitments for new financing on acceptable terms, if at all.

NOTE 3 — Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Aquamed Technologies, Inc., Oculus Technologies of Mexico C.V. ("OTM"), and Oculus Innovative Sciences B.V. ("OIS Europe"). All significant intercompany accounts and transactions have been eliminated in consolidation.

The consolidated financial statements are presented in United States Dollars in accordance with Statement of Financial Accounting Standard ("SFAS") No. 52, "Foreign Currency Translation." ("SFAS 52"). The Company's subsidiary OTM uses the local currency (Mexican Pesos) as its functional currency and OIS Europe uses the local currency (Euro) as its functional currency. Assets and liabilities are translated at exchange rates in effect at the balance sheet date and revenue and expense accounts are translated at average exchange rates during the period. Resulting translation adjustments are recorded directly to accumulated other comprehensive (loss) income.

The Company, in determining whether it is required to consolidate investee businesses, considers both the voting and variable interest models of consolidation as required under Financial Accounting Standards Board ("FASB") Interpretation No. 46(R) "Consolidation of Variable Interest Entities," ("FIN 46(R)"). Accordingly the Company consolidates investee entities when it owns less than 50% of the voting interests but, based on the risks and rewards of its participation, has established financial control. As described in Note 17, the Company's consolidated financial statements include the results of a variable interest entity that is being presented as a discontinued operation in accordance with SFAS No. 144 "Accounting for the Impairment and Disposal of Long Lived Assets."

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent liabilities at the dates of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates. These estimates and assumptions include revenue recognition reserves and write-downs related to receivables and inventories, the recoverability of long-term assets, deferred taxes and related valuation allowances and valuation of equity instruments.

OCULUS INNOVATIVE SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(INFORMATION AS OF SEPTEMBER 30, 2006 AND FOR THE SIX MONTHS ENDED SEPTEMBER 30, 2005 AND 2006 IS UNAUDITED)

Unaudited Interim Results

The accompanying consolidated balance sheet as of September 30, 2006, statement of changes in stockholders' equity (deficit) for the six months ended September 30, 2006, and the consolidated statements of operations and statements of cash flows for the six months ended September 30, 2005 and 2006 are unaudited. The unaudited interim consolidated financial statements have been prepared on the same basis as the annual consolidated financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary to present fairly the Company's financial position and results of operations and cash flows for the six months ended September 30, 2005 and 2006. The financial data and other information disclosed in the notes to the consolidated financial statements related to the three month periods are unaudited. The results for the six months ended September 30, 2006 are not necessarily indicative of the results to be expected for the year ending March 31, 2007 or for any other interim period or for any future year.

Revenue Recognition

The Company generates revenue from sales of its products to hospitals, medical centers, doctors, pharmacies, distributors and partners. The Company sells its products directly to third parties and to distributors through various cancelable distribution agreements. The Company has also entered into an agreement to license its products.

The Company also provides regulatory compliance testing and quality assurance services to medical device and pharmaceutical companies.

The Company applies the revenue recognition principles set forth in Securities and Exchange Commission Staff Accounting Bulletin ("SAB") 104 "Revenue Recognition" with respect to all of its revenue. Accordingly, the Company records revenue when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the fee is fixed or determinable, and (iv) collectability of the sale is reasonable assured.

The Company requires all of its product sales to be supported by evidence of a sale transaction that clearly indicates the selling price to the customer, shipping terms and payment terms. Evidence of an arrangement generally consists of a contract or purchase order approved by the customer. The Company has ongoing relationships with certain customers from which it customarily accepts orders by telephone in lieu of a purchase order.

The Company recognizes revenue at the time in which it receives a confirmation that the goods were either tendered at their destination when shipped "FOB destination," or transferred to a shipping agent when shipped "FOB shipping point." Delivery to the customer is deemed to have occurred when the customer takes title to the product. Generally, title passes to the customer upon shipment, but could occur when the customer receives the product based on the terms of the agreement with the customer.

The selling prices of all goods that the Company sells are fixed, and agreed to with the customer, prior to shipment. Selling prices are generally based on established list prices. The Company does not customarily permit its customers to return any of its products for monetary refunds or credit against completed or future sales. The Company, from time to time, may replace expired goods on a discretionary basis. The Company records these types of adjustments, when made, as a reduction of revenue. Sales adjustments were insignificant during the years ended March 31, 2004, 2005 and 2006 and for the six months ended September 30, 2006 and 2005.

The Company evaluates the creditworthiness of new customers and monitors the creditworthiness of its existing customers to determine whether events or changes in their financial circumstances would raise doubt

as to the collectability of a sale at the time in which a sale is made. Payment terms on sales made in the United States are generally 30 days and internationally, generally range from 30 days to 180 days.

In the event a sale is made to a customer under circumstances in which collectability is not reasonably assured, the Company either requires the customer to remit payment prior to shipment or defers recognition of the revenue until the time of collection. The Company maintains a reserve for amounts which may not be collectible.

During the fiscal year ended March 31, 2005, approximately $434,000 of sales in Mexico were recognized when cash was collected since collection was not reasonably assured.

The Company has entered into distribution agreements in Europe. Recognition of revenue and related cost of revenue from product sales is deferred until the product is sold from the distributors to their end customers.

When the Company receives letters of credit and the terms of the sale provide for no right of return except to replace defective product, revenue is recognized when the letter of credit becomes effective and the product is shipped.

Revenue from consulting contracts is recognized as services are provided. Revenue from testing contracts is recognized as tests are completed and a final report is sent to the customer.

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Cash equivalents may be invested in money market funds, commercial paper, and certificates of deposits. Cash equivalents are carried at cost, which approximates fair value.

Restricted Cash

In connection with operating lease agreements, the Company is required to maintain cash deposits in a restricted account. Restricted cash held as security under this arrangement amounted to $45,000, $44,000 and $46,000 at March 31, 2005 and 2006, and September 30, 2006, respectively.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentration of credit risk consist principally of cash, cash equivalents and accounts receivable. Cash and cash equivalents are maintained in financial institutions in the United States, Mexico, and The Netherlands. The Company is exposed to credit risk in the event of default by these financial institutions for amounts in excess of the Federal Deposit Insurance Corporation insured limits. Management believes that the financial institutions that hold the Company's deposits are financially sound and have minimal credit risk.

The Company grants credit to its business customers, which are primarily located in the United States, Mexico, and Europe. Collateral is generally not required for trade receivables. The Company maintains allowances for potential credit losses.

Accounts Receivable

Trade accounts receivable are recorded net of allowances for cash discounts for prompt payment, doubtful accounts, government chargebacks and sales returns. Estimates for cash discounts, government chargebacks and sales returns are based on contractual terms, historical trends and expectations regarding the utilization rates for these programs. With respect to government chargebacks, the Mexican Ministry of Health's ("MOH") policy is to levy penalties on its vendors for product received after scheduled delivery times. The Company

has not incurred any such chargebacks to date; however such penalties (if incurred) would be recorded as a reduction of revenue and the related accounts receivable balance.

The Company's policy is to reserve for uncollectible accounts based on its best estimate of the amount of probable credit losses in its existing accounts receivable. The Company periodically reviews its accounts receivable to determine whether an allowance for doubtful accounts is necessary based on an analysis of past due accounts and other factors that may indicate that the realization of an account may be in doubt. Other factors that the Company considers include its existing contractual obligations, historical payment patterns of its customers and individual customer circumstances, an analysis of days sales outstanding by customer and geographic region, and a review of the local economic environment and its potential impact on government funding and reimbursement practices. Account balances deemed to be uncollectible are charged to the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The Company had a low occurrence of credit losses through 2005 and therefore did not consider it necessary to establish an allowance for doubtful accounts as of March 31, 2005. The allowance for doubtful accounts at March 31, 2006 and September 30, 2006 represents probable credit losses in the amounts of $90,000 and $171,000, respectively.

Inventories

Inventories of finished goods and raw materials are stated at the lower of cost, determined first-in, first-out under a standard cost method, or market.

The Company also establishes reserves for obsolescence or unmarketable inventory. The Company recorded reserves to reduce the carrying amounts of inventories to their net realizable value in the amounts of $221,000, $996,000 and $44,000 for the years ended March 31, 2005, 2006 and the six months ended September 30, 2006, respectively, which is included in the accompanying statements of operations as a component of cost of goods sold. In the six month period ended September 30, 2006, the Company discarded inventory reserved for in prior periods.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation of property and equipment is computed using the straight-line method over the estimated useful lives of the respective assets. Depreciation of leasehold improvements is computed using the straight-line method over the lesser of the estimated useful life of the improvement or the remaining term of the lease. Useful lives by classification is as follows:

	Years
Office equipment	3
Manufacturing and other equipment	5
Furniture and fixtures	7

Upon retirement or sale, the cost and related accumulated depreciation are removed from the balance sheet and the resulting gain or loss is reflected in operations. Maintenance and repairs are charged to operations as incurred.

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Debt Issue Costs

Costs of obtaining lines of credit or revolving credit arrangements (which could include cash or the fair value of equity securities) are deferred and amortized over the term of the related facility in accordance with Accounting Principles Board Opinion ("APB") No. 21 "Debt Issue Costs." ("APB 21").

Impairment of Long-Lived Assets

The Company periodically reviews the carrying values of its long lived assets in accordance with SFAS 144 "Long Lived Assets" when events or changes in circumstances would indicate that it is more likely than not that their carrying values may exceed their realizable values, and records impairment charges when considered necessary. Specific potential indicators of impairment include, but are not necessarily limited to:

- a significant decrease in the fair value of an asset;
- a significant change in the extent or manner in which an asset is used or a significant physical change in an asset;
- a significant adverse change in legal factors or in the business climate that affects the value of an asset;
- an adverse action or assessment by the U.S. Food and Drug Administration or another regulator;
- an accumulation of costs significantly in excess of the amount originally expected to acquire or construct an asset; and operating or cash flow losses combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with an income-producing asset.

When circumstances indicate that an impairment may have occurred, the Company tests such assets for recoverability by comparing the estimated undiscounted future cash flows expected to result from the use of such assets and their eventual disposition to their carrying amounts. In estimating these future cash flows, assets and liabilities are grouped at the lowest level for which there are identifiable cash flows that are largely independent of the cash flows generated by other such groups. If the undiscounted future cash flows are less than the carrying amount of the asset, an impairment loss, measured as the excess of the carrying value of the asset over its estimated fair value, will be recognized. The cash flow estimates used in such calculations are based on estimates and assumptions, using all available information that management believes is reasonable.

Research and Development

Research and development expense is charged to operations as incurred and consists primarily of personnel expenses, outside services and supplies. For the years ended March 31, 2004, 2005 and 2006, research and development expense amounted to $1,413,000, $1,654,000 and $2,600,000, respectively. For the six months ended September 30, 2005 and 2006, research and development expense amounted to $965,000 and $1,595,000, respectively.

Advertising Costs

Advertising costs are expensed as incurred. Advertising costs amounted to $99,000, $122,000 and $126,000, for the years ended March 31, 2004, 2005 and 2006, respectively. Advertising costs amounted to $100,000 and $27,000 for the six months ended September 30, 2005 and 2006, respectively.

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Shipping and Handling Costs

The Company applies the guidelines enumerated in Emerging Issues Task Force Issue ("EITF") 00-10 "Accounting for Shipping and Handling Fees and Costs" with respect to its shipping and handling costs. Accordingly, the Company classifies amounts billed to customers related to shipping and handling in sale transactions as revenue. Shipping and handling costs incurred are recorded in cost of sales. To date, shipping and handling costs billed to customers have been insignificant.

Foreign Currency Transactions

Foreign currency gains (losses) relate to working capital loans that the Company's made to its foreign subsidiaries. The Company recorded foreign currency gains (losses) for the years ended March 31, 2004, 2005 and 2006 of ($4,000), $134,000, and ($283,000), respectively, and $(102,000) and $(119,000) for the six months ended September 30, 2005 and 2006, respectively. The related gains (losses) were recorded in other income (expense) in the accompanying statements of operations.

Stock-Based Compensation

Prior to April 1, 2006, the Company accounted for stock-based employee compensation arrangements in accordance with the provisions of APB No. 25, "Accounting for Stock Issued to Employees," and its related interpretations and applied the disclosure requirements of SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure, an amendment of FASB Statement No. 123." The Company used the minimum value method to measure the fair value of awards issued prior to April 1, 2006 with respect to its application of the disclosure requirements under SFAS 123.

Effective April 1, 2006, the Company adopted SFAS No. 123(R) "Share Based Payment" ("SFAS 123(R)"). This statement is a revision of SFAS Statement No. 123, and supersedes APB Opinion No. 25, and its related implementation guidance. SFAS 123(R) addresses all forms of share based payment ("SBP") awards including shares issued under employee stock purchase plans, stock options, restricted stock and stock appreciation rights. Under SFAS 123(R), SBP awards result in a cost that will be measured at fair value on the awards' grant date, based on the estimated number of awards that are expected to vest and will result in a charge to operations.

The Company had a choice of two attribution methods for allocating compensation costs under SFAS 123(R): the "straight-line method," which allocates expense on a straight-line basis over the requisite service period of the last separately vesting portion of an award, or the "graded vesting attribution method," which allocates expense on a straight-line basis over the requisite service period for each separately vesting portion of the award as if the award was, in substance, multiple awards. The Company chose the former method and amortized the fair value of each option on a straight-line basis over the requisite period of the last separately vesting portion of each award.

Under SFAS 123(R), nonpublic entities, including those that become public entities after June 15, 2005, that used the minimum value method of measuring equity share options and similar instruments for either recognition or pro forma disclosure purposes under Statement 123 are required to apply SFAS 123(R) prospectively to new awards and to awards modified, repurchased, or cancelled after the date of adoption. In addition, SFAS 123(R), requires such entities to continue accounting for any portion of awards outstanding at the date of initial application using the accounting principles originally applied to those awards. Accordingly, stock based compensation expense relating to awards granted prior to April 1, 2006 that are expected to vest in periods ending after April 1, 2006 are being recorded in accordance with the provisions of APB 25 and its related interpretive guidance.

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The Company has adopted the prospective method with respect to accounting for its transition to SFAS 123(R). Accordingly, the Company recognized in salaries and related expense in the statement of operations $104,000 of stock based compensation expense in the six month period ended September 30, 2006, which represents the intrinsic value amortization of options granted prior to April 1, 2006 that the Company is continuing to account for using the recognition and measurement principles prescribed under APB 25. The Company also recognized in salaries and related expense in the statement of operations $42,000 of stock based compensation expense in the six months ended September 30, 2006, which represents the amortization of the fair value of options granted subsequent to adoption of SFAS 123(R). In the current quarter we have reclassified certain components of our stockholders' equity section to reflect the elimination of deferred compensation arising from unvested share-based compensation pursuant to the requirements of Staff Accounting Bulletin No. 107, regarding Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment." This deferred compensation was previously recorded as an increase to additional paid-in capital with a corresponding reduction to stockholders' equity for such deferred compensation. This reclassification has no effect on net income or total stockholders' equity as previously reported. The Company will record an increase to additional paid-in capital as the share-based payments vest.

Non-Employee Stock Based Compensation

The Company accounts for equity instruments issued to non-employees in accordance with the provisions of SFAS No. 123(R) and EITF Issue No. 96-18, "Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services," ("EITF 96-18") which requires that such equity instruments are recorded at their fair value on the measurement date. The measurement of stock-based compensation is subject to periodic adjustment as the underlying equity instrument vests. Non-employee stock-based compensation charges are being amortized over the vesting period.

Income Taxes

The Company accounts for income taxes in accordance with SFAS No. 109, Accounting for Income Taxes ("SFAS No. 109"). Under SFAS No. 109, deferred tax assets and liabilities are determined based on the differences between the financial reporting and tax bases of assets and liabilities and net operating loss and credit carryforwards using enacted tax rates in effect for the year in which the differences are expected to impact taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

Comprehensive Loss

Other comprehensive loss includes all changes in stockholders' equity (deficit) during a period from non-owner sources and is reported in the consolidated statement of stockholders' equity (deficit). To date, other comprehensive loss consists of changes in accumulated foreign currency translation adjustments during the period.

Net Loss Per Share

The Company computes net loss per share in accordance with SFAS No. 128 "Earnings Per Share" and has applied the guidance enumerated in Staff Accounting Bulletin No. 98 ("SAB Topic 4D") with respect to evaluating its issuances of equity securities during all periods presented.

Under SFAS No. 128, basic net loss per share is computed by dividing net loss per share available to common stockholders by the weighted average number of common shares outstanding for the period and

excludes the effects of any potentially dilutive securities. Diluted earnings per share, if presented, would include the dilution that would occur upon the exercise or conversion of all potentially dilutive securities into common stock using the "treasury stock" and/or "if converted" methods as applicable. The computation of basic loss per share for the years ended March 31, 2004, 2005, 2006, and the six months ended September 30, 2005 and 2006 excludes potentially dilutive securities because their inclusion would be anti-dilutive.

In addition to the above, the SEC (under SAB Topic 4D) requires new registrants to retroactively include the dilutive effect of common stock or potential common stock issued for nominal consideration during all periods presented in its computation of basic earnings (loss) per share and diluted earnings per share as if they were, in substance, recapitalizations. The Company evaluated all of its issuances of equity securities and determined that it had no nominal issuances of common stock or common stock equivalents to include in its computation of loss per share for any of the periods presented.

Common stock equivalents excluded from the determination of basic and diluted net loss per share because their effect would be anti-dilutive are as follows (in thousands):

	Year Ended March 31,			Six Months Ended September 30,	
	2004	2005	2006	2005	2006
				(unaudited)	
Options to purchase common stock	1,535	1,340	1,969	1,429	2,125
Warrants to purchase common stock	30	464	858	517	875
Convertible preferred stock (as if converted)	1,338	2,352	3,984	3,906	4,068
Warrants to purchase preferred stock (as if converted)	—	17	17	17	88
Convertible debt	20	10	—	—	—
	2,923	4,183	6,828	5,869	7,156

Fair Value of Financial Instruments

The carrying amounts reported in the balance sheet for cash, accounts receivable, accounts payable and accrued expenses approximate fair value based on the short-term maturity of these instruments. The carrying amounts of the Company's line of credit obligation and other long term obligations approximate fair value as such instruments feature contractual interest rates that are consistent with current market rates of interest or have effective yields that are consistent with instruments of similar risk, when taken together with equity instruments issued to the holder.

Preferred Stock

The Company applies the guidance enumerated in SFAS No. 150 "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" and EITF Topic D-98 "Classification and Measurement of Redeemable Securities," when determining the classification and measurement of preferred stock. Preferred shares subject to mandatory redemption (if any) are classified as liability instruments and are measured at fair value in accordance with SFAS 150. All other issuances of preferred stock are subject to the classification and measurement principles of EITF Topic D-98. Accordingly the Company classifies conditionally redeemable preferred shares (if any), which includes preferred shares that feature redemption rights that are either within the control of the holder or subject to redemption upon the occurrence of uncertain events

not solely within the Company's control, as temporary equity. At all other times, the Company classifies its preferred shares in stockholders' equity.

The Company's preferred shares do not feature any redemption rights within the holders control or conditional redemption features not within the Company's control as of March 31, 2005, March 31, 2006 or September 30, 2006. Accordingly all issuances of preferred are presented as a component of stockholders equity (deficit).

Convertible Instruments

The Company evaluates and accounts for conversion options embedded in its convertible instruments in accordance with SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133") and EITF 00-19 "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock" ("EITF 00-19").

SFAS 133 generally provides three criteria that, if met, require companies to bifurcate conversion options from their host instruments and account for them as free standing derivative financial instruments in accordance with EITF 00-19. These three criteria include circumstances in which (a) the economic characteristics and risks of the embedded derivative instrument are not clearly and closely related to the economic characteristics and risks of the host contract, (b) the hybrid instrument that embodies both the embedded derivative instrument and the host contract is not remeasured at fair value under otherwise applicable generally accepted accounting principles with changes in fair value reported in earnings as they occur and (c) a separate instrument with the same terms as the embedded derivative instrument would be considered a derivative instrument subject to the requirements of SFAS 133. SFAS 133 and EITF 00-19 also provide an exception to this rule when the host instrument is deemed to be conventional (as that term is described in the implementation guidance to SFAS 133 and further clarified in EITF 05-2 "The Meaning of "Conventional Convertible Debt Instrument" in Issue No. 00-19).

The Company accounts for convertible instruments (when it has determined that the embedded conversion options should not be bifurcated from their host instruments) in accordance with the provisions of EITF 98-5 "Accounting for Convertible Securities with Beneficial Conversion Features," ("EITF 98-5") and EITF 00-27 "Application of EITF 98-5 to Certain Convertible Instruments." Accordingly, the Company records when necessary discounts to convertible notes for the intrinsic value of conversion options embedded in debt instruments based upon the differences between the fair value of the underlying common stock at the commitment date of the note transaction and the effective conversion price embedded in the note. Debt discounts under these arrangements are amortized over the term of the related debt to their earliest date of redemption. The Company also records when necessary deemed dividends for the intrinsic value of conversion options embedded in preferred shares based upon the differences between the fair value of the underlying common stock at the commitment date of the note transaction and the effective conversion price embedded in the note.

The Company evaluated the conversion option embedded in its convertible instruments during each of the reporting periods presented and has determined, in accordance with the provisions of these statements, that it does not meet the criteria requiring bifurcation of these instruments. Additionally, the Company's conversion options, if free standing, would not be considered derivatives subject to accounting guidelines prescribed under SFAS 133.

The Company had approximately $80,000 of convertible notes previously outstanding (Note 9). These notes were convertible into a fixed number of preferred shares. In addition, the holders of these notes could only realize the benefit of the conversion option by exercising the option and receiving the entire proceeds in a fixed number of preferred shares or cash at the Company's discretion. These notes, which amounted to

approximately $80,000 were either repaid or converted during the year ended March 31, 2006. In addition, discounts associated with the beneficial conversion features in these notes were insignificant to the Company's financial position and results of operations during each of the reporting periods presented.

The characteristics of common stock that is issuable upon a holder's exercise of conversion options embedded in the Company's preferred shares are deemed to be clearly and closely related to the characteristics of the preferred shares (as that term is clarified in paragraph 61 l of the implementation guidance included in Appendix A of SFAS 133). The Company did not record deemed dividends during any of the periods presented because the effective conversion price of the preferred shares exceeded the fair value of the Company common stock at the respective dates of issuance.

Common Stock Purchase Warrants and Other Derivative Financial Instruments

The Company accounts for the issuance of common stock purchase warrants issued and other free standing derivative financial instruments in accordance with the provisions of EITF 00-19. Based on the provisions of EITF 00-19, the Company classifies as equity any contracts that (i) require physical settlement or net-share settlement or (ii) gives the Company a choice of net-cash settlement or settlement in its own shares (physical settlement or net-share settlement). The Company classifies as assets or liabilities any contracts that (i) require net-cash settlement (including a requirement to net cash settle the contract if an event occurs and if that event is outside the control of the Company) or (ii) gives the counterparty a choice of net-cash settlement or settlement in shares (physical settlement or net-share settlement).

Recent Accounting Pronouncements

In EITF Issue No. 04-8, "The Effect of Contingently Convertible Instruments on Diluted Earnings per Share," the EITF reached a consensus that contingently convertible instruments, such as contingently convertible debt, contingently convertible preferred stock and other such securities should be included in diluted earnings per share (if dilutive) regardless of whether the market price trigger has been met. The consensus became effective for reporting periods ending after December 15, 2004. The adoption of this pronouncement did not have material effect on the Company's financial statements.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections — a replacement of APB Opinion No. 20 and FASB Statement No. 3 ("SFAS 154"). This Statement replaces APB Opinion No. 20, "Accounting Changes," and FASB Statement No. 3, "Reporting Accounting Changes in Interim Financial Statements," and changes the requirements for the accounting for and reporting of a change in accounting principle. This Statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed.

APB Opinion No. 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. This Statement requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. When it is impracticable to determine the period-specific effects of an accounting change on one or more individual prior periods presented, this Statement requires that the new accounting principle be applied to the balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable and that a corresponding adjustment be made to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that period rather than being reported in an income statement. When it is

impracticable to determine the cumulative effect of applying a change in accounting principle to all prior periods, this Statement requires that the new accounting principle be applied as if it were adopted prospectively from the earliest date practicable. This Statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company's does not believe that the adoption of SFAS 154 did not have an effect on its financial statements.

On June 29, 2005, the EITF ratified Issue No. 05-2, "The Meaning of 'Conventional Convertible Debt Instrument' in EITF Issue No. 00-19, 'Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock.' " EITF Issue 05-2 provides guidance on determining whether a convertible debt instrument is "conventional" for the purpose of determining when an issuer is required to bifurcate a conversion option that is embedded in convertible debt in accordance with SFAS 133. Issue No. 05-2 is effective for new instruments entered into and instruments modified in reporting periods beginning after June 29, 2005. The Company does not believe that the adoption of this pronouncement did not have a significant effect on its financial statements.

In September 2005, Issue No. 05-4, "The Effect of a Liquidated Damages Clause on a Freestanding Financial Instrument Subject to EITF Issue No. 00-19, 'Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock.' " EITF 05-4 provides guidance to issuers as to how to account for registration rights agreements that require an issuer to use its "best efforts" to file a registration statement for the resale of equity instruments and have it declared effective by the end of a specified grace period and, if applicable, maintain the effectiveness of the registration statement for a period of time or pay a liquidated damage penalty to the investor. The Company is currently in the process of evaluating the effect that the adoption of this pronouncement may have on its financial statements.

In September 2005, the FASB ratified EITF Issue No. 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues," which addresses whether a modification to a conversion option that changes its fair value affects the recognition of interest expense for the associated debt instrument after the modification and whether a borrower should recognize a beneficial conversion feature, not a debt extinguishment if a debt modification increases the intrinsic value of the debt (for example, the modification reduces the conversion price of the debt). This issue is effective for future modifications of debt instruments beginning in the first interim or annual reporting period beginning after December 15, 2005. The Company does not believe that the adoption of this pronouncement will have a significant effect on its financial statements.

In September 2005, the FASB also ratified EITF Issue No. 05-8, "Income Tax Consequences of Issuing Convertible Debt with a Beneficial Conversion Feature," which discusses whether the issuance of convertible debt with a beneficial conversion feature results in a basis difference arising from the intrinsic value of the beneficial conversion feature on the commitment date (which is treated and recorded in stockholder's equity for book purposes, but as a liability for income tax purposes) and, if so, whether that basis difference is a temporary difference under FASB Statement No. 109, "Accounting for Income Taxes." This Issue should be applied by retrospective application pursuant to Statement 154 to all instruments with a beneficial conversion feature accounted for under Issue 00-27 included in financial statements for reporting periods beginning after December 15, 2005. The Company does not believe that the adoption of this pronouncement will have a significant effect on its financial statements.

In February 2006, the FASB issued SFAS No. 155 "Accounting for Certain Hybrid Financial Instruments-an amendment of FASB Statements No. 133 and 140" ("SFAS 155"). SFAS 155 addresses the following: a) permits fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation; b) clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133; c) establishes a requirement to evaluate interests in securitized

financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation; d) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and e) amends Statement 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company is currently evaluating the requirements of SFAS 155, but does not expect that the adoption of this pronouncement will have a material effect on its financial statements.

In March 2006, the FASB issued SFAS 156 "Accounting for Servicing of Financial Assets — an amendment of FASB Statement No. 140" ("SFAS 156"). SFAS 156 is effective for the first fiscal year beginning after September 15, 2006. SFAS 156 changes the way entities account for servicing assets and obligations associated with financial assets acquired or disposed of. The Company has not yet completed its evaluation of the impact of adopting SFAS 156 on its results of operations or financial position, but does not expect that the adoption of SFAS 156 will have a material impact.

The FASB issued FASB Interpretation No. ("FIN") 48, "Accounting for Uncertainty in Income Taxes," on July 13, 2006. The new rules will be effective for the Company in fiscal 2008. At this time, the Company has not completed its review and assessment of the impact of the adoption of FIN 48.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on the consolidated financial statements upon adoption.

In September 2006, the FASB issued SFAS No. 157, "Accounting for Fair Value Measurements" ("SFAS 157"). SFAS 157 defines fair value, and establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosure about fair value measurements. SFAS 157 is effective for financial statements issued subsequent to November 15, 2007. We do not expect the new standard to have any material impact on our financial position, results of operations or cash flows.

NOTE 4 — Accounts Receivable

Accounts receivable consisted of the following (in thousands):

	March 31,		September 30,
	2005	2006	2006
			(unaudited)
Accounts receivable	$ 227	$ 1,166	$ 1,872
Less: allowance for doubtful accounts	—	(90)	(171)
	$ 227	$ 1,076	$ 1,701

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NOTE 5 — Inventories

Inventories consisted of the following (in thousands):

	March 31,		September 30,
	2005	2006	2006
			(unaudited)
Raw materials	$ 272	$ 267	$ 351
Finished goods	817	1,046	48
	1,089	1,313	399
Less: inventory allowances	(221)	(996)	(44)
	$ 868	$ 317	$ 355

NOTE 6 — Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consisted of the following (in thousands):

	March 31,		September 30,
	2005	2006	2006
			(unaudited)
Prepaid expenses	$ 355	$ 304	$ 333
Value added tax receivable	—	722	588
Other current assets	144	360	187
	$ 499	$ 1,386	$ 1,108

NOTE 7 — Property and Equipment

Property and equipment consisted of the following (in thousands):

	March 31,		September 30,
	2005	2006	2006
			(unaudited)
Manufacturing and other equipment	$ 1,834	$ 1,866	$ 2,187
Office equipment	447	653	688
Furniture and fixtures	200	209	213
Leasehold improvements	219	498	482
Capital projects in progress	51	—	251
	2,751	3,226	3,821
Less accumulated depreciation and amortization	(792)	(1,286)	(1,597)
	$ 1,959	$ 1,940	$ 2,224

Fixed assets include $217,000 and $186,000 of equipment purchases that were financed under capital lease obligations as of March 31, 2005 and 2006, respectively (Note 10). The Company made approximately

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$40,000 and $37,000 of such purchases during the years ended March 31, 2004 and 2005, respectively. The accumulated amortization on these assets amounted to $80,000, $108,000 and $126,000 as of March 31, 2005 and 2006 and September 30, 2006, respectively.

Depreciation expense (including amortization of leased assets) amounted to $163,000, $434,000 and $651,000 for the years ended March 31, 2004, 2005 and 2006, respectively, and $307,000 and $328,000 for the six months ended September 30, 2005 and 2006, respectively.

NOTE 8 — Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consisted of the following (in thousands):

	March 31,		September 30,
	2005	2006	2006
			(unaudited)
Accrued salaries	$ 220	$ 267	$ 371
Accrued professional fees	641	673	566
Estimated liability for pending litigation	335	300	300
Investor deposits	497	—	—
Accrued stock option rescission	250	—	—
Accrued value added tax payable	285	220	187
Deferred revenue	—	156	163
Accrued other	107	70	218
	$ 2,335	$ 1,686	$ 1,805

NOTE 9 — Long-Term Debt

From May 1, 1999 through January 7, 2003, the Company issued various notes for aggregate principal amounting to $385,000 with interest rates ranging from 8% to 10.3% per annum. The proceeds of these notes were used to fund the Company's operations. The Company made the remaining principal payments on these notes which amounted to $84,000 and $185,000 during the years ending March 31, 2004 and 2005, respectively. Aggregate interest expense under these obligations amounted to $19,000 and $9,000 for the years ended March 31, 2004 and 2005, respectively.

On May 1, 1999, the Company issued a note payable in the amount of $64,000 with interest at 8% per annum and a final payment due on December 31, 2009. The remaining balance on this obligation, which amounts to $68,000 including accrued interest, is included in non-current portion of long-term debt in the accompanying balance sheet at March 31, 2006. Contractual interest expense under this note amounted to $7,000 for each of the years ended March 31, 2004 and 2005. In the six months ended September 30, 2006, the Company made principal payments on this note in the amount of $15,000.

On February 7, 2003, the Company issued a $40,000 convertible note to a director of the Company bearing interest at the rate of 10% per annum. The note was convertible, at the option of the holder, into such number shares of the Company's common stock or Series A preferred stock determined by dividing the amount to be converted by the conversion price of $4.00 per share.

On February 26, 2003, the Company issued a $40,000 convertible note to a director of the Company bearing interest at the rate of 10% per annum with a maturity date of August 26, 2004. The note was

convertible, at the option of the holder, into such number shares of the Company's common stock or Series A preferred stock determined by dividing the amount to be converted by the conversion price of $4.00 per share.

The proceeds of these notes were used to finance operating activities. The fair value of the underlying stock, measured at the commitment date of each of these financing transactions, was $8.00 per share. Accordingly, the Company recorded a $40,000 discount against the principal values of the each of these notes and a corresponding increase in stockholders' equity for the intrinsic value of the beneficial conversion feature in accordance with EITF 98-5. The principal balance of the note originated on February 7, 2003 was repaid in October 2004. The principal balance of the note originated on February 26, 2003 was converted into 40,000 shares of convertible series A preferred stock in June 2005.

Aggregate contractual interest expense under the convertible notes amounted to $3,000, $8,000 and $4,000 for the years ended March 31, 2004, 2005 and 2006, respectively.

On April 30, 2003, the Company completed a $500,000 financing transaction through the issuance of a note bearing variable interest at the rate of 18% to 22% per annum and warrants to purchase up to 20,618 shares of the Company's common stock (Note 12). In accordance with APB Opinion No. 14 "Accounting for Convertible Debt Issued with Stock Purchase Warrants," the Company allocated $538,000 of the proceeds to the note and $117,000 of proceeds to the warrants. The difference between the carrying amount of the note and its contractual redemption amount was accreted as interest expense through July 31, 2005, its earliest date of redemption. Accretion of the aforementioned discount amounted to $36,500, $60,100 and $20,400 for the years ended March 31, 2004, 2005, and 2006, respectively and is included as a component of interest expense in the accompanying statements of operations. The proceeds from this note were used to fund operating activities. Contractual interest expense under this obligation amounted to $72,500, $99,700 and $30,100 for the years ended March 31, 2004, 2005 and 2006, respectively. Principal payments on this note amounted to $100,000 and $400,000 during the years ended March 31, 2005 and 2006, respectively, including the final payment made in July 2005.

From November 2003 to March 2006, the Company issued various notes for aggregate principal amounting to $443,000 with interest rates ranging from 6.65% to 8.2% per annum. The proceeds of these notes were used to fund certain operating activities. The Company made principal payments on these notes which amounted to $21,300, $91,500 and $191,200 during the years ending March 31, 2004, 2005 and 2006, respectively, and $85,000 for the six months ended September 30, 2006. Interest expense under these note obligations amounted to $900, $2,000 and $4,800 for the years ended March 31, 2004, 2005 and 2006, respectively, and $5,000 for the six months ended September 30, 2006. The aggregate remaining principal balance of these notes, which amounts to $139,000, is included in the current portion of long-term debt in the accompanying balance sheet at March 31, 2006.

In March 2004, the Company entered into an equipment financing facility providing it with up to $1,000,000 of available credit to finance equipment purchases through March 31, 2005. During the year ended March 31, 2005, the Company drew an aggregate of $994,000 of advances under this facility, which are payable in 33 monthly installments with interest at the rate of 13.5% per annum and mature at various times through May 1, 2007. The Company also paid approximately $82,000 of fees to the lender under this arrangement including $5,000 in cash and $77,000 representing the fair value of warrants to purchase up to 16,666 shares of the Company's Series A preferred stock (Note 12). The company recorded the fair value of warrants and other fees as interest expense during the year ended March 31, 2005, the one year period in which the Company was permitted to draw advances under this facility. All borrowings under this arrangement are collateralized by the equipment financed under this facility. The Company made principal payments on these notes which amounted to $288,000 and $337,000 during the years ending March 31, 2005 and 2006 respectively, and $187,000 for the six months ended September 30, 2006. Interest expense under this obligation

amounted to $83,000 and $73,000 for the years ended March 31, 2005 and 2006, respectively, and $19,000 for the six months ended September 30, 2006. The remaining principal balance on this long-term debt amounted to $350,000 at March 31, 2006, including $332,000 included in the current portion of notes payable obligations in the accompanying balance sheet.

From January 2004 to March 2006, the Company issued various notes for aggregate principal amounting to $182,000 with interest rates ranging from 6.25% to 14.44% percent per annum. The proceeds of these notes were used to purchase automobiles and software. The Company made principal payments on these notes of $1,000, and $24,000 during the years ending March 31, 2005 and 2006, respectively, and $17,000 for the six months ended September 30, 2006. Aggregate interest expense under these obligations amounted to $1,000 and $8,900 for the years ended March 31, 2005 and 2006, respectively, and $6,000 for the six months ended September 30, 2006. These notes are payable in aggregate monthly installments of $3,000 through March 14, 2011. The remaining balance of these notes amounted to $156,000 at March 31, 2006, including $33,000 in the current portion of long-term debt in the accompanying balance sheet.

In June 2006, the Company entered into a credit facility providing it with up to $5,000,000 of available credit. The facility permitted the Company to borrow up to a maximum of $2,750,000 for growth capital, $1,250,000 for working capital based on eligible accounts receivable and $1,000,000 in equipment financing. During the three months ended June 30, 2006, the Company drew an aggregate of $4,182,000 of borrowings under this facility. These borrowings are payable in 30 to 33 fixed monthly installments with interest at rates ranging from 12.4% to 12.7% per annum, maturing at various times through April 9, 2009. The Company has no unused availability under this credit facility since amounts drawn under the working capital facility were based upon an initial measurement of eligible accounts receivable.

The Company also issued to the lender warrants to purchase up to 71,534 shares of its Series B preferred stock upon originating the loan. In addition, the Company will issue warrants to purchase up to 3,466 additional shares of its Series B preferred stock in connection with its utilization of the line of credit. The aggregate fair value of all warrants issued to the lender under this arrangement amounts to $1,047,000 (Note 12). This amount was recorded as debt issue costs in the September 30, 2006 balance sheet and is being amortized as interest expense over the term of the credit facility.

Borrowings under the growth capital line are collateralized by the total assets of the Company. Borrowings under the equipment line are collateralized by the underlying assets funded, and borrowings under the working capital line are collateralized by eligible accounts receivable. On a monthly basis, the Company must maintain a 1:1 ratio of borrowing under the working capital line to eligible accounts receivable. The Company has 30 days from each measurement date to either increase eligible accounts receivable or pay the excess principal in the event that the ratio is less than 1:1. No restrictive covenants exist for either the equipment line or the growth capital line. The Company made $167,000 of principal payments and paid $101,000 of interest on these notes during the six months ended September 30, 2006. The Company is not required to direct customer remittances to a lock box, nor does the credit agreement provide for subjective acceleration of the loans. The aggregate remaining principal balance under this facility amounted to $4,013,000, including $1,410,000 in the current portion of long term debt in the accompanying balance sheet at September 30, 2006.

In June 2006, the Company entered into a note agreement for $69,000 with interest rate of 7.94% percent per annum. The proceeds of this note were used to purchase an automobile. This note is payable in monthly installments of $1,200 through May 2012. The Company made principal payments of $2,900 and interest payments of $2,000 in the six months ended September 30, 2006. The remaining balance of this note

amounted to $66,000 at September 30, 2006, including $9,300 in the current portion of long-term debt in the accompanying balance sheet.

From July 2006 to September 2006, the Company entered into note agreements for $129,000 with interest rates ranging from 9.6% to 9.7% percent per annum. The proceeds of these notes were used to finance insurance premiums. These notes are payable in monthly installments of $11,400 through June 2007. The Company made principal payments of $40,700 and interest payments of $770 in the six months ended September 30, 2006. The remaining balance of these notes amounted to $88,300 at September 30, 2006, and is included in the current portion of long-term debt in the accompanying balance sheet.

A summary of principal payments due in years subsequent to March 31, 2006 is as follows (in thousands):

For years ending March 31,	
2007	$ 504
2008	54
2009	39
2010	106
2011	11
Total principal payments	714
Less: current portion	(504)
Long-term portion	$ 210

NOTE 10 — Capital Lease Obligations

From September 1, 2001, through July 1, 2002, the Company entered into various capital leases under which the aggregate present value of the minimum lease payments amounted to $123,000. In accordance with SFAS 13, “Accounting for Leases” (“SFAS 13”), the present value of the minimum lease payments was calculated using discount rates ranging from 10% to 17%. Lease payments, including amounts representing interest, amounted to $38,000, $36,000 and $15,000, for the years ended March 31, 2004, 2005 and 2006, respectively. These capital leases were paid in full by March 2006.

From September 1, 2003, through October 1, 2003, the Company entered into various capital leases under which the aggregate present value of the minimum lease payments amounted to $40,000. The present value of the minimum lease payments was calculated using discount rates of ranging from 13% to 18%. Lease payments, including amounts representing interest, amounted to $3,000, $11,000 and $11,000 for the years ended March 31, 2004, 2005 and 2006, respectively, and $6,000 for the six months ended September 30, 2006. The remaining principal balance on these obligations amounted to $27,000 at March 31, 2006, including $7,700 included in the current portion of capital lease obligations in the accompanying balance sheet.

On November 10, 2004, the Company entered into a capital lease under which the present value of the minimum lease payments amounted to $37,000. The present value of the minimum lease payments was calculated using a discount rate of 10%. Lease payments, including amounts representing interest, amounted to $3,900 and $8,500 for the years ended March 31, 2005 and 2006, respectively, and $4,600 for the six months ended September 30, 2006. The remaining principal balance on these obligations amounted to $29,000 at March 31, 2006, including $7,000 included in the current portion of capital lease obligations in the accompanying balance sheet.

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The Company recorded interest expense in connection with these lease agreements in the amounts of $9,600, $11,000 and $8,900 for the years ended March 31, 2004, 2005 and 2006, respectively, and $3,500 for the six months ended September 30, 2006.

Minimum lease payments due in years subsequent to March 31, 2006 are as follows (in thousands):

For years ending March 31,	
2007	$ 21
2008	21
2009	21
2010	6
Total minimum lease payments	69
Less: amounts representing interest	(13)
Present value of minimum lease payments	56
Less: current portion	(15)
Long-term portion	$ 41

NOTE 11 — Commitments, Contingencies and Other Matters

Lease Commitments

The Company has entered into various non-cancelable operating leases, primarily for office facility space, that expire at various time through April 2011. Minimum lease payments for non-cancelable operating leases are as follows (in thousands):

For years ending March 31,	
2007	$341
2008	177
2009	163
2010	92
2011	105
Total minimum lease payments	$878

Rent expense amounted to $273,000, $510,000 and $535,000 for the years ended March 31, 2004, 2005 and 2006, respectively. Rent expense amounted to $351,000 and $268,000 for the six months ended September 30, 2005 and 2006, respectively.

In September 2006, the Company extended its operating lease on its Petaluma facility. This lease was extended through September 2007.

Employment Agreements

During years ended March 31, 2005 and 2006, the Company entered into employment agreements with five of its key executives. The agreements provide, among other things, for the payment of aggregate annual salaries of approximately $880,000 and up to twenty four months of severance compensation for terminations

under certain circumstances. Aggregate potential severance compensation amounted to $1,284,000 at March 31, 2006.

In October 2005, the Board of Directors also authorized the Company to grant 60,000 stock options at an exercise price of $3.00 per share to its Chief Financial Officer upon the successful completion of its proposed IPO (if completed). These options, if awarded, would be fully vested and non-forfeitable at the date of grant.

Legal Matters

The Company was named as a defendant in an employment related matter under a complaint filed by one of its former employees in the Superior Court of the State of California in the County of Sonoma in April 2005. The Company entered into a settlement agreement with the plaintiff in November 2006, which provides for the payment of $250,000 and the issuance of a warrant to purchase 50,000 shares of our common stock exercisable at $3.00 per share. The warrants which will be nonforfeitable at the date of issuance will be recorded at fair value which is estimated to be $550,000. The expense will be recorded as general and administrative expense. The issuance of the warrant is subject to our obtaining appropriate waivers from our preferred stockholders and the cash payment is subject to the closing of an equity financing resulting in gross proceeds to the Company of $10 million or more, or the completion of our initial public offering of securities. Under the terms of the agreement, the plaintiff has agreed to dismiss his claim and has waived any other previous claims against us. Although the Company believes that the employee's claim is without merit and intends to defend its position with respect to this matter, a $300,000 reserve was established based on the Company's estimate of potential loss. Although the Company believes that its estimate is reasonable with respect to this matter, there can be no assurance that the Company will successfully defend itself against this litigation. The reserve is a component of accrued expenses and other current liabilities in the accompanying balance sheets.

In November 2005, the Company identified a possible criminal misappropriation of its technology in Mexico, and it notified the Mexican Attorney General's office. The Company believes the Mexican Attorney General is currently conducting an investigation.

On March 14, 2006, the Company filed suit in the U.S. District Court for the Northern District of California against Nofil Corporation and Naoshi Kono, Chief Executive Officer of Nofil, for breach of contract, misappropriation of trade secrets and trademark infringement. The Company believes that Nofil Corporation violated key terms of both an exclusive purchase agreement and non-disclosure agreement by contacting and working with a potential competitor in Mexico. In the complaint, the Company seeks damages of $3,500,000 and immediate injunctive relief. No trial date has been set.

The Company is currently a party in two trademark matters asserting confusion in trademarks with respect to the Company's use of the name Microcyn60 in Mexico. Although the Company believes that the nature and intended use of its products are different from those with the similar names, it has agreed with one of the parties to stop using the name Microcyn60 by September 2007. Although such plaintiff referred the matter to the Mexico Trademark Office, the Company is not aware of a claim for monetary damages. Company management believes that the name change will satisfy an assertion of confusion; however, Company management believes that the Company could incur a possible loss of approximately $100,000 for the use of the name Microcyn60 during the twelve month period following the date of settlement.

In June 2006, the Company received a written communication from the grantor of a license to an earlier version of its technology indicating that such license was terminated due to an alleged breach of the license agreement by the Company. The license agreement extends to the Company's use of the technology in Japan only. While the Company does not believe that the grantor's revocation is valid under the terms of the license

agreement and no legal claim has been threatened to date, the Company cannot provide any assurance that the grantor will not take legal action to restrict the Company's use of the technology in the licensed territory.

While the Company management does not anticipate that the outcome of this matter is likely to result in a material loss, there can be no assurance that if the grantor pursues legal action, such legal action would not have a material adverse effect on the Company's financial position or results of operations.

In August 2006, the Company received a "show cause" letter from the U.S. Environmental Protection Agency ("EPA"), which stated that, in tests conducted by the EPA, Cidalcyn was found to be ineffective in killing certain specified pathogens when used according to label directions. Based on its results, the EPA strongly recommended that the Company immediately recalled all Cidalcyn distributed on and after September 28, 2005. Accordingly, the Company has commenced a voluntary recall of Cidalcyn. Although the Company has not marketed Cidalcyn on a large commercial scale, it has provided it in small quantities to numerous hospitals solely for use in product evaluation exercises. In a second letter, the EPA stated it intended to file a civil administrative complaint against the Company for violation of the Federal Insecticide, Fungicide, and Rodenticide Act ("FIFRA"). Under FIFRA, the EPA could assess civil penalties related to the sale and distribution of a pesticide product not meeting the label's claims as a broad-spectrum hospital disinfectant. The Company believes that such civil penalties could be up to $200,000. The Company currently cannot estimate the actual amount of penalties which may be incurred. The Company does not believe this issue will have a material impact on future operations. The amount of expense to be incurred with regard to the recall of the product is currently not estimable, however, the Company believes any potential expense would be insignificant because the product was not commercialized and the number of samples distributed was minimal. For these reasons, the Company has not established an accrual for the product recall.

In September 2006, a consulting firm in Mexico City contacted the Company threatening legal action in Mexico, alleging breach of contract and claiming damages of $225,000. A formal compliant has not been served and no trial date has been set. The Company is currently in settlement negotiations with the plaintiff. If these negotiations are not successful, the Company intends to vigorously defend this action. If the claims are litigated, the Company may incur considerable litigation costs.

The Company, from time to time, is involved in legal matters arising in the ordinary course of its business. While management believes that such matters are currently insignificant, there can be no assurance that matters arising in the ordinary course of business for which the Company is or could become involved in litigation, will not have a material adverse effect on its business, financial condition or results of operations.

Consulting Agreements

On October 1, 2005 the Company entered into a consulting agreement with White Moon Medical. Akihisa Akao, a member of the Board of Directors, is the sole stockholder of White Moon Medical. Under the terms of the agreement, the individual will be compensated for services provided outside his normal Board duties. Total compensation to be paid amounts to $146,000, payable in monthly installments over the one year term of the agreement. In accordance with the terms of this agreement, the Company made payments in the amount of $146,000 for the period of October 1, 2005 to September 30, 2006. The Company extended the agreement for an additional one-year term.

As described in Note 18, the Company entered into a consulting agreement with Mr. Robert Burlingame, one of the Company's directors who also provided the company with a $4.0 million Bridge Loan which is described in Note 18.

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Proposed Initial Public Offering

On September 1, 2005 the Board of Directors authorized the Company to file a registration statement with the SEC in connection with its proposed IPO. The Company incurred $478,000 of costs during the year ended March 31, 2006 and $731,000 of costs in the six months ended September 30, 2006 in connection with its proposed IPO, which amounts are presented as deferred offering costs in the accompanying balance sheet at March 31, 2006 and September 30, 2006.

The Company expects to receive net proceeds of approximately $34.0 million from this offering, based on an assumed initial public offering price of $13.00 per share, after deducting the underwriting discount and estimated offering expenses. If the underwriters exercise their over-allotment option in full, our estimated net proceeds will be approximately $42.4 million.

The Company currently intends to use the proceeds of this offering as follows: approximately $12.6 million will be used to expand sales and marketing capabilities, including the expansion of a direct sales force in the U.S. and Europe, approximately $13.0 million will be used to fund clinical trials and related research, to repay the principal and interest of our Bridge Loan and the remaining proceeds are to be used for general corporate purposes, including working capital.

The Company cannot provide any assurance that it will complete its proposed IPO. The Company expects to incur substantial additional costs in connection with its efforts to complete this offering. If the Company completes its IPO, these costs will be recorded as a reduction of the proceeds received. If the Company does not successfully complete its IPO, the costs will be recorded as a charge to operations.

NOTE 12 — Stockholders' Equity

Authorized Capital

The Company is authorized to issue up to 25,000,000 shares of common stock and 7,500,000 shares of preferred stock of which 1,375,000 shares have been designated as Series A preferred stock, 2,805,555 shares have been designated as Series B preferred stock and 875,000 shares have been designated Series C preferred stock.

Description of Common Stock

Each share of common stock has the right to one vote. The holders of common stock are entitled to dividends when funds are legally available and when declared by the Board of Directors, subject to the prior right of the preferred Series A stockholders to cumulative dividends that accrue beginning January 1, 2006.

Convertible Preferred Stock

During the year ended March 31, 2004, the Company issued in a private placement transaction, 1,337,709 shares of its Series A convertible preferred stock for net proceeds of $6,628,000 (gross proceeds of $8,027,000 less offering costs of $1,399,000).

The Company also issued in a private placement transaction, an aggregate of 2,635,744 shares of its Series B for net proceeds of $43,722,000 (gross proceeds of $47,446,000 less offering costs of $3,724,000) including 1,014,093 shares issued during the year ended March 31, 2005 for net proceeds of $16,696,000 and 1,621,651 shares issued during the year ended March 31, 2006 for net proceeds of $27,026,000.

In addition to the above, during the six months ended September 30, 2006, the Company issued in a private placement transaction, an aggregate of 84,539 shares of its Series C stock for net proceeds of $1,370,000 (gross proceeds of $1,521,700 less offering costs of $152,170).

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The Series A is convertible into common stock at any time, at the option of the holder at a conversion price of $6.00 per share. The Series B and Series C is convertible into common stock at any time, at the option of the holder, at a conversion price of $18.00 per share.

The conversion prices of the Series A, Series B and Series C is subject to adjustment for stock splits, stock dividends, recapitalizations, dilutive issuances and other anti-dilution provisions, including circumstances in which the Company, at its discretion, issues equity securities or convertible instruments that feature prices lower than the conversion prices specified in the Series A, B and C preferred shares. The Series A, Series B and Series C are also automatically convertible into shares of the Company's common stock, at the then applicable conversion price, (i) in the event that the holders of two-thirds of the outstanding shares of Series A, Series B and Series C consent to such conversion; or (ii) upon the closing of a firm commitment underwritten public offering of shares of common stock of the Company yielding aggregate proceeds of not less than $20 million (before deduction of underwriters commissions and expenses); or (iii) Company's going public by means of a merger or acquisition which has a resultant market capitalization of greater than $75 million.

The Company has reserved 5,055,555 shares of its common stock for issuance upon the conversion of its convertible preferred stock.

Each share of Series A, Series B and Series C preferred has voting rights equal to an equivalent number of common shares into which it is convertible and votes together as one class with common stock. The holders of the Series A are entitled to receive cumulative dividends in preference to any dividend on the common stock at the rate of 6% per annum on the initial investment amount commencing January 1, 2006. Dividends accrued but unpaid with respect to this feature amounted to $121,000 for both the year ended March 31, 2006 and $242,000 for the six months ended September 30, 2006, and is presented as an increase in net loss available to the common stockholders for the year ended March 31, 2006 and six months ended September 30, 2006. The Company has the option of paying the dividend in either common stock or cash. The holders of Series B are entitled to receive non-cumulative dividends when and if declared by the Board. The holders of Series C are entitled to non-cumulative dividends when and if declared by the Board and only after the Series A have been paid all accrued but unpaid dividends and any dividends declared by the Board and payable to the Series B have been paid. The holders of Series A, Series B and Series C are also entitled to participate pro rata in any dividends paid on the common stock, if declared by the board of directors on an as converted basis.

In the event of any liquidation or winding up of the Company, the holders of the Series A shall be entitled to participate in the ratable distribution of the assets of the Company until the holders of the Series A have received a per share amount equal to $12.00 plus any declared but unpaid dividends. The holders of Series B are entitled to participate in the ratable distribution of the assets of the Company after the holders of Series A have received a per share amount equal to $12.00 and holders of Series B have received a per share amount equal to $22.50, plus any declared but unpaid dividends. The holders of Series C are entitled to participate in the ratable distribution of the assets of the Company after the holders of Series A have received a per share amount equal to $12.00, Series B have received a per share amount equal to $22.50 and Series C have received a per share amount equal to $22.50, plus any declared but unpaid dividends. Thereafter, any remaining assets would be distributed ratably to the holders of common stock until the common stockholders have received a per share amount equal to $12.00. Any remaining assets of the Company thereafter would be distributed ratably to the Series A preferred stockholders, Series B preferred stockholders, Series C preferred stockholders and to the common stockholders, on an as converted basis.

Liquidation events include (i) a final dissolution or winding up of the Company's affairs requiring a liquidation of all classes of stock, (ii) a merger, consolidation or similar event resulting in a more than 50% change in control, (iii) the sale of all or substantially all of the Company's assets and (iv) the effectuation (at

the Company's election) of any transaction or series of transactions resulting in a more than 50% change in control.

Under the terms of Series A, Series B and Series C registration rights agreements between the Company and its preferred stockholders, any time after six months following the Company's IPO (if completed), the Series A, Series B and Series C investors may request that the Company file a registration statement covering the public sale of the underlying common stock under the Securities Act of 1933, as amended (the "1933 Act") with limited rights to delay by the Company. The investors are also entitled to unlimited piggyback registration rights on all 1933 Act registrations of the Company (except for registrations relating to employee benefit plans on Form S-8 and corporate reorganizations on Form S-4). The foregoing demand and piggyback registration rights terminate on the earlier of (i) one year after the Company's IPO or (ii) such time as Rule 144 or another similar exemption under the 1933 Act is available for sale of all of an Investor's shares during a three-month period without registration. The Investors Rights Agreement also places certain restrictions on the preferred stockholders from selling their shares and provides them with certain rights of first refusal, co-sale and drag along and tag along rights for sales effectuated under certain circumstances.

As described in Note 3, the Company applies the classification and measurement principles enumerated in EITF Topic D-98 with respect to accounting for its issuances of the Series A, Series B and Series C preferred stock. The Company is required, under California law, to obtain the approval of its board of directors in order to effectuate a merger, consolidation or similar event resulting in a more than 50% change in control or a sale of all or substantially all of its assets. The board of directors is then required to submit proposals to enter into these types of transactions to its stockholders for their approval by majority vote. The Company's preferred stockholders do not (i) have control of the Company's Board of Directors and (ii) currently do not have sufficient voting rights to control a redemption of these shares by either of these events. In addition the effectuation of any transaction or series of transactions resulting in a more than 50% change in control of the Company can be made only by the Company at its own election. Based on these provisions, the Company classified its Series A, Series B and Series C preferred shares in stockholders' equity in the accompanying balance sheet because the liquidation events are deemed to be within the Company's control in accordance with the provisions of EITF Topic D-98.

Also as described in Note 3, the Company evaluated the conversion options embedded in the Series A, Series B and Series C securities to determine (in accordance with SFAS 133 and EITF 00-19) whether they should be bifurcated from their host instruments and accounted for as separate derivative financial instruments. The Company determined, in accordance with SFAS 133, that the risks and rewards of the common shares underlying the conversion feature are clearly and closely related to those of the host instrument. Accordingly the conversion features, which are not deemed to be beneficial at the commitment dates of these financing transactions, are being accounted for as embedded conversion options in accordance with EITF 98-5 and EITF 00-27.

The Company evaluates the Series A, Series B and Series C convertible preferred stock at each reporting date for appropriate balance sheet classification.

Stock Purchase Warrants Issued in Financing Transactions

During the year ended March 31, 2004, the Company issued a warrant to purchase 15,618 shares of common stock in connection with bridge financing at an exercise price of $8.00 per share, subject to adjustment in the event that the Company, at its discretion, issues equity securities or convertible instruments with exercise prices lower than the exercise price of these warrants. The warrants were valued using the Black-Scholes pricing model. Assumptions used were as follows: Fair value of the underlying stock $8.00; risk-free interest rate 3.03%; contractual life of 5 years; dividend yield of 0%; and volatility of 70%. The fair value of

these warrants, which amounted to $88,478, was recorded as interest expense in the accompanying statement of operations for the year ended March 31, 2004.

During the year ended March 31, 2005, the Company issued a warrant to purchase 5,000 shares of common stock in connection with bridge financing at an exercise price of $6.00 per share subject to adjustment in the event that the Company, at its discretion, issues equity securities or convertible instruments with exercise prices lower than the exercise price of these warrants. The warrants were valued using the Black-Scholes pricing model. Assumptions used were as follows: Fair value of the underlying stock $1.41; risk-free interest rate 2.94%; contractual life of 4 years; dividend yield of 0%; and volatility of 70%. The fair value of the warrants amounted to $28,309 and was recorded as interest expense in the accompanying statement of operations for the year ended March 31, 2005.

During the year ended March 31, 2005, the Company issued a warrant to purchase 16,666 shares of Series A preferred stock at an exercise price of $6.00 per share in connection with an equipment leasing arrangement. The warrants were valued using the Black-Scholes pricing model. Assumptions used were as follows: Fair value of the underlying stock $5.76; risk-free interest rate 5.55% percent; contractual life of 10 years; dividend yield of 0%; and volatility of 70%. The fair value of the warrants, which amounted to $77,000, was recorded as interest expense in the accompanying statement of operations for the year ended March 31, 2005.

During the year ended March 31, 2005, the Company issued a warrant to purchase 433,774 shares of common stock at an exercise price of $3.00 per share to the placement agent that managed the Series A offering. The warrants were fully exercisable at the date of issuance with no future performance obligations by the placement agent and expire the second year following an IPO by the Company.

During the year ended March 31, 2006, the Company issued a warrant to purchase 329,471 shares of common stock at an exercise price of $18.00 per share to the placement agent that managed the Series B stock offering. The warrants were fully exercisable at the date of issuance with no future performance obligations by the placement agent and expire the second year following an IPO by the Company.

During the six month period ended September 30, 2006, the Company issued warrants to purchase 71,534 shares of Series B preferred stock at an exercise price of $18.00 per share in connection with the new financing facility described in Note 9. The warrants were valued using the Black-Scholes pricing model. Assumptions used were as follows: Fair value of the underlying stock $18.00; risk-free interest rate 5.15% percent; contractual life of 11 years; dividend yield of 0%; and volatility of 70%. The fair value of the warrants, which amounted to $1,047,000, was recorded as deferred debt issue costs and is being amortized as interest expense over the term of the credit facility. Amortization of the these costs amounted to $125,000 and is included as a component of interest expense in the accompanying statement of operations for the six months ended September 30, 2006.

During the six months ended September 30, 2006, the Company issued a warrant to purchase 10,567 shares of common stock at an exercise price of $18.00 per share to the placement agent of the Series C stock offering. The warrants were fully exercisable at the date of issuance with no future performance obligations by the placement agent and expire five years from the date of issuance.

During the six months ended September 30, 2006, the Company issued warrants to purchase 16,907 shares of common stock at an exercise price of $18.00 per share to investors in conjunction with the purchase of 84,539 Series C stock units. The warrants require settlement in shares of the Company's common stock. The Company accounts for the issuance of common stock purchase warrants issued in connection with sales of its Units in accordance with the provisions of EITF 00-19 "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock". Based on the provisions of EITF 00-19, the

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Company classified the warrants as equity. In addition, the Company determined the preferred stock was issued with no effective beneficial conversion feature and therefore it was not necessary to record a deemed dividend.

Common Stock and Common Stock Purchase Warrants Issued to Non-Employees for Services

During the year ended March 31, 2004, the Company issued warrants to purchase 9,664 shares of common stock to various consultants at exercise prices ranging from $3.00 to $8.00 per share. The warrants were fully exercisable at date of issuance and expire on dates ranging from May 31, 2013 to February 14, 2014. The warrants were valued using the Black-Scholes pricing model. Assumptions used were as follows: Fair value of the underlying stock of $5.24 to $8.00; risk-free interest rate 3.69% to 4.35%; contractual life of 10 years; dividend yield of 0%; and a volatility of 70%. The fair value of the warrants amounted to $44,000 and was recorded as selling, general and administrative expense in the accompanying statement of operations for the year ended March 31, 2004.

During the year ended March 31, 2006, the Company issued 12,500 shares of common stock to a consultant in exchange for services provided. The fair value of the underlying stock was valued at $10.16 per share. The shares were fully earned when issued with no future performance obligation by the consultant. The aggregate fair value of the shares amounted to $127,000 and was recorded as a selling, general and administrative expense in the accompanying statement of operations for the year ended March 31, 2006.

During the year ended March 31, 2006, the Company issued warrants to purchase 73,843 shares of common stock to various consultants at an exercise price of $18.00 per share. Fair value of the underlying stock at the date of grant was $10.16 per share. The warrants become exercisable at various dates through November 11, 2009 and expire at various dates through August 31, 2015. The fair value of the warrants amounted to $153,000, $82,000 and $70,000 and was recorded as a selling, general and administrative expense in the accompanying statement of operations for the year ended March 31, 2006 and the six months ended September 30, 2005 and 2006, respectively. The non-vested portion of the warrants were adjusted to fair value at each reporting date using the following weighted average assumptions:

	Year Ended March 31,	Six Months Ended September 30,	
	2006	2005	2006
		(unaudited)	
Fair market value of common stock	$ 12.00	$ 10.16	$ 13.00
Estimated life	6.24 yrs	5.47 yrs	6.35 yrs
Risk-free interest rate	4.85%	4.11%	4.64%
Dividend yield	0.00%	0.00%	0.00%
Volatility	70%	70%	70%

The Company accounted for its issuance of stock based compensation to non-employees for services using the measurements date guidelines enumerated in SFAS 123 and EITF 96-18. Accordingly, the value of any awards that were vested and non forfeitable at their date of issuance were measured based on the fair value of the equity instruments at the date of issuance. The non-vested portion of awards that are subject to the future performance of the counterparty are adjusted at each reporting date to their fair values based upon the then current market value of the company's stock and other assumptions that management believes are reasonable.

During the six month period ended September 30, 2006, the Company issued 3,750 shares of common stock to a consultant in exchange for services provided. The fair value of the underlying stock was valued at

$11.28 per share. The shares were fully vested and were non-forfeitable when issued with no future performance obligation by the consultant. The aggregate fair value of the shares, which amounted to $43,000, was recorded as a selling, general and administrative expense in the accompanying statement of operations for the six months ended September 30, 2006.

Valuation of Common Stock

For the year ended March 31, 2004, all stock options that the Company granted to employees and non-employees under its 1999, 2000 and 2003 Stock Option Plans were recorded at their cash settlement value due to a compliance matter for which the statute of limitations has expired (Note 13). In July 2005, the Company engaged Valuation Research Corporation, an outside valuation specialist to determine the fair value of its common stock. The fair value of the Company's common stock, based on this valuation study, was determined to be $10.16 per share. Accordingly, the fair value of the Company's common stock underlying all equity transactions completed during the years ended March 31, 2004, 2005 and 2006 (other than options granted under the 1999, 2000 and 2003 stock option plans) was based on the results of the valuation study. The results were adjusted to the date of grant based on an analysis performed by management. The results were assessed for reasonableness by comparing such amounts to concurrent sales of other equity instruments to unrelated parties for cash and intervening events reflected in the price of the Company's stock.

In June 2006, the Company engaged Valuation Research Corporation, an independent valuation specialist, to determine the fair value of its common stock. The fair value of the Company's common stock, based on this valuation study, was determined to be $11.28 per share. The fair value of the Company's common stock underlying common equity transactions completed during the six months ended September 30, 2006 was based on the valuation study, the mid point of the Company's proposed IPO which was determined to be $13.00 and a negotiated exercise price of $18.00 per share for warrants issued to the placement agent for the Series C stock offering.

NOTE 13 — Stock Compensation Plans

1999, 2000 and 2003 Stock Plans

The 1999, 2000 and 2003 Stock Option Plans became effective May 1999, June 2000 and July 2003, respectively. The Plans provide for grants of both incentive stock options (ISO's) and non-qualified stock options (NSO's) to employees, consultants and directors. A total of 1,151,250, 348,750 and 1,000,000 common shares were reserved for issuance under the 1999, 2000 and 2003 Plans, respectively.

In accordance with the Plans, stated exercise price shall not be less than 100% and 85% of the estimated fair market value of the Company's common stock on the date of grant for ISO's and NSO's, respectively, as determined by the board of directors at the date of grant. With respect to any 10% shareholder, the exercise price of an ISO or NSO was not to exceed 110% of the estimated fair market value per share on the date of grant.

Options issued under the Plan have a ten-year term and generally became exercisable over a five-year period.

As of March 31, 2006, the Company's compensation committee of the board of directors determined that it would not approve any further grants under its 1999, 2000, and 2003 Plans. At March 31, 2006 there were 1,436,317 options available for issue in the 1999, 2000, and 2003 Plans that will not be issued.

On June 29, 2006, the compensation committee of the Company's board of directors adopted a resolution authorizing the Company to cancel these plans. Accordingly, 1,436,317 options previously available for issue are no longer available for future grants.

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2004 Stock Plan

The 2004 Stock Option Plan ("the 2004 Plan") became effective July 2004. The 2004 Plan provides for the issuance of both ISO's and NSO's. Nonqualified and incentive stock options may be granted to employees, consultants and directors. A total of 1,500,000 common shares were reserved for issuance under the 2004 Plan at March 31, 2005. As of March 31, 2006, 550,411 shares are available for future grant under the Plan.

In accordance with the Plan, the stated exercise price shall not be less than 100% and 85% of the estimated fair market value of common stock on the date of grant for ISO's and NSO's, respectively, as determined by the board of directors at the date of grant. With respect to any 10% shareholder, the exercise price of an ISO or NSO shall not be less than 110% of the estimated fair market value per share on the date of grant.

Options issued under the Plan have a ten-year term and generally become exercisable over a five-year period.

Options Granted Outside of Plans

In May 2004, the Company granted an option to purchase 300,000 shares of the Company's common stock with an exercise price of $0.16 per share to the Chief Executive Officer of the Company. The fair value of the underlying common stock at the date of grant was $5.96 per share. The options were fully exercisable on the date of grant. Stock compensation expense related to these options amounted to $1,740,000 and was recorded in selling, general and administrative expense in the year ended March 31, 2005.

Options Subject to Repurchase

In the period from May 1999 to December 2003, the Company granted an aggregate of 1,827,405 stock options to various employees and non-employees under its 1999, 2000, and 2003 Plans. Subsequent to making such grants, the Company determined that such grants may not have been exempt from registration or qualification rights under the provisions of applicable state securities laws. A failure to comply with applicable state securities laws may give rise to claims optionees against the Company for the repurchase of their unexercised options at an amount determined by a formula specified by state securities law regulators, plus legal interest, or rescission of the purchase of the shares of common stock issued upon exercise of the options at an amount equal to the exercise price of the options, plus interest from the date of exercise. The repurchase and rescission rights held by the Company's security holders, if any, are subject to applicable statute of limitations prescribed by state law. In California, the statute of limitation is two years. During the period from May 2001 to December 2005 the statute of limitations would have lapsed for bringing claims against the Company related to options granted during the period from May 2001 to December 2005 subject to California law.

The Company accounted for the repurchase and rescission rights in accordance with APB 25 paragraph 25 and SFAS 123 paragraph 25, both of which are titled "Awards That Call for Settlement in Cash". These standards require entities to record stock based compensation awards as liability instruments when the optionee has the ability to compel the entity to settle the award by transferring cash or other assets. In addition, other accounting literature (including literature relating to accounting for derivative financial instruments) requires liability classification when a net cash settlement is in the holder's control. The Company believes that if the holders of these awards possess a free standing right to require cash settlement that liability classification of these awards is required under APB 25 and SFAS 123 (the standards applicable at the time of grant) and that such treatment is consistent with the principles of other literature relating to the classification of financial instruments. Accordingly, these awards were classified as liability instruments for their estimated cash

settlement amounts. The Company reclassified the liability instruments to permanent equity at the time the statute of limitations lapsed and the holder could no longer control settlement of the award in cash.

In the year ended March 31, 2004, 2005, 2006, and the six months ended September 30, 2005, the Company included in the accompanying statements of operations stock compensation expense of $343,000, $22,000, $6,000, and $6,000 respectively. In addition, included in accrued liabilities in the accompanying balance sheet at March 31, 2005 are liabilities relating to the repurchase offers, including statutory interest, of $250,169.

Stock-Based Compensation Before Adoption of SFAS No. 123(R)

Prior to April 1, 2006, the Company accounted for stock-based employee compensation arrangements in accordance with the provisions of APB No. 25, "Accounting for Stock Issued to Employees," and its related interpretations and applied the disclosure requirements of SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure, an amendment of FASB Statement No. 123." The Company used the minimum value method to measure the fair value of awards issued prior to April 1, 2006 with respect to its application of the disclosure requirements under SFAS 123.

The following table illustrates the effect on net loss as if the Company had applied the fair value recognition provisions of SFAS 123 to stock-based compensation arrangements (in thousands, except per share data):

	Year Ended March 31,		
	2004	2005	2006
Net loss available to common stockholders, as reported	$ (7,298)	$ (16,530)	$ (23,220)
Add: Total stock-based employee compensation expenses included in Net loss	30	2,297	279
Deduct: Total stock-based employee compensation determined under the fair-value based method for all awards	(81)	(2,448)	(503)
Net loss available to common stockholders, pro forma	$ (7,349)	$ (16,681)	$ (23,444)
Net loss per common share, basic and diluted:			
As reported	$ (1.88)	$ (4.22)	$ (5.60)
Pro forma	$ (1.88)	$ (4.26)	$ (5.65)

In accordance with the provisions of SFAS No. 123, the fair value of each employee option granted in reporting periods prior to the adoption of SFAS 123(R) was estimated on the date of grant using the minimum value method with the following weighted-average assumptions:

	Year Ended March 31,			Three Months Ended Sept 30,
	2004	2005	2006	2005
Estimated life	6 yrs	6 yrs	6 yrs	6 yrs
Risk-free interest rate	3.18%	3.95%	4.27%	3.76%
Dividend yield	0.00%	0.00%	0.00%	0.00%

The weighted-average estimated minimum values of options granted were $0.96, $5.00 and $3.12 for the years ended March 31, 2004, 2005 and 2006, respectively, and $7.12 for the six months ended September 30, 2005.

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A summary of activity under option Plans as of March 31, 2006 is presented below

		Options Outstanding	
	Options Available for Grant	Number of Options	Weighted Average Exercise Price
Balance at March 31, 2003	451,100	1,027,000	$ 0.45
Options authorized	1,000,000	—	
Options granted	(544,405)	544,405	3.00
Options exercised	—	(30,500)	0.18
Options canceled	6,500	(6,500)	2.69
Balance at March 31, 2004	913,195	1,534,405	1.35
Options authorized	1,500,000	—	—
Options granted	(313,089)	313,089	3.00
Options exercised	—		3.00
Options canceled	507,575	(507,575)	1.30
Balance at March 31, 2005	2,607,681	1,339,919	1.75
Options authorized	—	—	—
Options granted	(786,998)	786,998	9.20
Options exercised	—	(291,828)	1.02
Options canceled	166,050	(166,050)	6.17
Balance at March 31, 2006	1,986,733	1,669,039	$ 4.96

The options outstanding and currently exercisable under Plans by exercise price at March 31, 2006 are as follows:

	Options Outstanding and Exercisable			Options Vested	
Exercise Price	Number Outstanding	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$0.11-$0.85	396,000	3.41	$ 0.37	396,000	$ 0.37
$1.10-$2.50	56,000	4.53	$ 2.10	56,000	$ 2.10
$3.00-$3.00	547,791	7.77	$ 3.00	249,073	$ 3.00
$4.40-$4.40	90,000	9.05	$ 4.40	10,000	$ 4.40
$10.16-$12.00	579,248	9.57	$ 10.30	—	$ —
	1,669,039	7.32	$ 4.96	711,073	$ 1.49

Stock-Based Compensation After Adoption of SFAS 123(R) (Unaudited)

Effective April 1, 2006, the Company adopted SFAS No. 123(R), *Share-Based Payment*, using the prospective transition method, which requires the measurement and recognition of compensation expense for all share-based payment awards granted, modified and settled to the Company's employees and directors after April 1, 2006. The Company's financial statements as of and for the six months ended September 30, 2006 reflect the impact of SFAS No. 123(R). In accordance with the prospective transition method, the Company's

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financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123(R).

The effect of the change of recording stock-based compensation expense from the original provisions of APB No. 25 to the provisions of SFAS No. 123(R)for the six months ended September 30, 2006 is as follows (unaudited):

	Impact from SFAS No. 123(R) Provisions for Six Months Ended September 30, 2006
Cost of revenues service	$ 1,000
Selling, general and administrative	41,000
Total stock based compensation	$ 42,000
Effect on basic and diluted net loss per common share	$ (0.01)

No income tax benefit has been recognized relating to stock-based compensation expense and no tax benefits have been realized from exercised stock options. The implementation of SFAS No. 123(R) did not have an impact on cash flows from financing activities during the six months ended September 30, 2006.

The Company estimated the fair value of employee stock options using the Black-Scholes option pricing model. The fair value of employee stock options is being amortized on a straight-line basis over the requisite service period of the awards. The fair value of employee stock options was estimated using the following weighted-average assumptions for the six months ended September 30, 2006 (unaudited):

	Six Months Ended
Estimated life	6 yrs.
Risk-free interest rate	4.76%
Dividend yield	0.00%
Volatility	70%

The expected term of stock options represents the average period the stock options are expected to remain outstanding and is based on the expected term calculated using the approach prescribed by SAB 107 for “plain vanilla” options. The Company used this approach as it did not have sufficient historical information to develop reasonable expectations about future exercise patterns and post-vesting employment termination behavior. The expected stock price volatility for the Company’s stock options for the six months ended September 30, 2006 was determined by examining the historical volatilities for industry peers and using an average of the historical volatilities of the Company’s industry peers as the Company did not have any trading history for the Company’s common stock. The Company will continue to analyze the historical stock price volatility and expected term assumption as more historical data for the Company’s common stock becomes available. The risk-free interest rate assumption is based on the U.S. Treasury instruments whose term was consistent with the expected term of the Company’s stock options. The expected dividend assumption is based on the Company’s history and expectation of dividend payouts.

In addition, SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated

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based on historical experience. Prior to the adoption of SFAS No. 123(R), the Company accounted for forfeitures as they occurred.

A summary of all option activity, including options issued outside of plans, as of September 30, 2006 (unaudited), and changes during the six month period ended September 30, 2006 is presented below (unaudited):

Options	Shares (000)	Weighted-Average Exercise Price	Weighted-Average Contractual Term	Aggregate Intrinsic Value ($000)
Outstanding at April 1, 2006	1,969	$ 4.22		
Granted	170	12.00		
Forfeited or expired	(14)	10.16		
Outstanding at September 30, 2006	2,125	4.81	7.16	$ 17,402
Exercisable at September 30, 2006	1,103	$ 1.28	5.66	$ 12,939

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying stock options and the fair value of the Company's common stock ($13.00) for stock options that are in-the-money as of September 30, 2006.

At September 30, 2006, there was $598,000 of unrecognized compensation cost related to options that the Company accounted for under APB 25 through March 31, 2006. These costs are expected to be recognized over a weighted average amortization period of 1.82 years.

During the six months ended September 30, 2006, the Company granted 170,124 stock options to employees with a weighted-average grant date fair value of $7.92 per share. At September 30, 2006, there was unrecognized compensation costs of $1,299,000 related to these stock options. The cost is expected to be recognized over a weighted-average amortization period of 4.82 years.

The weighted-average estimated minimum values of options granted were $0.96, $5.00 and $3.12 for the years ended March 31, 2004, 2005 and 2006, respectively and $7.12 for the six months ended September 30, 2005.

In the six months ended September 30, 2006, the Company did not modify any stock options granted to employees or non-employees under share based arrangements or capitalize the cost associated with stock based compensation.

The Company issues new shares of common stock upon exercise of stock options.

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Non-Employee Options

The Company believes that the fair value of the stock options issued to non-employees is more reliably measurable than the fair value of the services received. The fair value of the stock options granted was calculated using the Black-Scholes option-pricing model as prescribed by SFAS No. 123 using the following weighted-average assumptions:

	Year Ended March 31,			Six Months Ended September 30,	
	2004	2005	2006	2005	2006
				(unaudited)	
Estimated life	8.25 yrs	9.06 yrs	8.67 yrs	8.73 yrs	8.52 yrs
Risk-free interest rate	3.88%	4.50%	4.27%	4.00%	4.67%
Dividend yield	0.00%	0.00%	0.00%	0.00%	0.00%
Volatility	70%	70%	70%	70%	70%

The stock-based compensation expense will fluctuate as the fair market value of the common stock fluctuates. In connection with stock options granted to non-employees, the Company recorded $7,000, $30,000, $32,000 of stock-based compensation expense in the years ended March 31, 2004, 2005 and 2006, respectively, and $22,000 and $10,000 for the six months ended September 30, 2005 and 2006, respectively.

NOTE 14 — Taxes

The Company has the following net deferred tax assets (in thousands):

	March 31,	
	2005	2006
Deferred tax assets:		
Net operating loss carryforwards	$ 8,870	$ 17,290
Tax credits carryforwards	123	212
Stock-based compensation	964	1,070
Reserves and accruals	327	186
Total deferred tax assets	10,284	18,758
Deferred tax liabilities:		
Basis difference in assets	(100)	(78)
State taxes	(508)	(897)
Total deferred tax liabilities	(608)	(975)
Net deferred tax asset	9,676	17,783
Valuation allowance	(9,676)	(17,783)
Net deferred tax asset	$ —	$ —

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The Company's recorded income tax benefit, net of the change in the valuation allowance, for each of the periods presented is as follows (in thousands):

	Year Ended March 31,		
	2004	2005	2006
Income tax benefit	$ 2,479	$ 6,019	$ 8,107
Change in valuation allowance	(2,479)	(6,019)	(8,107)
Net income tax benefit	$ —	$ —	$ —

A reconciliation of the statutory federal income tax rate to the Company's effective tax rate is as follows:

	Year Ended March 31,		
	2004	2005	2006
Expected statutory rate	(34.0)%	(34.0)%	(34.0)%
State income taxes, net of federal benefit	(3.0)%	(3.8)%	(3.3)%
Foreign earnings taxed at different rates	1.4%	1.0%	1.8%
Effect of permanent differences	1.7%	0.3%	0.3%
	(33.9)%	(36.5)%	(35.2)%
Change in valuation allowance	33.9%	36.5%	35.2%
Totals	0.0%	0.0%	0.0%

At March 31, 2006, the Company had net operating loss carryforwards for federal, state and foreign income tax purposes of approximately $28,800,000, $25,900,000 and $17,400,000, respectively. The carryforwards expire beginning 2020, 2010 and 2014, respectively. The Company also had, at March 31, 2006, federal and state research credit carryforwards of approximately $104,000 and $108,000, respectively. The federal credits expire beginning in 2026 and the state credits do not expire.

The Company experienced substantial ownership changes in connection with financing transactions it completed through the year ended March 31, 2006. Accordingly, the Company's utilization of its net operating loss and tax credit carryforwards against taxable income in future periods, if any, is subject to substantial limitations under the Change in Ownership rules of Section 382 of the Internal Revenue Code. The Company, after considering all available evidence, fully reserved for these and its other deferred tax assets since it is more likely than not such benefits will not be realized in future periods. The Company has incurred losses for both financial reporting and income tax purposes for the six months ended September 30, 2006 and anticipates it will incur such losses for the year ended March 31, 2007. Accordingly, the Company is continuing to fully reserve for its deferred tax assets. The Company will continue to evaluate its deferred tax assets to determine whether any changes in circumstances could affect the realization of their future benefit. If it is determined in future periods that portions of the Company's deferred income tax assets satisfy the realization standard of SFAS No. 109, the valuation allowance will be reduced accordingly.

NOTE 15 — Employee Benefit Plan

In 2002, the Company established a program to contribute and administer individual retirement accounts for regular full time employees. Under the plan the Company matches employee contributions to the plan up to 3% of the employee's salary. The Company contributed $34,000, $63,000 and $53,000 to the program for

the years ended March 31, 2004, 2005 and 2006, respectively, and $25,000 and $32,000 for the six months ended September 30, 2005 and 2006, respectively.

NOTE 16 — Segment and Geographic Information

In accordance with SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information" ("SFAS 131"), operating segments are identified as components of an enterprise for which separate and discreet financial information is available and is used by the chief operating decision maker, or decision-making group, in making decisions on how to allocate resources and assess performance. The Company's chief decision-makers, as defined by SFAS 131, are the Chief Executive Officer and his direct reports.

The Company's chief decision-makers review financial information presented on a consolidated basis, accompanied by disaggregated information about revenue and operating profit by operating unit. This information is used for purposes of allocating resources and evaluating financial performance.

The accounting policies of the segments are the same as those described in the "Summary of Significant Accounting Policies." Segment data includes segment revenue, segment operating profitability, and total assets by segment. Shared corporate operating expenses are reported in the U.S. segment.

The Company is organized primarily on the basis of operating units which are segregated by geography.

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The following tables present information about reportable segments (in thousands):

	U.S.	Europe	Mexico	Total
Year ended March 31, 2004:				
Product revenues	$ —	$ —	$ 95	$ 95
Service revenues	807	—	—	807
Total revenues	807	—	95	902
Depreciation expense	159	2	2	163
Operating loss	(4,914)	(209)	(1,974)	(7,097)
Interest expense	(178)	—	—	(178)
Interest income	3	—	—	3
Total assets	2,150	245	597	2,992
Year ended March 31, 2005:				
Product revenues	$ 4	$ 35	$ 434	$ 473
Service revenues	883	—	—	883
Total revenues	887	35	434	1,356
Depreciation expense	368	49	17	434
Operating loss	(12,242)	(1,529)	(2,541)	(16,312)
Interest expense	(372)	—	—	(372)
Interest income	8	—	—	8
Total assets	5,017	858	1,065	6,940
Year ended March 31, 2006:				
Product revenues	$ 109	$ 69	$ 1,788	$ 1,966
Service revenues	618	—	—	618
Total revenues	727	69	1,788	2,584
Depreciation expense	463	96	92	651
Operating loss	(12,621)	(2,685)	(5,545)	(20,851)
Interest expense	(172)	—	—	(172)
Interest income	282	—	—	282
Total assets	8,977	1,652	2,060	12,689
Six months ended September 30, 2005 (unaudited):				
Product revenues	$ 88	$ 64	$ 655	$ 807
Service revenues	275	—	—	275
Total revenues	363	64	655	1,082
Depreciation expense	227	42	39	307
Operating loss	(5,518)	(913)	(3,003)	(9,434)
Interest expense	(103)	—	—	(103)
Interest income	68	—	—	68
Total assets	19,069	1,187	7,098	27,354

OCULUS INNOVATIVE SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(INFORMATION AS OF SEPTEMBER 30, 2006 AND FOR THE SIX MONTHS ENDED SEPTEMBER 30, 2005 AND 2006 IS UNAUDITED)

	U.S.	Europe	Mexico	Total
Six months ended September 30, 2006 (unaudited):				
Product revenues	$ 56	$ 828	$ 1,058	$ 1,942
Service revenues	388	—	—	388
Total revenues	444	828	1,058	2,330
Depreciation expense	190	92	46	328
Operating loss	(5,715)	(1,053)	(1,829)	(8,597)
Interest expense	(261)	—	—	(261)
Interest income	100	—	—	100
Total assets	5,172	2,514	2,370	10,056

NOTE 17 — Discontinued Operations

On June 16, 2005, the Company entered into a series of agreements with Quimica Pasteur, or QP, a Mexico-based company engaged in the business of distributing pharmaceutical products to hospitals and health care entities owned or operated by the Mexican Ministry of Health. These agreements provided, among other things, for QP to act as the Company's exclusive distributor of Microcyn to the Mexican Ministry of Health for a period of three years. In connection with these agreements, an individual designated by the Company who is also one of the Company's executive officers concurrently acquired, in his individual capacity and for no additional consideration, a 0.25% equity interest in QP. The Company was granted an option to acquire the remaining 99.75% directly from its principals in exchange for 600,000 shares of common stock, contingent upon QP's attainment of certain financial milestones. The Company's distribution and related agreements were cancelable by the Company on thirty days' notice without cause and included certain provisions to hold the Company harmless from debts incurred by QP outside the scope of the distribution and related agreements. The Company terminated these agreements on March 26, 2006.

Due to its liquidity circumstances, QP was unable to sustain operations without the Company's subordinated financial and management support. Accordingly, QP was deemed to be a variable interest entity in accordance with FIN 46(R) and its results were consolidated with the Company's financial statements for the period of June 16, 2005 through March 26, 2006, the effective termination date of the distribution and related agreements.

In accordance with SFAS 144, the Company has reported QP's results for the period of June 16, 2005 through March 26, 2006 as discontinued operations because the operations and cash flows of QP have been eliminated from the Company's ongoing operations as a result of having terminated these agreements. The Company no longer has any continuing involvement with QP as of the date in which the agreements were terminated. Amounts associated with the Company's loss upon the termination of its agreements with QP, which consists of funds advanced by the Company for working capital, are presented separately from QP's operating results.

Subsequent to having entered into the agreements with QP, the Company became aware of an alleged tax avoidance scheme involving the principals of QP. The audit committee of the Company's board of directors engaged an independent counsel, as well as tax counsel in Mexico to investigate this matter. The audit committee of the board of directors was advised that QP's principals could be liable for up to $7,000,000 of unpaid taxes; however, the Company is unlikely to have any loss exposure with respect to this matter because the alleged tax omission occurred prior to the Company's involvement with QP. The Company has not received any communications to date from Mexican tax authorities with respect to this matter.

OCULUS INNOVATIVE SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(INFORMATION AS OF SEPTEMBER 30, 2006 AND FOR THE SIX MONTHS ENDED SEPTEMBER 30, 2005 AND 2006 IS UNAUDITED)

Based on an opinion of Mexico counsel, the Company management and the audit committee of the board of directors do not believe that the Company is likely to experience any loss with respect to this matter. However, there can be no assurance that the Mexican tax authorities will not pursue this matter and, if pursued, that it would not result in a material loss to the Company.

NOTE 18 — Subsequent Events

Private Placement of Series C Preferred Stock

On October 20, 2006, the Company sold 108,486 units, consisting of 108,486 shares of Series C convertible preferred stock and warrants to purchase 21,697 shares of the Company's common stock at $18.00 per share, at a per unit price of $18.00. Gross proceeds from this sale amounted to $1,952,748 and proceeds net of commissions amounted to $1,757,473. In addition, the Company issued to the placement agent warrants to purchase 13,560 shares of the Company's common stock at $18.00 per share. These shares were sold in connection with an agreement entered into between the Company and a placement agent in May 2006. The Series C shares are described in Note 12.

Termination of Distribution Agreement

In October 2006, the Company agreed to pay a distributor $90,000 to terminate an agreement which provided the distributor with exclusive rights to sell the Company's products in the United Kingdom. This agreement was reached between the Company and distributor without legal action.

Consulting Agreement

On November 7, 2006, the Company entered into a two-year consulting agreement with its new director, Robert Burlingame. Under the terms of the agreement, the Company has issued the consultant a warrant to purchase 75,000 shares of the Company's common stock, exercisable at $13.00 per share in consideration of corporate advisory services.

Bridge Financing

On November 7, 2006, the Company signed a loan agreement with Robert Burlingame, one of the company's directors, in the amount of $4.0 million, which funded on November 10, 2006 and which will accrue interest at an annual rate of 7%. Concurrently, Mr. Burlingame became a consultant to the Company under a two-year consulting agreement, and he was appointed to fill the vacancy on the Company's board of directors. The principal and all accrued interest under the loan agreement will become due and payable in full with interest on the earlier of November 10, 2007 or five business days after the completion of an initial public offering resulting in gross proceeds to us of at least 30.0 million. The loan will be secured by all of our assets, other than our intellectual property, but will be subordinate to the security interest held by our secured lender. At the time the principal is advanced to us, Brookstreet Securities Corporation will be paid a fee of $50,000 and will be granted a warrant to purchase 25,000 shares of the Company's common stock at an exercise price of $18.00 per share.

Settlement Agreement

In November 2006, the Company entered into a settlement agreement with a former director and chief operating officer. The settlement agreement provides for a $250,000 cash payment, which is subject to the Company closing equity financing with gross proceeds of $10 million or more, or its initial public offering. In addition, the plaintiff will be provided a warrant to purchase 50,000 shares of the Company's common stock at an exercise price of $3.00 per share. Issuance of the warrant is subject to the waiver of any applicable rights

by the holders of the Company's preferred stock under the Company's Amended and Restated Investors Rights Agreement. The Company previously reserved for this litigation and the expense will be recorded as a general and administrative expense in the period the warrants are approved and issued (Note 11).

Engagement Letter

In November 2006, the Company engaged an investment bank (the "Underwriter") as financial advisors and lead underwriter in connection with a proposed offering of approximately $40 million of the Company's common stock, plus a 15% over-allotment option and agreed to pay a fee equal to 7% and a non-accountable expense allowance of 1.0% of the gross proceeds from the offering. In addition, contingent upon the closing of the offering, the Company will issue to the Underwriter warrants to purchase common stock equal to 7% of the total shares issued and outstanding upon the final closing of the offering at an exercise price of 165% of the offering price.

Board Nomination

On November 7, 2006, the Board of Directors appointed an individual to fill the vacant Series A board seat. Pursuant to the terms of the Director Agreement, the Company will issue the individual an option to purchase 75,000 shares of the Company's common stock at $13.00 per share. The options vest immediately and are exercisable for a period of five years.

2006 Stock Incentive Plan

On November 7, 2006, the board authorized and reserved 1,250,000 shares for issuance of options that may be granted under the Company's 2006 Stock Incentive Plan, which was previously adopted by the board of directors.

Stock-split

On November 7, 2006, the board of directors authorized the Company to effectuate a reverse split of its common stock within a specified range to satisfy a pre-condition requiring it to complete a reverse split of its stock prior to completing its proposed IPO. Pursuant to delegation of authority by the board of directors, the pricing committee approved a 1 for 4 reverse split on December 1, 2006. Accordingly, the accompanying financial statements give retroactive effect to a 1 for 4 reverse stock split for all periods presented. The reverse stock split is subject to stockholder approval and may be subject to possible change based on the final terms and conditions of the underwriting commitment that the Company anticipates it will enter into in connection with completing its proposed IPO. Although management believes that the Company's stockholders will approve the reverse split, there can be no assurance that such approval will be obtained. The Company also cannot provide any assurance that the proposed IPO will be completed according to the terms that are currently contemplated, if at all.

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3,076,923 Shares

Oculus Innovative Sciences, Inc.

Common Stock

ROTH CAPITAL PARTNERS

MAXIM GROUP LLC

BROOKSTREET SECURITIES CORPORATION

The date of this prospectus is , 2006

Until , 2006, all dealers that effect transaction 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.

Part II

INFORMATION NOT REQUIRED IN PROSPECTUS

Item 13. Other Expenses of Issuance and Distribution

The following table sets forth the various expenses expected to be incurred by the Registrant in connection with the sale and distribution of the securities being registered hereby, other than underwriting discounts and commissions. All amounts listed are estimated except the Securities and Exchange Commission registration fee, the National Association of Securities Dealers, Inc. filing fee and the Nasdaq Global Market listing fee.

SEC registration fee	$ 8,614
National Association of Securities Dealers, Inc. filing fee	8,550
Nasdaq Global Market listing fee	100,000
Blue Sky fees and expenses	10,000
Accounting fees and expenses	875,000
Legal fees and expenses	1,200,000
Printing and engraving expenses	350,000
Registrar and Transfer Agent's fees	100,000
Miscellaneous fees and expenses	100,000
Nonaccountable underwriter expenses	$ 400,000
Total	$ 3,152,164

Item 14. Indemnification of Directors and Officers

In connection with the completion of this offering, the Registrant intends to reincorporate into Delaware. Section 145 of the Delaware General Corporation Law provides for the indemnification of officers, directors, and other corporate agents in terms sufficiently broad to indemnify such persons under certain circumstances for liabilities (including reimbursement for expenses incurred) arising under the Securities Act of 1933 (the "Securities Act"). The Registrant's form of Restated Certificate of Incorporation to be effective upon completion of this offering (Exhibit 3.3 hereto) and the Registrant's form of Bylaws to be effective upon completion of this offering (Exhibit 3.6 hereto) provide for indemnification of the Registrant's directors, officers, employees and other agents to the fullest extent permitted by the Delaware General Corporation Law. The Registrant also intends to enter into agreements with its directors and officers that will require the Registrant, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors or officers to the fullest extent not prohibited by law.

The Underwriting Agreement (Exhibit 1.1) will provide for indemnification by the Underwriters of the Registrant, its directors and officers, and by the Registrant, of the Underwriters, for certain liabilities, including liabilities arising under the Securities Act, and affords certain rights of contribution with respect thereto.

Item 15. Recent Sales of Unregistered Securities

The following information does not give effect to the Registrant's reverse split to be effected prior to the completion of this offering.

Exercises of Stock Options

On various dates between January 14, 2002 and November 30, 2006, the Registrant sold 1,334,916 shares of its common stock to employees and directors pursuant to the exercise of options granted under our 1999, 2000, 2003 and 2004 stock plans. The exercise prices per share ranged from $0.03 to $0.75, for an aggregate consideration of $297,585.

The sales of the above securities were considered to be exempt from registration under the Securities Act in reliance on Rule 701 promulgated under Section 3(b) of the Securities Act, as transactions under compensatory benefit plans and contracts relating to compensation as provided under Rule 701. The sale of the above securities in a 12 months period did not exceed the greater of (a) $1,000,000, (b) 15% of total assets as of the Registrant's most recent balance sheet or (c) 15% of the number of outstanding shares of the Registrant's common stock sold in reliance on this Rule.

Issuances of Capital Stock in Financing Rounds

On various dates between August 7, 2003 and February 25, 2004, the Registrant sold 5,391,244 shares of series A convertible preferred stock for aggregate consideration of $8,066,866 to 198 accredited investors. In connection with these sales the Registrant paid to Brookstreet Securities Corporation, or Brookstreet, as placement agent, an aggregate of $1,123,746 in commissions and issued to Brookstreet and its affiliates warrants to purchase an aggregate of 1,735,123 shares of the Registrant's common stock. The Registrant also issued a warrant to purchase 66,667 shares of its series A convertible preferred stock and a promissory note that could be converted into 40,000 shares of series A convertible preferred stock. On June 30, 2005, this convertible note was converted into 40,000 shares of the Registrant's Series A convertible preferred stock.

The sales of the above securities were considered to be exempt from registration under the Securities Act in reliance on Rule 506 of Regulation D promulgated under the Securities Act, as transactions by an issuer not involving a public offering. The purchasers of these securities were accredited investors, represented their intention to acquire the securities for investment only and not with a view to or for sale with any distribution thereof, and appropriate legends were affixed to the share certificates and instruments issued in the transaction. All purchasers had adequate access, through their relationship with the Registrant, to information about the Registrant.

On various dates between April 30, 2004 and October 27, 2005, the Registrant sold 10,543,474 shares of series B convertible preferred stock for aggregate consideration of $47,445,663 to 361 accredited investors. In connection with these sales the Registrant paid to Brookstreet, as placement agent, an aggregate of $3,413,818 in commissions and issued to Brookstreet and its affiliates warrants to purchase an aggregate of 1,317,933 shares of the Registrant's common stock.

The sales of the above securities were considered to be exempt from registration under the Securities Act in reliance on Rule 506 of Regulation D promulgated under the Securities Act, as transactions by an issuer not involving a public offering. The purchasers of these securities were accredited investors, represented their intention to acquire the securities for investment only and not with a view to or for sale with any distribution thereof, and appropriate legends were affixed to the share certificates and instruments issued in the transaction. All purchasers had adequate access, through their relationship with the Registrant, to information about the Registrant.

In September and October 2006, the Registrant sold 772,100 units, consisting of 772,100 shares of Series C convertible preferred stock at a per unit price of $4.50, and warrants to purchase 154,419 shares of common stock at $4.50 per share, for aggregate gross proceeds of $3,474,450 to one qualified institutional buyer and one institutional accredited investor. In connection with this sale, the Registrant paid to Brookstreet Securities Corporation, as placement agent, an aggregate of $347,444 in commissions and issued to Brookstreet fully vested warrants to purchase an aggregate of 96,512 shares of the Registrant's common stock.

The sales of the above securities were considered to be exempt from registration under the Securities Act in reliance on Rule 506 of Regulation D promulgated under the Securities Act, as transactions by an issuer not involving a public offering. The purchasers of these securities were qualified institutional buyers or institutional accredited investors, represented their intention to acquire the securities for investment only and not with a view to or for sale with any distribution thereof, and appropriate legends were affixed to the share certificates and instruments issued in the transaction. All purchasers had adequate access, through their relationship with the Registrant, to information about the Registrant.

Issuance of Securities in Debt Financing

In June 2006, the Registrant entered into a loan and security agreement with a financial institution. In conjunction with this agreement, the Registrant issued warrants to purchase an aggregate of 300,000 shares of its series B preferred stock at an exercise price of $4.50 per share. The sale of these securities was considered to be exempt from registration under the Securities Act in reliance on Rule 506 of Regulation D promulgated under the Securities Act, as a transaction by an issuer not involving a public offering. The purchaser is an accredited investor, represented its intention to acquire the securities for investment only and not with a view to or for sale with any distribution thereof, and appropriate legends were affixed to the instruments issued in the transaction. The purchaser had access, through its relationship with the Registrant, to information about the Registrant.

Issuance of Securities to Consultant

In November 2006, the Registrant issued a warrant to purchase an aggregate of 300,000 shares of its common stock at an exercise price of $3.25 per share to a consultant providing consulting services for the Registrant. The sale of these securities was considered to be exempt from registration under the Securities Act in reliance on Rule 506 of Regulation D promulgated under the Securities Act, as a transaction by an issuer not involving a public offering. The purchaser is an accredited investor, represented his intention to acquire the securities for investment only and not with a view to or for sale with any distribution thereof, and appropriate legends were affixed to the instruments issued in the transaction. The purchaser had access, through its relationship with the Registrant, to information about the Registrant.

Issuance of Securities for Finder's Fee

On November 7, 2006, the Registrant signed a loan agreement with Robert Burlingame, one of our directors, under which Mr. Burlingame advanced to the Registrant $4.0 million, which accrues interest at an annual rate of 7% (the "Bridge Loan"). The principal and all accrued interest under the loan agreement, which is available to the Registrant as working capital, will become due and payable in full on the earlier of November 10, 2007 or five days after the completion of an initial public offering of the Registrant's common stock resulting in gross proceeds to it of at least $30.0 million. The loan is secured by all of the Registrant's assets, other than its intellectual property, but is subordinate to the security interest held by its secured lenders. In connection with this Bridge Loan, the Registrant paid to Brookstreet, as finder, a fee in the amount of $50,000 and granted Brookstreet a warrant to purchase 100,000 shares of the Registrant's common stock at an exercise price of $4.50 per share. The sale of the above securities was considered to be exempt from registration under the Securities Act in reliance on Rule 506 of Regulation D promulgated under the Securities Act, as transactions by an issuer not involving a public offering. The purchaser of the securities was an accredited investor, represented its intention to acquire the securities for investment only and not with a view to or for sale with any distribution thereof, and appropriate legends were affixed to the share certificates and instruments issued in the transaction. The purchaser had adequate access, through its relationship with the Registrant, to information about the Registrant.

Item 16. Exhibits and Financial Statement Schedules

(a) Exhibits

Exhibit Number	Description
1.1*	Form of Underwriting Agreement.
3.1	Amended and Restated Articles of Incorporation of the Registrant.
3.2	Certificate of Incorporation of the Registrant's subsidiary, OIS Reincorporation Sub, Inc., a Delaware corporation.
3.3**	Form of Restated Certificate of Incorporation of the Registrant, to be filed upon the completion of the offering to which this Registration Statement relates (previously filed as Exhibit 3.5 to Amendment No. 2 of the Registrant's Registration Statement on Form S-1 filed with the Commission on September 18, 2006).

Exhibit Number	Description
3.4**	Bylaws of the Registrant, as amended (composite copy) (previously filed as Exhibit 3.6 to the Registrant's Registration Statement on Form S-1 filed with the Commission).
3.5	Bylaws of the Registrant's subsidiary, OIS Reincorporation Sub, Inc., a Delaware corporation.
3.6**	Form of Bylaws of the Registrant, to be effective upon the completion of the offering to which this Registration Statement relates (previously filed as Exhibit 3.8 to Amendment No. 2 of the Registrant's Registration Statement on Form S-1 filed with the Commission on September 18, 2006).
4.1	Specimen Common Stock Certificate.
4.2**	Warrant to Purchase Series A Preferred Stock of Registrant by and between the Registrant and Venture Lending & Leasing III, Inc., dated April 21, 2004.
4.3**	Warrant to Purchase Series B Preferred Stock of Registrant by and between the Registrant and Venture Lending & Leasing IV, Inc., dated June 14, 2006.
4.4**	Form of Warrant to Purchase Common Stock of Registrant.
4.5**	Form of Warrant to Purchase Common Stock of Registrant.
4.6	Amended and Restated Investors Rights Agreement, effective as of September 14, 2006.
4.7**	Form of Promissory Note issued to Venture Lending & Leasing III, Inc.
4.8**	Form of Promissory Note (Equipment and Soft Cost Loans) issued to Venture Lending & Leasing IV, Inc.
4.9**	Form of Promissory Note (Growth Capital Loans) issued to Venture Lending & Leasing IV, Inc.
4.10**	Form of Promissory Note (Working Capital Loans) issued to Venture Lending & Leasing IV, Inc.
4.11**	Form of Warrant to Purchase Common Stock of Registrant.
5.1*	Opinion of Pillsbury Winthrop Shaw Pittman LLP.
10.1**	Form of Indemnification Agreement between the Registrant and its officers and directors.
10.2**	1999 Stock Plan and related form stock option plan agreements
10.3**	2000 Stock Plan and related form stock option plan agreements.
10.4**	2003 Stock Plan and related form stock option plan agreements.
10.5**	2004 Stock Plan and related form stock option plan agreements.
10.6**	Form of 2006 Stock Incentive Plan and related form stock option plan agreement.
10.7**	Office Lease Agreement, dated October 26, 1999, between the Registrant and RNM Lakeville, L.P.
10.8**	Amendment to Office Lease No. 1, dated September 15, 2000, between Registrant and RNM Lakeville L.P.
10.9**	Amendment to Office Lease No. 2, dated July 29, 2005, between the Registrant and RNM Lakeville L.P.
10.10**	Office Lease Agreement, dated May 15, 2005, between Oculus Technologies of Mexico, S.A. de C.V. and Antonio Sergio Arturo Fernandez Valenzuela (translated from Spanish).
10.11**	Office Lease Agreement, dated July 2003, between Oculus Innovative Sciences Netherlands, B.V. and Artikona Holding B.V. (translated from Dutch).
10.12**	Loan and Security Agreement, dated March 25, 2004, between the Registrant and Venture Lending & Leasing III, Inc.
10.13**	Loan and Security Agreement, dated June 14, 2006, between the Registrant and Venture Lending & Leasing IV, Inc.
10.14**	Employment Agreement, dated January 1, 2004, between the Registrant and Hojabr Alimi.
10.15**	Employment Agreement, dated January 1, 2004, between the Registrant and Jim Schutz.
10.16**	Employment Agreement, dated June 1, 2004, between the Registrant and Robert Miller.
10.17**	Employment Agreement, dated June 1, 2005, between the Registrant and Bruce Thornton.
10.18**	Employment Agreement, dated March 23, 2005, between the Registrant and Theresa Mitchell.
10.19**	Employment Agreement, dated June 10, 2006, between the Registrant and Mike Wokasch.
10.20**	Form of Director Agreement.
10.21**	Consultant Agreement, dated October 1, 2005, by and between the Registrant and White Moon Medical.
10.22**	Leasing Agreement, dated May 5, 2006, made by and between Mr. Jose Alfonzo I. Orozco Perez and Oculus Technologies of Mexico, S.A. de C.V.

Exhibit Number	Description
10.23**	Amendment No. 3 to Lease dated August 23, 2006, between the Registrant and RNM Lakeville, L.P.
10.24**	Stock Purchase Agreement, dated June 16, 2005, between the Registrant, Quimica Pasteur, S de R.L., Francisco Javier Orozco Gutierrez and Jorge Paulino Hermosillo Martin.
10.25**	Framework Agreement, dated June 16, 2005, between Javier Orozco Gutierrez, Quimica Pasteur, S de R.L., Jorge Paulino Hermosillo Martin, the Registrant and Oculus Technologies de Mexico, S.A. de C.V.
10.26**	Mercantile Consignment Agreement, dated June 16, 2005, between Oculus Technologies de Mexico, S.A. de C.V., Quimica Pasteur, S de R.L. and Francisco Javier Orozco Gutierrez.
10.27**	Partnership Interest Purchase Option Agreement, dated June 16, 2005, between the Registrant and Javier Orozco Gutierrez.
10.28**	Termination of Registrant and Oculus Technologies de Mexico, S.A. de C.V. Agreements with Quimica Pasteur, S de R.L. by Jorge Paulino Hermosillo Martin (translated from Spanish).
10.29**	Termination of Registrant and Oculus Technologies de Mexico, S.A. de C.V. Agreements with Quimica Pasteur, S de R.L. by Francisco Javier Orozco Gutierrez (translated from Spanish).
10.30	Loan and Security Agreement, dated November 7, 2006, between the Registrant and Robert Burlingame.
10.31	Non-Negotiable Secured Promissory Note, dated November 10, 2006, between the Registrant and Robert Burlingame.
10.32	Subordination Agreement, dated November 7, 2006, by and among the Registrant, Robert Burlingame, Venture Lending & Leasing III, LLC, and Venture Lending & Leasing IV, LLC.
10.33	Consulting Agreement, effective November 9, 2006, by and between the Registrant and Robert Burlingame.
10.34	Director Agreement, dated November 8, 2006, by and between the Registrant and Robert Burlingame.
10.35†	Exclusive Marketing Agreement, dated December 5, 2005, by and between the Registrant and Alkem Laboratories Ltd.
10.36	Settlement Agreement, effective September 21, 2006, by and among the Registrant and Messrs. Jorge Ahumada Ayala and Fernando Ahumada Ayala.
10.37	Settlement Agreement, dated October 25, 2006, by and between the Registrant and Mr. Kim Kelderman.
16.1	Letter regarding change in certifying accountants.
21.1**	List of Subsidiaries.
23.1	Consent of Marcum & Kliegman LLP.
23.2*	Consent of Pillsbury Winthrop Shaw Pittman LLP (included in Exhibit 5.1).
23.3**	Consent of Cheryl Bongiovanni, Ph.D., RVT, CWS
23.4**	Consent of Tom A. Wolvos, M.D., F.A.C.S
23.5**	Consent of David Armstrong, M.D.
23.6**	Consent of David E. Allie, M.D.
23.7**	Consent of Dr. Alfredo Barrera
23.8**	Consent of Valuation Research Corporation
23.9**	Consent of Chevez, Ruiz, Zamarripa y Cia, S.C.
23.10**	Consent of Luca Dalla-Paola, M.D.
23.11**	Consent of Andrew Boulton, M.D.
23.12**	Consent of Dr. Ariel Miranda
24.1**	Power of Attorney (see page II-5 of this Registration Statement).
24.2	Power of Attorney for Robert Burlingame

† Confidential treatment has been requested for portions of this exhibit.

* To be filed by amendment.

** Previously filed.

Item 17. Undertakings

Insofar as indemnification for liabilities arising under the Securities Act, may be permitted to directors, officers and controlling persons of the Registrant pursuant to the foregoing provisions, 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 Securities 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 Securities Act and will be governed by the final adjudication of such issue.

The undersigned Registrant hereby undertakes that:

(1) For purposes of determining any liability under the Securities Act, the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by the Registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act shall be deemed to be part of this registration statement as of the time it was declared effective.

(2) For the purpose of determining any liability under the Securities Act, each post effective amendment that contains a form of prospectus 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) That, for the purpose of determining liability under the Securities Act to any purchaser, each prospectus filed pursuant to Rule 424(b) as part of a registration statement relating to an offering, other than registration statements relying on Rule 430B or other than prospectuses filed in reliance on Rule 430A, shall be deemed to be part of and included in the registration statement as of the date it is first used after effectiveness. *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 first use, 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.

(4) For the purpose of determining liability of the registrant under the Securities Act to any purchaser in the initial distribution of the securities, in a primary offering of securities of the undersigned registrant pursuant to this registration statement, regardless of the underwriting method used to sell the securities to the purchaser, if the securities are offered or sold to such purchaser by means of any of the following communications, the undersigned registrant will be a seller to the purchaser and will be considered to offer or sell such securities to such purchaser:

(i) Any preliminary prospectus or prospectus of the undersigned registrant relating to the offering required to be filed pursuant to Rule 424;

(ii) Any free writing prospectus relating to the offering prepared by or on behalf of the undersigned registrant or used or referred to by the undersigned registrant;

(iii) The portion of any other free writing prospectus relating to the offering containing material information about the undersigned registrant or its securities provided by or on behalf of the undersigned registrant; and

(iv) Any other communication that is an offer in the offering made by the undersigned registrant to the purchaser.

(5) It will provide to the underwriters at the closing(s) specified in the underwriting agreement certificates in such denominations and registered in such names as required by the underwriters to permit prompt delivery to each purchaser.

SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, the Registrant has duly caused this Amendment No. 3 to this Registration Statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Petaluma, State of California, on the 1st day of December, 2006.

Oculus Innovative Sciences, Inc.

By /s/ Hojabr Alimi
Hojabr Alimi
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.

Name	Title	Date
/s/ Hojabr Alimi Hojabr Alimi	President and Chief Executive Officer (Principal Executive Officer) and Director	December 1, 2006
/s/ Robert E. Miller Robert E. Miller	Chief Financial Officer (Principal Financial and Accounting Officer)	December 1, 2006
/s/ Akihisa Akao* Akihisa Akao	Director	December 1, 2006
/s/ Edward M. Brown* Edward M. Brown	Director	December 1, 2006
/s/ Richard Conley* Richard Conley	Director	December 1, 2006
/s/ Gregory M. French* Gregory M. French	Director	December 1, 2006
/s/ James J. Schutz* James J. Schutz	Director	December 1, 2006
/s/ Robert Burlingame* Robert Burlingame	Director	December 1, 2006
*/s/ Hojabr Alimi Hojabr Alimi	Attorney-in-fact	December 1, 2006

Exhibit Index

Exhibit Number	Description
1.1*	Form of Underwriting Agreement.
3.1	Amended and Restated Articles of Incorporation of the Registrant.
3.2	Certificate of Incorporation of the Registrant's subsidiary, OIS Reincorporation Sub, Inc., a Delaware corporation.
3.3**	Form of Restated Certificate of Incorporation of the Registrant, to be filed upon the completion of the offering to which this Registration Statement relates (previously filed as Exhibit 3.5 to Amendment No. 2 of the Registrant's Registration Statement on Form S-1 filed with the Commission on September 18, 2006).
3.4**	Bylaws of the Registrant, as amended (composite copy) (previously filed as Exhibit 3.6 to the Registrant's Registration Statement on Form S-1 filed with the Commission on July 3, 2006).
3.5	Bylaws of the Registrant's subsidiary, OIS Reincorporation Sub, Inc., a Delaware corporation.
3.6**	Form of Bylaws of the Registrant, to be effective upon the completion of the offering to which this Registration Statement relates (previously filed as Exhibit 3.8 to Amendment No. 2 of the Registrant's Registration Statement on Form S-1 filed with the Commission on September 18, 2006).
4.1	Specimen Common Stock Certificate.
4.2**	Warrant to Purchase Series A Preferred Stock of Registrant by and between the Registrant and Venture Lending & Leasing III, Inc., dated April 21, 2004.
4.3**	Warrant to Purchase Series B Preferred Stock of Registrant by and between the Registrant and Venture Lending & Leasing IV, Inc., dated June 14, 2006.
4.4**	Form of Warrant to Purchase Common Stock of Registrant.
4.5**	Form of Warrant to Purchase Common Stock of Registrant.
4.6	Amended and Restated Investors Rights Agreement, effective as of September 14, 2006.
4.7**	Form of Promissory Note issued to Venture Lending & Leasing III, Inc.
4.8**	Form of Promissory Note (Equipment and Soft Cost Loans) issued to Venture Lending & Leasing IV, Inc.
4.9**	Form of Promissory Note (Growth Capital Loans) issued to Venture Lending & Leasing IV, Inc.
4.10**	Form of Promissory Note (Working Capital Loans) issued to Venture Lending & Leasing IV, Inc.
4.11**	Form of Warrant to Purchase Common Stock of Registrant.
5.1*	Opinion of Pillsbury Winthrop Shaw Pittman LLP.
10.1**	Form of Indemnification Agreement between the Registrant and its officers and directors.
10.2**	1999 Stock Plan and related form stock option plan agreements
10.3**	2000 Stock Plan and related form stock option plan agreements.
10.4**	2003 Stock Plan and related form stock option plan agreements.
10.5**	2004 Stock Plan and related form stock option plan agreements.
10.6**	Form of 2006 Stock Incentive Plan and related form stock option plan agreement.
10.7**	Office Lease Agreement, dated October 26, 1999, between the Registrant and RNM Lakeville, L.P.
10.8**	Amendment to Office Lease No. 1, dated September 15, 2000, between the Registrant and RNM Lakeville L.P.
10.9**	Amendment to Office Lease No. 2, dated July 29, 2005, between the Registrant and RNM Lakeville L.P.
10.10**	Office Lease Agreement, dated May 15, 2005, between Oculus Technologies of Mexico, S.A. de C.V. and Antonio Sergio Arturo Fernandez Valenzuela (translated from Spanish).
10.11**	Office Lease Agreement, dated July 2003, between Oculus Innovative Sciences, B.V. and Artikona Holding B.V. (translated from Dutch).
10.12**	Loan and Security Agreement, dated March 25, 2004, between Registrant and Venture Lending & Leasing III, Inc.

Exhibit Number	Description
10.13**	Loan and Security Agreement, dated June 14, 2006, between Registrant and Venture Lending & Leasing IV, Inc.
10.14**	Employment Agreement, dated January 1, 2004, between the Registrant and Hojabr Alimi.
10.15**	Employment Agreement, dated January 1, 2004, between the Registrant and Jim Schutz.
10.16**	Employment Agreement, dated June 1, 2004, between the Registrant and Robert Miller.
10.17**	Employment Agreement, dated June 1, 2005, between the Registrant and Bruce Thornton.
10.18**	Employment Agreement, dated March 23, 2005, between the Registrant and Theresa Mitchell.
10.19**	Employment Agreement, dated June 10, 2006, between the Registrant and Mike Wokasch.
10.20**	Form of Director Agreement.
10.21**	Consultant Agreement, dated October 1, 2005, by and between the Registrant and White Moon Medical.
10.22**	Leasing Agreement, dated May 5, 2006, made by and between Mr. Jose Alfonso I. Orozco Perez and Oculus technologies of Mexico, S.A. de C.V.
10.23**	Amendment No. 3 to Lease, dated August 23, 2006, by and between the Registrant and RNM Lakeville, L.P.
10.24**	Stock Purchase Agreement, dated June 16, 2005, between the Registrant, Quimica Pasteur, S de R.L., Francisco Javier Orozco Gutierrez and Jorge Paulino Hermosillo Martin.
10.25**	Framework Agreement, dated June 16, 2005, between Javier Orozco Gutierrez, Quimica Pasteur, S de R.L., Jorge Paulino Hermosillo Martin, the Registrant and Oculus Technologies de Mexico, S.A. de C.V.
10.26**	Mercantile Consignment Agreement, dated June 16, 2005, between Oculus Technologies de Mexico, S.A. de C.V., Quimica Pasteur, S de R.L. and Francisco Javier Orozco Gutierrez.
10.27**	Partnership Interest Purchase Option Agreement, dated June 16, 2005, between the Registrant and Javier Orozco Gutierrez.
10.28**	Termination of Registrant and Oculus Technologies de Mexico, S.A. de C.V. Agreements with Quimica Pasteur, S de R.L. by Jorge Paulino Hermosillo Martin (translated from Spanish).
10.29**	Termination of Registrant and Oculus Technologies de Mexico, S.A. de C.V. Agreements with Quimica Pasteur, S de R.L. by Francisco Javier Orozco Gutierrez (translated from Spanish).
10.30	Loan and Security Agreement, dated November 7, 2006, between the Registrant and Robert Burlingame.
10.31	Non-Negotiable Secured Promissory Note, dated November 10, 2006, between the Registrant and Robert Burlingame.
10.32	Subordination Agreement, dated November 7, 2006, by and among the Registrant, Robert Burlingame, Venture Lending & Leasing III, LLC, and Venture Lending & Leasing IV, LLC.
10.33	Consulting Agreement, effective November 9, 2006, by and between the Registrant and Robert Burlingame.
10.34	Director Agreement, dated November 8, 2006, by and between the Registrant and Robert Burlingame.
10.35†	Exclusive Marketing Agreement, dated December 5, 2005, by and between the Registrant and Alkem Laboratories Ltd.
10.36	Settlement Agreement, effective September 21, 2006, by and among the Registrant and Messrs. Jorge Ahumada Ayala and Fernando Ahumada Ayala.
10.37	Settlement Agreement, dated October 25, 2006, by and between the Registrant and Mr. Kim Kelderman.
16.1	Letter regarding change in certifying accountants.
21.1**	List of Subsidiaries.
23.1	Consent of Marcum & Kliegman LLP.
23.2*	Consent of Pillsbury Winthrop Shaw Pittman LLP (included in Exhibit 5.1).
23.3**	Consent of Cheryl Bongiovanni, Ph.D., RVT, CWS
23.4**	Consent of Tom A. Wolvos, M.D., F.A.C.S
23.5**	Consent of David Armstrong, M.D.

Exhibit Number	Description
23.6**	Consent of David E. Allie, M.D.
23.7**	Consent of Dr. Alfredo Barrera
23.8**	Consent of Valuation Research Corporation
23.9**	Consent of Chevez, Ruiz, Zamarripa y Cia, S.C.
23.10**	Consent of Luca Dalla-Paola, M.D.
23.11**	Consent of Andrew Boulton, M.D.
23.12**	Consent of Dr. Ariel Miranda
24.1**	Power of Attorney (see page II-5 of this Registration Statement).
24.2	Power of Attorney for Robert Burlingame

† Confidential treatment has been requested for portions of this exhibit.

* To be filed by amendment.

** Previously filed.

Exhibit 3.1

AMENDED AND RESTATED
ARTICLES OF INCORPORATION
OF
OCULUS INNOVATIVE SCIENCES, INC.

The undersigned certify that:

1. They are the President and Chief Financial Officer, respectively, of Oculus Innovative Sciences, Inc., a California corporation.

2. The Articles of Incorporation of this corporation shall be amended and restated to read in full as follows:

ARTICLE I

The name of this corporation is Oculus Innovative Sciences, Inc. (the "Corporation").

ARTICLE II

The purpose of the Corporation is to engage in any lawful act or activity for which a corporation may be organized under the General Corporation Law of California other than the banking business, the trust company business or the practice of a profession permitted to be incorporated by the California Corporations Code.

ARTICLE III

(A) **Classes of Stock**. The Corporation is authorized to issue two classes of stock to be designated, respectively, "Common Stock" and "Preferred Stock." The total number of shares which the Corporation is authorized to issue is one hundred thirty million (130,000,000) shares. Of such authorized shares, one hundred million (100,000,000) shares shall be designated as Common Stock and thirty million (30,000,000) shares shall be designated as Preferred Stock. Five million five hundred thousand (5,500,000) shares of the Preferred Stock are designated "Series A Preferred Stock", eleven million two-hundred twenty-two thousand two-hundred twenty-two (11,222,222) shares of the Preferred Stock are designated "Series B Preferred Stock", and three million five-hundred thousand (3,500,000) shares of the Preferred Stock are designated "Series C Preferred Stock". The rights, preferences, privileges and restrictions granted to and imposed on the Preferred Stock are as set forth below in Article III(B).

(B) **Rights, Preferences and Restrictions of Preferred Stock**. The Preferred Stock authorized by these Restated Articles may be issued from time to time in one or more series, subject to the provisions of this Article III and any limitations prescribed by law. The Board of Directors is authorized to designate and to fix the number of shares of any series of Preferred Stock and to determine and to alter the rights, preferences, privileges and restrictions granted to or imposed on any wholly unissued series of Preferred Stock. The Board of Directors, within the limits stated in any resolution of the Board of Directors originally fixing the number of shares constituting any series, may increase or decrease (but not below the number of shares of such series then outstanding) the number of shares of any series subsequent to the issuance of shares

of that series. The Corporation shall from time to time in accordance with the laws of the State of California increase the authorized amount of its Common Stock if at any time the number of shares of Common Stock remaining unissued and available for issuance shall not be sufficient to permit conversion of the Preferred Stock.

1. **Dividend Provisions**.

(a) **Preferential Dividends After Filing Date of Restated Articles**. The holders of shares of Series A Preferred Stock shall be entitled to receive cumulative dividends, out of any assets legally available therefor, in an amount equal to $0.09 (as appropriately adjusted for any stock dividends, stock splits, combinations, recapitalizations or the like with respect to such shares) per annum on each outstanding share of Series A Preferred Stock, and holders of Series B Preferred Stock shall be entitled to receive non-cumulative dividends in the amount of $0.225 on each share of Series B Preferred Stock, when and as declared by the Board of Directors of the Corporation. No dividend shall be paid to the holders of Series C Preferred Stock or Common Stock unless and until (i) all accrued but unpaid dividends on shares of the Series A Preferred Stock shall have been paid or declared and set aside for payment, and (ii) dividends on the Series B Preferred Stock, as set forth above in this Section 1(b) of this Article III.B, shall have been declared and paid or set apart for payment; provided, however, that this restriction on the payment of dividends to holders of Series C Preferred Stock and Common Stock shall not apply to dividends payable (i) solely in Common Stock or other securities or rights convertible into or entitling the holder thereof to receive, directly or indirectly, additional shares of Common Stock, or (ii) pursuant to Section 4(e) of this Article III.B. After payment of cumulative dividends to holders of the Series A Preferred Stock at the annual rate set forth above and the declaration and payment (or setting apart for payment) of the dividends on the Series B Preferred Stock as set forth above in this Section 1(a) of this Article III.B, any additional dividends declared shall be distributed among all holders of Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock and Common Stock in proportion to the number of shares of Common Stock which would be held by each such holder if all shares of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock were converted into Common Stock at the then effective Conversion Price for each such series of Preferred Stock.

(b) **Payment of Dividends by Issuance of Common Stock**. The Corporation shall have the option of paying the dividends described in this Section l in either shares of Common Stock or in cash. If paid in shares of Common Stock, the number of shares to be distributed to the holders of the Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock shall be determined by dividing the amount of the accrued and unpaid dividends, and/or declared but unpaid dividends, as the case may be, by the Conversion Price then in effect for the applicable series of Preferred Stock. If at the time any shares of Series A Preferred Stock, Series B Preferred Stock or Series C Preferred Stock are converted into Common Stock there are any accrued but unpaid dividends, and/or declared but unpaid dividends, as the case may be, on such shares, then the Corporation at its option shall either pay the unpaid dividends or issue additional shares of Common Stock in the amount of the unpaid dividends at the applicable Conversion Price then in effect for the applicable series of Preferred Stock.

2. **Liquidation**.

(a) **Preference**. In the event of any Liquidation Event (as defined in Section 2(c) below) of the Corporation, prior and in preference to any distribution of any of the assets or surplus funds of the Corporation to the holders of Common Stock, (i) holders of the Series A Preferred Stock shall be entitled to receive, by reason of their ownership thereof, an amount per share equal to the sum of (x) $3.00 for each outstanding share of Series A Preferred Stock plus (y) all declared but unpaid dividends, and/or accrued and unpaid dividends, as the case may be, on each such share (the "Series A Liquidation Amount"), subject to appropriate adjustment of such dollar amounts for any stock dividends, stock splits, combinations, recapitalizations or like transaction with respect to such shares; (ii) holders of the Series B Preferred Stock shall be entitled to receive, by reason of their ownership thereof, an amount per share equal to the sum of (x) $5.625 for each outstanding share of Series B Preferred Stock plus (y) all declared but unpaid dividends on each such share (the "Series B Liquidation Amount"), subject to appropriate adjustment of such dollar amounts for any stock dividends, stock splits, combinations, recapitalizations or like transaction with respect to such shares, and (iii) holders of the Series C Preferred Stock shall be entitled to receive, by reason of their ownership thereof, an amount per share equal to the sum of (x) $5.625 for each outstanding share of Series C Preferred Stock plus (y) all declared but unpaid dividends on each such share (the "Series B Liquidation Amount"), subject to appropriate adjustment of such dollar amounts for any stock dividends, stock splits, combinations, recapitalizations or like transaction with respect to such shares. The Series A Liquidation Amount, the Series B Liquidation Amount and the Series C Liquidation Amount are referred to herein collectively as the "Preferred Liquidation Amount". If, upon the occurrence of a Liquidation Event, the assets and funds of the Corporation thus distributed among the holders of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock shall be insufficient to permit the payment to such holders of the full Preferred Liquidation Amount, then the entire assets and funds of the Corporation legally available for distribution shall be distributed ratably among the holders of the Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock in a per-share amount that is in proportion to the per-share Preferred Liquidation Amount of each such series of Preferred Stock.

(b) **Remaining Assets**. Any assets of the Corporation remaining after distribution to the holders of the Series A Preferred Stock, Series B Preferred Stock and Series C Stock of the full Preferred Liquidation Amount required by Section 2(a) above shall be distributed to the holders of the Series A Preferred Stock, the Series B Preferred Stock, the Series C Stock, and the Common Stock of the Corporation as follows:

(i) In the event the quotient obtained by dividing X by CO is equal to the sum of $3.00 and CD, then the holder of each outstanding share of Common Stock shall receive the sum of $3.00 and CD;

(ii) In the event the quotient obtained by dividing X by CO is less than the sum of $3.00 and CD, then X shall be distributed to holders of the outstanding shares of Common Stock on a pro rata basis; and

(iii) In the event the quotient obtained by dividing X by CO is greater than the sum of $3.00 and CD, then (a) the holder of each outstanding share of Series A Preferred

Stock, Series B Preferred Stock and Series C Preferred Stock shall receive such amount as shall equal the quotient obtained by dividing (1) the difference obtained by subtracting ($3 + CD)(DO) from X by (2) the sum of AO, BO, CO and DO; and (b) each outstanding share of Common Stock shall receive such amount as shall equal $3.00 plus CD plus the quotient obtained by dividing (1) the difference obtained by subtracting ($3 + CD)(DO) from X by (2) the sum of AO, BO, CO and DO;

where: X = the total remaining assets of the Corporation after payment of the full Preferred Liquidation Amount as set forth in Section 2(a) above;

AO = the total number of shares of Common Stock into which the total number of outstanding shares of Series A Preferred Stock is convertible at the then applicable conversion price;

BO = the total number of shares of Common Stock into which the total number of outstanding shares of Series B Preferred Stock is convertible at the then applicable conversion price;

CO = the total number of shares of Common Stock into which the total number of outstanding shares of Series C Preferred Stock is convertible at the then applicable conversion price;

DO = the total number of outstanding shares of Common Stock; and

CD = all declared but unpaid dividends on each outstanding share of Common Stock, subject to appropriate adjustment of such dollar amounts for any stock dividends, stock splits, combinations, recapitalizations or like transaction with respect to such shares.

(c) **Liquidation Event**. A "Liquidation Event" means (i) liquidation, dissolution or winding up of the Corporation, either voluntary or involuntary, (ii) any merger, consolidation or other similar transaction involving the Corporation pursuant to which the shareholders of the Corporation immediately prior to such transaction shall own less than fifty percent (50%) of the voting securities of the surviving entity, (iii) a sale, conveyance or disposition of all or substantially all of the assets of the Corporation, or (iv) the effectuation by the Corporation of a transaction or series of related transactions in which more than fifty percent (50%) of the voting power of the Corporation is disposed of (other than the sale of the Series C Preferred Stock). In the event of a Liquidation Event described in (ii), (iii) or (iv) of the preceding sentence, if the consideration received by the Corporation is other than cash, its value will be deemed to be its fair market value. Whenever the distribution provided for in this Section 2 of this Article III.B shall be payable in securities, such securities shall be valued as follows:

(1) Securities not subject to investment letter or other similar restrictions on free marketability:

(A) If traded on a securities exchange or The Nasdaq Stock Market, the value shall be deemed to be the average of the closing prices of the securities on such exchange over the thirty-day period ending three (3) days prior to the closing;

(B) If actively traded over-the-counter, the value shall be deemed to be the average of the closing bid or sale prices (whichever is applicable) over the thirty-day period ending three (3) days prior to the closing; and

(C) If there is no active public market, the value shall be the fair market value thereof, as mutually determined by the Corporation and the holders of at least a majority of the voting power of the then outstanding shares of the Series A Preferred Stock, Series B Preferred Stock and the Series C Preferred Stock voting together as a class.

(2) The method of valuation of securities subject to investment letter or other restrictions on free marketability (other than restrictions arising solely by virtue of a shareholder's status as an affiliate or former affiliate) shall be to make an appropriate discount from the market value determined as above in Section 2(c)(1) to reflect the approximate fair market value thereof, as mutually determined by the Corporation and the holders of at least a majority of the voting power of the then outstanding shares of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock voting together as a class.

3. **Redemption**. The Series A Preferred Stock, Series B Preferred Stock and the Series C Preferred Stock are not redeemable.

4. **Conversion**. The holders of the Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock, as applicable, shall have conversion rights as follows (the "Conversion Rights"):

(a) **Right to Convert**.

(i) Subject to Section 4(c), each share of Series A Preferred Stock shall be convertible, at the option of the holder thereof, at any time after the date of issuance of such share, at the office of the Corporation or any transfer agent for such stock, into such number of fully paid and nonassessable shares of Common Stock as is determined by dividing $1.50 by the Series A Conversion Price (as defined below) in effect at the time of the conversion. The initial Series A Conversion Price shall be $1.50 per share.

(ii) Subject to Section 4(c), each share of Series B Preferred Stock shall be convertible, at the option of the holder thereof, at any time after the date of issuance of such share, at the office of the Corporation or any transfer agent for such stock, into such number of fully paid and nonassessable shares of Common Stock as is determined by dividing $4.50 by the Series B Conversion Price (as defined below) in effect at the time of the conversion. The initial Series B Conversion Price shall be $4.50 per share.

(iii) Subject to Section 4(c), each share of Series C Preferred Stock shall be convertible, at the option of the holder thereof, at any time after the date of issuance of such share, at the office of the Corporation or any transfer agent for such stock, into such number of fully paid and nonassessable shares of Common Stock as is determined by dividing $4.50 by

the Series C Conversion Price (as defined below) in effect at the time of the conversion. The initial Series C Conversion Price shall be $4.50 per share.

(iv) The Series A Conversion Price, the Series B Conversion Price and the Series C Conversion Price are herein referred to collectively as the "Conversion Price". Such initial Conversion Prices shall be subject to adjustment as hereinafter provided.

(b) **Automatic Conversion**. Each share of each designated series of Preferred Stock shall automatically be converted into shares of Common Stock at the then applicable Conversion Price for such series of Preferred Stock immediately upon the earlier of: (i) the written consent or agreement of two-thirds (2/3) of the outstanding Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock, voting together as a class, to such conversion or (ii) except as provided below in Section 4(c), the closing of a firm commitment underwritten public offering of shares of Common Stock under the Securities Act of 1933, as amended (the "Securities Act") which results in aggregate cash proceeds to the Corporation of not less than $20,000,000 (before deduction of underwriting commissions and expenses) (a "Qualified IPO") or (iii) going public by means of a merger or acquisition which results in a market capitalization of the Corporation of greater than $75,000,000.

(c) **Mechanics of Conversion**. Before any holder of Preferred Stock shall be entitled to convert the same into shares of Common Stock, such holder shall surrender the certificate or certificates therefor, duly endorsed, at the office of the Corporation or of any transfer agent for the Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock, and shall give written notice to the Corporation at its principal corporate office, of the election to convert the same and shall state therein the name or names in which the certificate or certificates for shares of Common Stock are to be issued. The Corporation shall, as soon as practicable thereafter, issue and deliver at such office to the holder of such Preferred Stock, or to the nominee or nominees of such holder, a certificate or certificates for the number of shares of Common Stock to which such holder shall be entitled upon such conversion. Such conversion shall be deemed to have been made immediately prior to the close of business on the date such shares of Preferred Stock to be converted are surrendered in accordance with the foregoing provisions, and the person or persons entitled to receive the shares of Common Stock issuable upon such conversion shall be treated for all purposes as the record holder or holders of such shares of Common Stock as of such date. If the conversion is in connection with an underwritten offering of securities registered pursuant to the Securities Act the conversion may, at the option of any holder tendering shares of Series A Preferred Stock, Series B Preferred Stock or Series C Preferred Stock for conversion, be conditioned upon the closing with the underwriters of the sale of securities pursuant to such offering, in which event the person(s) entitled to receive Common Stock upon conversion of such Preferred Stock shall not be deemed to have converted such Preferred Stock until immediately prior to the closing of such sale of securities.

(d) **Anti-dilution Provisions**. The Conversion Price shall be subject to adjustment from time to time as follows:

(i) **Issuance of Additional Stock below Purchase Price**. If the Corporation shall issue, after the date upon which any shares of Series C Preferred Stock were first issued (the "Purchase Date"), any Additional Stock (as defined below) without consideration

or for a consideration per share less than the Conversion Price in effect immediately prior to the issuance of such Additional Stock, the Conversion Price for the applicable series of Preferred Stock in effect immediately prior to each such issuance shall automatically be adjusted as set forth in this Section 4(d)(i), unless otherwise provided in this Section 4(d)(i).

(A) **Adjustment Formula**. Whenever the Conversion Price applicable to Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock is adjusted pursuant to this Section (4)(d)(i), the new Conversion Price for such series of Preferred Stock shall be determined by multiplying the Conversion Price then in effect for such series of Preferred Stock by a fraction, (x) the numerator of which shall be the sum of (i) the number of shares of Common Stock outstanding immediately prior to such issuance (the "Outstanding Common"), plus (ii) the number of shares of Common Stock into which any shares of Series A Preferred Stock, Series B Preferred Stock or Series C Preferred Stock outstanding immediately prior to such issuance may be converted at the applicable Conversion Price then in effect, plus (iii) the number of shares of Common Stock for which any options to purchase, rights to subscribe, warrants or other derivative securities outstanding or authorized by any duly adopted stock option plan or other plan, arrangement or agreement of the Corporation may be exercised immediately prior to such issuance, plus (iv) the number of shares of Common Stock into which any other convertible or exchangeable securities, including convertible debt securities, outstanding immediately prior to such issuance may be converted or exchanged (the number that is the sum of items (i) through (iv) being referred to as the "Fully Diluted Common"), plus (v) the number of shares of Common Stock that the aggregate consideration received by the Corporation for such issuance would purchase at the Conversion Price applicable to such series of Preferred Stock as to which the calculation is being made; and (y) the denominator of which shall be the number of shares of Fully Diluted Common plus the number of shares of such Additional Stock.

(B) **Definition of "Additional Stock"**. For purposes of this Section 4(d)(i), "Additional Stock" shall mean any shares of Common Stock issued (or deemed to have been issued pursuant to Section 4(d)(i)(E) by the Corporation after the Purchase Date) other than:

(1) Shares of Common Stock issued pursuant to a transaction described in Section 4(d)(ii) hereof;

(2) Shares of Common Stock issued to employees, officers, directors, consultants, contractors or advisors of the Corporation pursuant to stock purchase or stock option plans or agreements, warrants, or other incentive stock arrangements approved by the Board of Directors of the Corporation;

(3) Shares of Common Stock issued to lenders, equipment lessors or other parties providing goods or services to the Corporation;

(4) Shares of Common Stock issued in connection with acquisition transactions;

(5) Shares of Common Stock issued in connection with the conversion of shares of any designated series of Preferred Stock;

(6) Shares of Common Stock issued in strategic partnership transactions;

(7) Shares of Common Stock issued in any other transaction in which exemption from the anti-dilution provisions of this Section 4(d)(i)(B) as applicable to the Series A Preferred Stock, Series B Preferred Stock or Series C Preferred Stock is approved by the holders of a majority of the then-outstanding shares of the applicable series of Preferred Stock; or

(8) Shares of Common Stock issued in connection with the adjustment of the Series A Conversion Price, Series B Conversion Price or Series C Conversion Price pursuant to this Section 4(d).

(C) **No Fractional Adjustments**. No adjustment of the Conversion Price shall be made in an amount less than one cent per share, provided that any adjustments which are not required to be made by reason of this sentence shall be carried forward and shall be either taken into account in any subsequent adjustment made prior to three years from the date of the event giving rise to the adjustment being carried forward, or shall be made at the end of three years from the date of the event giving rise to the adjustment being carried forward.

(D) **Determination of Consideration**. In the event the Corporation issues any Additional Stock for cash, the consideration shall be deemed to be the amount of cash paid therefor before deducting any reasonable discounts, commissions or other expenses allowed, paid or incurred by the Corporation for any underwriting or otherwise in connection with the issuance and sale thereof. In the event the Corporation issues any Additional Stock for a consideration in whole or in part other than cash, the consideration other than cash shall be deemed to be the fair value thereof as determined by the Board of Directors irrespective of any accounting treatment.

(E) **Deemed Issuances of Common Stock**. In the event the Corporation at any time or from time to time after the Purchase Date shall issue any options to purchase or rights to subscribe for Common Stock, securities (other than the Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock or convertible debt instruments) by their terms convertible into or exchangeable for Common Stock or options to purchase or rights to subscribe for such convertible or exchangeable securities, the following provisions shall apply for all purposes of this Section 4(d)(i), except as otherwise provided in Section 4(d)(i)(A):

(1) The aggregate maximum number of shares of Common Stock deliverable upon exercise (assuming the satisfaction of any conditions to exercisability, including without limitation, the passage of time, but without taking into account potential antidilution adjustments) of such options to purchase or rights to subscribe for Common Stock shall be deemed to have been issued at the time such options or rights were issued and for a consideration equal to the consideration (determined in the manner provided in Section

4(d)(i)(D)), if any, received by the Corporation upon the issuance of such options or rights plus the minimum exercise price provided in such options or rights (without taking into account potential antidilution adjustments) for the Common Stock covered thereby.

(2) The aggregate maximum number of shares of Common Stock deliverable upon conversion of or in exchange (assuming the satisfaction of any conditions to convertibility or exchangeability, including, without limitation, the passage of time, but without taking into account potential antidilution adjustments) for any such convertible or exchangeable securities or upon the exercise of options to purchase or rights to subscribe for such convertible or exchangeable securities and subsequent conversion or exchange thereof shall be deemed to have been issued at the time such securities were issued or such options or rights were issued and for a consideration equal to the consideration, if any, received by the Corporation for any such securities and related options or rights (excluding any cash received on account of accrued interest or accrued dividends), plus the minimum additional consideration, if any, to be received by the Corporation (without taking into account potential antidilution adjustments) upon the conversion or exchange of such securities or the exercise of any related options or rights (the consideration in each case to be determined in the manner provided in Section 4(d)(i)(D)).

(3) In the event of any change in the number of shares of Common Stock deliverable or in the consideration payable to the Corporation upon exercise of such options or rights or upon conversion of or in exchange for such convertible or exchangeable securities, including, but not limited to, a change resulting from the antidilution provisions thereof, the Conversion Price of the Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock, as applicable, to the extent in any way affected by or computed using such options, rights or securities, shall be recomputed to reflect such change, but no further adjustment shall be made for the actual issuance of Common Stock or any payment of such consideration upon the exercise of any such options or rights or the conversion or exchange of such securities.

(4) Upon the expiration of any such options or rights, the termination of any such rights to convert or exchange or the expiration of any options or rights related to such convertible or exchangeable securities, the Conversion Price of the Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock, to the extent in any way affected by or computed using such options, rights or securities or options or rights related to such securities, shall be recomputed to reflect the issuance of only the number of shares of Common Stock (and convertible or exchangeable securities which remain in effect) actually issued upon the exercise of such options or rights, upon the conversion or exchange of such securities or upon the exercise of the options or rights related to such securities.

(5) The number of shares of Common Stock deemed issued and the consideration deemed paid therefor pursuant to Sections 4(d)(i)(E)(1) and 4(d)(i)(E)(2) shall be appropriately adjusted to reflect any change, termination or expiration of the type described in either Section 4(d)(i)(E)(3) or 4(d)(i)(E)(4).

(F) **No Increased Conversion Price**. Notwithstanding any other provisions of this Section (4)(d)(i), except to the limited extent provided for in Sections

4(d)(i)(E)(3) and 4(d)(i)(E)(4), no adjustment of the Conversion Price pursuant to this Section 4(d)(i) shall have the effect of increasing the Conversion Price above the Conversion Price in effect immediately prior to such adjustment.

(ii) **Stock Splits and Dividends**. In the event the Corporation should at any time or from time to time after the Purchase Date fix a record date for the effectuation of a split or subdivision of the outstanding shares of Common Stock or the determination of holders of Common Stock entitled to receive a dividend or other distribution payable in additional shares of Common Stock or other securities or rights convertible into, or entitling the holder thereof to receive, directly or indirectly, additional shares of Common Stock (hereinafter referred to as "Common Stock Equivalents") without payment of any consideration by such holder for the additional shares of Common Stock or the Common Stock Equivalents (including the additional shares of Common Stock issuable upon conversion or exercise thereof), then, as of such record date (or the date of such dividend distribution, split or subdivision if no record date is fixed), the Conversion Price shall be appropriately decreased so that the number of shares of Common Stock issuable on conversion of each share of Series A Preferred Stock, Series B Preferred Stock or Series C Preferred Stock, as applicable, shall be increased in proportion to such increase of the aggregate of shares of Common Stock outstanding and those issuable with respect to such Common Stock Equivalents, with the number of shares issuable with respect to Common Stock Equivalents determined from time to time in the manner provided for deemed issuances in Section 4(d)(i)(E).

(iii) **Reverse Stock Splits**. If the number of shares of Common Stock outstanding at any time after the Purchase Date is decreased by a combination of the outstanding shares of Common Stock, then, following the record date of such combination, the Conversion Price shall be appropriately increased so that the number of shares of Common Stock issuable on conversion of each share of Series A Preferred Stock, Series B Preferred Stock or Series C Preferred Stock shall be decreased in proportion to such decrease in outstanding shares.

(e) **Other Distributions**. In the event the Corporation shall declare a distribution payable in securities of other persons, evidences of indebtedness issued by the Corporation or other persons, assets (excluding cash dividends) or options or rights not referred to in Section 4(d)(ii), then, in each such case for the purpose of this Section 4(e), the holders of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock shall be entitled to a proportionate share of any such distribution as though they were the holders of the number of shares of Common Stock of the Corporation into which their shares of Series A Preferred Stock, Series B Preferred Stock or Series C Preferred Stock are convertible as of the record date fixed for the determination of the holders of Common Stock of the Corporation entitled to receive such distribution.

(f) **Recapitalizations**. If at any time or from time to time there shall be a recapitalization of the Common Stock (other than a subdivision, combination or merger or sale of assets transaction provided for elsewhere in this Section 4 or Section 2), provision shall be made so that each holder of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock shall thereafter be entitled to receive upon conversion of such holder's Preferred Stock the number of shares of stock or other securities or property of the Corporation or otherwise, to which a holder of the number of shares of Common Stock deliverable upon

conversion of such Preferred Stock held by such holder would have been entitled on such recapitalization. In any such case, appropriate adjustment shall be made in the application of the provisions of this Section 4 with respect to the rights of the holders of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock after the recapitalization to the end that the provisions of this Section 4 (including adjustment of the Conversion Price then in effect and the number of shares purchasable upon conversion of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock) shall be applicable after that event and be as nearly equivalent as practicable.

(g) **No Impairment**. The Corporation will not, by amendment of these Restated Articles or through any reorganization, recapitalization, transfer of assets, consolidation, merger, dissolution, issue or sale of securities or any other voluntary action, avoid or seek to avoid the observance or performance of any of the terms to be observed or performed hereunder by the Corporation, but will at all times in good faith assist in the carrying out of all the provisions of this Section 4 and in the taking of all such action as may be necessary or appropriate in order to protect the Conversion Rights of the holders of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock against impairment.

(h) **No Fractional Shares and Certificate as to Adjustments**.

(i) No fractional shares shall be issued upon the conversion of any share or shares of Series A Preferred Stock, Series B Preferred Stock or Series C Preferred Stock. The number of shares issuable upon such conversion shall be determined on the basis of the total number of shares of Series A Preferred Stock, Series B Preferred Stock or Series C Preferred Stock the holder is at the time converting into Common Stock and the number of shares of Common Stock issuable upon such aggregate conversion. If the conversion would result in the issuance of any fractional share of Common Stock, the Company shall, in lieu of issuing any fractional share of Common Stock, pay cash equal to the product of such fraction multiplied by the Common Stock's fair value (as determined by the Corporation's Board of Directors) on the date of conversion.

(ii) Upon the occurrence of each adjustment or readjustment of the Conversion Price of the Series A Preferred Stock, Series B Preferred Stock or Series C Preferred Stock pursuant to this Section 4, the Corporation, at its expense, shall promptly compute such adjustment or readjustment in accordance with the terms hereof and prepare and furnish to each holder of the applicable series of Preferred Stock, the Conversion Price of which is adjusted, a certificate setting forth such adjustment or readjustment and showing in detail the facts upon which such adjustment or readjustment is based. The Corporation shall, upon the written request at any time of any holder of shares of any designated series of Preferred Stock, furnish or cause to be furnished to such holder a like certificate setting forth (A) such adjustment and readjustment, (B) the Conversion Price for the applicable series of Preferred Stock at the time in effect, and (C) the number of shares of Common Stock and the amount, if any, of other property which at the time would be received upon the conversion or a share of such series of Preferred Stock.

(i) **Notices of Record Date**. In the event of any taking by the Corporation of a record of the holders of any class of securities for the purpose of determining the holders

thereof who are entitled to receive any dividend (other than a cash dividend) or other distribution, any right to subscribe for, purchase or otherwise acquire any shares of stock of any class or any other securities or property, or to receive any other right, the Corporation shall mail to each holder of the Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock, at least twenty (20) days prior to the date specified therein, a notice specifying the date on which any such record is to be taken for the purpose of such dividend, distribution or right, and the amount and character of such dividend, distribution or right.

(j) **Reservation of Stock Issuable Upon Conversion**. The Corporation shall at all times reserve and keep available out of its authorized but unissued shares of Common Stock, solely for the purpose of effecting the conversion of the shares of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock, such number of its shares of Common Stock as shall from time to time be sufficient to effect the conversion of all outstanding shares of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock; and if at any time the number of authorized but unissued shares of Common Stock shall not be sufficient to effect the conversion of all then outstanding shares of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock, in addition to such other remedies as shall be available to the holders of such Preferred Stock, the Corporation will take such corporate action as may, in the opinion of its counsel, be necessary to increase its authorized but unissued shares of Common Stock to such number of shares as shall be sufficient for such purposes, including, without limitation, engaging in best efforts to obtain the requisite shareholder approval of any necessary amendment to these Restated Articles.

(k) **Notices**. Any notice required by the provisions of this Section 4 to be given to the holders of shares of Series A Preferred Stock, Series B Preferred Stock or Series C Preferred Stock shall be deemed given if deposited in the United States mail, postage prepaid, and addressed to each holder of record at his address appearing on the books of the Corporation.

5 **Voting Rights**.

(a) **Number of Votes**. The holders of each share of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock shall have the right to one vote for each share of Common Stock into which such share of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock could then be converted, and with respect to such vote, such holder shall have full voting rights and powers equal to the voting rights and powers of the holders of Common Stock, and shall be entitled, notwithstanding any provision hereof, to notice of any shareholders' meeting in accordance with the bylaws of the Corporation. Holders of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock shall be entitled to vote, together with holders of Common Stock, with respect to any question upon which holders of Common Stock have the right to vote. Fractional votes shall not, however, be permitted and any fractional voting rights available on an as-converted basis (after aggregating all shares into which shares of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock held by each holder could be converted) shall be rounded to the nearest whole number (with one-half being rounded upward).

(b) **Election of Directors**.

(i) **By Holders of Series A Preferred Stock**. The holders of Series A Preferred Stock, voting separately as a single class and to the exclusion of all other classes of capital stock of the Corporation, shall be entitled (A) to elect one (1) director at any meeting or pursuant to any written consent of the shareholders for the election of the Corporation's Board of Directors, and (B) to fill any vacancy caused by the resignation, death or removal of any such director elected by the holders of Series A Preferred Stock.

(ii) **By Holders of Series B Preferred Stock**. The holders of Series B Preferred Stock, voting separately as a single class and to the exclusion of all other classes of capital stock of the Corporation, shall be entitled (A) to elect one (1) director at any meeting or pursuant to any written consent of the shareholders for the election of the Corporation's Board of Directors, and (B) to fill any vacancy caused by the resignation, death or removal of any such director elected by the holders of Series B Preferred Stock.

(iii) **By Holders of Series C Preferred Stock and Common Stock**. The holders of Series C Preferred Stock and Common Stock, voting separately as a single class and to the exclusion of all other classes of capital stock of the Corporation, shall be entitled (A) to elect the remaining directors at any meeting or pursuant to any written consent of the shareholders for the election of the Corporation's Board of Directors, and (B) to fill any vacancy caused by the resignation, death or removal of any such director elected by the holders of the Series C Preferred Stock and the Common Stock.

(c) **Removal of Directors**. Any director who has been elected pursuant to Section 5(b)(i) or Section 5(b)(ii) may be removed without cause if such removal is approved by a majority of the then outstanding shares of Series A Preferred Stock or Series B Preferred Stock, as applicable, and any director who has been elected by the holders of Series C Preferred Stock and the holders of Common Stock pursuant to Section 5(b)(iii) may be removed without cause if such removal is approved by a majority of the then outstanding shares of Series C Preferred Stock and Common Stock, except that no director may be removed pursuant to this Section 5(c) (unless the entire Board of Directors of the Corporation is removed) when the votes cast against removal, or not consenting in writing to the removal, would be sufficient to elect the director if voted cumulatively at an election at which the same total number of votes were cast (or, if the action is taken by written consent, all shares entitled to vote were voted) and the entire number of directors authorized at the time of the director's most recent election were then being elected.

(d) **Declaration of Vacancy on Board of Directors**. The Corporation's Board of Directors may declare vacant the office of a director who has been declared of unsound mind by an order of court or convicted of a felony.

6. **Protective Provisions**. The Corporation shall not, without first obtaining the approval (by vote or written consent, as provided by law) of the holders of a majority of the then outstanding shares of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock, voting together as a class, take any action that (except in the case of clauses (a) through (c) below where the holders of not less than a majority of such outstanding shares of the series affected shall vote separately as a class):

(a) amends the Articles of Incorporation in any manner that would adversely alter or change the rights, preferences, privileges or restrictions of the Preferred Stock;

(b) increases or decreases the authorized number of shares of Common Stock or the Preferred Stock;

(c) creates (by reclassification or otherwise) any new class or series of shares, share equivalents, or share appreciation rights, having rights, preferences or privileges senior to any designated series of Preferred Stock; or

(d) results in the redemption of or dividend on any shares of Common Stock (other than pursuant to equity incentive agreements with service providers giving the Corporation the right to repurchase shares upon the termination of services or other agreements providing for a right of repurchase by the Corporation as approved unanimously by the Board of Directors of the Corporation).

7. **Status of Converted Stock**. In the event any shares of Preferred Stock shall be converted pursuant to Section 4 hereof, the shares so converted shall be cancelled and shall not be issuable by the Corporation. These Restated Articles shall be appropriately amended to effect the corresponding reduction in the Corporation's authorized capital stock.

(C) **Common Stock**.

1. **Dividend Rights**. Subject to the prior rights of holders of all classes of stock at the time outstanding having prior rights as to dividends, the holders of Common Stock shall be entitled to receive, when and as declared by the Board of Directors, out of any assets of the Corporation legally available therefor, such dividends as may be declared from time to time by the Board of Directors, which dividends shall be non-cumulative.

2. **Liquidation Rights**. Upon the liquidation, dissolution or winding up of the Corporation, the assets of the Corporation shall be distributed as provided in Section 2 of Division (B) of this Article III.

3 **Redemption**. The Common Stock is not redeemable.

4. **Voting Rights**. The holders of Common Stock shall be entitled to vote upon such matters and in such manner as may be provided in these Restated Articles or by law, and shall be entitled to notice of any shareholders' meeting in accordance with the bylaws of the Corporation. Each share of Common Stock shall be entitled to one vote on all matters, except as otherwise provided in these Restated Articles or by law.

ARTICLE IV

(A) The liability of the directors of the Corporation for monetary damages shall be eliminated to the fullest extent permissible under California law.

(B) The Corporation is authorized to provide indemnification of agents (as defined in Section 317 of the California Corporations Code) through bylaw provisions, agreements with

agents, vote of shareholders or disinterested directors, or otherwise, to the fullest extent permissible under California law.

(C) Any amendment, repeal or modification of any provision of this Article IV shall not adversely affect any right or protection of an agent of the Corporation existing at the time of such amendment, repeal or modification.

* * *

3. The foregoing amendment and restatement of this corporation's Articles of Incorporation has been duly approved by the Board of Directors of the corporation.

4. The foregoing amendment and restatement of the Articles of Incorporation has been duly approved by the required vote of shareholders, in accordance with Sections 902 and 903 of the California Corporations Code. This corporation currently has 16,890,928 shares of Common Stock, 5,391,244 shares of Series A Preferred Stock and 10,543,474 shares of Series B Preferred Stock outstanding. The number of shares voting in favor of the amendment herein set forth equaled or exceeded the vote required. The percentage vote required was (i) more than fifty percent (50% of the outstanding shares of Common Stock voting as a separate class; (ii) more than fifty percent (50%) of the outstanding shares of Series A Preferred Stock voting as a separate class; (iii) more than fifty percent (50%) of the outstanding shares of Series B Preferred Stock voting as a separate class; (iv) more than fifty percent (50% of the outstanding shares of Series A Preferred Stock and Series B Preferred Stock voting together as a separate class; and (v) more than fifty percent (50%) of the outstanding shares of Series A Preferred Stock, Series B Preferred Stock and Common Stock voting together as a single class.

[Signature Page Follows]

We declare under penalty of perjury under the laws of the State of California that the matters set forth in this certificate are true and correct of our own knowledge.

Date: August 28, 2006

/s/ Hojabr Alimi

Hojabr Alimi, President

/s/ Robert Miller

Robert Miller, Chief Financial Officer

Exhibit 3.2

CERTIFICATE OF INCORPORATION

OF

OIS REINCORPORATION SUB, INC.,

a Delaware corporation

ARTICLE I

The name of this corporation is OIS Reincorporation Sub, Inc. (the "**Corporation**").

ARTICLE II

The registered agent and the address of the registered office in the State of Delaware are: The Corporation Trust Company, 1209 Orange Street, Wilmington, County of New Castle, Delaware 19801.

ARTICLE III

The purpose of the Corporation is to engage in any lawful act or activity for which a corporation may be organized under the Delaware General Corporation Law.

ARTICLE IV

A. Authorized Stock. The Corporation is authorized to issue two classes of stock to be designated respectively Preferred Stock ("**Preferred Stock**") and Common Stock ("**Common Stock**"). The total number of shares of capital stock this Corporation shall have authority to issue is one hundred thirty million (130,000,000). The total number of shares of Preferred Stock this Corporation shall have authority to issue is thirty million (30,000,000). The total number of shares of Common Stock this Corporation shall have authority to issue is one hundred million (100,000,000). The Preferred Stock and the Common Stock shall have a par value of $0.0001.

B. Preferred Stock. The shares of Preferred Stock may be issued from time to time in one or more series. The Board of Directors of the Corporation (the "**Board of Directors**") is expressly authorized to provide for the issue of all or any of the remaining shares of the Preferred Stock in one or more series, and to fix the number of shares and to determine or alter for each such series, such voting powers, full or limited, or no voting powers, and such designations, preferences, and relative participating, optional, or other rights and such qualifications, limitations, or restrictions thereof, as shall be stated and expressed in the resolution or resolutions adopted by the Board of Directors providing for the issue of such shares and as may be permitted by the Delaware General Corporation Law. The Board of Directors is also expressly authorized to increase or decrease (but not below the number of shares of such series then outstanding) the number of shares of any series subsequent to the issue of shares of that series. In case the number of shares of any such series shall be so decreased, the shares

constituting such decrease shall resume the status that they had prior to the adoption of the resolution originally fixing the number of shares of such series.

C. Common Stock.

1. Relative Rights of Preferred Stock and Common Stock. All preferences, voting powers, relative, participating, optional or other special rights and privileges, and all qualifications, limitations or restrictions, of the Common Stock are expressly made subject and subordinate to those that may be fixed with respect to any shares of the Preferred Stock.

2. Voting Rights. Except as otherwise required by law or this Certificate of Incorporation, each holder of Common Stock shall have one vote in respect of each share of stock held by such holder of record on the books of the Corporation for the election of directors and on all matters submitted to a vote of stockholders of the Corporation.

3. Dividends. Subject to the preferential rights of the Preferred Stock, the holders of shares of Common Stock shall be entitled to receive, when and if declared by the Board of Directors, out of the assets of the Corporation which are by law available therefor, dividends payable either in cash, in property or in shares of capital stock.

4. Dissolution, Liquidation or Winding Up. In the event of any dissolution, liquidation or winding up of the affairs of the Corporation, after distribution in full of the preferential amounts, if any, to be distributed to the holders of shares of the Preferred Stock, holders of Common Stock shall be entitled, unless otherwise provided by law or this Certificate of Incorporation, to receive all of the remaining assets of the Corporation of whatever kind available for distribution to stockholders ratably in proportion to the number of shares of Common Stock held by them respectively.

ARTICLE V

The Board of Directors is authorized to adopt, amend or repeal the Bylaws of the Corporation. Election of directors need not be by ballot.

ARTICLE VI

The name and mailing address of the incorporator is:

Christophe D. Mosby
Pillsbury Winthrop Shaw Pittman LLP
2475 Hanover Street
Palo Alto, CA 94104

ARTICLE VII

The Corporation reserves the right to adopt, repeal, rescind or amend in any respect any provisions contained in this Certificate of Incorporation in the manner now or hereafter prescribed by applicable law, and all rights conferred on stockholders herein are granted subject to this reservation.

ARTICLE VIII

To the fullest extent permitted by the Delaware General Corporation Law, as the same exists or as may hereafter be amended, a director of the Corporation shall not be personally liable to the Corporation or its stockholders for monetary damages of breach of fiduciary duty as director.

(a) Right to Indemnification. Each person who was or is made a party or is threatened to be made a party to or is otherwise involved in any action, suit or proceeding, whether civil, criminal, administrative or investigative (hereinafter, a "**proceeding**"), by reason of the fact that he or she is or was a director, officer of the Corporation or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation or of a partnership, joint venture, trust or other enterprise, including service with respect to an employee benefit plan (hereinafter, an "**indemnitee**"), whether the basis of such proceeding is alleged action in an official capacity as a director, officer, employee or agent or in any other capacity while serving as a director, officer, employee or agent, shall be indemnified and held harmless by the Corporation to the fullest extent authorized by the Delaware General Corporation Law, as the same exists or may hereafter be amended (but, in the case of any such amendment, only to the extent that such amendment permits the Corporation to provide broader indemnification rights than permitted prior thereto), against all expense, liability and loss (including attorneys' fees, judgments, fines, ERISA excise taxes or penalties and amounts paid in settlement) reasonably incurred or suffered by such indemnitee in connection therewith and such indemnification shall continue as to an indemnitee who has ceased to be a director, officer, employee or agent and shall inure to the benefit of the indemnitee's heirs, executors and administrators; provided, however, that, except as provided in paragraph (c) hereof with respect to proceedings to enforce rights to indemnification, the Corporation shall indemnify any such indemnitee in connection with a proceeding (or part thereof) initiated by such indemnitee only if such proceeding (or part thereof) was authorized by the Board of Directors.

(b) Right to Advancement of Expenses. The right to indemnification conferred in paragraph (a) of this Article shall include the right to be paid by the Corporation the expenses incurred in defending any proceeding for which such right to indemnification is applicable in advance of its final disposition (hereinafter, an "**advancement of expenses**"); provided, however, that, if the Delaware General Corporation Law requires, an advancement of expenses incurred by an indemnitee in his or her capacity as a director or officer (and not in any other capacity in which service was or is rendered by such indemnitee, including, without limitation, service to an employee benefit plan) shall be made only upon delivery to the Corporation of an undertaking (hereinafter, an "**undertaking**"), by or on behalf of such indemnitee, to repay all amounts so advanced if it shall ultimately be determined by final judicial decision from which there is no further right to appeal (hereinafter, a "**final adjudication**") that such indemnitee is not entitled to be indemnified for such expenses under this Article or otherwise.

(c) Right of Indemnitee to Bring Suit. The rights to indemnification and to the advancement of expenses conferred in paragraphs (a) and (b) of this Article shall be contract rights. If a claim under paragraph (a) or (b) of this Article is not paid in full by the Corporation within sixty (60) days after a written claim has been received by the Corporation, except in the

case of a claim for an advancement of expenses, in which case the applicable period shall be twenty (20) days, the indemnitee may at any time thereafter bring suit against the Corporation to recover the unpaid amount of the claim. If successful in whole or in part in any such suit, or in a suit brought by the Corporation to recover an advancement of expenses pursuant to the terms of an undertaking, the indemnitee shall be entitled to be paid also the expense of prosecuting or defending such suit. In (i) any suit brought by the indemnitee to enforce a right to indemnification hereunder (but not in a suit brought by the indemnitee to enforce a right to an advancement of expenses) it shall be a defense that, and (ii) in any suit by the Corporation to recover an advancement of expenses pursuant to the terms of an undertaking the Corporation shall be entitled to recover such expenses upon a final adjudication that, the indemnitee has not met any applicable standard for indemnification set forth in the Delaware General Corporation Law. Neither the failure of the Corporation (including its Board of Directors, its independent legal counsel or its stockholders) to have made a determination prior to the commencement of such suit that indemnification of the indemnitee is proper in the circumstances because the indemnitee has met the applicable standard of conduct set forth in the Delaware General Corporation Law, nor an actual determination by the Corporation (including its Board of Directors, its independent legal counsel or its stockholders) that the indemnitee has not met such applicable standard of conduct, shall create a presumption that the indemnitee has not met the applicable standard of conduct or, in the case of such a suit brought by the indemnitee, be a defense to such suit. In any suit brought by the indemnitee to enforce a right to indemnification or to an advancement of expenses hereunder, or by the Corporation to recover an advancement of expenses pursuant to the terms of an undertaking, the burden of proving that the indemnitee is not entitled to be indemnified, or to such advancement of expenses, under this Article or otherwise shall be on the Corporation.

(d) Non-Exclusivity of Rights. The rights to indemnification and to the advancement of expenses conferred in this Article shall not be exclusive of any other right that any person may have or hereafter acquire under any statute, the Corporation's Certificate of Incorporation, Bylaws, agreement, vote of stockholders or disinterested directors or otherwise.

(e) Insurance. The Corporation may maintain insurance, at its expense, to protect itself and any director, officer, employee or agent of the Corporation or another corporation, partnership, joint venture, trust or other enterprise against any expense, liability or loss, whether or not the Corporation would have the power to indemnify such person against such expense, liability or loss under the Delaware General Corporation Law.

(f) Indemnification of Employees and Agents of the Corporation. The Corporation may, to the extent authorized from time to time by the Board of Directors, grant rights to indemnification, and to the advancement of expenses to any employee or agent of the Corporation to the fullest extent of the provisions of this Article with respect to the indemnification and advancement of expenses of directors and officers of the Corporation.

(g) Amendment. Neither any amendment nor repeal of this Article VIII, nor the adoption of any provision of the Corporation's Certificate of Incorporation inconsistent with this Article VIII, shall eliminate or reduce the effect of this Article VIII in respect of any matter occurring, or action or proceeding accruing or arising or that, but for this Article VIII, would accrue or arise, prior to such amendment, repeal or adoption of an inconsistent provision.

I, THE UNDERSIGNED, being the incorporator herein before named, for the purpose of forming a corporation pursuant to the General Corporation Laws of the State of Delaware, do make this certificate, hereby declaring and certifying that this is my act and deed and the facts herein stated are true, and accordingly have hereunto set my hand this ___ day of July, 2006.

Christophe D. Mosby
Incorporator

Exhibit 3.5

BYLAWS
OF
OIS REINCORPORATION SUB, INC.

(a Delaware corporation)

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BYLAWS

OF

OIS REINCORPORATION SUB, INC.

(a Delaware corporation)

ARTICLE 1

Offices

1.1 Principal Office. The Board of Directors (the "**Board**") shall fix the location of the principal executive office of the corporation at any place within or outside the State of Delaware.

1.2 Additional Offices. The Board may at any time establish branch or subordinate offices at any place or places.

ARTICLE 2

Meeting of Stockholders

2.1 Place of Meeting. All meetings of the stockholders for the election of directors shall be held at the principal office of the Corporation, at such place as may be fixed from time to time by the Board, or at such other place either within or without the State of Delaware, as shall be designated from time to time by the Board and stated in the notice of the meeting. Meetings of stockholders for any purpose may be held at such time and place within or without the State of Delaware as the Board may fix from time to time, and as shall be stated in the notice of the meeting or in a duly executed waiver of notice thereof.

2.2 Annual Meeting. Annual meetings of stockholders shall be held at such date and time as shall be designated from time to time by the Board and stated in the notice of the meeting. At such annual meetings, the stockholders shall elect a Board and transact such other business as may properly be brought before the meetings.

2.3 Special Meetings. Special meetings of the stockholders may be called for any purpose or purposes, unless otherwise prescribed by the statute or by the Certificate of Incorporation, at the request of the Board, the Chairman of the Board, the President or the holders of shares entitled to cast not less than ten percent (10%) of the votes at the meeting, or such additional persons as may be provided in the Certificate of Incorporation or these Bylaws. Such request shall state the purpose or purposes of the proposed meeting. Upon request in writing that a special meeting of stockholders be called for any proper purpose, directed to the Chairman of the Board, the President, the Vice President or the Secretary, by any person (other than the Board) entitled to call a special meeting of stockholders, the person forthwith shall cause notice to be given to the stockholders entitled to vote that a meeting will be held at a time requested by

the person or persons calling the meeting, such time not to be less than thirty-five (35) nor more than sixty (60) days after receipt of the request. Such request shall state the purpose or purposes of the proposed meeting.

2.4 Notice of Meetings. Written notice of stockholders' meetings, stating the place, date and time of the meeting, and the purpose or purposes for which the meeting is called, shall be given to each stockholder entitled to vote at such meeting not less than ten (10) nor more than sixty (60) days prior to the meeting.

When a meeting is adjourned to another place, date or time, written notice need not be given of the adjourned meeting if the place, date and time thereof are announced at the meeting at which the adjournment is taken; provided, however, that if the date of any adjourned meeting is more than thirty (30) days after the date for which the meeting was originally noticed, or if a new record date is fixed for the adjourned meeting, written notice of the place, date and time of the adjourned meeting shall be given in conformity herewith. At any adjourned meeting, any business may be transacted which might have been transacted at the original meeting.

2.5 Business Matter of a Special Meeting. Business transacted at any special meeting of stockholders shall be limited to the purposes stated in the notice.

2.6 List of Stockholders. The officer in charge of the stock ledger of the Corporation or the transfer agent shall prepare and make, at least ten (10) days before every meeting of stockholders, a complete list of the stockholders entitled to vote at the meeting arranged in alphabetical order, and showing the address of each stockholder and the number of shares registered in the name of each stockholder. Such list shall be open to the examination of any stockholder, for any purpose germane to the meeting, during ordinary business hours, for a period of at least ten (10) days prior to the meeting, at a place within the city where the meeting is to be held, which place, if other than the place of the meeting, shall be specified in the notice of the meeting. The list shall also be produced and kept at the place of the meeting during the whole time thereof, and may be inspected by any stockholder who is present in person thereat.

2.7 Organization and Conduct of Business. The Chairman of the Board or, in his or her absence, the President of the Corporation or, in their absence, such person as the Board may have designated or, in the absence of such a person, such person as may be chosen by the holders of a majority of the shares entitled to vote who are present, in person or by proxy, shall call to order any meeting of the stockholders and act as Chairman of the meeting. In the absence of the Secretary of the Corporation, the Secretary of the meeting shall be such person as the Chairman appoints.

The Chairman of any meeting of stockholders shall determine the order of business and the procedure at the meeting, including such regulation of the manner of voting and the conduct of discussion as seems to him or her in order.

2.8 Quorum and Adjournments. Except where otherwise provided by law or in the Certificate of Incorporation or these Bylaws, the holders of a majority of the stock issued and outstanding and entitled to vote, present in person or represented by proxy, shall constitute a

quorum at all meetings of the stockholders. The stockholders present at a duly called or held meeting at which a quorum is present may continue to do business until adjournment, notwithstanding the withdrawal of enough stockholders to have less than a quorum if any action taken (other than adjournment) is approved by at least a majority of the shares required to constitute a quorum. At such adjourned meeting at which a quorum is present or represented, any business may be transacted which might have been transacted at the meeting as originally noticed. If, however, a quorum shall not be present or represented at any meeting of the stockholders, the stockholders entitled to vote thereat who are present in person or represented by proxy shall have the power to adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum shall be present or represented.

2.9 Voting Rights. Unless otherwise provided in the Certificate of Incorporation, each stockholder shall at every meeting of the stockholders be entitled to one vote in person or by proxy for each share of the capital stock having voting power held by such stockholder.

2.10 Majority Vote. When a quorum is present at any meeting, the vote of the holders of a majority of the stock having voting power present in person or represented by proxy shall decide any question brought before such meeting, unless the question is one upon which, by express provision of the statutes or of the Certificate of Incorporation or of these Bylaws, a different vote is required, in which case such express provision shall govern and control the decision of such question.

2.11 Record Date for Stockholder Notice and Voting. For purposes of determining the stockholders (a) entitled to notice of any meeting or to vote, or (b) entitled to receive payment of any dividend or other distribution, or (c) entitled to exercise any right in respect of any change, conversion or exchange of stock, or for the purpose of any other lawful action, the Board may fix, in advance, a record date, which shall not be more than sixty (60) days, nor less than ten (10) days before the date of any such meeting, nor more than sixty (60) days before any other action.

If the Board does not so fix a record date, the record date for determining stockholders entitled to notice of or to vote at a meeting of stockholders shall be at the close of business on the business day next preceding the day on which notice is given or, if notice is waived, at the close of business on the business day next preceding the day on which the meeting is held.

2.12 Proxies. Every person entitled to vote for directors or on any other matter shall have the right to do so either in person or by one or more agents authorized by a written proxy signed by the person and filed with the Secretary of the Corporation. A proxy shall be deemed signed if the stockholder's name is placed on the proxy (whether by manual signature, typewriting, telegraphic transmission or otherwise) by the stockholder or the stockholder's attorney-in-fact. A validly executed proxy which does not state that it is irrevocable shall continue in full force and effect unless (a) revoked by the person executing it, before the vote pursuant to that proxy, by a writing delivered to the Corporation stating that the proxy is revoked or by a subsequent proxy executed by the maker of the proxy, or by that person's attendance and vote at the meeting; or (b) written notice of the death or incapacity of the maker of that proxy is received by the Corporation before the vote pursuant to that proxy is counted; provided, however, that no

proxy shall be valid after the expiration of eleven months from the date of the proxy, unless otherwise provided in the proxy.

2.13 Inspectors of Election. Before any meeting of stockholders, the Board may appoint any person other than nominees for office to act as inspectors of election at the meeting or its adjournment. If no inspectors of election are so appointed, the Chairman of the meeting may, and on the request of any stockholder or a stockholder's proxy shall, appoint inspectors of election at the meeting. The number of inspectors shall be either one (1) or three (3). If inspectors are appointed at a meeting on the request of one or more stockholders or proxies, the holders of a majority of shares or their proxies present at the meeting shall determine whether one (1) or three (3) inspectors are to be appointed. If any person appointed as inspector fails to appear or fails or refuses to act, the Chairman of the meeting may, and upon the request of any stockholder or a stockholder's proxy shall, appoint a person to fill that vacancy.

2.14 Action Without Meeting by Written Consent. All actions required to be taken at any annual or special meeting may be taken without a meeting, without prior notice and without a vote, if a consent or consents in writing, setting forth the action so taken, shall be signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted, and shall be delivered to the Corporation by delivery to its registered office, its principal place of business, or an officer or agent of the corporation having custody of the book in which proceedings of meetings or stockholders are recorded.

ARTICLE 3

Directors

3.1 Number; Qualifications. The authorized number of directors shall be determined from time to time by resolution of the Board. All directors shall be elected at the annual meeting or at any special meeting of the stockholders, except as provided in Section 3.2 hereof, and each director so elected shall hold office until the next annual meeting or any special meeting, or until his successor is elected and qualified, or until his earlier resignation or removal. Directors need not be stockholders.

3.2 Resignation and Vacancies. A vacancy or vacancies in the Board shall be deemed to exist in the case of the death, resignation or removal of any director, or if the authorized number of directors be increased. Vacancies may be filled by a majority of the remaining directors, though less than a quorum, or by a sole remaining director, unless otherwise provided in the Certificate of Incorporation. The stockholders may elect a director or directors at any time to fill any vacancy or vacancies not filled by the directors. If the Board accepts the resignation of a director tendered to take effect at a future time, the Board shall have power to elect a successor to take office when the resignation is to become effective. If there are no directors in office, then an election of directors may be held in the manner provided by statute.

3.3 Removal of Directors. Unless otherwise restricted by statute, or by the Certificate of Incorporation or these Bylaws, any director or the entire Board may be removed, with or

without cause, by the holders of at least a majority of the shares entitled to vote at an election of directors.

3.4 Powers. The business of the Corporation shall be managed by or under the direction of the Board which may exercise all such powers of the Corporation and do all such lawful acts and things which are not by statute or by the Certificate of Incorporation or by these Bylaws directed or required to be exercised or done by the stockholders.

Without prejudice to these general powers, and subject to the same limitations, the directors shall have the power to:

(a) Select and remove all officers, agents and employees of the Corporation; prescribe any powers and duties for them that are consistent with law, with the Certificate of Incorporation and with these Bylaws; fix their compensation; and require from them security for faithful service;

(b) Confer upon any office the power to appoint, remove and suspend subordinate officers, employees and agents;

(c) Change the principal executive office or the principal business office in the State of California, or any other state, from one location to another; cause the Corporation to be qualified to do business in any other state, territory, dependency or country, and conduct business within or without the State of California; and designate any place within or without the State of California for the holding of any stockholders meeting, or meetings, including annual meetings;

(d) Adopt, make and use a corporate seal; prescribe the forms of certificates of stock; and alter the form of the seal and certificates;

(e) Authorize the issuance of shares of stock of the Corporation on any lawful terms, in consideration of money paid, labor done, services actually rendered, debts or securities canceled, tangible or intangible property actually received;

(f) Borrow money and incur indebtedness on behalf of the Corporation, and cause to be executed and delivered for the Corporation's purposes, in the corporate name, promissory notes, bonds, debentures, deeds of trust, mortgages, pledges, hypothecation and other evidences of debt and securities;

(g) Declare dividends from time to time in accordance with law;

(h) Adopt from time to time such stock option, stock purchase, bonus or other compensation plans for directors, officers, employees and agents of the Corporation and its subsidiaries as it may determine; and

(i) Adopt from time to time regulations not inconsistent with these Bylaws for the management of the Corporation's business and affairs.

3.5 Place of Meetings. The Board may hold meetings, both regular and special, either within or without the State of Delaware.

3.6 Annual Meetings. The annual meeting of the Board shall be held immediately following the annual meeting of stockholders, and no notice of such meeting shall be necessary to the Board, provided a quorum shall be present. The annual meetings shall be for the purposes of organization, for an election of officers and for the transaction of other business.

3.7 Regular Meetings. Regular meetings of the Board may be held without notice at such time and place as may be determined from time to time by the Board.

3.8 Special Meetings. Special meetings of the Board may be called by the Chairman of the Board, the President, a Vice President or a majority of the Board, upon one (1) day's notice to each director.

3.9 Quorum and Adjournments. At all meetings of the Board, a majority of the directors then in office shall constitute a quorum for the transaction of business, and the act of a majority of the directors present at any meeting at which there is a quorum shall be the act of the Board, except as may otherwise be specifically provided by law or by the Certificate of Incorporation. If a quorum is not present at any meeting of the Board, the directors present may adjourn the meeting from time to time, without notice other than announcement at the meeting at which the adjournment is taken, until a quorum shall be present. A meeting at which a quorum is initially present may continue to transact business notwithstanding the withdrawal of directors, if any action taken is approved of by at least a majority of the required quorum for that meeting.

3.10 Action Without Meeting. Unless otherwise restricted by the Certificate of Incorporation or by these Bylaws, any action required or permitted to be taken at any meeting of the Board or of any committee thereof may be taken without a meeting, if all members of the Board or committee, as the case may be, consent thereto in writing, and the writing or writings are filed with the minutes of proceedings of the Board or committee.

3.11 Telephone Meetings. Unless otherwise restricted by the Certificate of Incorporation or by these Bylaws, any member of the Board or of any committee may participate in a meeting by means of conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other, and such participation in a meeting shall constitute presence in person at the meeting.

3.12 Waiver of Notice. Notice of a meeting need not be given to any director who signs a waiver of notice or a consent to holding the meeting or an approval of the minutes thereof, whether before or after the meeting, or who attends the meeting without protesting, either prior thereto or at its commencement, the lack of notice to such director. All such waivers, consents and approvals shall be filed with the corporate records or made a part of the minutes of the meeting.

3.13 Fees and Compensation of Directors. Unless otherwise restricted by the Certificate of Incorporation or by these Bylaws, the Board shall have the authority to fix the

compensation of directors. The directors may be paid their expenses, if any, of attendance at each meeting of the Board, and may be paid a fixed sum for attendance at each meeting of the Board or a stated salary as director. No such payment shall preclude any director from serving the Corporation in any other capacity and receiving compensation therefor. Members of special or standing committees may be allowed like compensation for attending committee meetings.

3.14 Rights of Inspection. Every director shall have the absolute right at any reasonable time to inspect and copy all books, records and documents of every kind, and to inspect the physical properties of the Corporation and also of its subsidiary corporations, domestic or foreign. Such inspection by a director may be made in person or by agent or attorney, and includes the right to copy and obtain extracts.

ARTICLE 4

Committees of Directors

4.1 Selection. The Board may, by resolution passed by a majority of the entire Board, designate one or more committees, each committee to consist of one or more of the directors of the Corporation. The Board may designate one or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee.

In the absence or disqualification of a member of a committee, the member or members thereof present at any meeting and not disqualified from voting, whether or not he or she or they constitute a quorum, may unanimously appoint another member of the Board to act at the meeting in the place of any such absent or disqualified member.

4.2 Power. Any such committee, to the extent provided in the resolution of the Board, shall have and may exercise all of the powers and authority of the Board in the management of the business and affairs of the Corporation, and may authorize the seal of the Corporation to be affixed to all papers which may require it; but no such committee shall have the power or authority in reference to amending the Certificate of Incorporation (except that a committee may, to the extent authorized in the resolution or resolutions providing for the issuance of shares of stock adopted by the Board as provided in Section 151(a) of the General Corporation Law of Delaware, fix any of the preferences or rights of such shares relating to dividends, redemption, dissolution, any distribution of assets of the Corporation or the conversion into, or the exchange of such shares for, shares of any other class or classes or any other series of the same or any other class or classes of stock of the Corporation), adopting an agreement of merger or consolidation, recommending to the stockholders the sale, lease or exchange of all or substantially all of the Corporation's property and assets, recommending to the stockholders a dissolution of the Corporation or a revocation of dissolution, removing or indemnifying directors or amending the Bylaws of the Corporation; and, unless the resolution or the Certificate of Incorporation expressly so provides, no such committee shall have the power or authority to declare a dividend or to authorize the issuance of stock or to adopt a certificate of ownership and merger. Such committee or committees shall have such name or names as may be determined from time to time by resolution adopted by the Board.

4.3 Committee Minutes. Each committee shall keep regular minutes of its meetings and report the same to the Board when required.

ARTICLE 5

Officers

5.1 Officers Designated. The officers of the Corporation shall be chosen by the Board and shall be a President, a Secretary and a Treasurer. The Board may also choose a Chairman of the Board, one or more Vice Presidents, and one or more assistant Secretaries and assistant Treasurers. Any number of offices may be held by the same person, unless the Certificate of Incorporation or these Bylaws otherwise provide.

5.2 Appointment of Officers. The officers of the Corporation, except such officers as may be appointed in accordance with the provisions of Section 5.3 or Section 5.5 hereof, shall be appointed by the Board, and each shall serve at the pleasure of the Board, subject to the rights, if any, of an officer under any contract of employment.

5.3 Subordinate Officers. The Board may appoint, and may empower the President to appoint, such other officers and agents as the business of the Corporation may require, each of whom shall hold office for such period, have such authority and perform such duties as are provided in the Bylaws or as the Board may from time to time determine.

5.4 Removal and Resignation of Officers. Subject to the rights, if any, of an officer under any contract of employment, any officer may be removed, either with or without cause, by an affirmative vote of the majority of the Board, at any regular or special meeting of the Board, or, except in case of an officer chosen by the Board, by any officer upon whom such power of removal may be conferred by the Board.

Any officer may resign at any time by giving written notice to the Corporation. Any resignation shall take effect at the date of the receipt of that notice or at any later time specified in that notice; and, unless otherwise specified in that notice, the acceptance of the resignation shall not be necessary to make it effective. Any resignation is without prejudice to the rights, if any, of the Corporation under any contract to which the officer is a party.

5.5 Vacancies in Offices. A vacancy in any office because of death, resignation, removal, disqualification or any other cause shall be filled in the manner prescribed in these Bylaws for regular appointment to that office.

5.6 Compensation. The salaries of all officers of the Corporation shall be fixed from time to time by the Board, and no officer shall be prevented from receiving a salary because he is also a director of the Corporation.

5.7 The Chairman of the Board. The Chairman of the Board, if such an officer be elected, shall, if present, perform such other powers and duties as may be assigned to him from time to time by the Board. If there is no President, the Chairman of the Board shall also be the

Chief Executive Officer of the Corporation and shall have the powers and duties prescribed in Section 5.8 hereof.

5.8 The President. Subject to such supervisory powers, if any, as may be given by the Board to the Chairman of the Board, if there be such an officer, the President shall be the Chief Executive Officer of the Corporation, shall preside at all meetings of the stockholders and in the absence of the Chairman of the Board, or if there be none, at all meetings of the Board, shall have general and active management of the business of the Corporation, and shall see that all orders and resolutions of the Board are carried into effect. He or she shall execute bonds, mortgages and other contracts requiring a seal, under the seal of the Corporation, except where required or permitted by law to be otherwise signed and executed, and except where the signing and execution thereof shall be expressly delegated by the Board to some other officer or agent of the Corporation.

5.9 The Vice President. The Vice President (or in the event there be more than one, the Vice Presidents in the order designated by the directors, or in the absence of any designation, in the order of their election), shall, in the absence of the President or in the event of his disability or refusal to act, perform the duties of the President, and when so acting, shall have the powers of and be subject to all the restrictions upon the President. The Vice President(s) shall perform such other duties and have such other powers as may from time to time be prescribed for him or her or them by the Board, the President, the Chairman of the Board or these Bylaws.

5.10 The Secretary. The Secretary shall attend all meetings of the Board and of the stockholders and record all votes and the proceedings of the meetings in a book to be kept for that purpose, and shall perform like duties for the standing committees, when required. The Secretary shall give, or cause to be given, notice of all meetings of stockholders and special meetings of the Board, and shall perform such other duties as may from time to time be prescribed by the Board, the Chairman of the Board or the President, under whose supervision he or she shall act. The Secretary shall have custody of the seal of the Corporation, and the Secretary, or an Assistant Secretary, shall have authority to affix the same to any instrument requiring it, and, when so affixed, the seal may be attested by his or her signature or by the signature of such Assistant Secretary. The Board may give general authority to any other officer to affix the seal of the Corporation and to attest the affixing thereof by his or her signature. The Secretary shall keep, or cause to be kept, at the principal executive office or at the office of the Corporation’s transfer agent or registrar, as determined by resolution of the Board, a share register, or a duplicate share register, showing the names of all stockholders and their addresses, the number and classes of shares held by each, the number and date of certificates issued for the same, and the number and date of cancellation of every certificate surrendered for cancellation.

5.11 The Assistant Secretary. The Assistant Secretary, or if there be more than one, the Assistant Secretaries in the order designated by the Board (or in the absence of any designation, in the order of their election) shall, in the absence of the Secretary, or in the event of his or her inability or refusal to act, perform the duties and exercise the powers of the Secretary and shall perform such other duties and have such other powers as may from time to time be prescribed by the Board.

5.12 The Treasurer. The Treasurer shall have the custody of the Corporate funds and securities and shall keep full and accurate accounts of receipts and disbursements in books belonging to the Corporation, and shall deposit all moneys and other valuable effects in the name and to the credit of the Corporation in such depositories as may be designated by the Board. The Treasurer shall disburse the funds of the Corporation as may be ordered by the Board, taking proper vouchers for such disbursements, and shall render to the President and the Board, at its regular meetings, or when the Board so requires, an account of all of his or her transactions as Treasurer and of the financial condition of the Corporation.

5.13 The Assistant Treasurer. The Assistant Treasurer, or if there shall be more than one, the Assistant Treasurers in the order designated by the Board (or in the absence of any designation, in the order of their election) shall, in the absence of the Treasurer or in the event of his or her inability or refusal to act, perform the duties and exercise the powers of the Treasurer, and shall perform such other duties and have such other powers as may from time to time be prescribed by the Board.

ARTICLE 6

Indemnification of Directors, Officers, Employees and Other Agents

6.1 Indemnification of Directors and Officers. The Corporation shall, to the maximum extent and in the manner permitted by the General Corporation Law of Delaware, indemnify each of its directors and officers against expenses (including attorneys' fees), judgments, fines, settlements and other amounts actually and reasonably incurred in connection with any proceeding, arising by reason of the fact that such person is or was an agent of the Corporation. For purposes of this Section 6.1, a "director" or "officer" of the Corporation includes any person (a) who is or was a director or officer of the Corporation, (b) who is or was serving at the request of the Corporation as a director or officer of another corporation, partnership, joint venture, trust or other enterprise, or (c) who was a director or officer of a corporation which was a predecessor corporation of the Corporation or of another enterprise at the request of such predecessor corporation.

6.2 Indemnification of Others. The Corporation shall have the power, to the maximum extent and in the manner permitted by the General Corporation Law of Delaware, to indemnify each of its employees and agents (other than directors and officers) against expenses (including attorneys' fees), judgments, fines, settlements and other amounts actually and reasonably incurred in connection with any proceeding, arising by reason of the fact that such person is or was an agent of the Corporation. For purposes of this Section 6.2, an "employee" or "agent" of the Corporation (other than a director or officer) includes any person (a) who is or was an employee or agent of the Corporation, (b) who is or was serving at the request of the Corporation as an employee or agent of another corporation, partnership, joint venture, trust or other enterprise, or (c) who was an employee or agent of a corporation which was a predecessor corporation of the Corporation or of another enterprise at the request of such predecessor corporation.

6.3 Payment Of Expenses In Advance. Expenses incurred in defending any action or proceeding for which indemnification is required pursuant to Section 6.1 hereof, or for which indemnification is permitted pursuant to Section 6.2 hereof, following authorization thereof by the Board, shall be paid by the Corporation in advance of the final disposition of such action or proceeding upon receipt of an undertaking by or on behalf of the indemnified party to repay such amount, if it shall ultimately be determined that the indemnified party is not entitled to be indemnified as authorized in this Article 6.

6.4 Indemnity Not Exclusive. The indemnification provided for under this Article 6 shall not be deemed exclusive of any other rights to which those seeking indemnification may be entitled under any bylaw, agreement, vote of shareholders or disinterested directors or otherwise, both as to action in an official capacity and as to action in another capacity while holding such office, to the extent that such additional rights to indemnification are authorized in the Certificate of Incorporation.

6.5 Insurance. The Corporation may purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the Corporation, or who is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against him or her and incurred by him or her in any such capacity, or arising out of his or her status as such, whether or not the Corporation would have the power to indemnify him or her against such liability under the provisions of the General Corporation Law of Delaware.

6.6 Conflicts. No indemnification or advance shall be made under this Article 6, except where such indemnification or advance is mandated by law or the order, judgment or decree of any court of competent jurisdiction, in any circumstance where it appears:

(a) That it would be inconsistent with a provision of the Certificate of Incorporation, these Bylaws, a resolution of the stockholders or an agreement in effect at the time of the accrual of the alleged cause of action asserted in the proceeding in which the expenses were incurred or other amounts were paid, which prohibits or otherwise limits indemnification; or

(b) That it would be inconsistent with any condition expressly imposed by a court in approving a settlement.

ARTICLE 7

Stock Certificates

7.1 Certificates for Shares. The shares of the Corporation shall be represented by certificates or shall be uncertificated. Certificates shall be signed by, or be in the name of the Corporation by, the Chairman of the Board, or the President or a Vice President and by the Treasurer or an Assistant Treasurer, or the Secretary or an Assistant Secretary of the Corporation.

Within a reasonable time after the issuance or transfer of uncertified stock, the Corporation shall send to the registered owner thereof a written notice containing the information required by the General Corporation Law of the State of Delaware or a statement that the Corporation will furnish without charge to each stockholder who so requests the powers, designations, preferences and relative participating, optional or other special rights of each class of stock or series thereof, and the qualifications, limitations or restrictions of such preferences and/or rights.

7.2 Signatures on Certificates. Any or all of the signatures on a certificate may be a facsimile. In case any officer, transfer agent or registrar who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer, transfer agent or registrar before such certificate is issued, it may be issued by the Corporation with the same effect as if he or she were such officer, transfer agent or registrar at the date of issue.

7.3 Transfer of Stock. Upon surrender to the Corporation or the transfer agent of the Corporation of a certificate of shares duly endorsed or accompanied by proper evidence of succession, assignation or authority to transfer, it shall be the duty of the Corporation to issue a new certificate to the person entitled thereto, to cancel the old certificate and record the transaction upon its books. Upon receipt of proper transfer instructions from the registered owner of uncertificated shares, such uncertificated shares shall be canceled, and issuance of new equivalent uncertificated shares or certificated shares shall be made to the person entitled thereto, and the transaction shall be recorded upon the books of the Corporation.

7.4 Registered Stockholders. The Corporation shall be entitled to recognize the exclusive right of a person registered on its books as the owner of shares to receive dividends, and to vote as such owner, and to hold liable for calls and assessments a percent registered on its books as the owner of shares, and shall not be bound to recognize any equitable or other claim to or interest in such share or shares on the part of any other person, whether or not it shall have express or other notice thereof, except as otherwise provided by the laws of Delaware.

7.5 Record Date. In order that the Corporation may determine the stockholders of record who are entitled to receive notice of, or to vote at, any meeting of stockholders or any adjournment thereof, or to express consent to corporate action in writing without a meeting, or entitled to receive payment of any dividend or other distribution or allotment of any rights, or to exercise any rights in respect of any change, conversion, or exchange of stock or for the purpose of any lawful action, the Board may fix, in advance, a record date which shall not be more than sixty (60) nor less than ten (10) days prior to the date of such meeting, nor more than sixty (60) days prior to the date of any other action. A determination of stockholders of record entitled to notice or to vote at a meeting of stockholders shall apply to any adjournment of the meeting; provided, however, that the Board may fix a new record date for the adjourned meeting.

7.6 Lost, Stolen or Destroyed Certificates. The Board may direct that a new certificate or certificates be issued to replace any certificate or certificates theretofore issued by the Corporation alleged to have been lost, stolen or destroyed, upon the making of an affidavit of that fact by the person claiming the certificate of stock to be lost, stolen or destroyed and on such terms and conditions as the Board may require. The Board may require indemnification of the Corporation secured by a bond or other adequate security sufficient to protect the Corporation

against any claim that may be made against it, including any expense or liability, on account of the alleged loss, theft or destruction of the certificate or the issuance of the replacement certificate. When authorizing the issue of a new certificate or certificates, the Board may, in its discretion and as a condition precedent to the issuance thereof, require the owner of the lost, stolen or destroyed certificate or certificates, or his or her legal representative, to advertise the same in such manner as it shall require, and/or to give the Corporation a bond in such sum as it may direct as indemnity against any claim that may be made against the Corporation with respect to the certificate alleged to have been lost, stolen or destroyed.

ARTICLE 8

Notices

8.1 Notice. Whenever, under the provisions of the statutes or of the Certificate of Incorporation or of these Bylaws, notice is required to be given to any director or stockholder, it shall not be construed to mean personal notice, but such notice may be given in writing, by mail, addressed to such director or stockholder, at his or her address as it appears on the records of the Corporation, with postage thereon prepaid, and such notice shall be deemed to be given at the time when the same shall be deposited in the United States mail. Notice to directors may also be given by telegram, telephone or electronic mail.

8.2 Waiver. Whenever any notice is required to be given under the provisions of the statutes or of the Certificate of Incorporation or of these Bylaws, a waiver thereof in writing, signed by the person or persons entitled to said notice, whether before or after the time stated therein, shall be deemed equivalent thereto.

ARTICLE 9

General Provisions

9.1 Dividends. Dividends upon the capital stock of the Corporation, subject to any restrictions contained in the General Corporation Laws of Delaware or the provisions of the Certificate of Incorporation, if any, may be declared by the Board at any regular or special meeting. Dividends may be paid in cash, in property or in shares of the capital stock, subject to the provisions of the Certificate of Incorporation.

9.2 Dividend Reserve. Before payment of any dividend, there may be set aside out of any funds of the Corporation available for dividends, such sum or sums as the directors from time to time, in their absolute discretion, think proper as a reserve or reserves to meet contingencies, or for equalizing dividends, or for repairing or maintaining any property of the Corporation, or for such other purpose as the directors shall think conducive to the interest of the Corporation, and the directors may modify or abolish any such reserve in the manner in which it was created.

9.3 Annual Statement. The Board shall present at each annual meeting, and at any special meeting of the stockholders when called for by vote of the stockholders, a full and clear statement of the business and condition of the Corporation.

9.4 Checks. All checks or demands for money and notes of the Corporation shall be signed by such officer or officers or such other person or persons as the Board may from time to time designate.

9.5 Corporate Seal. The Board may provide a suitable seal, containing the name of the Corporation, which seal shall be in the charge of the Secretary. If and when so directed by the Board or a committee thereof, duplicates of the seal may be kept and used by the Treasurer or by an Assistant Secretary or an Assistant Treasurer.

9.6 Execution of Corporate Contracts and Instruments. The Board, except as otherwise provided in these Bylaws, may authorize any officer or officers, or agent or agents, to enter into any contract or execute any instrument in the name of and on behalf of the Corporation; such authority may be general or confined to specific instances. Unless so authorized or ratified by the Board or within the agency power of an officer, no officer, agent or employee shall have any power or authority to bind the Corporation by any contract or engagement, or to pledge its credit or to render it liable for any purpose or for any amount.

ARTICLE 10

Amendments

In addition to the right of the stockholders of the Corporation to make, alter, amend, change, add to or repeal the Bylaws of the Corporation, the Board shall have the power (without the assent or vote of the stockholders) to make, alter, amend, change, add to or repeal the Bylaws of the Corporation.

CERTIFICATE OF SECRETARY

I, the undersigned, hereby certify:

1. That I am the duly elected, acting and qualified Secretary of OIS Reincorporation Sub, Inc., a Delaware corporation; and

2. That the foregoing Bylaws, comprising fourteen (14) pages, constitute the Bylaws of such corporation as duly adopted by Action by Unanimous Written Consent of the Board of Directors of the corporation.

IN WITNESS WHEREOF, I have hereunto subscribed my name this ___ day of _____, 2006.

Jim Schutz
Secretary

Exhibit 4.1


COMMON STOCK
NUMBER
0001
OCULUS
Innovative Sciences
COMMON STOCK
SHARES
INCORPORATED UNDER THE LAWS OF THE STATE OF DELAWARE
OCULUS INNOVATIVE SCIENCES, INC.
CUSIP 67575P 10 8
SEE REVERSE FOR CERTAIN DEFINITIONS
THIS CERTIFIES THAT
PROOF
is the record holder of
FULLY PAID AND NON-ASSESSABLE SHARES OF COMMON STOCK, NO PAR VALUE PER SHARE, OF
OCULUS INNOVATIVE SCIENCES, INC.
transferable on the books of the Corporation in person or by duly authorized attorney upon surrender of this Certificate properly endorsed. This Certificate is not valid until countersigned by the Transfer Agent and registered by the Registrar.
WITNESS the facsimile signatures of its duly authorized officers.
DATED:
SECRETARY
OCULUS INNOVATIVE SCIENCES INC INCORPORATED SEAL 2006 DELAWARE
PRESIDENT
COUNTERSIGNED AND REGISTERED:
MELLON INVESTOR SERVICES LLC
TRANSFER AGENT AND REGISTRAR
BY
AUTHORIZED SIGNATURE

OCULUS INNOVATIVE SCIENCES, INC.

The Corporation will furnish without charge to each stockholder who so requests the powers, designations, preferences and relative, participating, optional, or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preferences and/or rights. Such request shall be made to the Corporation's Secretary at the principal office of the Corporation.

The following abbreviations, when used in the inscription on the face of this certificate, shall be construed as though they were written out in full according to applicable laws or regulations:

TEN COM — as tenants in common

TEN ENT — as tenants by the entireties

JT TEN — as joint tenants with right of survivorship and not as tenants in common

UNIF GIT MIN ACT- _____ (Cust) Custodian _____ (Minor) under Uniform Gifts to Minors Act _____ (State)

UNIF TRF MIN ACT- _____ (Cust) Custodian (until age _____) _____ (Minor) under Uniform Transfers to Minors Act _____ (State)

Additional abbreviations may also be used though not in the above list.

FOR VALUE RECEIVED, _____ hereby sell, assign and transfer(s) unto

PLEASE INSERT SOCIAL SECURITY OR OTHER IDENTIFYING NUMBER OF ASSIGNEE

_____

(PLEASE PRINT OR TYPEWRITE NAME AND ADDRESS, INCLUDING ZIP CODE, OF ASSIGNEE)

_____

_____

_____

_____ Shares of the Common Stock represented by the within Certificate, and do(es) hereby irrevocably constitute and appoint

_____ Attorney to transfer the said stock on the books of the within named Corporation with full power of substitution in the premises.

Dated _____

X _____

X _____

NOTICE: THE SIGNATURE(S) TO THIS ASSIGNMENT MUST CORRESPOND WITH THE NAME(S) AS WRITTEN UPON THE FACE OF THE CERTIFICATE IN EVERY PARTICULAR WITHOUT ALTERATION OR ENLARGEMENT OR ANY CHANGE WHATEVER.

SIGNATURES GUARANTEED:

By. _____

THE SIGNATURE(S) MUST BE GUARANTEED BY AN ELIGIBLE GUARANTOR INSTITUTION (BANKS, STOCKBROKERS, SAVINGS AND LOAN ASSOCIATIONS AND CREDIT UNIONS WITH MEMBERSHIP IN AN APPROVED SIGNATURE GUARANTEE MEDALLION PROGRAM), PURSUANT TO S.E.C. RULE17Ad-15.

Exhibit 4.6

OCULUS INNOVATIVE SCIENCES, INC.
AMENDED AND RESTATED
INVESTORS RIGHTS AGREEMENT

THIS AMENDED AND RESTATED INVESTORS RIGHTS AGREEMENT (this "Agreement") is made and entered into effective as of the 14th day of September, 2006, by and among (i) Oculus Innovative Sciences, Inc., a California corporation (the "Company"), (ii) those parties (each an "Existing Series A Investor" and collectively the "Existing Series A Investors") listed on Schedule A attached to that certain Series A Preferred Shares Investors' Rights Agreement previously entered into by and among such Series A Existing Investors and the Company (the "Prior Series A IRA") and those parties (each an "Existing Series B Investor" and collectively the "Existing Series B Investors") listed on Schedule A attached to that certain Series B Preferred Shares Investor Right Agreement (the "Prior Series B IRA" and, together with the Prior Series A IRA, the "Prior Agreements"), (iii) those parties as set forth in Schedule A attached hereto (each a "New Investor" and collectively the "New Investors"), and (iv) the individuals as set forth in Schedule B attached hereto (each a "Principal Shareholder" and collectively the "Principal Shareholders"). The Existing Investors and the New Investors are referred to herein collectively as the "Investors".

RECITALS

WHEREAS, the Company and the Existing Investors have previously entered into the Prior Agreement providing certain registration and other rights to the Existing Investors.

WHEREAS, the Company proposes to sell and issue to certain New Investors and such New Investors desire to purchase shares of Series C Preferred Stock of the Company (the "Series C Preferred"), any or all of which Series C Preferred may be sold pursuant to a Private Placement Memorandum (the "Memorandum") and the Series C Preferred Share Subscription Agreement attached to the Memorandum as Exhibit E (the "Subscription Agreement"), or such other documents as the Company may deem appropriate (the "Other Documents") (the Memorandum, Subscription Agreement, and the Other Documents are referred to herein collectively as the "Purchase Documents").

WHEREAS, the Company may sell such number of shares of the Series C Preferred as may be necessary to accommodate the exercise of the Existing Preemptive Rights held by the Existing Investors under the Prior Agreement.

WHEREAS, the Company may propose to sell to certain New Investors in the future shares of one or more series of preferred stock of the Company to be designated in the future.

WHEREAS, the Company, the Investors, and the Principal Shareholders desire that this Agreement amend and supersede the Prior Agreement in its entirety to govern the registration and other rights set forth herein with respect to all Investors and Principal Shareholders.

NOW, THEREFORE, in consideration of the mutual promises and covenants hereinafter set forth, the parties hereto agree as follows:

1. Certain Definitions. As used in this Agreement, the following terms shall have the following respective meanings:

"Board" means the Board of Directors of the Company.

"Change of Control" means (i) the Company's sale of all or substantially all of its assets, (ii) any merger, consolidation or other similar transaction involving the Company, where the shareholders of the Company immediately prior to such transaction fail to hold more than 50% of the capital stock of the surviving entity immediately following such transaction, or (iii) any transaction involving the transfer, directly or indirectly, of capital stock of the Company representing 50% or more of the voting power of the Company.

"Commission" means the Securities and Exchange Commission or any successor agency.

"Common Shares" means the Common Stock of the Company.

"Exchange Act" means the Securities Exchange Act of 1934, as amended.

"Existing Preemptive Rights" means the preemptive rights held by the Existing Investors under Section 16 of each of the Prior Agreements.

"Holder" means any person owning of record outstanding Registrable Securities which have not been sold to the public, or any assignee thereof in accordance with Sections 7 and 13 hereof. In addition, for purposes of Sections 2 through 12 hereof, the term "Holder" shall also include the Managing Dealer and the parties to whom the rights of the Managing Dealer under the Managing Dealer Warrants were transferred in accordance with Section 1.3 of each applicable Managing Dealer Warrant.

"Initial Public Offering" means an initial public offering of securities of the Company pursuant to a registration statement filed and declared effective under the Securities Act, upon completion of which the Company has a class of stock that is registered under the Exchange Act and is listed or quoted on an exchange or quotation system.

"Investor Warrants" means the Warrants to purchase Common Stock of the Company issued in connection with the issuance of the Series C Preferred.

"Major Shareholder" means any shareholder, as of the applicable date, who is an officer or director of the Company, or holder of more than 4.9% of the Company's capital stock on a fully-diluted basis as calculated by dividing (1) the number of Common Shares and Preferred Shares held by such holder by (2) the sum of (i) the number of Common Shares outstanding at the applicable time, plus (ii) the number of Common Shares into which any Preferred Shares outstanding at the applicable time may be converted at the applicable conversion price then in effect, plus (iii) the number of Common Shares and Preferred Shares for which any options to purchase, rights to subscribe, warrants or other derivative equity securities are outstanding or authorized by any duly adopted stock option plan or other plan of the Company at the applicable time, plus (iv) the number of Common Shares into which any other convertible or exchangeable securities, including convertible debt securities, outstanding at the applicable time may be converted or exchanged; provided, however, that the term "Major Shareholder" shall not include any Holder.

"Managing Dealer" means Brookstreet Securities Corporation, a California corporation.

"Managing Dealer Warrants" means those certain warrants issued, as of the applicable date, to the Managing Dealer pursuant to that certain Managing Dealer Agreements entered into effective April 19, 2004 and May ___, 2006, each by and between the Company and the Managing Dealer, each as may be subsequently amended from time to time.

"Parties" means the parties that are signatories of this Agreement or hereafter agree in writing to be bound by this Agreement; "Party" shall refer to any one of the Parties.

"Permitted Transfers" means (i) any sale or transfer by a Principal Shareholder of less than 10% of the Shares such Principal Shareholder then owns in a single transaction or series of related transactions, (ii) any transfer to another Holder, or (iii) any transfer of the Shares to a Principal Shareholder's ancestors, descendants or spouse, brother or sister of the Principal Shareholder, the adopted child or adopted grandchild of the Principal Shareholder, or to a trust or trusts for the benefit of such Principal Shareholder or such Principal Shareholder's family members as described above, or transfers by a Principal Shareholder by devise or descent, in all cases for estate planning purposes.

"Preferred Shares" means the Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock of the Company, as well as any one or more series of the Preferred Stock of the Company to be designated as of a future date.

"Principal Shareholders" means the individuals identified in Schedule B attached hereto, who are, as of the date of this Agreement, Major Shareholders.

"Registrable Securities" means (i) Common Shares issued or issuable upon the conversion of the Preferred Shares or the Investor Warrants; and (ii) any other Common Shares issued as (or issuable upon conversion or exercise of any warrant, right or other security which is issued as) a dividend or other distribution with respect to or in exchange for or replacement of the Preferred Shares. In addition, for purposes of Sections 2 through 12 hereof, the term "Registrable Securities" shall also include Common Shares issued or issuable upon the exercise of the Managing Dealer Warrants. Notwithstanding the foregoing, the term "Registrable Securities" shall not include any securities (i) sold by a person to the public either pursuant to a registration statement or Rule 144, or (ii) sold in a private transaction in which the transferor's rights under Section 2 or Section 3 of this Agreement are not assigned.

The terms "register," "registered" and "registration" refer to a registration effected by preparing and filing a registration statement in compliance with the Securities Act, and the declaration or ordering of the effectiveness of such registration statement.

"Registration Expenses" means all reasonable out-of-pocket expenses incurred by the Company in complying with Sections 2 and 3 hereof, including, without limitation, all registration, qualification and filing fees, printing expenses, escrow fees, fees and disbursements of counsel for the Company, blue sky fees and expenses, accounting fees of the Company, and the reasonable fees and expenses of one special counsel, if any, for the selling Holders, not to exceed $25,000.

"Restricted Securities" has the meaning set forth in Section 12 hereof.

"Securities Act" means the Securities Act of 1933, as amended.

"Selling Expenses" means all underwriting discounts, selling commissions and share transfer taxes applicable to the securities registered by the Holders pursuant to this Agreement inclusive of all fees and disbursements of counsel for any Holder (excluding amounts specified under the definition for Registration Expenses).

"Series A Holder" means the holder of any Series A Preferred.

"Series A Preferred" means the Series A Preferred Stock of the Company.

"Series A Director" means the director on the Board whom the holders of Series A Preferred have a right to elect under the Company's Articles of Incorporation.

"Series B Director" means the director on the Board whom the holders of Series B Preferred have a right to elect under the Company's Articles of Incorporation.

"Series B Holder" means the holder of any Series B Preferred.

"Series B Preferred" means the Series B Preferred Stock of the Company.

"Series C Preferred" means the Series C Preferred Stock of the Company.

"Shares" has the meaning set forth in Section 9 hereof.

2. Piggyback Registration Rights.

2.1 Obligation to Register. If the Company determines, in its discretion, to register any of its securities under the Securities Act in connection with the public offering of such securities for cash, either for its own account or the account of a security holder on a form in which the Registrable Securities may be included, other than (i) a registration relating to employee stock option, stock purchase or other benefit plans, (ii) a registration relating to Rule 145 of the Securities Act or similar transaction, or (iii) a registration on any form that does not include substantially the same information as could be required to be included in a registration statement covering the sale of Registrable Securities, the Company will (i) promptly give to each Holder written notice thereof; and (ii) include in such registration (and any related qualification under blue sky laws or other compliance), and in any underwriting involved therein, all the Registrable Securities specified in a written request or requests, made within twenty (20) days after mailing of written notice by the Company, by any Holder, except as set forth in Section 2.2 below.

2.2 Underwriting. If the registration is for a registered public offering involving an underwriting, the Company shall so advise the Holders as part of the written notice given pursuant to Section 2.1 above and the right of any Holder to registration pursuant to this Section 2 shall be conditioned upon such Holder's participation in such underwriting and the inclusion of such Holder's Registrable Securities in the underwriting to the extent provided herein. All Holders proposing to distribute their securities through such underwriting shall (together with the Company and other holders distributing their securities through such underwriting) enter into an underwriting agreement in customary form with the underwriter or underwriters selected for such underwriting by the Company. Notwithstanding any other provision of this Section 2, if the managing underwriter advises the Company that it wishes to

limit the number of shares to be underwritten, then (i) in the Company's Initial Public Offering of Common Shares, the managing underwriter may exclude all Registrable Securities from such registration involving an underwriting; and (ii) in a registered public offering and underwriting not involving an Initial Public Offering, limit the number of Registrable Securities to be included in the registration and underwriting by reducing the number of Registrable Securities included on behalf of the Holders on a *pro rata* basis based on the total number of Registrable Securities entitled to registration held by each Holder; provided, however, that no Registrable Securities shall be excluded from a registration under this clause (ii) until all other outstanding securities of the Company held by the Major Shareholders shall have first been excluded from such registration and underwriting and provided further that in no event may the number of Registrable Securities to be included in a registration and underwriting other than the Company's Initial Public Offering of Common Shares be reduced to less than 30% of the total number of shares to be included in such registration and underwriting. The Company shall advise all Holders of Registrable Securities which would otherwise be registered and underwritten pursuant hereto of any such limitations.

3. Demand Registration. If, at any time after six months following the Company's Initial Public Offering of Common Shares, the Holders holding at least 50% of the total Registrable Securities ("Initiating Holders") request in writing that the Company file a registration statement on a form in which the Registrable Securities may be included, the Company shall (i) promptly give written notice of the proposed registration to all other Holders; and (ii) cause all or such portion of such Registrable Securities as are specified in such request in writing received by the Company within thirty (30) days after mailing of such written notice from the Company to be registered on such form (or any successor thereto). Notwithstanding the foregoing, if the Board determines that such a filing would not be in the best interest of the Company at the time of the request, the Company may delay the filing of a registration statement requested pursuant to this Section 3 for a period (a "Company Delay Period") not in excess of 120 days, which right may not be exercised more than twice in any 12-month period provided that in the aggregate any and all Company Delay Periods shall not exceed 120 days. The Company shall be required to file no more than one registration statement pursuant to this Section 3. The Company may elect to use Form S-3 (or any successor thereto) to satisfy any registration pursuant to this Section 3 if such form is available.

4. Expenses of Registration. All Registration Expenses incurred in connection with any registration, qualification or compliance pursuant to Section 2 and Registration Expenses of up to one registration pursuant to Section 3 shall be borne by the Company, provided, however, that the Company shall not be required to pay for any expenses of any registration proceeding begun pursuant to such Section 3 if the registration request is subsequently withdrawn at the request of the Holder(s) that requested such registration or the Holders of a majority of the Registrable Securities to be registered (in which case such Holders shall bear such expenses). All Selling Expenses relating to securities registered by the Holders shall be borne by the Holders of such securities.

5. Registration Procedures. In the case of each registration, qualification or compliance effected by the Company with respect to Registrable Securities pursuant to this Agreement, the Company will keep each Holder advised in writing as to the initiation of each registration, qualification or compliance and as to the completion thereof, and, at the Company's expense, will:

5.1 Effectiveness. Prepare and file with the Commission a registration statement with respect to such Registrable Securities and use its commercially reasonable best efforts to cause such registration statement to become and remain effective for at least 90 days or until the distribution described in the registration statement has been completed, whichever is shorter; provided, however, that such 90 day period shall be extended (i) to the extent required by Section 5.7, and (ii) for a period of time equal to any period the Holder refrains from selling any securities during the effectiveness of such registration at the request of an underwriter or the Company pursuant to Section 9;

5.2 Amendments. Prepare and file with the Commission such amendments and supplements to such registration statement and the prospectus used in connection with such registration statement as may be necessary to comply with the provisions of the Securities Act with respect to the disposition of all securities covered by such registration statement;

5.3 Copies of Documents. Furnish to the Holders participating in such registration and to the underwriters of the securities being registered such reasonable number of copies of the registration statement, preliminary prospectus, final prospectus and such other documents as such underwriters or such Holders may reasonably request in order to facilitate the public offering of such Registrable Securities;

5.4 Blue Sky Laws. Use its commercially reasonable best efforts to register and qualify the Registrable Securities covered by such registration statement under such other securities or blue sky laws of such jurisdictions as shall be reasonably requested by the Holders; provided that the Company shall not be required in connection therewith or as a condition thereto to qualify to do business or to file a general consent to service of process in any such states or jurisdictions, unless the Company is already subject to service in such jurisdiction and except as may be required by the Securities Act;

5.5 Underwriting Agreement. In the event of any underwritten public offering, enter into and perform its obligations under an underwriting agreement, in usual and customary form, with the managing underwriter of such offering; provided that each Holder participating in such underwriting shall also enter into and perform its obligations under such underwriting agreement;

5.6 Notification. Notify each Holder of Registrable Securities covered by such registration statement if at any time the Company shall determine that the registration statement or any prospectus included therein shall contain an untrue statement of material fact or omit a material fact necessary to make the statements therein, in the light of the circumstances in which they were made, not misleading, and thereafter, subject to Section 5.7 and the last paragraph of this Section 5, promptly prepare and file with the Commission an amendment to the registration statement or a supplement to the prospectus as may be necessary to correct such untrue statement or omission, and notify the selling Holders of such filing;

5.7 Amendment or Supplement to Registration Statement. In the event that, at any time when a prospectus relating to such Registrable Securities is required to be delivered under the Securities Act, the Company determines that any event shall have occurred as the result of which any such prospectus or any other prospectus then in effect would include an untrue statement of a material fact or omit a material fact necessary to make the statements therein, in light of the circumstances in which they were made, not misleading or if the Company

determines that an amendment to the registration statement or supplement to the prospectus is advisable before further sales of Registrable Securities should be made, prepare and file as soon as reasonable with the Commission such amendment to the registration statement or supplement to the prospectus and promptly notify each Holder of Registrable Securities covered by such registration statement of the filing of such amendment or supplement to the registration statement or prospectus as may be necessary to correct any statements or omissions; provided that if the Board of Directors of the Company determines that amending the registration statement or supplementing the prospectus might be detrimental to the Company, then, notwithstanding this Section 5.7, the Company may defer such amendment or supplement for up to 120 days, provided that: (i) the Company shall not use such right of deferral with respect to any registration statement for more than an aggregate of 120 days in any 12-month period; and (ii) the number of days the Company is required to keep the registration statement effective shall be extended by the number of days for which the Company shall have used such right of deferral;

5.8 Stop Order. Advise each Holder of Registrable Securities covered by such registration statement promptly after it shall receive notice or obtain knowledge thereof, of the issuance of any stop order by the Commission suspending the effectiveness of the Registration Statement or the initiation or threatening of any proceeding for that purpose and promptly use its commercially reasonable best efforts to prevent the issuance of any stop order or to obtain its withdrawal if such stop order should be issued;

5.9 Listing. Cause such Registrable Securities registered hereunder to be listed on each securities exchange or quoted on a quotation system on which similar securities issued by the Company are then listed; and

5.10 Transfer Agent and Registrar. Provide a transfer agent and registrar for all Registrable Securities registered hereunder and a CUSIP number for all such Registrable Securities, in each case not later than the effective date of such registration.

If a Holder receives a notification from the Company pursuant to this Section 5 that a registration statement or prospectus contains an untrue statement or omission or that the Company is exercising its rights pursuant to Section 5.7, then such Holder shall: (i) keep the fact of such notification and its contents confidential, and (ii) immediately suspend all sales of securities of the Company and any use of the registration statement or prospectus as to which the notification applies, until such time as such Holder receives notification from the Company that an amendment to the registration statement or a supplement to the prospectus has been filed and that sales may be made.

6. Termination of Registration Rights. Except as provided elsewhere in this Agreement, the registration rights granted pursuant to this Agreement shall terminate on the first to occur of the following: (i) as to all Holders, on the second anniversary of the closing of the Initial Public Offering, and (ii) as to any Holder, at anytime after the Initial Public Offering that such Holder holds less than 1% of the total outstanding Common Shares of the Company, or (iii) as to any Holder, at such time as such Holder is eligible to sell all Registrable Securities held by it pursuant to Rule 144 promulgated under the Securities Act.

7. Transfer of Registration Rights. The rights granted hereunder to cause the Company to register securities or to participate in a registration of the Company may not be

assigned to any transferee or assignee of Restricted Securities unless the transferee agrees to be bound by the terms and conditions of this Agreement and the Company receives written notice within twenty (20) days after such transfer.

8. Indemnification.

8.1 Company Indemnification. The Company will indemnify each Holder, each of its officers, directors and partners, and each person controlling such Holder within the meaning of Section 15 of the Securities Act, with respect to which registration, qualification or compliance has been effected pursuant to this Agreement, and each underwriter, if any, and each person who controls any underwriter within the meaning of Section 15 of the Securities Act, against all expenses, claims, losses, damages and liabilities (or actions in respect thereof), including any of the foregoing incurred in settlement of any litigation, arising out of or based on any untrue statement (or alleged untrue statement) of a material fact contained in any registration statement, prospectus, offering circular or other document, or any amendment or supplement thereto, incident to any such registration, qualification or compliance, or based on any omission (or alleged omission) to state therein a material fact required to be stated therein or necessary to make the statements therein not misleading, or any violation by the Company of any rule or regulation promulgated under the Securities Act applicable to the Company and relating to action or inaction required of the Company in connection with any such registration, qualification or compliance, and will reimburse each such Holder, each of its officers, directors and partners, and each person controlling such Holder, each such underwriter and each person who controls any such underwriter, for any legal and any other expenses reasonably incurred in connection with investigating, preparing or defending any such claim, loss, damage, liability or action, provided the Company shall not be liable for amounts paid in settlement of any claims if such settlement is made without the consent of the Company, which consent shall not be unreasonably withheld, and that the Company will not be liable in any such case to the extent that any such claim, loss, damage, liability or expense arises out of or is based on any untrue statement or omission or alleged untrue statement or omission, made in reliance upon and in conformity with written information furnished to the Company by a Holder or underwriter specifically for use therein.

8.2 Holder Indemnification. Each Holder will, if Registrable Securities held by such Holder are included in the securities as to which registration, qualification or compliance has been effected pursuant to this Agreement, indemnify the Company, each of its directors and officers, each underwriter, if any, of the Company's securities covered by such a registration statement, each person who controls the Company or such underwriter within the meaning of Section 15 of the Securities Act, and each other such Holder, each of its officers and directors and each person controlling such Holder within the meaning of Section 15 of the Securities Act, against all claims, losses, damages and liabilities (or actions in respect thereof) arising out of or based on any untrue statement (or alleged untrue statement) of a material fact contained in any such registration statement, prospectus, offering circular or other document, or any omission (or alleged omission) to state therein a material fact required to be stated therein or necessary to make the statements therein not misleading, and will reimburse the Company, such Holders, such directors, officers, underwriters or control persons for any legal or any other expenses reasonably incurred in connection with investigating or defending any such claim, loss, damage, liability or action, in each case to the extent, but only to the extent, that such untrue statement (or alleged untrue statement) or omission (or alleged omission) is made in such registration statement, prospectus, offering circular or other document in reliance upon and in conformity with written

information furnished to the Company by or on behalf of such Holder and stated to be specifically for use therein; provided, however, that the obligations of any such Holder hereunder shall be limited to an amount equal to the gross proceeds before expenses and commissions to such Holder of Registrable Securities sold as contemplated herein.

8.3 Notification of Claim. Each party entitled to indemnification under this Section 8 (the "Indemnified Party") shall give notice to the party required to provide indemnification (the "Indemnifying Party") promptly after such Indemnified Party has actual knowledge of any claim as to which indemnity may be sought, and shall permit the Indemnifying Party to assume the defense of any such claim or any litigation resulting therefrom, provided that counsel for the Indemnifying Party, who shall conduct the defense of such claim or litigation, shall be approved by the Indemnified Party (whose approval shall not be unreasonably withheld), and the Indemnified Party may participate in such defense at such party's expense; provided, however, that the Indemnified Party (together with all other Indemnified Parties that may be represented without conflict by one counsel) shall have the right to retain one separate counsel, with the fees and expenses to be paid by the Indemnifying Party, if representation of such Indemnified Party by the counsel retained by the Indemnifying Party would be inappropriate due to differing interests between such Indemnified Party and any other party represented by such counsel in such proceeding; and provided further that the failure of any Indemnified Party to give notice as provided herein shall not relieve the Indemnifying Party of its obligations under this Agreement, except to the extent, but only to the extent, that the Indemnifying Party's ability to defend against such claim or litigation is impaired as a result of such failure to give notice. No Indemnifying Party, in the defense of any such claim or litigation, shall, except with the consent of each Indemnified Party, consent to entry of any judgment or enter into any settlement which does not include as an unconditional term thereof the giving by the claimant or plaintiff to such Indemnified Party of a release from all liability in respect to such claim or litigation.

8.4 Contribution. If the indemnification provided for in Sections 8.1 and 8.2 of this Section 8 is unavailable or insufficient to hold harmless an Indemnified Party thereunder, then each Indemnifying Party thereunder shall contribute to the account paid or payable by such Indemnified Party as a result of the losses, claims, damages, costs, expenses, liabilities or actions referred to in Sections 8.1 and 8.2 in such proportion as is appropriate to reflect the relative fault of the Indemnifying Party on the one hand and the Indemnified Party on the other in connection with statements or omissions which resulted in such losses, claims, damages or liabilities, as well as any other relevant equitable considerations. The relative fault shall be determined by a court of law by reference to, among other things, whether the untrue or alleged untrue statement of a material fact or the omission or alleged omission to state a material fact relates to information supplied by the Indemnifying Party or the Indemnified Party and the parties' relative intent, knowledge, access to information and opportunity to correct or prevent such untrue statements or omissions. The parties hereto agree that it would not be just and equitable if contributions pursuant to this Section 8.4 were to be determined by *pro rata* or per capita allocation or by any other method of allocation which does not take account of the equitable considerations referred to in the first sentence of this Section 8.4. The amount paid by an Indemnified Party as a result of the losses, claims, damages or liabilities referred to in the first sentence of this Section 8.4 shall be deemed to include any legal or other expenses reasonably incurred by such Indemnified Party in connection with investigating or defending any action or claim which is the subject of this Section 8.4. Promptly after receipt by an Indemnified Party of notice of the commencement of any action against such party in respect of which a claim for contribution may be made against

an Indemnifying Party under Section 8.4, such Indemnified Party shall notify the Indemnifying Party in writing of the commencement thereof if the notice specified in Section 8.3 has not been given with respect to such action; provided that the omission so to notify the Indemnifying Party shall not relieve the Indemnifying Party from any liability which it may have to any Indemnified Party otherwise under Section 8.4, except to the extent that the Indemnifying Party is actually prejudiced by such failure to give notice. The parties hereto agree with each other and shall agree with the underwriters of the Common Shares of the Company pursuant to the terms hereof, if requested by such underwriters, that (i) the underwriters' portion of such contribution shall not exceed the underwriting discount, commission and other compensation, and (ii) the amount of such contribution shall not exceed an amount equal to the proceeds received by such Indemnifying Party from the sale of securities in the offering to which the losses, claims, damages or liabilities of the indemnified parties relate. No person guilty of fraudulent misrepresentation (within the meaning of Section 11(f) of the Securities Act) shall be entitled to contribution from any person who was not guilty of such fraudulent misrepresentation.

9. Lock-up Agreement. In consideration for the Company agreeing to its obligations under this Agreement, each Holder severally hereby agrees that such Holder shall not, to the extent requested by the managing underwriter of a public offering in which Shares (as defined below) are sold, directly or indirectly, offer, sell, pledge, contract to sell, transfer the economic risk of ownership in, make any short sale, grant any option to purchase or otherwise dispose of any Registrable Securities or any securities convertible into or exchangeable or exercisable for or any other rights to purchase or acquire Registrable Securities, including, without limitation, Common Shares which may be deemed to be beneficially owned by the Holders in accordance with the rules and regulations of the Commission and Common Shares which may be issued upon exercise of a stock option or warrant, or enter into any Hedging Transaction (as defined below) relating to Registrable Securities (each of the foregoing referred to as a "Disposition") for a period of 180 days after the effective date of the registration statement relating to such public offering (the "Lock-Up Period") unless the managing underwriter otherwise agrees, and the Warrantholder shall enter into such an agreement if requested by the managing underwriter of a public offering in which equity securities of the Company are sold; provided, however, that all officers and directors of the Company enter into similar agreements. The foregoing restriction is expressly intended to preclude any Holder from engaging in any Hedging Transaction or other transaction which is designed to or reasonably expected to lead to or result in a Disposition during the Lock-Up Period even if the securities would be disposed of by someone other than such Holder. "Hedging Transaction" means any short sale (whether or not against the box) or any purchase, sale or grant of any right (including, without limitation, any put or call option) with respect to any security (other than a broad-based market basket or index) that includes, relates to or derives any significant part of its value from the Shares. "Shares" shall mean equity securities of the Company that are, or that are convertible directly or indirectly into, Common Shares. Each Holder agrees that the Company may instruct its transfer agent to place stop transfer notations in its records to enforce the provisions of this Section 9.

10. Information by Holder. The Holder or Holders of Registrable Securities included in any registration shall furnish to the Company such information regarding such Holder or Holders and the distribution proposed by such Holder or Holders as the Company may request in writing and as shall be required in connection with any registration, qualification or compliance referred to in this Agreement.

11. Rule 144 Reporting. With a view to making available the benefits of certain rules and regulations of the Commission which may at any time permit the sale of the Restricted Securities to the public without registration, after such time as a public market exists for the Common Shares of the Company, the Company agrees to:

11.1 Public Information. Make and keep public information available, as those terms are understood and defined in Rule 144 under the Securities Act, at all times after 90 days from the effective date of the first registration statement under the Securities Act filed by the Company for an offering of its securities to the general public;

11.2 Filings with Commission. Use its commercially reasonable best efforts to file with the Commission in a timely manner all reports and other documents required of the Company under the Securities Act and the Exchange Act (at any time after it has become subject to such reporting requirements); and

11.3 Compliance Statement. Furnish to Holders of Registrable Securities forthwith upon request, a written statement by the Company as to its compliance with the reporting requirements of Rule 144 (at any time after 90 days after the effective date of the first registration statement filed by the Company for an offering of its securities to the general public), and of the Securities Act and the Exchange Act (at any time after it has become subject to such reporting requirements), a copy of the most recent annual or quarterly report of the Company, and such other reports and documents of the Company as a Holder of Registrable Securities may reasonably request in availing itself of any rule or regulation of the Commission allowing such Holder to sell any such securities without registration.

12. Restrictive Legend. Each certificate representing (i) Common Shares, (ii) Preferred Shares, (iii) Common Shares issued upon conversion of the Preferred Shares or exercise of Investor Warrants or Managing Dealer Warrants, and (iv) any other securities issued in respect of the Preferred Shares and Common Shares issued upon conversion of the Preferred Shares (any such securities listed in the preceding subsections (i), (ii), (iii) or (iv), "Restricted Securities"), shall (unless otherwise permitted by the provisions of Section 13 below) be stamped or otherwise imprinted with a legend substantially in the following form (in addition to any legend required under applicable state securities laws):

THESE SECURITIES HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED. THEY MAY NOT BE SOLD, OFFERED FOR SALE, PLEDGED, HYPOTHECATED OR OTHERWISE TRANSFERRED EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION UNDER THE SECURITIES ACT OF 1933, OR AN OPINION OF COUNSEL SATISFACTORY TO THE COMPANY THAT SUCH REGISTRATION IS NOT REQUIRED. THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO AN AGREEMENT RESTRICTING THEIR TRANSFER, A COPY OF WHICH IS ON FILE AT THE OFFICE OF THE COMPANY AND WILL BE FURNISHED TO ANY PROSPECTIVE PURCHASERS ON REQUEST. THE AGREEMENT PROVIDES, AMONG OTHER THINGS, FOR CERTAIN RESTRICTIONS ON THE SALE, TRANSFER, PLEDGE, HYPOTHECATION OR OTHER DISPOSITION OF THE SHARES REPRESENTED BY THIS CERTIFICATE.

13. Restrictions on Transferability. Each Holder of certificates representing Restricted Securities, by acceptance thereof, agrees to comply in all respects with the provisions of this Section 13. Prior to any proposed transfer of any Restricted Securities by a Holder, unless there is in effect a registration statement under the Securities Act covering the proposed transfer, such Investor shall give written notice to the Company of such Investor's intention to effect such transfer. Each such notice shall describe the manner and circumstances of the proposed transfer in sufficient detail, and shall, if the Company so requests, be accompanied (except in transactions in compliance with Rule 144) by an unqualified written opinion of legal counsel who shall be reasonably satisfactory to the Company, addressed to the Company and reasonably satisfactory in form and substance to the Company's counsel, to the effect that the proposed transfer of the Restricted Securities may be effected without registration under the Securities Act or applicable blue sky laws. Each Investor shall cause any proposed transferee of the Registrable Securities held by such Investor to agree to take and hold such securities subject to the provisions specified in this Section 13 and Section 9 hereof. Each certificate evidencing the Restricted Securities transferred as above provided shall bear the appropriate restrictive legend set forth in Section 12 above, except that such certificate shall not bear such restrictive legend if in the opinion of counsel for the Company such legend is not required in order to establish compliance with any provisions of the Securities Act.

14. Information Rights. The Company shall furnish to any Investor, (i) within 90 days after the end of each fiscal year, unaudited annual financial reports, or audited financial statements if they are available, (ii) within 45 days after the end of each quarter, quarterly management reports, and (iii) at least 30 days prior to the end of each fiscal year, an annual budget. The Company shall also make its officers available to any Investor upon reasonable notice to answer questions and shall make its financial records available to any Investor upon reasonable notice. The information rights set forth in this Section 14 shall expire upon the earlier of: (i) the closing date of the Initial Public Offering, (ii) the time the Company becomes a reporting company under the Exchange Act, or (iii) a Change of Control.

15. Co-Sale Rights.

15.1 Notice of Proposed Transfer. Before a Principal Shareholder may effect any transfer of any Common Shares owned by such Principal Shareholder (the "Offered Shares") other than pursuant to a Permitted Transfer, such Principal Shareholder (the "Selling Principal Shareholder") must give to the Company and to the Holders a written notice signed by the Selling Principal Shareholder (the "Selling Principal Shareholder's Notice") stating (a) the number of Offered Shares to be transferred, and (b) the bona fide cash price or, in reasonable detail, other consideration, per share (the "Offered Price") for which the Selling Principal Shareholder proposes to transfer such Offered Shares.

15.2 Rights of Co-Sale.

(1) Each Holder will have the right to sell, on the terms and to the proposed transferee described in the Selling Principal Shareholder's Notice, that number of Shares equal to the product obtained by multiplying (i) the aggregate number of Offered Shares by (ii) a fraction, the numerator of which is the number of Shares then held by such Holder, and the denominator of which is the total combined number of Shares then held by the Selling Principal Shareholder (including shares transferred pursuant to Permitted Transfers by such

selling Principal Shareholder in accordance herewith) and the number of Shares issued or issuable to all Holders that desire to exercise their co-sale rights pursuant to this Section 15. For purposes of making such computation, the Holder shall be deemed to own the number of Shares issued or issuable upon conversion of all its Preferred Shares. Holders may exercise such rights of co-sale by giving written notice to the Selling Principal Shareholder within ten (10) days after the date of the Selling Principal Shareholder's Notice, specifying the number of Shares which the Holder desires to transfer to the Selling Principal Shareholder's proposed transferee, in which case the number of Offered Shares which the Selling Principal Shareholder may sell pursuant to the Selling Principal Shareholder's Notice shall be correspondingly reduced.

(2) The Holder may effectuate its right of co-sale contemplated by this Section 15 by delivering to the Selling Principal Shareholder for transfer to the proposed transferee one or more certificates, properly endorsed for transfer, which represent:

i. the number of Common Shares which the Holder is entitled to, and elects to, sell pursuant to this Section 15; or

ii. that number of Preferred Shares which is at such time convertible into the number of Common Shares which such Holder elects to sell pursuant to this Section 15; provided, however, that if the proposed transferee objects to the delivery of Preferred Shares in lieu of Common Shares, the Holder may convert and deliver Common Shares as provided in subparagraph 15.2(2)i above.

15.3 Deliveries. The stock certificate or certificates which a Holder delivers to a Selling Principal Shareholder pursuant to Section 15.2 shall be transferred by such Selling Principal Shareholder to the proposed transferee in consummation of the sale of the Shares pursuant to the terms and conditions specified in the Selling Principal Shareholder's Notice, and such Selling Principal Shareholder shall promptly thereafter remit to such Holder that portion of the sale proceeds to which such Holder is entitled by reason of its participation in such sale.

15.4 Subsequent Sale of Shares. The exercise or non-exercise of the rights of any Holder under this Section 15 to participate in one or more sales of the Shares made by a Selling Principal Shareholder shall not adversely affect its right to participate in subsequent sales of Shares by such Selling Principal Shareholder pursuant to this Section 15.

15.5 Prohibited Transfers. In the event any Principal Shareholder should sell any Shares in contravention of the right of co-sale set forth in this Section 15 (a "Prohibited Transfer"), a Holder, in addition to such other remedies as may be available at law or in equity or hereunder, shall have the put option provided Section 15.6 below, and such Principal Shareholder shall be bound by the applicable provisions of such put option.

15.6 Put Option. In the event of a Prohibited Transfer by a Principal Shareholder, a Holder shall have the right (but shall not be obligated) to sell, to the Principal Shareholder who made the Prohibited Transfer, a number of Common Shares (either directly or through conversion of Preferred Shares) equal to the number of Shares that the Holder would have been entitled to transfer to the proposed purchaser in the Prohibited Transfer pursuant to this Section 15, assuming the Holder elected to exercise its co-sale rights under Section 15.2 to their fullest extent. Such sale shall be made on the following terms and conditions:

15.6.1 The price per share at which the Shares are to be sold to any such Principal Shareholder shall be equal to the price per share paid by the purchaser to such Principal Shareholder in the Prohibited Transfer. Such Principal Shareholder shall also reimburse the Holder for any and all reasonable fees and expenses, including attorneys' fees and expenses, incurred pursuant to any exercise of the Holder's rights under this Section 15.6.

15.6.2 Within 90 days after the earlier of the dates on which the Holder (i) received notice from such Principal Shareholder of the Prohibited Transfer, or (ii) otherwise obtained actual knowledge of the Prohibited Transfer, the Holder shall, if exercising the put option created hereby, deliver to such Principal Shareholder the certificate or certificates representing Shares to be sold, each certificate to be properly endorsed for transfer. The failure of the Holder to exercise the put option in such 90-day period shall constitute a waiver of the Holder's right under this Section 15.6.

15.6.3 Such Principal Shareholder shall, upon receipt of the certificate or certificates for the Shares to be sold by the Holder, pursuant to Section 15.6.2, pay the aggregate purchase price therefor and the amount of fees and expenses reimbursable under Section 15.6.1, by check or wire transfer made payable to the order of the Holder.

15.7 Permitted Transfers. The rights of the Holders under Section 15 shall not pertain or apply to Permitted Transfers; provided, however, that in the event of a Permitted Transfer relating to any transfer of the Shares to a Principal Shareholder's ancestors, descendants or spouse, brother or sister of the Principal Shareholder, the adopted child or adopted grandchild of the Principal Shareholder, or to a trust or trusts for the benefit of such Principal Shareholder or such Principal Shareholder's family members as described above, or transfers by a Principal Shareholder by devise or descent, the Principal Shareholder shall inform the Company and the Holders of such transfer prior to effecting it, and (2) the permitted transferee shall furnish the Company and the Holders with a written agreement to be bound by and to comply with all provisions of this Agreement applicable to such Principal Shareholder.

15.8 Termination. The provisions of this Section 15 shall terminate upon the occurrence of any one of the following events: (i) the closing of an Initial Public Offering; or (ii) a Change of Control.

15.9 Legends. Each certificate representing Shares now or hereafter owned by the Principal Shareholders or issued to any permitted transferee pursuant to this Section 15 above shall be endorsed with a legend in substantially the following form:

> THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO CERTAIN RIGHTS OF CO-SALE AS SET FORTH IN AN AMENDED AND RESTATED INVESTORS RIGHTS AGREEMENT DATED [_____ __], 2006, BY AND AMONG THE REGISTERED HOLDER, THE CORPORATION AND OTHERS. COPIES OF SUCH AGREEMENT MAY BE OBTAINED BY THOSE PERSONS OR ENTITIES HAVING A LEGITIMATE INTEREST UPON WRITTEN REQUEST TO THE SECRETARY OF THE CORPORATION.

15.10 Amendment of Co-Sale Rights. The observance of any provision of this Section 15 may be waived (either generally or in a particular instance and either retroactively or

prospectively) only with the written consent of Holders owning a majority of the Preferred Shares (including shares issuable upon conversion of Preferred Shares) or their permitted transferees of such rights. Any provision of this Section 15 may be amended or terminated only with the written consent of (i) the Company; (ii) Holders owning a majority of the Preferred Shares (including shares issuable upon conversion of Preferred Shares) or their permitted transferees of such rights, and (iii) the Principal Shareholders holding a majority of the shares of capital stock of the Company then held by such Principal Shareholders.

16. Rights of First Refusal.

16.1 Subsequent Offerings. Each Holder shall have a right of first refusal to purchase its *pro rata* share of all Equity Securities, as defined below, that the Company may, from time to time, propose to sell and issue for cash after the date of this Agreement, other than the Equity Securities excluded by Section 16.7 hereof; provided, however, that such Holder shall be, at the time of the offer of such Equity Securities, an "accredited investor" as such term is defined under Rule 501(a) promulgated under the Securities Act (or such other investor suitability standards required under the exemption from registration of the securities offered relied upon by the Company, as determined by the Company and its counsel) and shall have provided to the Company with evidence reasonably satisfactory to the Company that such Holder is an "accredited investor" or otherwise meets the required investor suitability standards. Each Holder's *pro rata* share is equal to the ratio of (a) the number of Common Shares (including all Common Shares issued or issuable upon conversion of the Preferred Shares) which such Holder is deemed to be a holder immediately prior to the issuance of such Equity Securities to (b) the total number of shares of the Company's Fully Diluted Common immediately prior to the issuance of the Equity Securities. The term "Equity Securities" shall mean (i) any Common Shares, Preferred Shares or other equity security of the Company, (ii) any equity security convertible, with or without consideration, into any Common Shares, Preferred Shares or other equity security (including any option to purchase such a convertible security), (iii) any security carrying any warrant or right to subscribe to or purchase any Common Shares, Preferred Shares or other equity security or (iv) any such warrant or right. For purposes of calculating a Holder's *pro rata* share pursuant to this Section 16.1, the number of shares of the Company's Common Shares which such Holder is deemed to hold may, at the election of such Holder, include shares held by any entity affiliated with such Holder, provided that, if such affiliated entity is also a Holder, such shares shall only be counted once in such *pro rata* calculation, such that the shares are included for only one such Holder. The term "Fully Diluted Common" shall mean the sum of (i) the number of Common Shares outstanding immediately prior to such issuance, plus (ii) the number of Common Shares into which any Preferred Shares outstanding immediately prior to such issuance may be converted at the applicable conversion price then in effect, plus (iii) the number of Common Shares for which any options to purchase, rights to subscribe, other warrants or derivative equity securities are outstanding or authorized by any duly adopted stock option plan or other plan or agreement of the Company prior to such issuance, plus (iv) the number of Common Shares into which any other convertible or exchangeable equity securities outstanding immediately prior to such issuance may be converted or exchanged.

16.2 Exercise of Rights. If the Company proposes to issue any Equity Securities, it shall give each Holder written notice (the "First Refusal Notice") of its intention, describing the Equity Securities, the price and the terms and conditions upon which the Company proposes to issue the same. Each Holder shall have 15 days from the giving of such

notice to agree to purchase its *pro rata* share of the Equity Securities for the price and upon the terms and conditions specified in the notice by giving written notice to the Company and stating therein the quantity of Equity Securities to be purchased. If the Holders fail to exercise in full the rights of first refusal, the Company shall have 90 days thereafter to sell the Equity Securities in respect of which the Holders' rights were not exercised, at a price and upon general terms and conditions no more favorable to the purchasers thereof than specified in the First Refusal Notice. If the Company has not sold such Equity Securities within 90 days of the date of the First Refusal Notice, the Company shall not thereafter issue or sell any Equity Securities, without first offering such securities to the Holders in the manner provided above. Notwithstanding the foregoing, the Company shall not be required to offer or sell such Equity Securities to any Holder who would cause the Company to be in violation of applicable federal or state securities laws by virtue of such offer or sale.

16.3 Reserved.

16.4 Sale Without Notice. In lieu of giving notice to the Holders prior to the issuance of Equity Securities as provided in Section 16.2, the Company may elect to give notice to the Holders within 30 days after the issuance of Equity Securities. Such notice shall describe the type, price and terms of the Equity Securities. Each Holder shall have 30 days from the date of receipt of such notice to elect to purchase its *pro rata* share of Equity Securities (as defined in Section 16.1, and calculated by excluding such already issued Equity Securities from the Fully Diluted Common). The closing of such sale shall occur within 60 days of the date of notice to the Holders.

16.5 Termination of Rights of First Refusal. The rights of first refusal established by this Section 16 shall terminate immediately prior to the effective date of the registration statement pertaining to the Company's Initial Public Offering.

16.6 Transfer of Rights of First Refusal. The rights of first refusal of each Holder under this Section 16 may be transferred to the same parties, subject to the same restrictions as any transfer of registration rights pursuant to Section 7.

16.7 Excluded Securities. The rights of first refusal established by this Section 16 shall have no application to any of the following Equity Securities:

(1) Equity Securities issued pursuant to stock splits, stock dividends or other recapitalization transactions;

(2) Equity Securities issued to employees, officers, directors, consultants, contractors or advisors of the Company pursuant to stock purchase or stock option plans or agreements or other incentive stock arrangements approved by the Board of Directors of the Company;

(3) Equity Securities or convertible debt securities issued to lenders, equipment lessors or other parties providing goods or services to the Company;

(4) Equity Securities issued in connection with acquisition transactions;

(5) Equity Securities issued upon exercise of the Managing Dealer Warrants;

(6) Equity Securities issued in strategic partnership transactions;

(7) Any shares of the Series A Preferred, Series B Preferred or Series C Preferred; and

(8) Equity Securities issued in any other transaction in which exemption from the right of first refusal provisions of this Section 16 is approved by the Holders of a majority of the then outstanding Preferred Shares.

16.8 Waiver of Rights of First Refusal. The Existing Series A Investors hereby acknowledge having waived the right of first refusal under Section 16 of the Prior Series A IRA with respect to an additional 17,911 shares of Series A Preferred issued and sold by the Company in connection with the Series A Offering (as such term is defined under the Prior Series A IRA).

17. Series A and Series B Director.

17.1 Covenants regarding Director.

(a) Series A. Each Investor who now holds or hereafter acquires any shares of the Series A Preferred hereby agrees that, in the event of an Initial Public Offering or Change of Control, such Investor shall (i) take all such action as may be requested by the Company to facilitate the amendment of the Articles of Incorporation of the Company so as to remove the rights of the Series A Preferred Holders to elect the Series A Director; (ii) not exercise its right to elect the Series A Director as provided for in the Company's Articles of Incorporation; and (iii) take all such action as may be requested by the Company to remove the Series A Director, if any, then serving on the Board.

(b) Series B. Each Investor who now holds or hereafter acquires any shares of the Series B Preferred hereby agrees that, in the event of an Initial Public Offering or Change of Control, such Investor shall (i) take all such action as may be requested by the Company to facilitate the amendment of the Articles of Incorporation of the Company so as to remove the rights of the Series B Preferred Holders to elect the Series B Director; (ii) not exercise its right to elect the Series B Director as provided for in the Company's Articles of Incorporation; and (iii) take all such action as may be requested by the Company to remove the Series B Director, if any, then serving on the Board.

17.2 Voting Shares. Each Party to this Agreement agrees to hold all of its Common Shares and Preferred Shares and any and all other voting securities of the Company legally or beneficially acquired by each such Party after the date hereof (the "Voting Shares") subject to, and to vote such shares (and consent to actions taken by written consent) in accordance with, the provisions of this Section 17. In the event that the Articles of Incorporation of the Company are required to be amended by the terms of Section 17.1 above, each Party shall vote all of its Voting Shares (and consent to actions taken by written consent) in favor of such amendment pursuant to the terms of Section 17.1 above.

17.3 Successors in Interest. The provisions of this Section 17 shall be binding upon and inure to the benefit of all transferees or assignees of the Voting Shares. The Company shall not permit the transfer of any of the Voting Shares on its books or issue a new certificate representing any of the Voting Shares unless and until the person to whom such security is to be transferred agrees to be bound by the terms and conditions of this Agreement.

17.4 Legend Requirement. In addition to other legends that are required, either by agreement or by the relevant federal or state securities laws, each certificate representing any of the Voting Shares shall be marked by the Company with a legend substantially in the following form:

THE SHARES EVIDENCED HEREBY ARE SUBJECT TO CERTAIN VOTING RESTRICTIONS AS SET FORTH IN AN AMENDED AND RESTATED INVESTORS RIGHTS AGREEMENT DATED [_____ __], 2006, BY AND AMONG THE REGISTERED HOLDER, THE CORPORATION AND OTHERS (A COPY OF WHICH MAY BE OBTAINED FROM THE COMPANY) AND BY ACCEPTING ANY INTEREST IN SUCH SHARES, THE PERSON HOLDING SUCH INTEREST SHALL BE DEEMED TO AGREE TO AND SHALL BE BOUND BY ALL THE PROVISIONS OF SAID AGREEMENT.

17.5 Specific Performance. The Parties recognize that irreparable injury will result from a breach of any provision of this Section 17 and that money damages will be inadequate to fully remedy the injury. Accordingly, in the event of a breach or threatened breach of this Section 17, any Party who may be injured (in addition to any other remedies which may be available to that Party) will be entitled to one or more preliminary or permanent orders (i) restraining and enjoining any act which would constitute a breach, or (ii) compelling the performance of any obligation which, if not performed, would constitute a breach.

18. Governing Law; Jurisdiction and Venue. This Agreement shall be governed in all respects by the internal laws of the State of California, without giving effect to principles of conflicts of laws. The Parties submit to the jurisdiction of the Courts of the County of Orange, State of California, or a Federal Court empanelled in the State of California for the resolution of all legal disputes arising under the terms of this Agreement.

19. Entire Agreement. This Agreement and, as applicable, the Purchase Documents, constitute the full and entire understanding and agreement among the parties regarding the transactions contemplated herein and therein. Except as otherwise expressly provided herein and therein, the provisions hereof shall inure to the benefit of, and be binding upon, the successors, assigns, heirs, executors and administrators of the parties hereto.

20. Notices, etc. All notices required or permitted hereunder shall be in writing and shall be deemed effectively given (i) upon personal delivery to the party to be notified, (ii) three days after deposit in the United States mail, postage prepaid and properly addressed to the party to be notified as set forth on the signature page hereof or at such other address as such party may designate by ten days' advance written notice to the other parties hereto, or (iii) when transmitted if transmitted by telecopy (to be followed by U.S. mail), electronic or digital transmission method. In each case notice shall be sent to (a) if to a New Investor, to the address of such New Investor as set forth in Schedule A attached hereto; (b) if to an Existing Investor, to the address

of such Existing Investor as set forth on the signature page to the Prior Agreement; (c) if to a Principal Shareholder, to the address of such Principal Shareholder as set forth on the books and records of the Company; and (d) if to the Company, to the address set forth on the signature page hereto; or in all cases, at such other address as a Party may designate by ten (10) days' advance written notice to the other Parties pursuant to the provisions of this Section 20.

21. Counterparts. This Agreement may be executed in any number of counterparts, each of which may be executed by fewer than all of the parties hereto, each of which shall be enforceable against the parties actually executing such counterparts, and all of which together shall constitute one and the same instrument. Signatures to this Agreement may be transmitted by facsimile and such signatures shall be deemed to be originals.

22. Amendment. Subject to Section 15.10 hereof, any provision of this Agreement may be amended, waived, modified, discharged or terminated only with the written consent of the Company and the Holders of a majority in interest of the Registrable Securities. Any amendment or waiver effected in accordance with this paragraph will be binding upon the Company and each holder of any securities subject to this Agreement (including securities into which such securities are convertible) and future holders of all such securities. Any Holder may waive his or her rights or the Company's obligations hereunder without obtaining the consent of any other person. Notwithstanding the foregoing, any purchaser purchasing Series C Preferred pursuant to any of the Purchase Documents after the date hereof, as well as any purchaser purchasing shares of one or more series of Preferred Shares to be designated in the future, may be required by the Company to execute a signature page to this Agreement (after such purchaser has been provided with a copy of this Agreement and an opportunity to review this Agreement) upon which execution such purchaser shall be deemed a party hereto and the Company shall be authorized to unilaterally amend Schedule A hereto to reflect the addition of any such purchaser as a New Investor.

23. Successors and Assigns. Except as otherwise provided herein, the provisions hereof shall inure to the benefit of, and be binding upon, the successors, assigns, heirs, executors and administrators of the parties hereto.

24. Severability. If any provision of this Agreement is held to be invalid or unenforceable to any extent in any context, it shall nevertheless be enforced to the fullest extent allowed by law in that and other contexts, and the validity and force of the remainder of this Agreement shall not be affected thereby.

25. Attorneys' Fees. In the event that any dispute among the parties to this Agreement should result in litigation, the prevailing party in such dispute shall be entitled to recover from the losing party all reasonable fees, costs and expenses of enforcing any right of such prevailing party under or with respect to this Agreement, including without limitation, such reasonable fees and expenses of attorneys and accountants, which shall include, without limitation, all reasonable fees, costs and expenses of appeals.

26. Titles and Subtitles. The titles and subtitles used in this Agreement are used for convenience only and are not to be considered in construing or interpreting this Agreement.

27. Prior Agreement. The Parties who are parties to the Prior Agreement hereby agree that, upon the effectiveness of this Agreement, the Prior Agreement shall be superseded and replaced in its entirety by this Agreement.

28. Effective Date of Agreement. This Agreement shall become effective upon the first closing in the Company's offering of its Series C Preferred, subject to the execution of this Agreement by the Company and the holders of a majority of the outstanding shares of Series A Preferred and Series B Preferred.

[Signature Page Follows]

IN WITNESS WHEREOF, the parties have executed this Amended and Restated Investors Rights Agreement as of the date first set forth above.

OCULUS INNOVATIVE SCIENCES, INC.

By: _____
Name: _____
Title: _____
Address: 1129 No. McDowell Blvd.
Petaluma, CA 94954
Fax No.: 707-283-0551

INVESTORS

_____

By: _____
Print Name: _____
Title: _____

PRINCIPAL SHAREHOLDERS

By: _____
Print Name: _____

BROOKSTREET SECURITIES CORPORATION
(for purposes of Sections 2-12 only)

By: _____
Print Name: _____
Title: _____

HOLDERS OF MANAGING DEALER WARRANTS
(for purposes of Sections 2-12 only)

By: _____
Print Name: _____
Title: _____

[SIGNATURE PAGE TO AMENDED AND RESTATED INVESTORS RIGHTS AGREEMENT]

SCHEDULE A

New Investors

Name	Address and Fax Number

SCHEDULE B

Principal Shareholders

Akihisa Akao
Hojabr Alimi
Richard Conley
Greg French

Exhibit 10.30

LOAN AND SECURITY AGREEMENT

This Security Agreement (the "Agreement") is made as of November 7, 2006 by and between Oculus Innovative Sciences, Inc., a California corporation (the "Debtor") in favor of R.C. Burlingame, as an individual (the "Secured Party").

RECITALS

The Debtor wishes to borrow, and the Secured Party wishes to lend, funds in the amount of $4,000,000 on the terms and subject to the conditions of this Agreement, the non-negotiable secured promissory note in the form attached as Exhibit A hereto in favor of the Secured Party of even date with this Agreement (the "Note"), and the subordination agreement proposed to be entered into by and among Debtor, Secured party and Venture Lending & Leasing IV, Inc. and Venture Lending & Leasing III, LLC, in the form attached as Exhibit B hereto, and the parties intend that, on the terms and subject to the conditions of this Agreement, the Debtor's obligations to repay the Note be secured by all of the assets of the Debtor.

Venture Lending & Leasing IV, Inc. ("VLL4") holds a security interest in all of the assets of Debtor pursuant to that certain Loan and Security Agreement and ancillary documents referenced therein entered into by and between Debtor and Venture Lending & Leasing IV dated as of June 14, 2006 (the "2006 LSA"), which security interest secures the obligations of VLL4 under the LSA. Venture Lending & Leasing III, LLC, as successor in interest to Venture Lending & Leasing III, Inc. ("VLL3") and under that certain Loan and Security Agreement and ancillary documents referenced therein entered into by and between Debtor and Venture Lending & Leasing III dates as of March 31, 2005 (the "2004 LSA").

In consideration of the covenants and agreements set forth herein and in the Note, and for other good and valuable consideration, the Debtor hereby agrees with the Secured Party as follows:

1. **Loan Commitment**. Secured Party hereby agrees to advance to Debtor on November 10, 2006, by wire transfer to an account specified by Debtor, the amount of $4,000,000, which loan shall be evidenced by the Note, to be dated the date Debtor receives the funds, executed by Debtor payable to the order of Secured Party, in the total principal amount of the Loan.

2. **Grant of Security Interest.** To secure the Debtor's full and timely performance of all of the Debtor's obligations and liabilities to the Secured Parties pursuant to the Note (including, without limitation, Debtor's obligation to timely pay the principal amount of, and interest on, the Note) (the "Obligations"), the Debtor hereby grants to the Secured Parties a continuing security interest (the "Security Interest") in and to all of the property described on Exhibit C to this Agreement (the "Collateral"), subject, however, to the security interest of VLL3 and VLL4 (the "Prior Security Interests").

3. **Covenants.** The Debtor covenants and agrees with the Secured Party that, from and after the date of this Agreement until the Obligations are paid in full:

(a) **Other Liens.** Except for the Security Interest and the Prior Security Interests, the Debtor is the owner of the Collateral and will be the owner of the Collateral hereafter acquired free from any adverse lien, security interest or encumbrance (other than equipment leases, vehicle liens and other than the Prior Security Interest (collectively, the "Permitted Liens")), and the Debtor will defend the Collateral against the claims and demands of all persons at any time claiming the same or any interest therein. Except for financing statements relating to the Permitted Liens, no financing statements covering any Collateral or any proceeds thereof are on file in any public office.

(b) **Further Documentation.** At any time and from time to time, upon the written request of the Secured Parties, and at the sole expense of the Debtor, the Debtor will promptly and duly execute and deliver such further instruments and documents and take such further action as the Secured Parties may reasonably request for the purpose of obtaining or preserving the full benefits of this Agreement and of the rights and powers herein granted, including, without limitation, filing any financing or continuation statements under the Uniform Commercial Code in effect in any jurisdiction with respect to the liens created hereby. The Debtor also hereby authorizes the Secured Party to file any such financing or continuation statement without the signature of the Debtor to the extent permitted by applicable law. A reproduction of this Agreement shall be sufficient as a financing statement (or as an exhibit to a financing statement on form UCC) for filing in any jurisdiction.

(c) **Indemnification.** The Debtor agrees to defend, indemnify and hold harmless the Secured Parties against any and all liabilities, costs and expenses (including, without limitation, legal fees and expenses): (i) with respect to, or resulting from, any delay in paying, any and all excise, sales or other taxes which may be payable or determined to be payable with respect to any of the Collateral, (ii) with respect to, or resulting from, any delay in complying with any law, rule, regulation or order of any governmental authority applicable to any of the Collateral or (iii) in connection with any of the transactions contemplated by this Agreement.

(d) **Maintenance of Records.** The Debtor will keep and maintain at its own cost and expense satisfactory and complete records of the Collateral.

(e) **Inspection Rights.** The Secured Party shall have full access during normal business hours, and upon reasonable prior notice, to all the books, correspondence and other records of the Debtor relating to the Collateral, and the Secured Party or their representatives may examine such records and make photocopies or otherwise take extracts from such records. The Debtor agrees to render to the Secured Parties, at the Debtor's expense, such clerical and other assistance as may be reasonably requested with regard to the exercise of its rights pursuant to this paragraph.

(f) **Compliance with Laws, etc.** The Debtor will comply in all material respects with all laws, rules, regulations and orders of any governmental authority applicable to any part of the Collateral or to the operation of the Debtor's business; provided, however, that the Debtor may contest any such law, rule, regulation or order in any reasonable manner which

does not, in the reasonable opinion of the Debtor, adversely affect the Secured Party's rights or the priority of its lien on the Collateral.

(g) **Payment of Obligations.** The Debtor will pay promptly when due all taxes, assessments and governmental charges or levies imposed upon the Collateral or with respect to any of its income or profits derived from the Collateral, as well as all claims of any kind (including, without limitation, claims for labor, materials and supplies) against or with respect to the Collateral, except that no such charge need be paid if (i) the validity of such charge is being contested in good faith by appropriate proceedings, (ii) such proceedings do not involve any material danger of the sale, forfeiture or loss of any of the Collateral or any interest in the Collateral and (iii) such charge is adequately reserved against on the Debtor's books in accordance with generally accepted accounting principles.

(h) **Limitation on Liens on Collateral.** The Debtor will not create, incur or permit to exist, will defend the Collateral against, and will take such other action as is necessary to remove, any lien or claim on or to the Collateral arising after the date hereof.

(i) **Limitations on Dispositions of Collateral.** The Debtor will not sell, transfer, lease or otherwise dispose of any of the Collateral, or attempt, offer or contract to do so, other than in the ordinary course of business. For the avoidance of doubt, the Debtor will be allowed to grant licenses to its products and related documentation in the ordinary course of business and to establish or provide for escrows of related intellectual property in connection therewith. exclusive licenses of Intellectual Property and approved by the Board of Directors;

4. **Remedies.** If an Event of Default has occurred and is continuing, the Secured Party may exercise all rights and remedies of a secured party under the California Uniform Commercial Code, as amended from time to time. The rights and remedies provided in this Agreement are cumulative, may be exercised singly or concurrently and are not exclusive of any rights or remedies provided by law.

5. **Miscellaneous.**

(a) **Amendments and Waivers.** Any term of this Agreement may be amended with the written consent of the Debtor and of the Secured Party. Any amendment or waiver effected in accordance with this Section 5(a) shall be binding upon the parties and their respective successors and assigns.

(b) **Transfer; Successors and Assigns.** The terms and conditions of this Agreement shall be binding upon the Debtor and its successors and assigns and inure to the benefit of the Secured Party and its successors and assigns. Nothing in this Agreement, express or implied, is intended to confer upon any party other than the parties hereto or their respective successors and assigns any rights, remedies, obligations, or liabilities under or by reason of this Agreement, except as expressly provided in this Agreement.

(c) **Governing Law.** This Agreement and all acts and transactions pursuant hereto and the rights and obligations of the parties hereto shall be governed, construed and

interpreted in accordance with the laws of the State of California, without giving effect to principles of conflicts of law.

(d) **Counterparts.** This Agreement may be executed in two or more counterparts, each of which shall be deemed an original and all of which together shall constitute one instrument.

(e) **Titles and Subtitles.** The titles and subtitles used in this Agreement are used for convenience only and are not to be considered in construing or interpreting this Agreement.

(f) **Notices.** Any notice required or permitted by this Agreement shall be in writing and shall be deemed sufficient upon receipt, when delivered personally or by courier, overnight delivery service or confirmed facsimile, or forty-eight (48) hours after being deposited in the U.S. mail as certified or registered mail with postage prepaid, if such notice is addressed to the party to be notified at such party's address or facsimile number as set forth below or as subsequently modified by written notice.

(g) **Severability.** If one or more provisions of this Agreement are held to be unenforceable under applicable law, the parties agree to renegotiate such provision in good faith in order to maintain the economic position enjoyed by each party as close as possible to that under the provision rendered unenforceable. In the event that the parties cannot reach a mutually agreeable and enforceable replacement for such provision, then (i) such provision shall be excluded from this Agreement, (ii) the balance of the Agreement shall be interpreted as if such provision were so excluded and (iii) the balance of the Agreement shall be enforceable in accordance with its terms.

(h) **Entire Agreement.** This Agreement, and the documents referred to herein constitute the entire agreement between the parties hereto pertaining to the subject matter hereof, and any and all other written or oral agreements existing between the parties hereto concerning such subject matter are expressly canceled.

The Debtor and Secured Party have caused this Agreement to be duly executed and delivered as of the date first above written.

DEBTOR:

OCULUS INNOVATIVE SCIENCES, INC.,
a California corporation

By: /s/ Jim Schutz
Name: Jim Schutz
Title: Gen. Counsel
Address: 1129 North McDowell Blvd.
Petaluma, CA 94954

Facsimile Number: 707-283-0551

SECURED PARTY:

/s/ R.C. Burlingame
R.C. BURLINGAME, an individual

SIGNATURE PAGE TO SECURITY AGREEMENT

EXHIBIT A

Non-Negotiable Promissory Note

EXHIBIT B

Subordination Agreement

EXHIBIT C

Collateral

The Collateral shall consist of all right, title and interest of Debtor in and to the following:

(a) All goods and equipment now owned or hereafter acquired, including without limitation, all machinery, fixtures, vehicles (including motor vehicles and trailers), and any interest in any of the foregoing, and all attachments, accessories, accessions, replacements, substitutions, additions, and improvements to any of the foregoing, wherever located;

(b) All inventory, now owned or hereafter acquired, including without limitation, all merchandise, raw materials, parts, supplies, packing and shipping materials, work in process and finished products including such inventory as is temporarily out of Debtor's custody or possession or in transit and including any returns upon any accounts or other proceeds, including insurance proceeds, resulting from the sale or disposition of any of the foregoing and any documents of title representing any of the above, and Debtor's books relating to any of the foregoing;

(c) All now existing and hereafter arising accounts, contract rights, royalties, license rights and all other forms of obligations owing to Debtor arising out of the sale or lease of goods, the licensing of technology or the rendering of services by Debtor, whether or not earned by performance, and any and all credit insurance, guaranties, and other security therefor, as well as all merchandise returned to or reclaimed by Debtor and Debtor's books relating to any of the foregoing;

(d) All documents, cash, deposit accounts, securities, letters of credit, certificates of deposit, instruments and chattel paper now owned or hereafter acquired and Debtor's books relating to the foregoing; and

(e) Any and all claims, rights and interests in any of the above and all substitutions for, additions and accessions to and proceeds thereof.

The Collateral shall exclude all right, title and interest of Debtor in and to Debtor's intellectual property, general intangibles and contract rights now owned or hereafter acquired, including, without limitation, goodwill, trademarks, servicemarks, trade styles, trade names, patents, patent applications, copyrights, leases, license agreements, franchise agreements, blueprints, drawings, purchase orders, customer lists, route lists, infringements, claims, computer programs, computer discs, computer tapes, literature, reports, catalogs, design rights.

Exhibit 10.31

THIS NOTE IS SUBJECT TO THE TERMS OF THAT CERTAIN SUBORDINATION AGREEMENT ENTERED INTO AS OF NOVEMBER 7, 2006 BY AND AMONG OCULUS INNOVATIVE SCIENCES, INC., VENTURE LENDING & LEASING IV, INC., VENTURE LENDING & LEASING III, LLC, AS SUCCESSOR IN INTEREST TO VENTURE LENDING & LEASING III, INC., AND PAYMENT HEREOF IS SUBORDINATE TO THE PAYMENT OF ALL THE LENDERS OBLIGATIONS (AS DEFINED THEREIN).

NON-NEGOTIABLE SECURED PROMISSORY NOTE

Principal: $4,000,000

Petaluma, California
November 10, 2006

FOR VALUE RECEIVED, Oculus Innovative Sciences, Inc., a California corporation, with its principal office at 1129 North McDowell Blvd., Petaluma, CA 94954 ("**Payor**") hereby promises to pay R.C. Burlingame, as an individual ("**Holder**"), in lawful money of the United States, the principal sum of Four Million and 00/100 Cents ($4,000,000). The outstanding principal amount of this Note shall accrue interest at the rate of seven percent (7%) per annum, or the highest rate permitted by applicable law, if less, commencing from the date hereof, until fully satisfied.

The principal and all accrued and unpaid interest on this Note shall be due and payable on the earlier of twelve (12) months from the date hereof or five days after the consummation of the initial public offering of the Payor's shares of common stock resulting in gross proceeds to the Payor of at least $30,000,000 (the "**Due Date**"), at Holder's principal office. All payments hereunder, if any, shall be applied first to accrued and unpaid interest hereunder and thereafter to the unpaid principal amount hereof.

1. Security. This Note is secured by the Security Agreement between Maker and Payor of even date, and all of Maker's rights and remedies hereunder and thereunder are cumulative. All capitalized terms used herein without definition shall have the definition ascribed thereto in the Security Agreement.

2. Prepayment. All or any portion of the amount due under this Note may be prepaid, without penalty, in whole or in part, at any time or from time to time; provided, that such payment will be applied first to accrued interest due hereunder with the balance, if any, applied to reduce the unpaid principal.

3. No Waiver. Payor waives diligence, protest, further demand, and dishonor. Holder may waive its right to require performance of or compliance with any term, covenant or condition of this Note only by express written waiver.

4. Remedies. If an Event of Default has occurred and is continuing, the Secured

Party may exercise all rights and remedies of a secured party under the California Uniform Commercial Code, as amended from time to time.

5. Expenses of Collection. Payor agrees to pay all costs and expenses, including reasonable attorney's fees, expended or incurred by the holder of this Note in connection with the enforcement of this Note and the collection of any sums due hereunder.

6. Construction. This Note shall be governed, construed and interpreted in accordance with the laws of the State of California, without giving effect to principles of conflicts of law.

7. Modification. This Note may be modified only by a written agreement executed by Payor and Holder.

OCULUS INNOVATIVE SCIENCES, INC.,
a California corporation

By: /s/ Jim Schutz
Name: Jim Schutz
Title: Gen. Counsel

Exhibit 10.32

SUBORDINATION AGREEMENT
("Agreement")

Each of the undersigned persons and any other party signatory hereto as a Creditor (singly and collectively, **"Creditor"**), is interested in the financial success of **OCULUS INNOVATIVE SCIENCES, INC.** (**"Debtor"**) and acknowledges that **VENTURE LENDING & LEASING IV, INC.** and **VENTURE LENDING & LEASING III, LLC, as successor in interest to VENTURE LENDING & LEASING III, INC.** (**"Lenders"**) have entered or are presently intending to enter into certain financing arrangements with Debtor. Each Creditor agrees that the financing arrangements between Lenders and each of them, and Debtor are in Debtor's and Creditor's best interests and, in order to induce Lenders and each of them, to continue such financing arrangements, Creditor agrees as follows:

1. The term **"Obligations"** is used in this Agreement in its broadest and most comprehensive sense and shall mean all present and future indebtedness of Debtor which may be, from time to time, incurred by Debtor, including, but not limited to, any negotiable instruments evidencing the same, all guaranties, debts, demands, monies, indebtedness, liabilities and obligations owed or to become owing, including interest, principal, costs, and other charges, and all claims, rights, causes of action, judgments, decrees, remedies, or other obligations of any kind whatsoever and howsoever arising, whether voluntary, involuntary, absolute, contingent, direct, indirect, or by operation of law.

2. The term **"Creditor Obligations"** means all Obligations owing at any time by Debtor to Creditor.

3. The term **"Lenders Obligations"** means any and all Obligations owed by Debtor to Lenders and each of them, including, but not limited to, Obligations arising pursuant to any agreements between either of the Lenders and Debtor, now or hereafter existing, whether matured or not.

4. Except as provided in section 6, below, the Creditor Obligations are hereby subordinated in right of payment and lien priority and subject, in the manner and to the extent described below, to any and all Lenders Obligations so long as any Lenders Obligations shall remain unpaid, in whole or in part, or Lenders or either of them, are committed or otherwise obligated to extend credit to Debtor.

5. So long as any of the Lenders Obligations remain unpaid, in whole or in part, or so long as either of the Lenders are committed or otherwise obligated to extend credit to Debtor, Creditor agrees that, except to the extent that payments under the Creditor Obligations are permitted under Section 6 below, Creditor shall not: (a) collect, or receive payment upon, by setoff or in any other manner, all or any portion of the Creditor Obligations now or hereafter existing; (b) sell, assign, transfer, pledge, or give a security interest in the Creditor Obligations (except subject expressly to this Agreement); (c) declare or in any other manner find or hold Debtor in default under the

Creditor Obligations; (d) enforce or apply any security, now or hereafter existing for the Creditor Obligations; (e) commence, prosecute or participate in any administrative, legal, or equitable action against Debtor concerning the Creditor Obligations; (f) join in any petition for bankruptcy, assignment for the benefit of creditors, or creditors' agreement; (g) take, maintain or enforce any lien or security, which is senior to Lenders' interests, in any property, real or personal, to secure the Creditor Obligations; or (h) incur any obligation to, or receive any loans, advances, dividends, payments of any kind or gifts from, Debtor.

6. Notwithstanding the preceding section, Creditor and Debtor shall be permitted at any time without Lenders' consent (i) to convert or exchange any or all outstanding Creditor Obligations into other forms of indebtedness ("New Indebtedness") so long as such New Indebtedness would constitute Creditor Obligations under this Agreement and would be governed by the terms of this Agreement, or (ii) to convert or exchange any or all outstanding Creditor Obligations (including New Indebtedness that constitutes Creditor Obligations) into equity securities, or rights to purchase equity securities, of Debtor. New Indebtedness or equity securities of Debtor received by Creditor pursuant to the preceding sentence shall not be considered to be a collection or receipt of payment upon the Creditor Obligations under this Agreement, nor shall such equity securities be subject to Section 11 hereof. Further, notwithstanding the preceding section, Debtor shall be permitted to make and Creditor may accept and retain payment upon that portion of the Creditor Obligations evidenced by that certain Non-Negotiable Secured Promissory Note dated November 10, 2006 in the original principal amount of $4,000,000.00, provided, however, that prior to any such payment Debtor has consummated an initial public offering of Debtor's shares of common stock resulting in gross proceeds of at least $30,000,000.00.

7. All security interests and liens now or hereafter existing of the Creditor, if any, in respect of the Creditor Obligations or in respect of any future Obligations of Debtor to Creditor shall be subject, subordinate and junior in all respects and at all times to the security interests and liens now or hereafter existing of Lenders and each of them, regardless of the time or order of attachment or perfection of such Liens, the time or order of filing of financing statements or other instruments. All of the Lenders Obligations now or hereafter existing shall be first paid by Debtor before any payment shall be made by Debtor on the Creditor Obligations. This priority of payment shall apply at all times until all of the Lenders Obligations have been repaid in full. In the event of any assignment by Debtor for the benefit of Debtor's creditors, any bankruptcy proceedings instituted by or against Debtor, the appointment of any receiver for Debtor or Debtor's business or assets, or any dissolution or other winding up of the affairs of Debtor or of Debtor's business, and in all such cases, the officers of Debtor and any assignee, trustee in bankruptcy, receiver or other person or persons in charge, respectively, are hereby directed to pay to Lenders the full amount of the Lenders Obligations before making any payments to Creditor.

8. Creditor agrees that if part or all of the Creditor Obligations are evidenced, now or in the future, by a promissory note or other instrument, Creditor shall place or cause to be placed on its face a legend stating that the payment thereof is subject to the terms of this Agreement and is subordinate to the payment of all the Lenders Obligations. Creditor agrees to mark all books of

account in such manner as to indicate that payment thereof is subordinated pursuant to the terms of this Agreement.

9. Creditor agrees that Lenders and each of them, shall have absolute power and discretion, without notice to Creditor, to deal in any manner with the Lenders Obligations, including, interest, costs and expenses payable by Debtor to Lenders and each of them, and any security and guaranties therefor including, but not limited to, release, surrender, extension, renewal, acceleration, compromise, or substitution. Creditor hereby waives and agrees not to assert against Lenders and each of them, any rights which a guarantor or surety could exercise; but nothing in this Agreement shall constitute Creditor a guarantor or surety. Creditor hereby waives the right, if any, to require that Lenders marshal, or otherwise proceed to dispose of or foreclose upon, collateral Lenders may have in any manner or order.

10. If, at any time hereafter, either of the Lenders shall, in their own judgment, determine to discontinue the extension of credit to or on behalf of Debtor, Lenders and each of them, may do so. This Agreement and Lenders' rights and privileges hereunder shall continue until payment in full of all of the Lenders Obligations notwithstanding any action or non-action by either of the Lenders with respect to the Lenders Obligations or with respect to any collateral therefor or any guaranties thereof. All rights, powers and remedies hereunder shall apply to all past, present and future Lenders Obligations, including under successive transactions, any of which may continue, renew, increase, decrease or from time to time create new Lenders Obligations and notwithstanding that from time to time any of the Lenders Obligations theretofore existing may have been paid in full.

11. Creditor further agrees that if Creditor should, contrary to Section 5 above, take or receive any additional security interest in, or additional lien by way of attachment, execution, or otherwise on any property, real or personal, or should take or join in any other measure or advantage contrary to this Agreement, at any time prior to the payment in full of all of the Lenders Obligations, Lenders and each of them, shall be entitled to have the same vacated, dissolved and set aside by such proceedings at law, or otherwise, as Lenders may deem proper, and this Agreement shall be and constitute full and sufficient grounds therefor and shall entitle Lenders and each of them, to become a party to any proceedings at law, or otherwise, initiated by either of the Lenders or by any other party, in or by which Lenders and each of them, may deem it proper to protect their respective interests hereunder. Creditor agrees that if Creditor violates this Agreement, Creditor shall be liable to Lenders and each of them, for all losses and damages sustained by either of the Lenders by reason of such breach.

12. Except as otherwise expressly agreed to herein, if Creditor shall receive any payments, security interests, or other rights in any property of Debtor in violation of this Agreement, such payment or property shall be received by Creditor in trust for Lenders and each of them, and shall forthwith be delivered and transferred to Lenders.

13. For so long as any of the Lenders Obligations remain unpaid, Creditor irrevocably appoints Lenders and each of them, as Creditor's attorney-in-fact, and grants to Lenders and each of them, a power of attorney with full power of substitution, in the name of Creditor or in the name of Lenders, for the use and benefit of Lenders, without notice to Creditor, to perform at Lenders' option the following acts in any bankruptcy, insolvency or similar proceeding involving Debtor: To file the appropriate claim or claims in respect of the Creditor Obligations on behalf of Creditor if Creditor does not do so prior to 30 days before the expiration of the time to file claims in such proceeding and if Lenders and each of them, elects, in their sole discretion, to file such claim or claims.

14. Creditor represents and warrants that Creditor has not previously subordinated the Creditor Obligations for the benefit of any other party, and agrees that any such subordinations hereafter executed shall be expressly made subject and subordinate to the terms of this Agreement. Creditor further warrants having established with Debtor adequate means of obtaining, on an ongoing basis, such information as Creditor may require which may affect the ultimate satisfaction by Debtor of the Creditor Obligations. Lenders and each of them, shall have no duty to provide any such information to Creditor.

15. Subject to the execution and delivery of this Agreement by Lenders, each Creditor and Debtor, Lenders and each of them, hereby authorize, consent to, ratify and approve Debtor's execution and delivery of all documents pursuant to the Creditor Obligations, including any promissory notes issued to Creditors, all actions of Debtor in connection with the Creditor Obligations and Debtor's entering into the transactions contemplated by the Creditor Obligations. Lenders and each of them, hereby waive any and all provisions of the documents evidencing the Lenders Obligations for the sole purpose of allowing Debtor to incur the Creditor Obligations and to enter into the transactions contemplated thereby. This waiver is specific as to content and time and shall not constitute a waiver of any other current or future default or breach of any covenant contained in any document evidencing the Lenders Obligations.

16. This Agreement shall be binding upon the successors and assigns of Creditor, and shall inure to the benefit of Lenders' successors and assigns.

17. This Agreement and all rights and liabilities of the parties hereto shall be governed as to validity, interpretation, enforcement and effect by the laws of the State of California without regard to its conflicts of law rules. This Agreement may be executed in two or more counterparts, including counterparts transmitted by facsimile or other means of electronic transmission, each of which when taken together shall constitute one and the same instrument and agreement.

18. In the event of any dispute under this Agreement, the prevailing party shall be entitled to recover its reasonable attorneys' fees and costs whether or not suit is brought.

19. This Agreement shall remain in full force and effect until each of the Lenders Obligations has been indefeasibly repaid.

Remainder of this page intentionally left blank; signature page follows

IN WITNESS WHEREOF, the parties hereto have caused this Subordination Agreement to be executed and delivered by their proper and duly authorized officers as of November 7, 2006.

Lender:

Venture Lending & Leasing III, LLC

By: /s/ Ronald W. Swenson

Name: Ronald W. Swenson

Title: Chief Executive Officer

Lender:

Venture Lending & Leasing IV, Inc.

By: /s/ Ronald W. Swenson

Name: Ronald W. Swenson

Title: Chief Executive Officer

Creditor:

/s/ R.C. Burlingame

R.C. BURLINGAME , an individual

Acknowledgment of Debtor

The undersigned, being the Debtor named in the foregoing Agreement accepts and consents to such Agreement, and agrees to be bound by all of the provisions thereof and to recognize all priorities and other rights granted thereby to Venture Lending & Leasing IV, Inc. and to pay its Obligations only in accordance therewith.

Dated: November 7, 2006

OCULUS INNOVATIVE SCIENCES, INC.

By: /s/ Jim Schutz
Name: Jim Schutz
Title: Gen. Counsel

Exhibit 10.33

Consulting Agreement

THIS AGREEMENT (this "Agreement") made and entered into this 9th Day of November by and between OCULUS INNOVATIVE SCIENCES INC. (hereinafter "Oculus"), a California Corporation and Robert C. Burlingame (hereinafter "Advisor").

WHEREAS, Oculus desires that Advisor provide certain global planning expertise and general business management services to Oculus (such services, including all know-how, trade secrets, copyrights and patentable inventions, being hereinafter referred to collectively as the "Materials");

WHEREAS, both Oculus and Advisor desire to set forth in writing the terms and conditions of their dealings, including rights as to the Materials;

NOW THEREFORE, in consideration of the premises hereof and the mutual covenants and conditions hereinafter set forth and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto, intending to be legally bound, hereby agree as follows:

Section 1. ADVISOR'S SERVICES

1.1 On the terms and conditions set forth herein, Oculus hereby engages Advisor during the term described below, and Advisor hereby accepts such engagement, to provide the following services to Oculus:

- Global business review of the US and international operations,
- Creation of key performance indicators to track Oculus's performance on certain ongoing and future company-wide projects, and
- General business advice to US and international management

Advisor agrees to use its best efforts, at a level consistent with persons having a similar level of education, experience and expertise in the industry, in the performance of the services called for hereunder. This Agreement is nonexclusive.

Section 2. TERM OF AGREEMENT

2.1 The term of this Agreement shall be for two (2) years commencing upon the full execution of this Agreement (the "Effective Date") and may renewed by mutual written agreement between Oculus and Advisor.

Section 3. INDEPENDENT CONTRACTOR

3.1 Advisor agrees that he shall be an independent contractor acting for or on behalf of Oculus. Advisor shall have no authority to contract for or bind Oculus in any manner. Advisor shall have no status as employee or any right to any benefits that Oculus grants its employees.

Section 4. COMPENSATION

As compensation for Advisor's services to the Company, subject to the availability of an exemption from securities registration and compliance with all applicable securities laws, the Advisor shall be granted a warrant to purchase Three Hundred Thousand (300,000) shares of Common Stock of the Company at an exercise price per share of $3.25 (the "Warrant"), pursuant to the Company's standard form of warrant agreement, with such changes as the Company's Board of Directors shall approve. The Warrant shall immediately vest upon execution of this Agreement.

The Warrants must be exercised within ten (10) years after the Effective Date; provided, however, that if the Advisor is requested to resign, the Warrants must be exercised, in whole or in part (but only with respect to such shares as are vested), within thirty (30) days after such resignation or removal or termination of this Agreement.

The Warrants and the underlying shares of the Company's Common Stock issuable upon conversion thereof (the "Conversion Shares") shall be subject to certain restrictions and legends as shall be specified in any documents authorizing the Warrant and the Conversion Shares. The Warrants and the Conversion Shares shall not be issued unless the issuance and delivery of such Warrants and Conversion Shares shall comply with all relevant provisions of law, including, without limitation, the Securities Act of 1933, as amended (the "33 Act"), the Securities Exchange Act of 1934, as amended, the rules and regulations promulgated thereunder, and the requirements of any stock exchange or quotation system upon which the Conversion. Shares may then be listed or quoted, and shall be further subject to the approval of counsel for the Company with respect to such compliance. Inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance of any of the Conversion Shares, shall relieve the Company of any liability in respect of the non issuance of the Warrants and any Conversion Shares as to which such requisite authority shall not have been obtained.

The Advisor represents and warrants that it is acquiring or will acquire the Warrants and, as applicable, the Conversion Shares, solely for its account for investment and not with a view-to or for sale or distribution of said Warrants or Conversion Shares or any part thereof. The Advisor also represents that the entire legal and beneficial interest of the Warrants, and the Conversion Shares, is being acquired for, and will be held for, his/her account only. Advisor represents that (i) he/she has a preexisting personal or business relationship with the Company or one or more of its officers, directors or controlling persons, (ii) that by reason of his/her business or financial experience, or the business or financial experience of his/her financial experience, or the business or financial experience of his/her professional advisers, could be reasonably assumed to have the capacity to protect his/her own interests in connection wit this transaction, and/or (iii) that he/she is an accredited investor, as that term is defined in Section 501 (a) of Regulation D promulgated under the '33 Act.

Section 5. OBLIGATION FOR EXPENSE

5.1 Oculus will reimburse Advisor for reasonable and appropriate out-of-pocket travel expenses according to a budget submitted by Advisor to, and approved by, Oculus. Advisor shall be responsible for submitting a monthly expense report to Oculus for reasonable reimbursable expenses incurred by Advisor. Oculus shall have no duty or obligation to reimburse expenses for which a monthly expense report has not been submitted. From time to time, in anticipation of certain expenses such as airfare, extended travel and living expenses, Oculus may advance certain monies to Advisor pursuant to an expense budget mutually agreed upon by Oculus and Advisor. Any expense exceeding One Thousand ($1,000) Dollars will require pre-approval by Oculus.

Section 6. OWNERSHIP OF MATERIALS

6.1 Advisor agrees that all Materials, reports and other data or materials generated or developed by Advisor under this Agreement or furnished by Oculus to Advisor shall be and remain the property of Oculus. Advisor specifically agrees that all copyrightable Material generated or developed under this Agreement shall be considered works made for hire and that such material shall, upon creation, be owned exclusively by Oculus. To the extend that any such Material, under applicable law, may not be considered works made for hire, Advisor hereby assigns to Oculus the ownership of copyright in such Materials, without the necessity of any further consideration, and Oculus shall be entitled to obtain and hold in its own name all copyrights in respect of such Materials.

6.2 If and to the extend Advisor may, under applicable law, be entitled to claim any ownership interest in the Materials, reports and other data or materials generated or developed by Advisor under this Agreement, Advisor hereby transfers, grants, conveys, assigns and relinquishes exclusively to Oculus all of Advisor's right, title and interest in and to such Materials, under patent, copyright, trade, secret and trademark law, in perpetuity or for the longest period otherwise permitted by law.

6.3 Advisor shall perform any acts that may be deemed necessary or desirable by Oculus to evidence more fully transfer of ownership of all Materials designated under this Section 6 to Oculus to the fullest extent possible, including but not limited to the making of further written assignments in a form determined by Oculus.

6.4 To the extent that any preexisting rights are embodied or reflected in the Materials, Advisor hereby grants to Oculus the irrevocable, perpetual, non-exclusive, worldwide, royalty-free right and license to (1) use, execute, reproduce, display, perform, distribute copies of, and prepare derivative works based upon such preexisting rights and any derivate works thereof and (2) authorize others to do any or all of the foregoing.

6.5 Advisor hereby represents and warrants that it has full right and authority to perform, its obligations and grant the rights and licenses herein granted and that it has neither assigned nor otherwise entered into an agreement by which it purports to assign or transfer any right, title, or interest to any technology or intellectual property right that would conflict with its obligations under this Agreement. Advisor covenants and agrees that it shall not enter into any such agreements.

Section 7. PROTECTION OF PROPRIETARY MATERIALS

7.1 From the date of execution hereof and for as long as the information or data remain Trade Secrets, Advisor shall not use, disclose, or permit any person to obtain any Trade Secrets of Oculus, including any materials developed or generated hereunder (whether or not the Trade Secrets are in written or tangible form), except as specifically authorized by Oculus.

7.2 As used herein, “Trade Secret” shall mean a whole or any portion or phase of any scientific or technical information, design, process, procedure, formula, or improvement that is valuable and not generally known to competitors of Oculus.

7.3 Irreparable harm should be presumed if Advisor breaches any covenant in this Agreement for any reason, This Agreement is intended to protect Oculus’s proprietary rights pertaining to the Materials, and any misuse of such rights would cause substantial balm to Oculus’s business. Therefore, Advisor agrees that a court of competent jurisdiction should immediately enjoin any breach of this Agreement, upon a request by Oculus.

Section 8. RETURN OF MATERIALS

8.1 Upon the request of Oculus, but in any event upon termination of this Agreement, Advisor shall surrender to Oculus all memoranda, notes, records, drawings, manuals, computer services and other documents or materials (and all copies of same) pertaining to the Materials, reports and other data or materials generated or developed by Advisor or furnished by Oculus to the Advisor, including all materials embodying any Trade Secrets. This Section is intended to apply to all materials made or compiled by Advisor, as well as to all materials furnished to Advisor by Oculus or by anyone else that pertain to the Materials.

Section 9. SCOPE OF AGREEMENT

9.1 This Agreement is intended by the parties hereto to be the final expression of their agreement and it constitutes the full and entire understanding between the parties with respect to the subject hereof, notwithstanding any representations, statements, or agreements to the contrary heretofore made. This Agreement may be amended only in writing signed by the parties to this Agreement.

9.2 For purpose of enforcing this Agreement, all sections of this Agreement, except Section 4.1 hereof, shall be construed as covenants independent of one another and as obligations distinct from all other contracts and agreements between the parties hereto.

Section 10. TERMINATION

10.1 This Agreement may be terminated by either party upon 30-days prior written notice to the other party. Te respective obligations and covenants of the parties and this Agreement, which by their nature extend beyond the expiration or termination of this agreement, including, without limitation, its confidentiality and warranty provisions, shall survive the termination or expiration of this Agreement.

Section 11. GOVERNING LAW

11.1 This Agreement is made under and in all respects shall. be interpreted, construed and governed by and in accordance with the Laws of the State of California. Sole and exclusive jurisdiction in any case or controversy arising under this. Agreement or by reason of this Agreement shall be with the Sonoma County Superior Court or the United States District Court for the Northern District of California, and for this purpose each party hereby expressly and irrevocably consents to the exclusive jurisdiction of such courts.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed on the day and year first above written.

OCULUS INNOVATIVE SCIENCES INC.

/s/ Robert C. Burlingame
Robert C. Burlingame

Date: November 8, 2006

By: /s/ H. Alimi
Hojabr Alimi, Chief Executive Officer

Date: November 8, 2006

Exhibit 10.34

DIRECTOR AGREEMENT

THIS DIRECTOR AGREEMENT ("Agreement") is dated for reference purposes only as of this 8th day of November 2006, by and between ROBERT C. BURLINGAME (the "Director") and OCULUS INNOVATIVE SCIENCES, INC., a California corporation (the "Company"), and, subject to the prior amendment of Section 2.10 of the Bylaws, shall become effective as of the date the requisite affirmative vote of the holders of Series A Preferred Stock of the Company in favor of the election of Director shall be obtained (the "Effective Date") .

WHEREAS, the Company is engaged in the business of developing and manufacturing products for the anti - -infection and wound management markets ;

WHEREAS, as of the Effective Date, the Director will be a duly elected director of the Company;

WHEREAS, the Company and the Director desire that the confidentiality obligations of the Director and the indemnification obligations of the Company be memorialized by this Agreement; and

WHEREAS, the Company desires that the Director be compensated for his services to the Company by the granting of options to purchase the stock of the Company on the terms provided herein.

NOW, THEREFORE, in consideration of the foregoing premises and the mutual covenants herein contained, the parties hereto agree as follows:

1. Director Availability. The Director shall make himself reasonably available to attend the noticed meetings of the Board of Directors of the Company at the Company's Petaluma offices, and if not practicable, by telephone conference call. The Director shall make himself reasonably available to the officers of the Company for purpose of general consultation in connection with the business of the Company.

2. Competing Activities. While a director of the Company, the Director shall not engage in any other employment, occupation, consulting or other business activity that is directly competitive with the business of the Company.

3. Covenant Not to Solicit. For the period beginning on the date hereof and ending on the date one (1) year after the completion or termination of the Director's engagement with the Company, the Director shall not either directly or indirectly solicit, induce, recruit or encourage any of the Company's employees to leave their employment, or

take away such employees, or attempt to solicit, induce, recruit, encourage or take away employees of the Company, either for the Director or for any other person or entity.

4. Confidential Information. The Director acknowledges that during the course of his engagement with the Company that he will produce and have access to information relating to personnel, sales, forecasts, customers and financial, operational and scientific matters of the Company, whether developed by the Director or by others (collectively, "Confidential Information"). The Director understands that any and all Confidential Information is received or developed by him and is disclosed to him in confidence, and is to be used only for the purposes for which it is provided. During the term of his engagement with the Company or thereafter, the Director shall not directly or indirectly, except as required by the normal business of the Company or expressly consented to in writing by the Board of Directors of the Company: (i) disclose, publish or make available any Confidential Information, other than to an employee, officer or director of the Company who, in the reasonable exercise of the Director's judgment, needs to know such Confidential. Information in order to perform his duties to the Company; (ii) sell, transfer or otherwise use or exploit or permit the sale, transfer, use or exploitation of the Confidential Information for any purposes other than those for which they were provided; or (iii) remove from the Company's premises or retain upon termination of his engagement any Confidential Information, any copies thereof or any tangible or retrievable materials containing or constituting Confidential Information. The Director further agrees that all files, letters, memos, reports, sketches, drawings, customer lists, telephone lists or other written material containing Confidential Information which shall come into his possession shall be the exclusive property of the Company to be used only in the performance of Company duties. All such written materials shall be delivered to the Company upon termination of the Director's engagement with the Company.

The restrictions on the use or disclosure of Confidential Information shall not apply to any information that the Director can document is or was: (i) independently developed by the Director prior to the time of disclosure; (ii) in the public domain without breach of this Agreement and through no fault of the Director; (iii) at the time of disclosure to the Director properly known to such party free of restriction or lawfully received free of restriction from another source having the right to so furnish such information; or (iv) which the Company agrees in writing is free of such restrictions.

5. Equitable Remedies. The Director agrees that it would be impossible or inadequate to measure and calculate the Company's damages from any breach or threatened breach of the covenants set forth in sections 2, 3, and 4 of this Agreement. Accordingly, the Director agrees that in the event of any alleged breach or threatened breach of those sections, the Company will have available, in addition to any other right or remedy available, the right to obtain an injunction from a court of competent jurisdiction restraining such alleged breach or threatened breach.

6. Company Stock Options. As partial compensation for Director's services to the Company, the Director shall be granted an option to purchase 300,000 fully vested shares of Common Stock of the Company at an exercise price of Three dollars and Twenty Five cents ($3.25) per share (the "Stock Options"). The Stock Options must be exercised within ten (10) years after the date on which the last vesting of the Stock Options occur; provided, however, that if the Director is requested to resign for cause (as defined below) or is removed for cause (as defined below), the Stock Options must be exercised, in whole or in part, within thirty (30) days of such resignation or removal.

The Stock Options and the underlying shares shall be subject to certain restrictions and legends as shall be specified in any documents authorizing such Stock Options and shares. The Stock Options and the underlying shares shall not be issued unless the issuance and delivery of such Stock Options and shares shall comply with all relevant provisions of law, including, without limitation, the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, the rules ad regulations promulgated thereunder, and the requirements of any stock exchange or quotation system upon which the underlying shares may then be listed or quoted, and shall be further subject to the approval of counsel for the Company with respect to such compliance. Inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance of any underlying shares hereunder, shall relieve the Company of any liability in respect of the non-issuance of such Stock Options and shares as to which such requisite authority shall not have been obtained.

7. Expenses. The Director shall be entitled to reimbursement of his reasonable expenses incurred on behalf of the Company and reimbursement to the Director shall be due and made against an itemized list of such expenses. Any expenses in excess of $100 shall require the prior approval of the Company.

8. Indemnification. The Company will indemnify and defend the Director against any liability incurred in the performance of his services to the Company to the fullest extent authorized in. Company's Articles of Incorporation, bylaws, and applicable law. The Company has purchased Director's and Officer's liability insurance, and Director shall be entitled to the protection of any insurance policies the Company maintains for the benefit of its directors and officers against all costs, charges and expenses in connection with any action, suit or proceeding to which he may be made a party by reason of his affiliation with the Company, its subsidiaries, or affiliates.

9. Assignment by Director. This Agreement is personal, and the Director's rights and obligations under this Agreement are not and shall not be transferable by assignment or otherwise. Any attempted assignment in violation of this section 9 shall be voidable at the Company's option and shall entitle the Company to terminate the Agreement.

10. Assignment by the Comp. Nothing in this Agreement shall prevent the consolidation of the Company with, or its merger into, any other corporation or the assignment by the Company of this Agreement and the performance of its obligations hereunder to any affiliated company. If the Company shall merge into, sell, as sign or transfer its operations to any successor, the Company shall have the right to assign all of its right, title and interest in this Agreement to such successor; provided, however, that such successor assumes and agrees to perform, from and after the date of such assignment, all of the terms, conditions and provisions imposed by this Agreement upon the Company. In the event of such an assignment by the Company and of such assumption and agreement by a successor, all further rights, as well as all further obligations, of the Company under this Agreement shall cease and terminate, and thereafter, the term "the Company" wherever used herein shall be deemed to refer to such. successor or assignee. This Agreement shall inure to the benefit of, and be enforceable by, any corporate successor to or assignee of the Company.

11. Notice. Any notice to be given to the Company under the terms of this Agreement shall be addressed to the Company at the address of its principal place of business, and any notice to be given to the Director shall be addressed to him at his home address last shown on the records of the Company, or at such other address as either party may hereafter designate in writing to the other. Any such notice shall be deemed to have been duly given when enclosed in a properly sealed and addressed envelope, registered or certified, and deposited (postage and registry or certification. fee prepaid) in a post office or branch post office regularly maintained by the United States government.

12. Construction. The provisions of this Agreement are divisible and, so far as they are covenants not to compete, shall be operative to the extent, both as to time and area covered, that they may be made so applicable; if any provisions, or any part hereof, are declared invalid or unenforceable, the validity and enforceability of the remainder of such provisions, or parts hereof, and the applicability hereof shall not be affected thereby.

13. Waiver. Waiver of any term or condition contained in this Agreement-by any party to this Agreement shall not be construed as a waiver of a subsequent breach or failure of the same term or condition or a waiver of any other term or condition contained in this Agreement.

14. Applicable Law. The provisions of this Agreement shall be interpreted under, and performance of the parties hereto shall be governed by, the laws of the State of California.

15. Amendments. The provisions of this Agreement may be waived, amended, modified, or repealed, in whole or in part, only on the written consent of all parties to this Agreement.

16. Survival. The respective obligations and covenants of the parties under this Agreement which shall by their nature extend beyond the expiration or termination of this Agreement, including, without limitation, the confidentiality and non -solicitation obligations of the Director and the indemnification obligations of the Company, shall survive the termination or expiration of this Agreement.

17. Headings. The headings throughout this Agreement are for the convenience and reference purposes only and shall not be deemed to expand, modify, amplify, or aid in the interpretation, construction, or meaning of any provision of this Agreement.

18. Entire Agreement. The terms of this Agreement are intended by the parties as a final expression of their agreement with respect to such terms as are included in this Agreement, and such terms may not be contradicted by evidence of any prior or contemporaneous agreement. The parties further intend that this Agreement constitutes the complete and exclusive statement of its terms and that no extrinsic evidence whatsoever may be introduced in any judicial proceedings, if any, involving this Agreement.

IN WITNESS WHEREOF, the parties hereto have executed or caused this Agreement to be executed as of the Effective Date.

The Director:

/s/ Robert C. Burlingame
Robert C. Burlingame

The Company:

Oculus Innovative Sciences, Inc.
a California Corporation

By: /s/ H. Alimi
Its: President

Exhibit 10.35

CONFIDENTIAL TREATMENT REQUESTED.
CONFIDENTIAL PORTIONS OF THIS DOCUMENT HAVE
BEEN REDACTED AND HAVE BEEN SEPARATELY FILED
WITH THE COMMISSION.

EXCLUSIVE MARKETING AGREEMENT

This Agreement, dated as of December 5, 2005, is made and entered into by and between: **Alkem Laboratories Ltd,** a company **i**ncorporated under the laws of the Republic of India (hereinafter referred to as "Alkem") and **Oculus Innovative Sciences, Inc**., a company incorporated under the laws of the State of California, USA (hereinafter referred to as "Supplier");

WHEREAS:

(a) the Supplier has represented to Alkem that they are in the business of manufacturing a 'super oxidized solution' (the 'Product') for use as a disinfectant, sterilant application, etc;

(b) Alkem is a well diversified pharmaceutical company having interalia its own research, manufacturing and marketing facilities. Further, Alkem also sells various hospital supplies and medical devices and has considerable experience in the marketing, sale and servicing of such supplies and devices;

(c) the Supplier has represented to Alkem that, in relation to the Product, they have proprietary rights in a US patent bearing number 60/533,583 and its derivative filings through September 15 2005, and which is more particularly identified by them as "The Microcyn Technology" (the 'Technology');

(d) the Supplier has represented to Alkem that their aforesaid patented technology also enjoys statutory patent protection in numerous other countries;

(e) the Supplier has represented to Alkem that they have made a PCT application in respect of their aforesaid patent, wherein India is a designated country. Further, the Supplier has represented to Alkem that they have entered the 'National Phase' in India, and that they shall take all steps necessary to secure patent protection for their Microcyn Technology in India and Nepal;

(f) the parties to this agreement have, in Phase I of their relationship, entered into a Memorandum Of Understanding dated the 19th of September 2005.

(g) as envisaged in the said MOU, this Exclusive Marketing Agreement marks the commencement of Phase II in the relationship between the parties to this agreement;

(h) in this Phase II the Supplier desires that Alkem market, distribute and sell the Supplier's proprietary/patented products in the Territory, and Alkem desires to market, distribute and sell the Supplier's proprietary/patented products in the said Territory in accordance with the terms and conditions set forth in this Agreement; and

(i) as envisaged in the aforementioned MOU, the Supplier and Alkem have agreed that they during Phase II of their relationship the parties shall initiate discussions as regards Phase III of their relationship wherein it is proposed that the parties take steps to manufacture the Supplier's proprietary/patented product/s in India, either through Alkem or through a Joint Venture;

CONSEQUENTLY THE PARTIES HEREBY AGREE AS FOLLOWS:

1 DEFINITIONS

In this Agreement the following terms and expressions shall have the meaning set out below.

Alkem	Shall mean Alkem Laboratories Ltd; a company incorporated in India under the Companies Act 1956, having its registered office at Exhibition Road, Patna — 800 001, and its corporate office at ALKEM HOUSE, Dev Ashish, Near Matulya Centre, SB Marg, Lower Parel, Mumbai — 400 013, India.
Field	Shall mean the field of use for applications consistent with the laws and customs of the Territory and consistent with the product claims of Supplier.
Order	Shall mean an order for Supplier's Products submitted by Alkem.
Price Schedule	Shall mean the schedule of prices for the Supplier's Products as agreed upon by the parties, in writing, from time to time. The current Price Schedule is set forth in

	Annexure A hereto.
Sub-Distributor	Shall mean any third party (including stockists) appointed by Alkem to act for Alkem in marketing, selling and distributing Supplier's Products in the Territory for use in the Field under this Agreement pursuant to Section 2.2.
Supplier	Shall mean Oculus Innovative Sciences, Inc., a California Corporation, having its principal place of business at: 1129 N. McDowell Blvd. Petaluma, CA 94954, USA
Supplier Improvements	Shall mean any improvements, modifications, developments or additions of the Products. Supplier Improvements shall not include any improvement, modification, development or addition developed solely for use in an application outside the Field or for a specific customer at the expense of such customer.
Product/s	Shall mean the current list of Supplier's Products and Pricing attached in Annexure A.
Term	Shall mean the term of this Agreement as set forth in Section 10 of this Agreement.
Territory	Shall mean The Republic of India, and the Kingdom of Nepal. Alkem may not re-export Supplier's Product beyond the Territory without written consent of Supplier.

2 MARKETING AGENCY

2.1 Supplier hereby appoints Alkem, and Alkem hereby accepts its appointment, as the exclusive Marketing Partner/Company for the Supplier's Products in the Field throughout the Territory, with the right to import, market, re-package, sell, and distribute Supplier's Products for use in the Field throughout the Territory in accordance with the terms and conditions of this Agreement. Alkem agrees to

use all commercially reasonable efforts to successfully market Supplier's Products throughout the Territory for use in the Field on a continuing basis throughout the Term.

2.2 Alkem may appoint third parties as sub-distributors, to act for Alkem in selling and distributing Supplier's Products in the Territory for use in the Field as under this Agreement. Alkem shall be and remain fully responsible for each sub-distributor's activities and the compliance by such sub-distributors of Alkem's covenants and obligations under this Agreement. Any shipment by Supplier to any of Alkem's sub-distributors made at the specific request of Alkem shall be invoiced by Supplier to Alkem directly.

2.3 Alkem shall not have any right to actively export, market, sell, distribute or use, or authorize any sub-distributor to export, market, sell, distribute or use, any Supplier's Product outside of the Territory or for any use outside of the Field.

3 MINIMUM PURCHASE VOLUMES

3.1 Alkem shall use commercially reasonable efforts to place orders with the Supplier for delivery of Supplier's Products in quantities as per the minimum volumes set forth in Annexure B.

4 ORDERING , SHIPPING AND DELIVERY

4.1 Subject to the terms of payment, the Supplier shall execute and deliver Alkem's orders within 8 (weeks) weeks from the receipt of the order by the Supplier. Each of Alkem's orders shall specify: (a) the product ordered, (b)the quantity of Product ordered; (c) the applicable purchase prices; and (c) delivery due date.

4.2 Alkem shall on or prior to the end of each year provide the Supplier with a quarterly non-binding rolling forecast of its orders for the products to be shipped by Supplier in each of the months covered by the forecast.

4.3 Supplier shall use its best commercially reasonable efforts to deliver the products in accordance with the applicable orders. Unless otherwise specified, Supplier shall deliver all Supplier's Products under this Agreement CIF Mumbai shipped from Supplier's facilities in Petaluma, California, USA; or Sittard, The Netherlands.

4.4 Should the Supplier fail to deliver the ordered quantity of the product to Alkem within *** weeks of the stated delivery schedule, Alkem shall be entitled to a *** of *** on the ***.

4.5 While Alkem shall be responsible for all packaging and labeling of Supplier's Products sold in the territory, the Supplier shall be responsible for all such aspects of the packaging and labeling clearance in respect of which has been

*** CONFIDENTIAL MATERIAL REDACTED AND SEPARATELY FILED WITH THE COMMISSION.

prior obtained by Alkem from the Supplier. Alkem shall ensure that all packaging and labeling shall be in conformity with the statutory requirements within the Territory.

5 PRICING AND PAYMENT

5.1 The purchase price for each Supplier's Product purchased by Alkem under this Agreement shall be determined in accordance with the Price Schedule as at Annexure A.

5.2 Supplier shall issue invoices for any Supplier's Products purchased by Alkem and, Alkem shall pay each of Supplier's invoices in accordance with the terms and conditions as stated in Annexure B.

6 MARKETING, SALES AND SERVICES

6.1 Alkem shall broadly consult the Supplier in connection with the marketing, re-packaging, sale and distribution of Supplier's Products under this Agreement, and the Supplier shall extend all possible support in the marketing of the products in the Territory. Without limiting the generality of the foregoing, Alkem shall prepare and submit to Supplier, at least ninety (90) days prior to the commencement of each financial Year, a written plan for the marketing, sale and distribution of Supplier's Products under this Agreement in the Territory. Alkem's plan shall include, without limitation: (a) a description of the promotional, advertising and other marketing activities planned by Alkem for each division within the Territory (b) a budget and schedule for such activities; (c) Alkem's best estimate of anticipated sales of Supplier's Products in each division within the Territory and (d) a description of any training or other support to be provided by Alkem. While Alkem shall use all commercially reasonable effort to comply with the plan for each year, the Supplier shall, on Alkem's request, provide all reasonable support, including staff training and costs thereof.

6.2 Alkem shall supply all sales and marketing material in the Field (included, but not limited to translation of promotional literature marketing materials manuals and other documentation for the Microcyn Technology); provided that as and where necessary, all such material shall be prepared by Alkem in consultation with the Supplier. Supplier shall supply Alkem, as reasonably, requested from time to time, information required in order to prepare sales and marketing materials.

6.3 Alkem shall comply with all applicable laws and regulations relating to the import, marketing, sale and distribution of Supplier's Products under this Agreement (including, without limitation, any applicable requirements under the laws, regulations, acts, executive orders of The Republic of India and the Kingdom of Nepal.)

6.4 During the Term and for a period of 2 (two) years after the end of the Term, Alkem shall keep and maintain records of all sales and other distributions of Supplier's Products made by Alkem or its Sub-distributors, sufficient to effectively, efficiently and economically implement any recall of any Supplier's Product. Upon Supplier's request, Alkem shall make such records available to Supplier and otherwise cooperate as reasonably required to effectively, efficiently and economically implement any recall.

6.5 The Supplier shall ensure that Supplier's Product when delivered to Alkem, or to any of its distributors as the case may be, shall have an expiry period of not less than 15 (fifteen) months.

6.6 Upon Supplier's request, Alkem shall provide a sales status report for the period requested.

7 INTELLECTUAL PROPERTY RIGHTS

7.1 The Supplier shall be the owner of and hereby reserves any and all patents, trade secrets, trademarks and other intellectual property rights with respect to Supplier's Products (including, without limitation, any and all Supplier Improvements.

7.2 During the tenure of this agreement, Alkem shall, as the Supplier's exclusive licensed user within the territory, be entitled to use and commercially exploit, in relation to the Product, the Supplier's patents, trade secrets, trademarks and other intellectual property rights.

7.3 Within the Territory and in relation to the Supplier's product, Alkem may at its option, and in consultation with the Supplier as to the manner of use, exploit any of the Supplier's trademarks or Alkem may develop and adopt its own trademarks for use upon and in relation to Suppliers products. Further, Alkem may at its option also opt for co-branding of the Supplier's products. All trademarks, copyrights and other intellectual property developed by Alkem in relation to the Supplier's products shall be the property of Alkem at all times and Alkem shall be entitled to register the same in its name.

7.4 Alkem shall immediately notify the Supplier of any infringement, misuse, misappropriation or violation of any patent, trade secret, trademark or other intellectual property rights of the Supplier that comes to Alkem's attention. In the event of any such infringement, misuse, misappropriation or violation, the Supplier shall have exclusive control over the commencement, prosecution and settlement of any legal proceeding to enforce, recover damages on account of or obtain other relief with respect to any infringement, misuse, misappropriation or violation of any patent, trade secret, trademark or other intellectual property rights of the Supplier. In connection with any such legal proceeding in the Territory, Alkem shall provide such assistance related to such proceeding as

Supplier may reasonably request (including, without limitation, in enforcing any judgment, settlement or order made in connection with such proceeding); provided that Supplier shall reimburse the expenses reasonably incurred by Alkem to provide such assistance in accordance with Supplier's request for the same.

7.5 In the event that the Supplier, subsequent to receiving a notification from Alkem of intellectual property violation/s as hereinabove stated, fails to initiate or launch any proceedings in respect of any infringement, misuse, misappropriation of the aforesaid intellectual property of the Supplier, Alkem may initiate any proceeding/s as it deems appropriate to prevent the said infringerment, misuse or misappropriation. Costs in respect of such proceedings shall be reimbursed by the Supplier to Alkem or Alkem may adjust the same against the Supplier's invoice.

8 INSPECTIONS, RETURNS, REPRESENTATION, WARRANTIES AND REMEDIES

8.1 In the event of any shortage, damage, discrepancy to or in relation to the Supplier's Products, or in the event of product expiry, or in the event that any Supplier's Product fails to comply with the warranty set forth in Section 8.4 below, Alkem shall without unreasonable delay report the same to the Supplier and shall furnish such written evidence or other documentation as the Supplier reasonably may deem appropriate and which is in the possession of Alkem. Alkem may return only such Supplier's Product that is damaged prior to delivery or is subject to discrepancy or fails to comply with the warranties setforth in section 8 below. Further, Alkem may at its option either request the Supplier to promptly deliver, at the Supplier's cost, replacement of the Supplier's Products, or may request the Supplier for a credit against future purchases.

8.2 The Supplier warrants that the claims made by them in relation to patents and various intellectual properties are valid. It is further clarified that the relationship between the parties, in relation to the product, proceeds on the footing that supplier's intellectual property rights are valid and the same would be sustained during the term of the this Agreement.

8.3 Supplier warrants to Alkem that the use, sale, offer for sale or import of Supplier's Products in accordance with this Agreement shall not infringe any patents, trade secrets, trademarks or other intellectual property rights of any third party. The warranty set forth in this Section 8 shall not apply to use of Supplier's Product not in accordance with the applicable manuals, instructions, label claims, and other documentation provided by Supplier, where use of Supplier's Product in accordance with such manuals, instructions and other documentation would have avoided the infringement.

8.4 Supplier warrants to Alkem that the Supplier's Product sold to Alkem under this Agreement shall, when delivered to Alkem, have a shelf life of not less than 15 months, and shall also meet the then effective and agreed upon specifications and shall be free from quality defects. Further, the Supplier shall guide Alkem as regards the correct procedure/methodology to be followed by Alkem during re-packaging of the product and shall also provide Alkem with specifications in respect of the container quality and volume so as to ensure that the re-packaged product maintains a shelf-life of not less than 12 months from the date of re-packaging.

8.5 Supplier hereby extends to any original purchaser of a Supplier's Product from Alkem or its Sub-distributors pursuant to the terms of this Agreement a warranty against defects in product quality. Supplier shall be responsible for and shall bear all costs in respect of the replacement of Supplier's Products that prove to be defective. The warranty set forth in this Section 8 shall in respect of each Supplier's Product delivered hereunder expire upon the earlier of (a) the sterilization expiration date for the applicable Supplier's Product, or (b) the completion of the first use of the applicable Supplier's Product. If compulsory law in any jurisdiction within the Territory requires warranties, which are more favorable to the purchaser than stated in the foregoing sentence, Alkem shall notify Supplier hereof in writing. Should Supplier not accept to extend the warranty in accordance with compulsory requirements in the relevant jurisdiction, Supplier shall without undue delay inform Alkem hereof in writing, in which case the parties shall as soon as reasonably possible thereafter negotiate in good faith a solution acceptable to both parties.

8.6 Supplier's representations and warranties set forth in this section 8 are exclusive and in lieu of any and all other warranties, express or implied (including, without limitation, any implied warranties of merchantability or fitness). the remedies set forth in this section 8 are exclusive and in lieu of any and all other remedies for any breach of supplier's representations and warranties set forth in this section 8.

8.7 **S**upplier's obligation to indemnify Alkem for any consequential damages on account of any breach of Supplier's representations and warranties under this section 8 shall be in accordance with clause 9.1 of this Agreement.

9 INDEMNITY AND INSURANCE

9.1 Supplier shall indemnify, defend and hold harmless Alkem from and against and in respect of any and all demands, claims, actions or causes of action, assessments, losses, damages, liabilities, interest, penalties, costs and expenses (including without limitation, reasonable legal fees and disbursements) resulting from, arising out of, or imposed upon or incurred by Alkem by reason of (i) any breach of any representation or warranty of Supplier set forth in paragraph 8 of this Agreement; (ii) total or partial recalls of Supplier's Products; or (iii) any

bodily injury caused by any alleged defects in product performance/quality of Supplier's Products. Supplier shall maintain product liability insurance in such amounts as is advisable pursuant to ordinary good business practice for a similar company in a similar type of business, and shall provide Alkem with evidence of this coverage upon written request.

9.2 Alkem shall indemnify, defend and hold harmless Supplier from and against and in respect of any and all demands, claims, actions or causes of action, assessments, losses, damages, liabilities, interest, penalties, costs and expenses (including without limitation, reasonable legal fees and disbursements) resulting from, arising out of, or imposed upon or incurred by Supplier by reason of (i) any breach of Alkem's obligations under this Agreement; (ii) product claims, representations or warranties, whether written or oral, made or alleged to be made, by Alkem in its advertising, publicity, promotion or sale of any Supplier's Product where such product claims, representations or warranties were not provided by or approved by Supplier; (iii) any infringement, misuse, misappropriation or violation of any intellectual property right of any third party by any trademark of Alkem; or (iv) negligent handling by Alkem of Supplier's Products. Alkem shall maintain product liability insurance in such amounts as is advisable pursuant to ordinary good business practice for a similar company in a similar type of business, and shall provide Supplier with evidence of this coverage upon written request.

10 TERM

10.1 Unless otherwise terminated in accordance with Section 10 hereof, this Agreement shall have an initial term commencing upon signature of this Agreement and ending upon the fifth anniversary of the date of this Agreement (the "Initial Term").

10.2 At the end of the Initial Term, this Agreement may be renewed by the parties for such additional term and upon such terms and conditions as the parties may agree to in writing.

11 EARLY TERMINATION

11.1 This Agreement shall be subject to early termination:

(i) by either party at any time upon one hundred-eighty (180) days advance written notice to the other party if the other party fails to fulfill its obligations under this Agreement and such failure is not remedied within thirty (30) days from having received a request for such remedial action from the non-defaulting party;

(ii) by Alkem, at its option, should the Supplier be unable to sustain the intellectual property warranties made to Alkem; or where the term of the intellectual property expires during the validity of this agreement; or where the rights

afforded by any intellectual property are restricted in any manner; or where the intellectual property rights are revoked during the term of this Agreement;

(iii) by Alkem, at its option, if the Supplier fails to execute Alkem's orders within the time schedules mentioned in the purchase order.

(iv) by either party immediately upon written notice if the other party should become insolvent or start negotiations about composition for the benefit of its creditors, if a petition for bankruptcy should be filed by or against the other party and is, in the latter, not dismissed within sixty (60) days or if the other party makes an assignment of all or a material part of its assets for the benefit of its creditors, other than an assignment given as security in connection with a loan or other borrowing on marketable terms by such party.

11.2 In the event of a change in control of fifty (50%) percent or more of the outstanding stock or assets of Alkem, Supplier may, at its option, terminate this Agreement.

11.3 In the event of a change in management/control of the Supplier company, the Supplier shall take all necessary actions to ensure that the said change does not affect the working of this agreement.

12 EFFECTS OF TERMINATION

Upon expiration or termination of the Term, the following shall apply:

12.1 Unless otherwise agreed upon by the parties, each party shall fulfill its obligations under any and all Orders entered into by the parties during the Term in accordance with Section 4; provided, however, that, in the event of any termination pursuant to Section 11.1(ii) or (iii), the terminating party may, at its option, cancel any outstanding Orders by giving the other party written notice of such cancellation.

12.2 The parties' respective rights and obligations with respect to any breach of this Agreement during the Term shall survive.

12.3 The parties' respective rights and obligations under Sections 7, 8, 11, 12, 14, 15, 16 and 17 shall survive.

12.4 Post the tenure of this agreement (whether by way of early termination or expiry), Alkem would continue to use and commercially exploit the Supplier's intellectual properties until exhaustion of all stocks of the Supplier's products by Alkem and or its sub-distributors.

12.5 Except as otherwise specifically provided for in Section 11, neither party shall have any liability (e.g., for any claim of damages, loss of revenue, profit or

compensation, for anticipated sales or for any costs, expenses, investments or other commitments made in reliance upon or otherwise in connection with this Agreement) to the other on account of any expiration or termination of the Term, other than any liability accruing prior to the termination of this agreement. Without limiting the generality of the foregoing, neither party shall have any right, either express or implied by applicable law or otherwise, to renewal of this Agreement or to any damages or compensation for any such termination.

13 NON-COMPETITION

13.1 During the tenure of this agreement Alkem shall not, directly or indirectly (e.g., through any of its affiliates), market sell, distribute any product that competes with Supplier's Products.

13.2 The obligations of Alkem set forth in this Section 13 shall not (i) extend to any activity or business currently carried out, directly or indirectly, by Alkem and (ii) apply if and to the extent such obligations are not permitted or enforceable under applicable laws.

14 FORCE MAJEURE

14.1 Force Majeure shall mean any event or condition, not existing on the date of signature of this Agreement, not reasonable foreseeable as of such date and without control of either party, which prevents, in whole or in material part, the performance by one of the parties of its obligations hereunder, such as an act of God, act of government, war or related actions, civil insurrection, riot, sabotage, general strike, general lockout, epidemic, fire flood windstorm and similar events.

14.2 Upon giving notice to the other party, a party affected by an event of Force Majeure shall be released without any liability on its part from the performance of its obligations under this Agreement, except for the obligation to pay any amounts due and owing hereunder, but only to the extent and only for the period that its performance of such obligations is prevented by the event of Force Majeure.

14.3 During the period that the performance by one of the parties of its obligations under this Agreement has been suspended by reason of an event of Force Majeure, the other may likewise suspend the performance of all or part its obligations hereunder to the extent that such suspension is commercially reasonable.

15 MISCELLANEOUS

15.1 Confidentiality

15.1.1 During the term of this Agreement and for a period of five (5) years thereafter, each party undertakes not to disclose to any third party any Confidential Information (as defined below) that the party receives from the other party and shall not be used for any other purpose than is required in order to fulfill its obligations under this Agreement.

15.1.2 For the purpose of this Agreement, Confidential Information shall include any and all technical, financial, business or other information disclosed by one party to the other verbally, in writing or in any other way, including without limitation documents, data or information related to products, technologies, know-how and trade secrets, provided that Confidential Information shall not include:

(i) information which the receiving party can show was known by the receiving party at the time of disclosure;

(ii) information which at the time of disclosure is in the public domain or which is published after disclosure or otherwise becomes part of the public domain through no fault of the receiving party;

(iii) information which the receiving party can show was received by it from a third party who did not to the best knowledge of the receiving party acquire the information , directly or indirectly, from the disclosing party under an obligation of confidence.

15.1.3 Alkem shall ensure that any Sub-distributor shall accept a similar confidentiality undertaking.

15.2 Relationship Between Parties This Agreement does not make either party the employee, agent or legal representative of the other for any purpose whatsoever. Neither party is granted any right or authority to assume or create any obligation or responsibility, expressed or implied, on behalf of or in the name of the other party. In fulfilling its obligations pursuant to this Agreement, each party shall be acting as an independent contractor.

15.3 Headings

The titles and headings to Sections herein are inserted for the convenience of reference only and are not intended to be a part of or affect the meaning or interpretation of this Agreement.

15.4 Notice

15.4.1 All notices or other communications to a party hereto required or permitted hereunder shall be deemed to be given if in writing and delivered personally or sent by facsimile (with confirmation of transmission) or certified mail (return receipt requested) to such party at the following addresses (or at such other addresses as shall be specified by like notice):

If to Supplier:

Oculus Innovative Sciences, Inc
1129 N. McDowell Blvd.
Petaluma, CA 94954, USA

If to Alkem, to:

Alkem Laboratories Ltd;
ALKEM House,
Dev Ashish,
Near Matulya Centre,
S.B.Marg, Lower Parel, Mumbai — 400013, India

15.4.2 All notices shall be deemed to be given on the day when actually delivered as provided above (if delivered personally or by facsimile) or on the day shown on the return receipt (if delivered by mail) or on the second day following delivery to a reputable courier.

16 GOVERNING LAW

This Agreement shall be governed, construed and enforced in accordance with the laws of the United Kingdom. In the event of any differences/disputes arising out of the performance of this Agreement, the parties hereto agree that the same shall be settled through discussions between them. If the differences/disputes remain unresolved thereafter, the same would be settled through an arbitration proceeding, to be held in London, under the substantive law/s of the United Kingdom.

17 ENTIRE AGREEMENT

This Agreement constitutes the entire agreement with respect to the appointment of Alkem as Supplier's Marketing Partner/Company. No amendment, modification or waiver of any of the provisions of this Agreement shall be valid unless set forth in a written instrument signed by the party to be bound thereby.

This Agreement has been executed in two (2) copies of which the parties have taken one each.

SUPPLIER	ALKEM
By: /s/ Jim Schutz	By: /s/ Samprada Singh
Vice President and General Counsel	Chairman
Date: 12/5/2005	Date: 12/5/2005

ANNEXURE A

TO THE

EXCLUSIVE MARKETING AGREEMENT

Between: Oculus Innovative Sciences, Inc. And Alkem Laboratories Ltd.

Description of Supplier Product/s and Pricing:

Note: Product/s brand name may be changed by mutual agreement.

(1) Product is a Superoxidized Water known as Microcyn Technology and other trade names as listed on Supplier's US and International web sites which may be accessed via www.oculusis.com

Price for bulk shipment (in 40 FT Containers) orders is: $USD ***/liter CIF Mumbai, shipped from Petaluma, California, USA. Or Sittard, The Netherlands PLUS ***% Royalty on the CIF value of the goods.

*** CONFIDENTIAL MATERIAL REDACTED AND SEPARATELY FILED WITH THE COMMISSION.

ANNEXURE B

TO THE

EXCLUSIVE MARKETING AGREEMENT

Between : Oculus Innovative Sciences, Inc. And Alkem Laboratories Ltd

Minimum Purchase Volumes to maintain pricing as established in Annexure A

Delivery Schedule to be as follows:

1.

Ordering Date	Product QTY	Terms
Prior to December 31, 2005 *	*** liters	LC 120 days usance
Prior to December 31, 2005 *	*** liters	LC 180 days usance

* subject to Alkem receiving the necessary regulatory clearances

2. During the calendar year 2006 and in every subsequent year till the tenure of this agreement, Alkem's yearly purchase of the Supplier's product shall reflect a minimum ***% year-on-year growth. The payment by Alkem to the Supplier for the said purchases shall be by irrevocable letter of credit *** days usance.

*** CONFIDENTIAL MATERIAL REDACTED AND SEPARATELY FILED WITH THE COMMISSION.

Exhibit 10.36

(Translation from Spanish)

(On the left hand margin of each page of the document appear several sets of initials)

AGREEMENT ENTERED INTO BY MR. JORGE AHUMADA AYALA AND FERNANDO AHUMADA AYALA, IN THEIR OWN RIGHT, HEREINAFTER JOINTLY REFERRED TO AS "THE PLAINTIFF", AND BY THE PUBLIC ACCOUNTANT, EVERARDO GARIBAY RAMIREZ, AS ATTORNEY-IN-FACT OF THE COMPANY NAMED: OCULUS TECHNOLOGIES OF MEXICO, S.A. DE C.V. (CORPORATION OF VARIABLE CAPITAL), HEREINAFTER REFERRED TO AS "THE DEFENDANT", IN ACCORDANCE WITH THE FOLLOWING REPRESENTATIONS AND CLAUSES:

REPRESENTATIONS

I. "THE PLAINTIFF" represents in its own right:

a) To be individuals of Mexican nationality, with legal capacity for the entering into of this agreement.

b) To be the titleholders of trademark registry number: 594389 "MICROMYCIN®".

c) To have filed, before the Mexican Institute of Industrial Property, the proceeding in order to

obtain the administrative-law declaration of infringement against “Oculus Technologies of Mexico, S.A. de C.V. based on the grounds provided for in sections I and IV of article 213 of the Industrial Property Law, under file number P.C. 421/2005 (I-310)8735, which it agrees to conclude by means of the relinquishment of the claim and of the corresponding proceeding.

d) That it is its wish to enter into this agreement with **“THE DEFENDANT”,** in order to definitively conclude the dispute specified in paragraph c) hereinabove, without the existence of pressure, fraud, bad faith or any other vice of consent.

II. “THE DEFENDANT” represents, though its attorney-in-fact:

a) That its client is a corporation incorporated in accordance with the laws of the United Mexican States, as confirmed in original instrument number 3,605, dated April 30, 2003, executed before Mr. Armando G. Manzano Alba, head of notary public’s office number one of the State of Michoacán.

b) That it holds the necessary and sufficient powers for the entering into of this agreement, as confirmed in public instrument number 95370, dated November 30, 2005, executed before Mr. Francisco Javier Arce Gargollo, head of notary public's office number 74 of the Federal District, which henceto have by no means been revoked or modified.

c) That it is its wish to enter into this agreement with **"THE PLAINTIFF",** in order to definitively conclude with the motion established in clause five of this agreement, the dispute specified in point I, paragraph c) hereinabove, without the existence of pressure, fraud, bad faith or any other vice of consent.

Both parties assert that they have freely negotiated the terms and conditions of this agreement, without the existence of any vice of consent that could cause it to be invalid or null, wherefore this agreement is entered into in accordance with the following:

CLAUSES

ONE: "THE DEFENDANT" is bound, given that it is in its best interests, before **"THE PLAINTIFF"** to cease to utilize the name Microcyn 60, or any other name that is the same or similar in degree of confusion to trademark: 594389 "MICROMYCIN®, which is printed on the labels of the product, within the term not exceeding one year as from the signing date of this agreement.

TWO: The term specified in the above clause may be used by **"THE DEFENDANT"** in order to perform the processes and acts needed to register a distinct trademark before the Mexican Institute of Industrial Property, at the sole discretion of **"THE DEFENDANT",** as well as to undertake the application processes, corresponding to the product, before the Federal Board for Protection against Health Risks.

THREE: The phases in which **"THE DEFENDANT"** shall perform the processes and acts needed to change the name of its product Microcyn 60 for a distinct trademark, are the following:

FIRST PHASE

COMMENCEMENT DATE	ACTIVITY	PROBABLE CONCLUSION DATE
WEEK OF AUG/01/2006	COMMENCEMENT OF THE APPLICATION PROCESS OF THE TRADEMARK REGISTRATION WITH THE IMPI (MEXICAN INSTITUTE OF INDUSTRIAL PROPERTY)	ESTIMATE OF SIX MONTHS IN ORDER TO OBTAIN THE RESULT OF THE APPLICATION PROCESS

SECOND PHASE

COMMENCEMENT DATE	ACTIVITY	PROBABLE CONCLUSION DATE
WEEK OF FEB/05/2007	COMMENCEMENT OF THE APPLICATION PROCESS AT COFEPRIS (FEDERAL BOARD FOR PROTECTION AGAINST HEALTH RISKS)	ESTIMATE OF SIX MONTHS FOR THE APPROVAL OF THE CHANGE OF NAME AND LABELS

THIRD PHASE

COMMENCEMENT DATE	ACTIVITY	PROBABLE CONCLUSION DATE
WEEK OF AUG/01/2007	FIRST PRODUCT DELIVERIES WITH NEW LABELING INCLUDING THE CHANGE OF NAME	FOLLOWING WEEKS

FOUR: Upon completion of the year referred to in clause one of this agreement, **"THE DEFENDANT"** should begin to make the first deliveries to businesses of the product with new labeling, which shall include a trademark different from the name: Microcyn 60, or another name that is not similar in degree of confusion to trademark: 594389 "MICROMYCIN®, while fully abiding by the stipulations of this meeting of the minds.

FIVE: Upon the signing of this agreement, **"THE PLAINTIFF"** is bound before **"THE DEFENDANT"** to file, in the administrative-law declaration of infringement proceeding before the Mexican Institute of Industrial Property, Divisional Office for the Protection of Intellectual Property, Divisional Sub-office for the Prevention of Unfair Competition, Departmental Coordination of Inspection and Supervision, File P.C. 421/2005 (I-310)8735, for the relinquishment of the claim and the corresponding proceeding, without reserving any action or right to exercise against **"THE DEFENDANT",** by virtue of the entering into of this agreement. This provision shall be invalid if **"THE DEFENDANT"** continues to use the

product showing the Microcyn 60 trademark after one year as from the signing of this agreement.

Furthermore, it is the responsibility of **"THE PLAINTIFF"** to by no means permit the company: Laboratorios Dermatológicos Darier, S.A. de C.V. to file any similar proceeding against **"THE DEFENDANT"** regarding the Microcyn 60 product and by virtue of this meeting of minds.

SIX: "THE DEFENDANT" is bound to pay **"THE PLAINTIFF"** the sum of $80,000.00 (Eighty Thousand Mexican Pesos 00/100) in order to recover legal costs, which shall be paid within fifteen days following the date on which **"THE DEFENDANT"** receives the corresponding receipt and/or invoice.

SEVEN: Upon termination of the term specified in clause one, and only in case **"THE DEFENDANT"** continues manufacturing and labeling the product with the name Microcyn 60 or another similar name in degree of confusion to trademark 594389 "MICROMYCIN®, following the termination of the aforementioned term of one year, both parties agree to establish as liquidated damages the sum of $100,000.00 (one hundred thousand Mexican Pesos

00/100) per month, which **"THE DEFENDANT"** is bound to pay in favor of **"THE PLAINTIFF"** during the time **"THE DEFENDANT"** continues labeling the product with the aforementioned name.

EIGHT: On its part, **"THE PLAINTIFF"** promises and is bound with **"THE DEFENDANT"** not to directly or indirectly use the name: Microcyn 60 or another name similar in degree of confusion.

Both parties agree to ratify this agreement before the Mexican Institute of Industrial Property.

NINE: There exists no custom, use or practice against the terms and conditions of this agreement. Any modification of the expressly agreed matters shall only be effective between the parties if the respective agreement is recorded in writing and signed by all the parties.

TEN: For all matters regarding the fulfillment and execution of this agreement, the parties specify the following domiciles:

"THE PLAINTIFF": Insurgentes Sur 3579, Torre 3, 8th floor, offices 801-804, Tlalpan Residential Zone, Tlalpan City District, Zip Code 14020, in Mexico, Federal District.

"THE DEFENDANT": Industria Vidriera number 81, Zapopan Norte Industrial Development, Zip Code 45130, Zapopan, Jalisco.

ELEVEN: For the interpretation and compliance with the agreement, the parties expressly submit themselves to the authority of the Mexican Institute of Industrial Property, Divisional Office for the Protection of Intellectual Property, Divisional Sub-office for the Prevention of Unfair Competition, Departmental Coordination of Inspection and Supervision. The foregoing is for all corresponding legal effects.

The parties agree with the content of this agreement and it is signed on four copies in Mexico City, Federal District, this July 31, 2006.

By "THE PLAINTIFF"
(Signed)

Mr. Jorge Ahumada Ayala

By "THE DEFENDANT"
(Signed)

Public Accountant, Everardo Garibay Ramirez

By "THE PLAINTIFF"

(Signed)

Mr. Fernando Ahumada Ayala

WITNESSES

By "THE PLAINTIFF"

(Signed)

Mr. Arturo Dominguez Vargas

By "THE DEFENDANT"

(Signed)

Mr. José Luis Camacho Lozano

(Translation from Spanish)

(Emblem):
IMPI
Mexican Institute of Industrial Property

(Stamp):
MEXICAN INSTITUTE OF INDUSTRIAL PROPERTY
Divisional Office for the Protection
of Intellectual Property
Folio: 14983
Date: SEP/22/2006 – Time: 15:37
File: P.C. 421/2005(I-310)8735
- -Illegible- 579125
(Barcode): -Illegible-

DIVISIONAL OFFICE FOR THE PROTECTION
OF INTELLECTUAL PROPERTY.
DIVISIONAL SUB-OFFICE FOR THE PREVENTION
OF UNFAIR COMPETITION.
DEPARTMENTAL COORDINATION OF
INSPECTION AND SUPERVISION.
REG. 011834

JORGE AHUMADA AYALA AND
FERNANDO AHUMADA AYALA.
VS.
OCULUS TECHNOLOGIES OF MEXICO, S.A. DE C.V.
TRADEMARK: 594389 MICROMYCIN.

P.C. 421/2005(I-310)8735.

MATTER: THE ABANDONMENT OF THIS PROCEEDING BY RENOUNCEMENT IS DECLARED.

MR. SALVADOR CHAVEZ OSEGUERA.
ATTORNEY-IN-FACT OF JORGE AHUMADA AYALA AND
FERNANDO AHUMADA AYALA.
CALLE DE ORIENTE 107 No. 4606,
COL. GERTRUDIS SANCHEZ, 2DA. SECCION,
DEL. GUSTAVO A. MADERO,
C.P. 07839, MEXICO, D.F.

Having seen the document presented at the filing office of the Divisional Office for the Protection of Intellectual Property of this Institute on September 21, 2006, with entry folio **011834,** by **Mr. Salvador Chávez**

Osequera, in representation of **JORGE AHUMADA AYALA AND FERNANDO AHUMADA AYALA,** and by Mr. Everardo Garibay Ramírez, in representation of OCULUS TECHNOLOGIES OF MEXICO, S.A. DE C.V. whereby the former relinquishes the request of administrative-law declaration of infringement, specifying that an agreement has been entered into with the presumed infringer, dated July 31, 2006, while attaching the original thereof for the corresponding legal effects, which is signed in agreement by Mr. Everardo Garibay Ramírez, attorney-in-fact of OCULUS TECHNOLOGIES OF MEXICO, S.A. DE C.V. the following is agreed.

The document in question is formally placed on record, by Mr. Salvador Chávez Oseguera, in representation of JORGE AHUMADA AYALA AND FERNANDO AHUMADA AYALA, with his legal capacity being accredited in the records, relinquishing the aforementioned proceeding, by virtue of the fact that an agreement was entered into with the supposed infringer in July 31, 2006, as well as Mr. Javier Santos Ríos, attorney-in-fact of OCULUS TECHNOLOGIES OF MEXICO, S.A. DE C.V. whose legal capacity is accredited in the records, signing in agreement, the relinquishment and, given that from the aforementioned agreement, which was

attached in original to the document in question, the following is seen in CLAUSE FIVE: *"Upon the signing of this agreement, "THE PLAINTIFF" is bound before "THE DEFENDANT" to file, in the administrative-law declaration of infringement proceedings before the Mexican Institute of Industrial Property, Divisional Office for the Protection of Intellectual Property, Divisional Sub-office for the Prevention of Unfair Competition, Departmental Coordination of Inspection and Supervision, File P.C. 421/2005 (I-310)8735, for the relinquishment of the claim and the corresponding proceeding, without reserving any action or right to exercise against "THE DEFENDANT", by virtue of the entering into of this agreement. This provision shall be invalid if "THE DEFENDANT" continues to use the product showing the Microcyn 60 trademark after one year as from the signing of this agreement."* Consequently, with the existence of said agreement between the parties for the relinquishment in question, based on articles 1, 2 and 57, section II of the Federal Code of Administrative-law procedure, and article 373, sections I and II of the Federal Code of Civil Procedure; it is resolved:

ONE: The abandonment of this proceeding is declared, due to the asserted and duly grounded reasons.

TWO: Kindly archive the file specified at the head of this document, as a full and definitively concluded matter.

THREE: Let this resolution be known to the parties. This document is signed in Mexico City, Federal District, based on article 6, sections IV, V and XXII, Articles 7 bis, 184, 187, 188, 193, 191, 192 bis and 215, Headings Six and Seven and other applicable articles of the Industrial Property Law; articles 1 and 2 and other applicable articles of the Federal Code of Administrative-law procedure, and articles 1, 70, 80, 129, 197 and 202 of the Federal Code of Civil Procedure, supplying deficiency; articles 1 and 3, section V, paragraph c), subparagraph i), first and second lines, articles 4, 5 and 11, last paragraph and article 14 of the Regulations of the Mexican Institute of Industrial Property; articles 1, 3, 4, 5, 18, 25, 26 and 32 of the Organic Bylaws of the Mexican Institute of Industrial Property, and articles 1, 3, and 7, sections c), e) and r) and last paragraphs of the Agreement that confers powers upon the Assistant General Directors, Coordinator, Divisional Directors, Incumbents of the Regional Offices, Divisional Deputy Directors, Departmental Coordinators and other employees of the Mexican Institute of

Industrial Property, with said laws being published in the Official Gazette on August 2, 1994, August 4, 1994 (reformed on May 30, 2000), February 24, 1943, December 14, 1999 (reformed and added to by Decree published on July 15, 2004, whose *errata* was published on the 28th of the same month and year), December 27, 1999 (reformed and added to by agreement published on July 29, 2004, whose clarification note was published on August 4, 2004), and December 15, 1999 (reformed by agreement published on July 29, 2004, whose clarification note was published on August 4, 2004).

YOURS SINCERELY
THE DIVISIONAL DEPUTY DIRECTOR FOR THE
PREVENTION OF UNFAIR COMPETITION
(Signed)
MS. MARÍA GUADALUPE LAZCANO XOXOTLA

With copy: Everardo Garibay Ramírez, Attorney-in-fact of OCULUS TECHNOLOGIES OF MEXICO, S.A. DE C.V. Río Rhin No. 56, Penthouse 2, Col. Cuauhtémoc, Delegación Cuauhtémoc, C.P. 06500, Mexico, D.F. For his knowledge.

RCL/***CAP*** (Initials)

Periférico Sur No. 3106, Col. Jardines del Pedregal, C.P.01900.

Switchboard: 5624-0400

(Translation from Spanish)

(Stamp):
MEXICAN INSTITUTE OF INDUSTRIAL PROPERTY
Divisional Office for the Protection
of Intellectual Property
Folio: 011834
Date: SEP/21/2006 – Time: 13:45
File: P.C. 421/2005(I-310)8735

ATTACHED DOCUMENT:
TRANSFER
PROMOTION
823412

REGISTERED TRADEMARK: 594389 MICROMYCIN
DIVISIONAL OFFICE FOR THE PROTECTION
OF INTELLECTUAL PROPERTY.
DIVISIONAL SUB-OFFICE FOR THE PREVENTION
OF UNFAIR COMPETITION.
DEPARTMENTAL COORDINATION OF
INFRINGEMENTS AND CRIMES

HEAD OF THE MEXICAN
INSTITUTE OF INDUSTRIAL PROPERTY

I, SALVADOR CHAVEZ OSEGUERRA, Lawyer for and in representation of JORGE AHUMADA AYALA and FERNANDO AHUMADA AYALA, with such legal capacity being accredited in the “P.C”. specified hereinabove, with all due respect to appear before you in order to assert:

I, EVERARDO GARIBAY RAMIREZ, as attorney-in-fact of OCULUS TECHNOLOGIES OF MEXICO, S.A. DE C.V. with such legal capacity being accredited in the “P.C”. specified hereinabove, with all due respect to appear before you in order to assert:

That having reached a satisfactory arrangement for both parties, under the terms of the agreement entered into on July 31, 2006, we appear in order to exhibit same for its due approval and inclusion in the corresponding file.

Furthermore, and based on the provisions of article 373, section II of the Civil Code of Procedure, supplying deficiency to the Industrial Property Law, JORGE AHUMADA AYALA and FERNANDO AHUMADA AYALA, in representation of the undersigned, do hereby fully relinquish the

proceeding against OCULUS TECHNOLOGIES OF MEXICO, S.A. DE C.V. given that it is in their bests interests which I represent.

Due to the foregoing, I kindly request you, the HEAD THE MEXICAN INSTITUTE OF INDUSTRIAL PROPERTY, to:

ONE: To formally enter my appearance on record, in the name and representation of JORGE AHUMADA AYALA and FERNANDO AHUMADA AYALA, relinquishing the proceeding given that it is in the interests of my clients, under the terms of the agreement attached hereto for all corresponding legal effects.

TWO: To formally enter my appearance on record, in the name and representation of OCULUS TECHNOLOGIES OF MEXICO, S.A. DE C.V., and to formally place on record the acceptance of the relinquishment, for the effects established in article 373, section II of the Civil Code of Procedure, supplying deficiency to the Industrial Property Law and under the terms of the exhibited agreement.

Mexico, Federal District, this September 21, 2006.

THANK YOU FOR YOUR CONSIDERATION OF THIS LETTER

(Signed)
MR. SALVADOR CHAVEZ
OSEGUERA
Attorney-in-fact of
MR. JORGE AHUMADA AYALA and
MR. FERNANDO AHUMADA AYALA

(Signed)
PUBLIC ACCOUNTANT: EVERARDO
GARIBAY RAMIREZ
Attorney-in-fact of
OCULUS TECHNOLOGIES OF
MEXICO, S.A. DE C.V.

Exhibit 10.37

CONFIDENTIAL SETTLEMENT AGREEMENT AND GENERAL RELEASE

This Confidential Settlement Agreement and General Release ("AGREEMENT") is entered into by and between KIM KELDERMAN ("KELDERMAN") and OCULUS INNOVATIVE SCIENCES, INC. ("OCULUS" or "DEFENDANT"), (collectively "PARTIES"), and with respect to the investor representations and warrants in paragraph 3 and the provisions of paragraph 18 only, McGuinn, Hllsinan and Paiefsky ("MCGUINN").

RECITALS

This AGREEMENT is made with reference to the following facts:

A. WHEREAS, KELDERMAN filed a Lawsuit against OCULUS that is currently pending in the Sonoma County Superior Court and that is designated as *Kim Kelderman v. Oculus Innovative Sciences, Inc. et al., Case No. SCY 236643* (the "Lawsuit"); and

B. WHEREAS, DEFENDANT denies the validity of KELDERMAN's claims and further denies that it is subject to any liability; and

C. WHEREAS, all wages concededly due to KELDERMAN have been unconditionally paid other than those wages specifically at issue in the Lawsuit; and

D. WHEREAS, the PARTIES wish to settle their differences without resort to further litigation; and

E. WHEREAS, DEFENDANT is willing to provide KELDERMAN with certain considerations described below, which it is not ordinarily required to, provided certain conditions are met.

NOW THEREFORE, in consideration of the mutual covenants and promises contained herein, and other good and valuable consideration, the sufficiency of which are hereby acknowledged by the PARTIES, the PARTIES agree to be legally bound by the following terms and conditions, which constitute full settlement of any and all disputes between them:

1. Recitals: The PARTIES acknowledge that the "WHEREAS" clauses preceding paragraph 1 are true and correct, and are incorporated herein as material parts to this AGREEMENT.

2. Definitions: Throughout this AGREEMENT, the term "DEFENDANT" shall include the following:

   (A) Oculus Innovative Sciences, Inc., MicroMed Laboratories, Inc., as well as any subsidiary, parent company, affiliated entity, related entity, operating entity, franchise, or division of Oculus Innovative Sciences, Inc.; and

(13) Any officer, director, trustee, agent, employee, or insurer of an entity encompassed by subparagraph (A).

3. Settlement Sum: As consideration for signing this AGREEMENT and compliance with the promises made herein, and subject to the waiver by the requisite vote of the shareholders of OCULUS of any right (including right of first refusal and anti-dilution rights) that could be triggered by the issuance of the Warrants (as defined below), DEFENDANT agrees to issue Warrants in the forms attached as Exhibit A-1 and A-2 hereto (the "Warrant") exercisable at $0.75 per share for a total of TWO HUNDRED THOUSAND (200,000) shares of the Common Stock of Oculus (the "Underlying Shares"). One Warrant in the form attached as Exhibit A-1 will be issued to KIM KELDERMAN exercisable at $0.75 per share for ONE HUNDRED THIRTY THREE THOUSAND, THREE HUNDRED AND THIRTY THREE (133,333) Underlying Shares. One Warrant in the form attached as Exhibit A-2 will be issued to McGUINN HILLSMAN & PALEFSKY exercisable at $0.75 per share for SIXTY SIX THOUSAND, SIX HUNDRED AND SIXTY SEVEN (66,667) Underlying Shares. Obtaining shareholder approval for the issuance of these Warrants is a material term and condition of this Agreement. If OCULUS fails to obtain the requisite permission from shareholders to issue the Warrants by November 13, 2006, this Agreement shall be deemed null and void, regardless of whether the Agreement has been executed by the parties.

   DEFENDANT further agrees, in consideration for KELDERMAN's signature to this AGREEMENT and compliance with the promises made herein, to pay to KELDERMAN the total sum of TWO HUNDRED FIFTY THOUSAND DOLLARS and 00/100 CENTS ($250,000.00) in cash if and only if one of the following two conditions is satisfied: (1) Beginning July 1, 2006, OCULUS receives an aggregate $10,000,000 in gross proceeds from fundraising, debt or equity, and whether from one funding event or multiple events, (2) OCULUS successfully completes an Initial Public Offering of its securities. Such sum shall be payable as soon as practicable after the closing of the earlier event to occur, if ever, but no later than 15 calendar days after receipt of the proceeds by OCULUS. The sum will be distributed as follows: One draft will be made payable to "Kim Kelderman" in the amount of ONE HUNDRED AND SIXTY-THREE THOUSAND EIGHTY SIX DOLLARS AND NINETY-ONE CENTS ($163,086.91), and a second draft will be made payable to "Kim Kelderman and the law firm of McGuinn Hillsman & Palefsky" in the amount of EIGHTY-SIX THOUSAND NINE HUNDRED THIRTEEN DOLLARS AND NINE CENTS ($86,913,09).

   KELDERMAN and MCGUINN (each a "HOLDER") each hereby severally represents and warrants to DEFENDANT as follows as of the date hereof, and such representations and warranties shall be true as of the date of issuance and exercise of the Warrant, if ever:

(A) HOLDER is acquiring the Warrant and, upon exercise of the Warrant, the Underlying Shares, for investment for his or its own respective account and not with the view to, or for resale in connection with, any distribution, assignment or resale within the meaning of the Securities Act to others, and no other person has a direct or indirect beneficial interest, in whole or in part, in the Warrant or the Underlying Shares. HOLDER understands that the Warrant and the Underlying Shares have not been registered under the Securities Act by reason of a specific exemption from the registration provisions of the Securities Act which depends upon, among other things, the bona fide nature of the investment intent as expressed herein.

(B) HOLDER has a preexisting business or personal relationship with OCULUS and its officers, directors or controlling persons or, by reason of their business or financial experience has the capacity to protect his or its own interests in connection with HOLDER's acquisition of the Warrant and, upon exercise of the Warrant, the Underlying Shares. HOLDER has such knowledge and experience in financial, tax and business matters to enable HOLDER to utilize the information made available to HOLDER in connection with the Placement, to evaluate the merits and risks of the prospective investment and to make an informed investment decision with respect thereto.

(C) HOLDER acknowledges that the Warrant and the Underlying Shares must be held indefinitely unless subsequently registered under the Securities Act or OCULUS receives an opinion of counsel satisfactory to OCULUS that such registration is not required. HOLDER is aware of the provisions of Rule 144 promulgated under the Securities Act which permit limited resale of securities purchased in a private placement subject to the satisfaction of certain conditions. HOLDER further acknowledges and understands that OCULUS may not be satisfying the current public information requirement of Rule 144 at the time HOLDER wish to sell the Underlying Shares, and, if so, HOLDER would be precluded from selling the Underlying Shares under Rule 144 even if the two year minimum holding period has been satisfied. HOLDER understands that no public market now exists for either of the Warrant held by HOLDER or the Underlying Shares, that there can be no assurance that a public market will ever exist for the Warrant or the Underlying Shares, and OCULUS is under no obligation to register the Warrant or the Underlying Shares. HOLDER further acknowledges that, in the event all of the requirements of Rule 144 are not met, compliance with Regulation A or some other registration exemption will be required; and that, although Rule 144 is not exclusive, the staff of the Commission has expressed its opinion that persons proposing to sell private placement securities other than in a registered offering and other than pursuant to Rule 144 will have a substantial burden of proof in establishing that an exemption from

registration is available. HOLDER understands that there is no assurance that any exemption from registration under the Securities Act will be available, or if available, will allow them to dispose of or otherwise transfer, all or any portion of the Warrant held by HOLDER or the Underlying Shares.

(D) HOLDER understands that its right to transfer his or its Warrant and the Underlying Shares will be subject to restrictions against transfer under the Securities Act and applicable federal and state securities laws (including investor suitability standards). HOLDER understands that legends will be placed on the Warrant and the Underlying Shares with respect to the above restrictions on the assignment, resale or other disposition of the Warrant and Underlying Shares, and that stop transfer instructions have been or will be placed with respect to the Warrant and the Underlying Shares so as to restrict the assignment, resale or other dispositions thereof.

(E) HOLDER is an "accredited investor" (as defined in Rule 501 as promulgated under the Securities Act), which standards are set forth on Exhibit B.

(F) OCULUS agrees that HOLDER's Warrants and/or Underlying Shares shall be treated similarly to other Warrants and/or Shares for purposes of registration in connection with an IPO, and that OCULUS shall not refuse to register HOLDER's Warrants and/or Underlying Shares in a manner inconsistent with how other Warrants and/or Shares are treated.

(G) DEFENDANT shall provide the Warrants identified in this paragraph 3 after it receives an original of this AGREEMENT appropriately signed and dated by KELDERMAN. DEFENDANT will issue the Warrants to KELDERMAN and deliver them no later than (10) ten business days after OCULUS obtains the requisite shareholder approval, subject to the other conditions in this paragraph 3. DEFENDANT will tender the Warrants via U.S. Certified Mail to plaintiff's counsel of record. Upon receipt of the Warrants, KELDERMAN's counsel will forward to DEFENDANT'S counsel a signed Dismissal With Prejudice in the matter of *Kim Kelderman v. Oculus Innovative Sciences, Inc. et al.*, Case No. SCV 236643, currently pending in the Sonoma County Superior Court for the state of California. DEFENDANT'S counsel will file the executed Dismissal for Prejudice with the Superior Court.

4. Consideration: KELDERMAN understands and agrees that he would not receive the monies, Warrants, and/or benefits specified in paragraph 3, above, but for his execution of this AGREEMENT and the fulfillment of the promises contained herein. KELDERMAN further understands, acknowledges and agrees that he has no right, title or interest in or to any securities of OCULUS (including any options granted to KELDERMAN during his employment by OCULUS) or

any right to receive any securities of OCULUS other than the Warrants provided for in this Agreement.

5. Mutual General Release of Claims: In exchange for, and in consideration of the payments, benefits, and other commitments described above, KELDERMAN agrees to secure the dismissal of his Lawsuit filed against DEFENDANT (and any other claims or assertions of liability that may exist). In addition, KELDERMAN and DEFENDANT, their heirs, executors, administrators, and assigns, hereby fully and mutually release, acquit, and forever discharge the other's heirs, executors, administrators, predecessors, successors and assigns, parent corporations, subsidiary corporations, affiliated corporations, and the officers, directors, shareholders, partners, employees, attorneys and agents, past and present, of each of the aforesaid entities ("Related Persons") of and from any and all claims, liabilities, causes of action, demands to any rights, damages, costs, attorneys' fees, expenses, and compensation whatsoever, of whatever kind or nature, in law, equity or otherwise, whether known or unknown, vested or contingent, suspected or unsuspected, that the PARTIES may now have, has ever had, or hereafter may have relating directly or indirectly to the allegations in the Lawsuit, including, but not limited to, claims for wages, which as set forth in "WHEREAS" clause "C" preceding paragraph 1 of this AGREEMENT have been fully paid to KELDERMAN prior to the execution of this AGREEMENT, or are fully paid by way of paragraph 3 of this AGREEMENT; options; back pay; front pay; reinstatement; damages; or benefits.

   KELDERMAN also releases any and all claims he may have that arose prior to the date of this AGREEMENT, and hereby specifically waives and releases all claims, including, but not limited to, those arising under the California Fair Employment and Housing Act; the California Labor Code; the Title VII of the Civil Rights Act of 1964, as amended, the Civil Rights Act of 1991; the Equal Pay Act; the Americans with Disabilities Act of 1990; the Rehabilitation Act of 1973, as amended; the Immigration Reform and Control Act, as amended; the Workers Adjustment and Retraining Notification Act, as amended; the Occupational Safety and Health Act, as amended; the Sarbanes-Oxley Act of 2002; the Consolidated Omnibus Budget Reconciliation Act (COBRA); the Family and Medical Leave Act; the California Family Rights Act; the Employee Retirement Income Security Act of 1974, as amended; the National Labor Relations Act; the Fair Labor Standards Act; and any and all state or local statutes, ordinances, or regulations, as well as all claims arising under federal, state, or local law involving any tort, employment contract (express or implied), public policy, wrongful discharge, or any other claim.

   This AGREEMENT shall not apply to rights or claims that may arise after the Effective Date of this AGREEMENT; nor shall any provision of this AGREEMENT be interpreted to waive, release, or extinguish any rights that — by express and unequivocal terms of law — may not under any circumstances be waived, released, or extinguished.

6. Tax Liability: KELDERMAN understands that DEFENDANT shall issue an IRS Form W-2 to KELDERMAN and IRS Form 1099 to KELDERMAN's Counsel of Record for DEFENDANT'S payments to KELDERMAN and his attorney as set forth in Paragraph 3. In providing the benefits or issuing the Warrants specified in paragraph 3, DEFENDANT makes no representation regarding the tax consequences or liability arising from said provision. KELDERMAN understands and agrees that any and all tax liability that may be due or become due because of the payment referenced above is his sole responsibility, and that he will pay any such taxes that may be due or become due. DEFENDANT has no monetary liability or obligation regarding any payments whatsoever (other than delivering valid compensation in the sum referenced in paragraph 3 of this AGREEMENT to KELDERMAN). KELDERMAN and his Counsel of Record agree to bear all tax consequences, if any, attendant upon the respective payments to them of the above-recited sums.

7. Affirmations: KELDERMAN represents and affirms that, other than his Lawsuit referenced herein against DEFENDANT, he has no suits, claims, charges, complaints or demands of any kind whatsoever currently pending against DEFENDANT with any local, state, or federal court or any governmental, administrative, investigative, civil rights or other agency or board. KELDERMAN further represents and affirms that he has been paid and/or received. All leave (paid or unpaid), compensation, wages, bonuses, commissions, and/or benefits to which he may be entitled and that no other leave (paid or unpaid), compensation, wages, bonuses, commissions, and/or benefits are due him, except as provided for in this AGREEMENT.

8. No Further Employment: KELDERMAN acknowledges that he was no longer employed with OCULUS INNOVATIVE SCIENCES, INC. as of January 2005. KELDERMAN permanently, unequivocally, and unconditionally waives any and all rights KELDERMAN may now have, may have had in the past, or may have in the future to obtain or resume employment with DEFENDANT. KELDERMAN agrees never to apply for employment with DEFENDANT, their parent, successors, affiliates, and subsidiaries. In the event that KELDERMAN is ever mistakenly employed by DEFENDANT, their parent, successors, affiliates, and/or subsidiaries, KELDERMAN agrees to have his employment terminated with no resulting claim or cause of action against DEFENDANT, their parent, successors, affiliates, and/or subsidiaries.

9. No Assignment: The PARTIES represent and warrant that no person other than the signatories hereto had or has any interest in the matters referred to in this AGREEMENT, that the PARTIES have the sole right and exclusive authority to execute this AGREEMENT, and that the PARTIES have not sold, assigned, transferred, conveyed, or otherwise disposed of any claim, demand or legal right that is the subject of this AGREEMENT.

Plaintiff further agrees that he is solely responsible for satisfaction of all liens, legal, medical, tax or otherwise, which may have arisen allegedly as a result of Plaintiff's employment with OCULUS INNOVATIVE SCIENCES, INC. or Plaintiffs lawsuit against DEFENDANT.

10. Confidentiality: In consideration of the obligations under this AGREEMENT, the PARTIES agree that this AGREEMENT and the terms and conditions hereof, are strictly, and shall forever remain, confidential, and that neither the PARTIES nor their respective heirs, agents, executors, administrators, attorneys, legal representatives or assigns shall disclose or disseminate, directly or indirectly, any information concerning any, such terms to any third person(s), including, but not limited to, representatives of the media or other present or former associates of OCULUS INNOVATIVE SCIENCES, INC., under any circumstances, except the PARTIES may disclose the terms of this AGREEMENT to their respective spouses, attorneys, accountants, tax advisors, the Internal Revenue Service, or as otherwise required by law ("Third Parties"), provided, however, that the Third PARTIES to whom such disclosure is made shall agree in advance to be bound by the terms of this paragraph 10 and all of its subparts.

    (A) If one of the PARTIES is required to disclose this AGREEMENT or its terms pursuant to court order and/or subpoena, the disclosing party shall notify the other, in writing via facsimile or overnight mail, within 24 hours of him receipt of such court order or subpoena, and simultaneously provide the non-disclosing party with a copy of such court order or subpoena. The notice shall comply with the notice requirements set forth below in paragraph 20. The disclosing party agrees to waive any objection to the non-disclosing party's request that the document production or testimony be done *in camera* and under seal.

    (B) The PARTIES acknowledge that a violation of paragraph 10 or any of its subparts would cause immeasurable and irreparable damage to DEFENDANT in an amount incapable of precise determination. Accordingly, the PARTIES agree that the non-breaching party shall be entitled to injunctive relief in any court of competent jurisdiction for any actual or threatened violation of paragraph 10 and all of its subparts, in addition to any other available remedies.

    (C) The PARTIES agree that the terms of paragraph 10 and all of its subparts are a material inducement for the execution of this AGREEMENT. Any disclosure or dissemination, other than as described above in paragraph 10 and 10(A) will be regarded as a breach of this AGREEMENT and a cause of action shall immediately accrue for damages and injunctive relief upon verifiable proof that the breaching party directed the prohibited disclosure and such disclosure has indeed occurred. The PARTIES agree that damages sustained by such breach would be impractical or extremely difficult to determine and, therefore, agree that in the event that the

PARTIES or any of the individuals identified in paragraph-10(A), violate this paragraph 10 or any of its subparts, the breaching party shall pay the non breaching party liquidated damages in the sum of THREE THOUSAND DOLLARS AND 00/100 CENTS ($3,000.00) for each violation upon verifiable proof that the breaching party has violated paragraph 10 and its subparts and a prohibited disclosure in fact occurred. The PARTIES further agree that such damages are not intended to be, and shall not be construed as, a penalty.

11. Non-Disparagement: The PARTIES agree that none of them will provide information, issue statements, or take any action, directly or indirectly, that would cause the other to suffer embarrassment or humiliation or otherwise cause or contribute to the other being held in disrepute. This provision specifically excludes any information that the PARTIES are required to disclose in any pending or future litigation against OCULUS INNOVATIVE SCIENCES, INC., or its agents, employees, subsidiaries, divisions, parent companies, affiliated entities, related entities, operating entities, franchises.

12. Governing Law and Jurisdiction: This AGREEMENT shall be governed and conformed in accordance with the laws of the state in which KELDERMAN was employed at the time of his last day of employment with DEFENDANT without regard to its conflict of laws provision. In the event KELDERMAN or DEFENDANT breach any provision of this AGREEMENT, the PARTIES affirm that either of them may institute an action to specifically enforce any term or terms of this AGREEMENT.

13. Conditions: Should KELDERMAN or DEFENDANT ever breach any provision or obligation under this AGREEMENT, the breaching party explicitly agrees to pay all damages (including, but not limited to, litigation and/or defense costs, expenses, and reasonable attorneys' fees) incurred by the non-breaching party as a result of the other's breach. Nothing in this paragraph shall, or is intended to, limit or restrict any other rights or remedies the PARTIES may have by virtue of this AGREEMENT or otherwise.

14. No Admission of Liability: The PARTIES agree that neither this AGREEMENT nor the furnishing of the consideration for this AGREEMENT shall be deemed or construed at any time for any purpose as an admission by DEFENDANT of any liability or unlawful conduct of any kind.

15. Headings: The headings of the provisions herein are intended for convenient reference only, and the same shall not be, nor be deemed to be, interpretative of the contents of such provision.

16. Modification of Agreement: This AGREEMENT may not be amended, revoked, changed, or modified in any way, except in writing executed by all PARTIES. KELDERMAN agrees not to make any claim at any time or place that

this AGREEMENT has been verbally modified in any respect whatsoever. No waiver of any provision of this AGREEMENT will be valid unless it is in a writing and signed by the party against whom such waiver is charged. The PARTIES acknowledge that only the assigned legal counsel of DEFENDANT has the authority to modify this AGREEMENT on behalf of DEFENDANT.

17. Interpretation: The language of all parts of this AGREEMENT shall in all cases be construed as a whole, according to its fair meaning, and not strictly for or against any of the PARTIES. This AGREEMENT has been negotiated by and between attorneys for the PARTIES and shall not be construed against the drafter of the AGREEMENT. If any portion or provision of this AGREEMENT (including, without implication of limitation, any portion or provision of any section of this AGREEMENT) is determined to be illegal, invalid, or unenforceable by any court of competent jurisdiction and cannot be modified to be legal, valid, or enforceable, the remainder of this AGREEMENT shall not be affected by such determination and shall be valid and enforceable to the fullest extent permitted by law, and said illegal, invalid, or unenforceable portion or provision shall be deemed not to be a part of this AGREEMENT. To the extent that the dismissal of KELDERMAN'S Lawsuit or the general release of claims described in paragraph 5 above is deemed to be illegal, invalid, or unenforceable, DEFENDANT is not obligated to honor any of the terms set forth herein and KELDERMAN and MCGUINN shall return any Warrant and Underlying Shares issued and all amounts paid by DEFENDANT.

18. Binding Nature of Agreement: This AGREEMENT shall be binding upon each of the PARTIES and upon their respective heirs, administrators, representatives, executors, successors, and assigns, and shall inure to the benefit of each party and to their respective heirs, administrators, representatives, executors, successors, and assigns.

19. Entire Agreement: This AGREEMENT sets forth the entire AGREEMENT between the PARTIES hereto, and fully supersedes any prior obligation of DEFENDANT to KELDERMAN. KELDERMAN acknowledges that he has not relied on any representations, promises, or agreements of any kind made to him in connection with his decision to accept this AGREEMENT, except for those set forth in this AGREEMENT.

20. Notice Requirements: Each notice ("Notice") provided for under this AGREEMENT, must comply with the requirements as set forth in this paragraph. Each Notice shall be in writing and sent by facsimile or depositing it with a nationally recognized overnight courier service that obtains receipts (such as Federal Express or UPS Next Day Air), addressed to the appropriate party (and marked to a particular individual's attention, if so indicated) as hereinafter provided. Each Notice shall be effective upon being so telecopied or deposited, but the time period in which a response to any notice must be given or any action taken with respect thereto shall commence to run from the date of receipt of the

Notice by the addressee thereof, as evidenced by the return receipt. Rejection or other refusal by the addressee to accept or the inability to deliver because of a changed address of which no Notice was given shall be deemed to be the receipt of the Notice sent. Any party shall have the right from time to time to change the address or individual's attention to which notices to it shall be sent by giving to the other party at least ten (10) days prior Notice thereof. The PARTIES' addresses for providing Notices hereunder shall be as follows:

Oculus Innovative Sciences, Inc.
c/o Robert K. Phillips, Esq.
Phillips, Spallas & Angstadt LLP
650 California Street, 10th Floor
San Francisco, CA 94108
(415) 278-9400(tel)
(415) 278-9411(fax)

Mr. Kim Kelderman c/o
Cliff Palefsky, Esq.
McGuinn Hilisman & Palefsky
535 Pacific Avenue
San Francisco, CA 94133
(415) 421-9292(tel)
(415) 403-0202(fax)

21. Selective Enforcement: The PARTIES agree that the failure of any party to enforce or exercise any right, condition, term, or provision of this AGREEMENT shall not be construed as or deemed a relinquishment or waiver thereof, and the same shall continue in full force and effect.

22. Signatures in Counterparts: This AGREEMENT may be executed in counterparts, and each counterpart, when executed, shall have the efficacy of a signed original. Such counterparts shall together constitute one and the same document. The PARTIES agree that facsimile signatures shall be treated as original signatures.

23. Compliance with California Civil Code: KELDERMAN agrees that this AGREEMENT will cover all claims of every nature and kind whatsoever, which KELDERMAN may have, known, or unknown, suspected or unsuspected, past or

present, which he may have against DEFENDANT, despite the fact that California Civil Code Section 1542 ("Section 1542") may provide otherwise. KELDERMAN expressly waives any right or benefit available to him in any capacity under the provisions of Section 1542, which provides: "A general release does not extend to the claims which the creditor does not know or suspect to exist in his favor at the time of executing the release, which if known by him must have materially affected his settlement with debtor."

HAVING ELECTED TO EXECUTE THIS AGREEMENT, TO FULFILL THE PROMISES AND TO RECEIVE THE SUMS AND BENEFITS IN PARAGRAPH 3 ABOVE PROVIDED THE CONDITIONS DESCRIBED THEREIN ARE SATISFIED, KELDERMAN FREELY AND KNOWINGLY, AND AFTER DUE CONSIDERATION, ENTERS INTO THIS AGREEMENT INTENDING TO WAIVE, SETTLE, AND RELEASE ALL CLAIMS HE HAS OR OUGHT HAVE AGAINST DEFENDANT.

I ACCEPT AND AGREE TO THE ENTIRE AGREEMENT SET FORTH ABOVE:

By: /s/ Kim Kelderman — 2006-10-25

KIM KELDERMAN — Date

OCULUS INNOVATIVE SCIENCES, INC.

By: /s/ Jim Schutz — 10/7/06

Print Name: Jim Schutz — Date

Print Title: Gen. Counsel

on behalf of OCULUS INNOVATIVE SCIENCES, INC
and MICROMED LABORATORIES, INC. AND THE OTHER
PERSONS NAMED HEREIN

With respect to the investor representations and warrants in paragraph 3 and the previous of paragraph 18 only:

McGUINN, HILLSMAN & PALEFSKY

By: /s/ Cliff Palefsky — 10/25/06

Print Name: Cliff Palefsky — Date

Print Title: VP

Approved as to from:

By: /s/ Cliff Palefsky — 10/25/06

Cliff Palefsky — Date
Attorney of record, for plaintiff

By: _____ — _____

Robert K. Phillips — Date
Attorney of record for defendant

EXHIBIT A-1

WARRANT

THIS WARRANT AND THE UNDERLYING SECURITIES HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"). THEY MAY NOT BE SOLD, OFFERED FOR SALE, PLEDGED OR HYPOTHECATED IN THE ABSENCE OF AN EFFECTIVE REGISTRATION STATEMENT AS TO SUCH SECURITIES UNDER THE ACT OR AN OPINION OF COUNSEL SATISFACTORY TO THE COMPANY THAT SUCH REGISTRATION IS NOT REQUIRED.

Oculus Innovative Sciences, Inc.
WARRANT TO PURCHASE COMMON STOCK

No._____ _____, 2006

Void AFTER _____ , 2008

This CERTIFIES THAT, for value received, Kim Kelderman, or his designee if and as permitted in this Warrant (the "Holder"), is entitled to subscribe for. and purchase at the Exercise Price (defined below) from OCULUS INNOVATIVE SCIENCES, INC., a California corporation, with its principal office at 1129 N. McDowell Blvd., Petaluma, CA 94954 (the "Company") One Hundred Thirty-Three Thousand Three Hundred Thirty-Three (133,333) shares of the Common Stock of the Company (the "Common Stock").

1. DEFINITIONS. As used herein, the following terms shall have the following respective meanings:

(a) "Exercise Period" shall mean the period commencing with the date 'of the execution of this Agreement and ending on November -, 2008, unless sooner terminated as provided below.

(b) "Exercise Price" shall mean $0.75 per share, subject to adjustment pursuant to Section 5 below.

(c) "Exercise Shares" shall mean the shares of the Company's Common Stock issuable upon exercise of this Warrant, subject to adjustment pursuant to the terms herein, including but not limited to adjustment pursuant to Section 5 below.

2. EXERCISE OF WARRANT. The rights represented by this Warrant may be exercised in whole or in part at any time during the Exercise Period, by delivery of the following to the Company at its address set forth above (or at such other address as it may designate by notice in writing to the Holder):

(a) An executed Notice of Exercise in the form attached hereto;

(b) Payment of the Exercise Price either (i) in cash or by check, or (ii) by cancellation of indebtedness; and

(c) This Warrant.

Upon the exercise of the rights represented by this Warrant, a certificate or certificates for the Exercise Shares so purchased, registered in the name of the Holder, if the Holder so designates, shall be issued and delivered to the Holder within a reasonable time after the rights represented by this Warrant shall have been so exercised.

The person in whose name any certificate or certificates for Exercise Shares are to be issued upon exercise of this Warrant shall be deemed to have become the holder of record of such shares on the date on which this Warrant was surrendered and payment of the Exercise Price was made, irrespective of the date of delivery of such certificate or certificates, except that, if the date of such surrender and payment is a date when the stock transfer books of the Company are closed, such person shall be deemed to have become the holder of such shares at the close of business on the next succeeding date on which the stock transfer books are open.

3. COVENANTS OT m COMPANY.

(a) Covenants as to Exercise Shares. The Company covenants and agrees that all Exercise Shares that may be issued upon the exercise of the rights represented by this Warrant will, upon issuance, be validly issued and outstanding, fully paid and nonassessable, and free from all taxes, liens and charges with respect to the issuance thereof. The Company further covenants and agrees that the Company will at all times during the Exercise Period, have authorized and reserved a sufficient number of shares of its Common Stock to provide for the exercise of the rights represented by this Warrant. If at any time during the Exercise Period the number of authorized but unissued shares of Common Stock shall not be sufficient to permit exercise of this Warrant, the Company will take such corporate action as may, in the opinion of its counsel, be necessary to increase its authorized but unissued shares of Common Stock to such number of shares as shall be sufficient for such purposes.

(b) No Impairment. Except ‘and to the extent as waived or consented to by the Holder, the Company will not, by amendment of its Articles of Incorporation or through any reorganization, transfer of assets, consolidation, merger, dissolution, issue or sale of securities or any other voluntary action, avoid or seek to avoid the observance or performance of any of the terms to be observed or performed hereunder by the Company, but will at all times in good faith assist in the carrying out of all the provisions of this Warrant and in the taking of all such action as may be necessary or appropriate in order to protect the exercise rights of the Holder against impairment.

4. REPRESENTATIONS OF HOLDER.

(a) Acquisition of Warrant for Personal Account. The Holder represents and warrants that it is acquiring the Warrant and the Exercise Shares solely for its account for investment and not with a view to or for sale or distribution of said Warrant or Exercise Shares or any part thereof. The Holder also represents that the entire legal and beneficial interests of the

Warrant and Exercise Shares the Holder is acquiring is being acquired for, and will be held for, its account only.

(b) Securities Are Not Registered.

(i) The Holder understands that the Warrant and the Exercise Shares have not been registered under the Act on the basis that no distribution or public offering of the stock of the Company is to be effected. The Holder realizes that the basis for the exemption may not be present if, notwithstanding its representations, the Holder has a present intention of acquiring the securities for a fixed or determinable period in the future, selling (in connection with a distribution or otherwise), granting any participation in, or otherwise distributing the securities. The Holder has no such present intention.

(ii) The Holder recognizes that the Warrant and the Exercise Shares must be held indefinitely unless they are subsequently registered under the Act or an exemption from such registration is available. The Holder recognizes that the Company has no obligation to register the Warrant, or the Exercise Shares of the Company, or to comply with any exemption from such registration.

(iii) The Holder is aware that neither the Warrant nor the Exercise Shares may be sold pursuant to Rule 144 adopted under the Act unless certain conditions are met, including, among other things, the existence of a public market for the shares, the availability of certain current public information about the Company, the resale following the required holding period under Rule 144 and the number of shares being sold during, any three month period not exceeding specified limitations. Holder is aware that the conditions for resale set forth in Rule 144 have not been satisfied and that the Company may not presently have any plans to satisfy these conditions in the foreseeable future.

(c) Disposition of Warrant and Exercise Shares.

(i) The Holder further agrees not to make any disposition of all or any part of the Warrant or Exercise Shares in any event unless and until:

(A) The Company shall have received a letter secured by the Holder from the Securities and Exchange Commission stating that no action will be recommended to the Commission with respect to the proposed disposition;

(B) There is then in effect a registration statement under the Act covering such proposed disposition and such disposition is made in accordance with said registration statement and applicable securities laws;

(C) The Holder shall have notified the Company of the proposed disposition and shall have furnished the Company with a detailed statement of the circumstances surrounding the proposed disposition, and if reasonably requested by the Company, the Holder shall have furnished the Company with an opinion of counsel, reasonably satisfactory to the Company, for the Holder to the effect that such disposition will not require registration of such Warrant or Exercise Shares under the Act or any applicable state securities laws; or

(D) The Warrant may not be exercised if the issuance of the Exercise Shares upon such exercise would constitute a violation of any applicable federal or state securities law or the laws or regulations or would not be exempt from federal securities law registration and qualification under applicable state law. As a condition to the exercise of the Warrant, the Company may require Holder to make such representations and warranties to the Company as may be required by applicable law or regulation.

(ii) The Holder understands and agrees that all certificates evidencing the shares to be issued to the Holder may bear the following legend:

THESE SECURITIES HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"). THEY MAY NOT BE SOLD, OFFERED FOR SALE, PLEDGED OR HYPOTHECATED IN THE ABSENCE OF AN EFFECTIVE REGISTRATION STATEMENT OR AN OPINION OF COUNSEL SATISFACTORY TO THE COMPANY THAT SUCH REGISTRATION IS NOT REQUIRED.

5. ADJUSTMENT OF EXERCISE PRICE. In the event of changes in the outstanding Common Stock of the Company by reason of stock dividends, split-ups, recapitalizations, reclassifications, combinations or exchanges of shares, separations, reorganizations, liquidations, or the like, the number and class of shares available under the Warrant in the aggregate and the Exercise Price shall be correspondingly adjusted to give the Holder of the Warrant, on exercise for the same aggregate Exercise Price, the total number, class, and kind of shares as the Holder would have owned had the Warrant been exercised • prior to the event and. had the Holder continued to hold such shares until after the event requiring adjustment; provided, however, that such adjustment shall not be made with respect to, and this Warrant shall terminate if not exercised prior to, the events set forth in Section 7 below. The form of this Warrant need not be changed because of any adjustment in the number of Exercise Shares subject to this Warrant.

6. FRACTIONAL SHARES. No fractional shares shall be issued upon the exercise of this Warrant as a consequence of any adjustment pursuant hereto. All Exercise Shares (including fractions) issuable upon exercise of this Warrant may be aggregated for purposes of determining whether the exercise would result in the issuance of any fractional share. If, after aggregation, the exercise would result in the issuance of a fractional share, the Company shall, in lieu of issuance of any fractional share, pay the Holder otherwise entitled to such fraction a sum in cash equal to the product resulting from multiplying the then current fair market value of an Exercise Share by such fraction.

7. MARKET STAND-OFF AGREEMENT. Holder shall not sell, dispose of, transfer, make any short sale of, grant any option for the purchase of or enter into any hedging or similar transaction with the same economic effect as a sale, any Common Stock (or other securities) of the Company held by Holder, for a period. of time specified by the managing underwriter(s) not to exceed one hundred eighty (180) days following the effective date of a registration statement of the Company filed under the Act. Holder agrees to execute and deliver such other agreements as may be reasonably requested by the Company and/or the managing underwriter(s) which are consistent with the foregoing or which are necessary to give further effect thereto. In order to

enforce the foregoing covenant, the Company may impose stop-transfer instructions with respect to such Common Stock (or other securities) until the end of such period. The underwriters of the Company's stock are intended third party beneficiaries of this Section 8 and shall have the right, power and authority to enforce the provisions hereof as though they were a party hereto.

8. No STOCKHOLDER RIGHTS. This Warrant in and of itself shall not entitle the Holder to any voting rights or other rights as a stockholder of the Company.

9. No TRANSFER OF WARRANT. This Warrant may not be transferred, assigned, pledged or hypothecated without the prior written consent of the Company, and any purported transfer, assignment, pledge or hypothecation in contravention of this Section 1.0 shall be of no force or effect.

10. LOST, STOLEN, MUTILATED OR DESTROYED WARRANT. If this Warrant is lost, stolen, mutilated or destroyed, the Company may, on such terms as to indemnity or otherwise as it may reasonably impose (which shall, in the case of a mutilated Warrant, include the surrender thereof), issue a new Warrant of like denomination and tenor as the Warrant so lost, stolen, mutilated or destroyed. Any such new Warrant shall constitute an original contractual obligation of the Company, whether or not the allegedly lost, stolen, mutilated or destroyed Warrant shall be at any time enforceable by anyone.

11. NOTICES, ETC. All notices required or permitted hereunder shall be in writing and shall be deemed effectively given: (a) upon personal delivery to the party to be notified, (b) when sent by confirmed telex or facsimile if sent during normal business hours of the recipient, if not, then on the next business day, (c) five (5) days after having been sent by registered or certified mail, return receipt requested, postage prepaid, or (d) one (1) day after deposit with a nationally recognized overnight courier, specifying next day delivery, with written verification of receipt. All communications shall be sent to the Company at the address listed on the signature page and to Holder at 1129 N. McDowell Blvd., Petaluma, California 94954 or at such other address as the Company or Holder may designate by ten (10) days advance written notice to the other PARTIES hereto.

12. ACCEPTANCE. * Receipt of this Warrant by the Holder shall constitute acceptance of and agreement to all of the terms and conditions contained herein.

13. GOVERNING LAW. This Warrant and all rights, obligations and liabilities hereunder shall be governed by the laws of the State of California.

IN WITNESS WHEREOF, the Company has caused this Warrant to be executed by its duly authorized officer as of _____, 2006.

OCULUS INNOVATIVE SCIENCES, INC.

By: _____

Hoji Alimi

President and. CEO

ACKNOWLEDGED AND AGREED:

_____

Kim Kelderman

NOTICE OF EXERCISE

TO: OCULUS INNOVATIVE SCIENCES, INC.

(1) The undersigned hereby elects to purchase _____shares of Common Stock of OCULUS INNOVATIVE SCIENCES, INC. (the "Company") pursuant to the terms of the attached Warrant, and tenders herewith payment of the exercise price in full, together with all applicable transfer taxes, if any.

(2) Please issue a certificate or certificates representing said shares of Common Stock in the name of the undersigned or in such other name as is specified below:

_____

(Name)

_____

_____

(Address)

(3) The undersigned represents that (i) he is an accredited investor, as defend in Regulation D promulgated under the Securities Act of 1933, as amended; (ii) the aforesaid shares of Common Stock are being acquired for the account of the undersigned for investment and not with a view to, or for resale in connection with, the distribution thereof and that the undersigned has no present intention of distributing or reselling such shares; (iii) the undersigned is aware of the Company's business affairs and financial condition and has acquired sufficient information about the Company to reach an informed and knowledgeable decision regarding its investment in the Company; (iv) the undersigned is experienced in making investments of this type and has such knowledge and background in financial and business matters that the undersigned is capable of evaluating the merits and risks of this investment and protecting the undersigned's own interests; (v) the undersigned understands that the shares of Common Stock issuable upon exercise of this Warrant have not been registered under the Securities Act of 1933, as amended (the "Securities Act"), by reason of a specific exemption from the registration provisions of the Securities Act, which exemption depends upon, among other things, the bona fide nature of the investment intent as expressed herein, and, because such securities have not been registered under the Securities Act, they must be held indefinitely unless subsequently registered under the Securities Act or an exemption from such registration is available; (vi) the undersigned is aware that the aforesaid shares of Series A Preferred Stock may not be sold pursuant to Rule 144 adopted under the Securities Act unless certain conditions are met and until the undersigned has held the shares for the number of years prescribed by Rule 144, that among the conditions for use of the Rule is the availability of current information to the public about the Company and the Company has not made such information available and has no present plans to do so; and (vii) the undersigned agrees not to make any disposition of all or any part of the aforesaid shares of Common Stock unless and until there is then in effect a registration statement

under the Securities Act covering such proposed disposition and such disposition is made in accordance with said registration statement, or the undersigned has provided the Company with an opinion of counsel satisfactory to the Company, stating that such registration is not required.

(Date)	(Signature)
	(Print name)

EXHIBIT A-2

Warrant

THIS WARRANT AND THE UNDERLYING SECURITIES HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"). THEY MAY NOT BE SOLD, OFFERED FOR SALE, PLEDGED OR HYPOTHECATED IN THE ABSENCE OF AN EFFECTIVE REGISTRATION STATEMENT AS TO SUCH SECURITIES UNDER THE ACT OR AN OPINION OF COUNSEL SATISFACTORY TO THE COMPANY THAT SUCH REGISTRATION IS NOT REQUIRED.

Oculus Innovative Sciences, Inc.
WARRANT TO PURCHASE COMMON STOCK

No. _____ _____ , 2006

VOID AFTER _____, 2008

This Certifies That, for value received, McGuinn, Hillsman and Palefsky, or its designee if and as permitted in this Warrant (the "Holder"), is entitled to subscribe for and purchase at the Exercise Price (defined below) from Oculus Innovative Sciences, Inc., a California corporation, with its principal office at 1129 N. McDowell Blvd., Petaluma, CA 94954 (the "Company"). Sixty-Six Thousand Six Hundred Sixty-Seven (66,667) shares of the Common Stock of the Company (the "Common Stock").

1. Definitions. As used herein, the following terms shall have the following respective meanings:

(a) "Exercise Period" shall mean the period commencing with the date of the execution of this Agreement and ending on November ___, 2008, unless sooner - -terminated as provided below.

(b) "Exercise Price" shall mean $0.75 per share, subject to adjustment pursuant to Section 5 below.

(c) "Exercise Shares" shall mean the shares of the Company's Common Stock issuable upon exercise of this Warrant, subject to adjustment pursuant to the terms herein, including but not limited to adjustment pursuant to Section 5 below.

2. Exercise of Warrant. The rights represented by this Warrant may be exercised in whole or in part at any time during the Exercise Period, by delivery of the following to the Company at its address set forth above (or at such other address as it may designate by notice in writing to the Holder):

(a) An executed Notice of Exercise in the form attached hereto;

(b) Payment of the Exercise Price either (i) in cash or by check, or (ii) by cancellation of indebtedness; and

(c) This Warrant.

Upon the exercise of the rights represented by this Warrant, a certificate or certificates for the Exercise Shares so purchased, registered in the name of the Holder, if the Holder so designates, shall be issued and delivered to the Holder within a reasonable time after the rights represented by this Warrant shall have been so exercised.

The person in whose name any certificate or certificates for Exercise Shares are to be issued upon exercise of this Warrant shall be deemed to have become the holder of record of such shares on the date on which this Warrant was surrendered and payment of the Exercise Price was made, irrespective of the date of delivery of such certificate or certificates, except that, if the date of such surrender and payment is a date when the stock transfer books of the Company are closed, such person shall be deemed to have become the holder of such shares at the close of business on the next succeeding date on which the stock transfer books are open.

3. Covenants of the Company.

(a) Covenants as to Exercise Shares. The Company covenants and agrees that all Exercise Shares that may be issued upon the exercise of the rights represented by this Warrant will, upon issuance, be validly issued and outstanding, fully paid and nonassessable, and free from all taxes, liens and charges with respect to the issuance thereof. The Company further covenants and agrees that the Company will at all times during the Exercise Period, have authorized and reserved a sufficient number of shares of its Common Stock to provide for the exercise of the rights represented by this Warrant. If at any time during the Exercise Period the number of authorized but unissued shares of Common Stock shall not be sufficient to permit exercise of this Warrant, the Company will take such corporate action as may, in the opinion of its counsel, be necessary to increase its authorized but unissued shares of Common Stock to such number of shares as shall be sufficient for such purposes.

(b) No Impairment. Except and to the extent as waived or consented to by the Holder, the Company will not, by amendment of its Articles of Incorporation or through any reorganization, transfer of assets, consolidation, merger, dissolution, issue or sale of securities or any other voluntary action, avoid or seek to avoid the observance or performance of any of the terms to be observed or performed hereunder-by the Company, but will at all times in good faith assist in the carrying out of all the provisions of this Warrant and in the taking of all such action as may be necessary or appropriate in order to protect the exercise rights of the Holder against impairment.

4. Representations of Holder.

(a) Acquisition of Warrant for Personal Account. The Holder represents and warrants that it is acquiring the Warrant and the Exercise Shares solely for its account for investment and not with a view to or for sale or distribution of said Warrant or Exercise Shares or any part thereof. The Holder also represents that the entire legal and beneficial interests of the

Warrant and Exercise Shares the Holder is acquiring is being acquired for, and will be held for, its account only.

(b) Securities are Not Registered.

(i) The Holder understands that the Warrant and the Exercise Shares have not been registered under the Act on the basis that no distribution or public offering of the stock of the Company is to be effected. The Holder realizes that the basis for the exemption may not be present if, notwithstanding its representations, the Holder has a present intention of acquiring the securities for a fixed or determinable period in the future, selling (in connection with a distribution or otherwise), granting any participation in, or otherwise distributing the securities. The Holder has no such present intention.

(ii) The Holder recognizes that the Warrant and the Exercise Shares must be held indefinitely unless they are subsequently registered under the Act or an exemption from such registration is available. The Holder recognizes that the Company has no obligation to register the Warrant or the Exercise Shares of the Company, or to comply with any exemption from such registration.

(iii) The Holder is aware that neither the Warrant nor the Exercise Shares may be sold pursuant to Rule 144 adopted under the Act unless certain conditions are met, including, among other things, the existence of a public market for the shares, the availability of certain current public information about the Company, the resale following the required holding period under Rule 144 and the number of shares being sold during any three month period not exceeding specified limitations. Holder is aware that the conditions for resale set forth in Rule 144 have not been satisfied and that the Company may not presently have any plans to satisfy these conditions in the foreseeable future.

(c) Disposition of Warrant and Exercise Shares.

(i) The Holder further agrees not to make any disposition of all or any part of the Warrant or Exercise Shares in any event unless and until:

(A) The Company shall have received a letter secured by the Holder from the Securities and Exchange Commission stating that no action will be recommended to the Commission with respect to the proposed disposition;

(B) There is then in effect a registration statement under the Act covering such proposed disposition and such disposition is made in accordance with said registration statement and applicable securities laws;

(C) The Holder shall have notified the Company of the proposed disposition and shall have furnished the Company with a detailed statement of the circumstances surrounding the proposed disposition, and if reasonably requested by the Company, the Holder shall have furnished the Company with an opinion of counsel, reasonably satisfactory to the Company, for the Holder to the effect that such disposition will not require registration of such Warrant or Exercise Shares under the Act or any applicable state securities laws; or

(D) The Warrant may not be exercised if the issuance of the Exercise Shares upon such exercise would constitute a violation of any applicable federal or state securities law or the laws or regulations or would not be exempt from federal securities law registration and qualification under applicable state law. As a condition to the exercise of the Warrant, the Company may require Holder to make such representations and warranties to the Company as may be required by applicable law or regulation.

(ii) The Holder understands and agrees that all certificates evidencing the shares to be issued to the Holder may bear the following legend:

THESE SECURITIES HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"). THEY MAY NOT BE SOLD, OFFERED FOR SALE, PLEDGED OR HYPOTHECATED IN THE ABSENCE OF AN EFFECTIVE REGISTRATION STATEMENT OR AN OPINION OF COUNSEL SATISFACTORY TO THE COMPANY THAT SUCH REGISTRATION IS NOT REQUIRED.

5. ADJUSTMENT OF EXERCISE PRICE. In the event of changes in the outstanding Common Stock of the Company by reason of stock dividends, split-ups, recapitalizations, reclassifications, combinations or exchanges of shares, separations, reorganizations, liquidations, or the like, the number and class of shares available under the Warrant in the aggregate and the Exercise Price shall be correspondingly adjusted to give the Holder of the Warrant, on exercise for the same aggregate Exercise Price, the total number, class, and kind of shares as the Holder would have owned had the Warrant been exercised prior to the event and had the Holder continued to hold such shares until after the event requiring adjustment; provided, however, that such adjustment shall not be made with respect to, and this Warrant shall terminate if not exercised prior to, the events set forth in Section 7 below. The form of this Warrant need not be changed because of any adjustment in the number of Exercise Shares subject to this Warrant.

6. FRACTIONAL SHARES. No fractional shares shall be issued upon the exercise of this Warrant as a consequence of any adjustment pursuant hereto. All Exercise Shares (including fractions) issuable upon exercise of this Warrant may be aggregated for purposes of determining whether the exercise would result in the issuance of any fractional share. If, after aggregation, the exercise would result in the issuance of a fractional share, the Company shall, in lieu of issuance of any fractional share, pay the Holder otherwise entitled to such fraction a sum in cash equal to the product resulting from multiplying the then current fair market value of an Exercise Share by such fraction.

7. MARKET STAND-OFF AGREEMENT. Holder shall not sell, dispose of transfer, make any short of, grant any option for the purchase of or enter into any hedging or similar transaction with the same economic effect as a sale, any Common Stock (or other securities) of the Company held by Holder, for a period of time specified by the managing underwriter(s) not to exceed one hundred eighty (180) days following the effective date of a registration statement of the Company filed under the Act. Holder agrees to execute and deliver such other agreements as may be reasonably requested by the Company and/or the managing underwriter(s) which are consistent with the foregoing or which are necessary to give further effect thereto. In order to

enforce the foregoing covenant, the Company may impose stop-transfer instructions with respect to such Common Stock (or other securities) until the end of such period. The underwriters of the Company's stock are intended third party beneficiaries of this Section 8 and shall have the right, power and authority to enforce the provisions hereof as though they were a party hereto.

8. No Stockholder Rights. This Warrant in and of itself shall not entitle the Holder to any voting rights or other rights as a stockholder of the Company:

9. No Transfer of Warrant. This Warrant may not be transferred, assigned, pledged or hypothecated without the prior written consent of the Company, and any purported transfer, assignment, pledge or hypothecation in contravention of this Section 10 shall be of no force or effect.

10. Lost, Stolen, Mutilated or Destroyed Warrant. If this Warrant is lost, stolen, mutilated or destroyed, the Company may, on such terms as to indemnity or otherwise as it may reasonably impose (which shall, in the case of a mutilated Warrant, include the surrender thereof), issue a new Warrant of like denomination and tenor as the Warrant so lost, stolen, mutilated or destroyed. Any such new Warrant shall constitute an original contractual obligation of the Company, whether or not the allegedly lost, stolen, mutilated or destroyed Warrant shall be at any time enforceable by anyone.

11. Notices, RTC. All notices required or permitted hereunder shall be in writing and shall be deemed effectively given: (a) upon personal delivery to the party to be notified, (b) when sent by confirmed telex or facsimile if sent during normal business hours of the recipient, if not, then on the next business day, (c) five (5) days after having been sent by registered or certified mail, return receipt requested, postage prepaid, or (d) one (1) day after deposit with a nationally recognized overnight courier, specifying next day delivery, with written verification of receipt. All communications shall be sent to the Company at the address listed on the signature page and to Holder at 1129 N. McDowell Blvd., Petaluma, California 94954 or at such other address as the Company or Holder may designate by ten (10) days advance written notice to the other PARTIES hereto.

12. Acceptance. Receipt of this Warrant by the Holder shall constitute acceptance of and agreement to all of the terms and conditions contained herein.

13. Governing Law. This Warrant and all rights, obligations and liabilities hereunder shall be governed by the laws of the State of California.

In Witness Whereof, the Company has caused this Warrant to be executed by its duly authorized officer as of , 2006.

Oculus Innovative Sciences, Inc.

By: _____

Hoji Alimi

President and CEO

ACKNOWLEDGED AND AGREED:

Mcguinn, Hillsman & Palefsky

By: _____

Name: _____

Title: _____

NOTICE OF EXERCISE

TO: OCULUS INNOVATIVE SCIENCES, INC.

(1) The undersigned hereby elects to purchase shares of Common Stock of OCULUS INNOVATIVE SCIENCES, INC. (the "Company") pursuant to the terms of the attached Warrant, and tenders herewith payment of the exercise price in full, together with all applicable transfer taxes, if any.

(2) Please issue a certificate or certificates representing said shares of Common Stock in the name of the undersigned or in such other name as is specified below:

(Name)

(Address)

(3) The undersigned represents that (i) he is an accredited investor, as defined in Regulation D promulgated under the Securities Act of 1933, as amended; (ii) the aforesaid shares of Common Stock are being acquired for the account of the undersigned for investment and not with a view to, or for resale in connection with, the distribution thereof and that the undersigned has no present intention of distributing or reselling such shares; (iii) the undersigned is aware of the Company's business affairs and financial condition and has acquired sufficient information about the Company to reach an informed and knowledgeable decision regarding its investment in the Company; (iv) the undersigned is experienced in making investments of this type and has such knowledge and background in financial and business matters that the undersigned is capable of evaluating the merits and risks of this investment and protecting the undersigned's own interests; (v) the undersigned understands that the shares of Common Stock issuable upon exercise of this Warrant have not been registered under the Securities Act of 1933, as amended (the "Securities Act"), by reason of a specific exemption from the registration provisions of the Securities Act, which exemption depends upon, among other things, the bona fide nature of the investment intent as expressed herein, and, because such securities have not been registered under the Securities Act, they must be held indefinitely unless subsequently registered under the Securities Act or an exemption from such registration is available; (vi) the undersigned is aware that the aforesaid shares of Series A Preferred Stock may not be sold pursuant to Rule 144 adopted under the Securities Act unless certain conditions are met and until the undersigned has held the shares for the number of years prescribed by Rule 144, that among the conditions for use of the Rule is the availability of current information to the public about the Company and the Company has not made such information available and has no present plans to do so; and (vii) the undersigned agrees not to make any disposition of all or any part of the aforesaid shares of Common Stock unless and until there is then in effect a registration statement

under the Securities Act covering such proposed disposition and such disposition is made in accordance with said registration statement, or the undersigned has provided the Company with an opinion of counsel satisfactory to the Company, stating that such registration is not required.

(Date)	(Signature)
	(Print name)

EXHIBIT B

Accredited Investor Standards

Regulation D of the Securities and Exchange Commission defines an "accredited investor" as any person coming within any of the following categories:

(1) Any bank as defined in section 3(a)(2) of the Act, or any savings and loan association or other institution as defined in section 3(a)(5)(A) of the Act whether acting in its individual or fiduciary capacity; any broker or dealer registered pursuant to section 15 of the Securities Exchange Act of 1934; insurance company as defined in section 2(13) of the Securities Act; investment company registered under the Investment Company Act of 1940 or a business development company as defined in section 2(a)(48) of that Act; Small Business Investment Company licensed by the U.S. Small Business Administration under section 3.01(c) or (d) of the Small Business Investment Act of 1958; employee benefit plan within the meaning of Title I of the Employee Retirement Income Security Act of 1974, if the investment decision is made by a plan fiduciary, as defined in section 3(21) of such Act, which is either a bank, savings and loan association, insurance company, or registered investment advisor, or if the employee benefit plan has total assets in excess of $5,000,000 or, if a self directed plan, with investment decisions made solely by persons that are accredited investors;

(2) Any private business development company as defined in section 202(a)(22) of the Investment Advisors Act of 1940;

(3) Any organization described in section 501(c)(3) of the Internal Revenue Code, corporation, Massachusetts or similar business trust, or partnership, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of $5,000,000;

(4) Any director, executive officer, or general partner of the issuer of the securities being offered or sold, or any director, executive officer, or general partner of a general partner of that issuer:

(5) Any natural person whose individual net worth, or joint net worth with that person's spouse, at the time of his purchase exceeds $1,000,000;

(6) Any natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year; and

(7) Any trust, with total assets in excess of $5,000,000, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as described in Rule 506(b)(2)(ii); and

(8) Any entity in which all of the equity owners are accredited investors.

With regard to category (5), the term “net worth” means the excess of total assets over total liabilities. In computing net worth for the purposes of category (5) above, the undersigned’s principal residence must be valued either at (A) cost, including the cost of improvements, net of current encumbrances upon the property or (B) the appraised value of the property as determined upon a written appraisal used by an institutional lender making a loan to the individual secured by the property, including the cost of subsequent improvements, net of current encumbrances upon the property. In determining income, the undersigned should add to his adjusted gross income any amounts attributable to tax exempt income received, losses claimed as a limited partner in any limited partnership, deductions claimed for depletion, contributions to an IRA or Keogh retirement plan, alimony payments, and any amount by which income from long-term capital gains has been reduced in arriving at adjusted gross income.

Exhibit 16.1

PriceWaterhouseCoopers Letterhead

November 30, 2006

Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Commissioners:

We have read the statements made by Oculus Innovative Sciences, Inc. (copy attached), which we understand will be filed with the Securities and Exchange Commission, as part of the Form S-1 (Amendment No. 3) of Oculus Innovative Sciences, Inc. under the heading "Change in Independent Registered Public Accounting Firm". We agree with the statements concerning our Firm in such Form S-1 (Amendment No. 3). However, we make no comment on the current status of remedial actions taken with respect to reportable events disclosed in such Form S-1 (Amendment No. 3).

Very truly yours,

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Exhibit 23.1

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM'S CONSENT

We consent to the inclusion in this Registration Statement of Oculus Innovative Sciences, Inc. and Subsidiaries on Form S-1 Amendment No. 3, of our report dated June 26, 2006, with respect to our audits of the consolidated financial statements of Oculus Innovative Sciences, Inc. and Subsidiaries as of March 31, 2006 and 2005 and for each of the three years in the period ended March 31, 2006, which report appears in the Prospectus, which is part of this Registration Statement. We also consent to the reference to our Firm under the heading "Experts" in such Prospectus.

/s/ Marcum & Kliegman llp

Marcum & Kliegman llp
New York, New York
December 1, 2006

Exhibit 24.2

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 Petaluma, State of California, on the ___day of ___, 2006.

Oculus Innovative Sciences, Inc.

By: _____

Hojabr Alimi
President and Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Hojabr Alimi and Robert Miller and each of them, his true and lawful attorneys in fact and agents, each with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments, including post-effective amendments, to this Registration Statement, and any registration statement relating to the offering covered by this Registration Statement and filed pursuant to Rule 462(b) under the Securities Act of 1933, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that each of said attorneys in fact and agents or their substitute or substitutes may lawfully do or cause to be done by virtue hereof.

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.

Name	Title	Date
Hojabr Alimi	President and Chief Executive Officer (Principal Executive Officer) and Director	_____ , 2006
Robert E. Miller	Chief Financial Officer (Principal Financial and Accounting Officer)	_____ , 2006
Akihisa Akao	Director	_____ , 2006
Edward M. Brown	Director	_____ , 2006
Richard Conley	Director	_____ , 2006
Gregory M. French	Director	_____ , 2006
James J. Schutz	Director	_____ , 2006
/s/ Robert Burlingame Robert Burlingame	Director	November 8, 2006

[Pillsbury Winthrop Shaw Pittman LLP Letterhead]

December 1, 2006

Sylvia K. Burks
Phone: 650.233.4606
sylvia.burks@pillsburylaw.com

VIA ELECTRONIC TRANSMISSION

Securities and Exchange Commission
100 F Street, N.W.
Washington, D.C. 20549-0406
Mail Stop 6010
Attn: Mr. Thomas A. Jones

Re: Oculus Innovative Sciences, Inc.-Registration Statement on Form S-1 (File No. 333-135584)

Ladies and Gentlemen:

On behalf of Oculus Innovative Sciences, Inc. (the "Registrant"), we enclose for filing under the Securities Act of 1933, as amended (the "Securities Act"), Amendment No. 3 to the above-referenced registration statement (the "Registration Statement"), together with exhibits thereto.

Amendment No. 3 to the Registration Statement contains revisions that have been made in response to comments received from the staff (the "Staff") of the Securities and Exchange Commission (the "Commission") in its letter dated November 27, 2006. Set forth below are the Registrant's responses to the Staff's comments. The number of the responses and headings set forth below correspond to the numbered comments and headings on the letter from the Staff. Marked copies of Amendment No. 3 to the Registration Statement are being provided supplementally with copies of this letter for the convenience of the Staff.

General

1. *Please amend your filing to include all non-Rule 430A information, including the number of securities to be offered. Refer to Item B.90 of our Manual of Publicly Available Telephone interpretations available on our website at www.sec.gov. Also, revise the fee table if necessary.*

Response: The Registrant has revised the Registration Statement as requested.

2. *We reissue comment 1. If you must include technical terms in the body of your prospectus that are understood only by industry experts, you should explain these terms where you first use them. In addition, do not use technical terms or industry jargon in your explanations. We note, for example your references to "oxidized chemical species," "receptor binding, molecular transport," hypochlorite-based solution," "adhesive metrix," "histamine production and cytokine release," and "in vitro" on page 59 and "bacterial load reduction," "log 10 reduction" and "baseline" on page 61. Please note that these are merely examples and do not constitute a comprehensive list.*

   Response: The Registrant has revised the Registration Statement with a view toward removing unnecessary technical terms or defining them at first use.

We may face intellectual property infringement claims, page 19

3. *Please tell us why you have not filed as exhibits the settlement agreements disclosed in the last paragraph of this section.*

   Response: The Registrant has filed the settlement agreement as an Exhibit to the Registration Statement. The Registrant notes that there is no agreement between the parties with respect to the second dispute described in the referenced disclosure.

Use of Proceeds, page 30

4. *We note your disclosure that you plan to repay your bridge loan with proceeds from this offering. Please provide the disclosure required by Instruction 4 to Item 504 of Regulation S-K.*

   Response: The Registrant has revised the Registration Statement as requested.

Dilution page 33

5. *Regarding your dilution table, please make sure you start with historical net tangible book value per share. Then show how you derived the pro forma amounts before the offering (reflecting conversion of preferred to common) that you are using for comparison to net tangible book value per share after the offering.*

   Response: The Registrant has revised the Registration Statement as requested.

Our dependence on distributors for sales could limit or prevent us from selling, page 16

6. *Please file as an exhibit your agreement with your Indian distributor.*

Response: The Registrant has filed the distribution agreement as requested.

Revenues. page 42

7. *Please expand the last paragraph on page 42 to explain why the revenues increased. Also, expand the second full paragraph on page 44 to explain why the expenses increased.*

Response: The Registrant has revised the Registration Statement as requested.

Business, page 53

8. *Please tell us why you deleted the disclosure on pages 55 and 56 about your products.*

Response: The Registrant advises the Staff that its removal of the referenced disclosure was partially in response to the Staff's comment number 21 in its October 12, 2006 letter, which requested the Registrant to clarify (i) the reasons why the indications for its products differ from one another and (ii) whether similarly named products have different or identical formulations. In formulating its response to this comment, the Registrant determined that, given the Registrant's strategic focus on the wound care market, the discussion of various products that are not key to the Registrant's strategy might be confusing and a discussion of regulatory approvals would be more appropriate. Providing such similar information in two places in the Registration Statement seemed redundant.

In addition, in the interim between the filing of Amendment No. 1 and Amendment No. 2 to the Registration Statement, the Registrant had received a "show cause" letter form the U.S. Environmental Protection Agency. The hurdles and uncertainties to commercialization that this letter introduced lead the Registrant to decide not to pursue commercialization of the hard surface disinfectant at this time. Accordingly, there was one less product to present.

Finally, the Registrant notes that substantially the same information as was contained in the deleted disclosure is contained elsewhere in Amendment No. 3 to the Registration Statement. The information about the products is set forth in "Current Regulatory Approvals and Clearance," which shows the region,

approval, year of the approval and summary information about the indication. The deleted disclosure referenced the product name rather than the regulatory authority, and included the exact label claim. The deleted disclosure also contained information relating to the EPA recall of the Registrant's non-commercialized hard surface disinfectant product. The information contained in that disclosure is included in the risk factor "One of the Registrant's non-commercialized products, when recently tested ..." on page 11 of Amendment No. 3 to the Registration Statement.

Overview, page 54

9. *We note your disclosure regarding milestones you hope to achieve through 2009. Please balance your disclosure here by addressing the material hurdles to achieving these milestones and/or assumptions made in estimating your timetable for achieving these milestones.*

Response: The Registrant has revised the Registration Statement as requested.

Industry Background, page 54

10. *Please provide us with copies of the industry reports you cite on pages 54-56 and page 65. Also, clearly mark the relevant sections that support the data you have included in your prospectus and the page number of your prospectus where such data has been used.*

Response: The Registrant will provide the requested information to the Staff supplementally.

11. *Please revise pages 56 and 65 to clarify which portion of the billion dollar and multi-million dollar markets are related to your business.*

Response: The Registrant has revised the Registration Statement as requested.

Physician Clinical Studies, page 62

12. *We note your disclosure in the first full paragraph on page 62 regarding clinical studies of Microcyn. Please address in your risk factors any risk in relying on the results of those studies, given your disclosure in the last sentence of that paragraph.*

Response: The Registrant has added a paragraph to the risk factor "We do not have the necessary regulatory approvals..." on page 10 of the Registration Statement.

13. *We reissue comment 19 from our letter dated July 28, 2006. We note, for example, your reference to a study conducted by Fermin Martinez de Jesus. We have previously filed other required consents.*

    Response: The Registrant has deleted the reference to the study by Fermin Martinez de Jesus.

Equity Compensation Plans, page 87

14. *Please discuss the material terms of the plans. For example, we note the reference on page 14 to the "right of rescission" granted under certain stock option plans.*

    Response: The Registrant respectfully notes the reference to "right of rescission" on page 14 was wording from the former independent public accountant's letter, which the Registrant included word-for-word in an effort to provide full disclosure of the substance of that letter. While our former accountants referenced rescission rights in the sentence, "the failure to maintain effective control to ensure the identification of accounting issues related to and the proper accounting for stock options with the right of rescission that were granted under certain stock option plans...", there are no rescission rights contained in the stock option plans or agreements. The reference to rescission rights are to those statutory rights that could arise in connection with a failure to comply with applicable securities laws. The Registrant respectfully submits that the description of the stock option plans is accurate, and, therefore, the Registrant has made no change to the disclosure.

Financial Statements, page F-1

Report of Independent Registered Public Accounting Firm, page F-2

15. *We note your "draft" report for the effect of a reverse stock split of your stock. Prior to going effective, the audit report should be signed and the draft language should be removed.*

    Response: The Registrant notes the Staff's observation. The audit report will be signed and the draft language will be removed prior to going effective.

Note 1 — The Company, page F-11

Stock Split, page F-11

16. *Since your board of directors has not approved the actual reverse stock split ratio, please tell us why it is appropriate to retroactively adjust your consolidated financial statements to reflect a 1 for 4 reverse stock split.*

Response: Pursuant to authority delegated by the Registrant's Board of Directors, the Registrant's pricing committee approved a 1 for 4 reverse stock split on December 1, 2006 and will seek shareholder approval to effect the split.

Note 3. Summary of Significant Accounting Policies, page, F-12

Convertible Instruments, page F-20

17. *We note your response to prior comment 13 in our letter dated October 12, 2006. Your disclosure on page F-20 states that your convertible preferred stock is conventionally convertible because the stock is convertible into a fixed number of shares. However, we note on page F-32 that the conversion rate of your preferred stock will be adjusted in the event of future issuances of equity securities or convertible instruments that feature prices more favorable than the conversion rates specified in the preferred shares. Please tell us how this feature impacts your assessment of whether the preferred shares are conventional convertible instruments in your EITF 00-19 analysis. If the instrument does not qualify as conventional convertible, paragraphs 12-32 of EITF 00-19 must be analyzed to determine whether the conversion feature should be accounted for as a liability or equity.*

Response: The Registrant notes the Staff's observation with respect to the disclosure on page F-20 which states that the convertible preferred stock is conventionally convertible into a fixed number of shares and the disclosure on page F-32 which states that the conversion rate of the preferred stock will be adjusted in the event of future issuances of equity securities or convertible

instruments that feature prices that are lower than the conversion rates specified in the preferred shares. The Registrant has modified its disclosure to more clearly state its policy with respect to accounting for convertible instruments and embedded derivatives.

The Registrant, in determining whether to bifurcate conversion options embedded in its preferred shares, applied the guidance in paragraphs 11 (a), and 12 (a), (b) and (c) of SFAS 133 "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock."

Under the guidelines of paragraph 12, SFAS 133 states that an embedded derivative instrument shall be separated from the host contract and accounted for as a derivative instrument if and only if all of the criteria specified in paragraphs 12 (a), (b) and (c) of the statement are met. Paragraph 12 (a) of SFAS 133 provides for embedded derivatives to be separated from their host instruments when the economic characteristics and risks of the embedded derivative instrument are not clearly and closely related to the economic characteristics and risks of the host contract. Additional guidance on applying this criterion to various contracts containing embedded derivative instruments is included in Appendix A of SFAS 133. The guidance in Paragraph 61 l of Appendix A states that participating perpetual preferred stock is more akin to an equity instrument than a debt instrument. Based on this guidance, the Registrant believes that its convertible preferred shares do not fall within the scope of paragraph of 12 (a) of SFAS 133.

In addition, the Registrant separately evaluated the conversion feature embedded in the preferred shares to determine whether, if free standing, such conversion feature (which is indexed to its own stock) would (a) be classified in stockholders' equity under paragraphs 12 to 32 of EITF 00-19 and (b) not be considered a derivative under paragraphs 11(a) and 12(c) of SFAS 133. The Registrant determined that net share settlement of the conversion option under each of the conditions noted in paragraphs 12 to 32 of EITF 00-19 is at all times within its control. Accordingly, the conversion option (if freestanding) would qualify for equity classification and therefore not fall within the scope of SFAS 133.

In this analysis, the Registrant considered the provision to adjust the conversion price of the preferred (as described on page F-32). Such provision is an anti-dilution provision that becomes effective only if the Registrant, in its sole discretion, subsequently completes financing transactions in which it issues equity

securities at prices that are lower than the conversion price of the preferred. Since the number of shares issuable under the conversion feature is at all times fixed and determinable, and subsequent issuances of equity securities at any price is solely at the Registrant's discretion, this provision does not affect any of EITF 00-19 classification criteria at any of the reporting dates presented. Under this circumstance, the Registrant believes that its preferred shares do not fall within the scope of paragraphs 11(a) and 12(c) of SFAS 133.

Based on these provisions, the Registrant has accounted for the preferred stock conversion options as embedded derivatives because not all of the criteria requiring separation under paragraph 12 of SFAS 133 have been met and the conversion option, which if indexed to its own stock would be classified in stockholders equity if freestanding.

18. *Additionally, we refer to your disclosure that you record the embedded conversion options as a discount to convertible notes and that you record as deemed dividends the intrinsic value of conversion options embedded in preferred shares. Please revise to identify the embedded derivatives you have identified, disclose the value of these derivatives at each balance sheet date and discuss the related accounting treatment in your footnotes.*

Response: The Registrant would like to clarify that its references to the aforementioned accounting treatment is a statement of its policy with respect to convertible instruments that feature embedded, as opposed to, freestanding derivatives. The Registrant refers the Staff to its response to Question 17. The Registrant preformed its analysis of the embedded derivatives at each of the preferred stock commitment dates and concluded, based on the then fair values of its stock, the embedded conversion features were not beneficial. Accordingly, the Registrant was not required to record deemed dividends upon its issuances of these securities.

The Registrant would also like to clarify that it had only two insignificant issuances of convertible notes in the amount of $40,000 each (an aggregate of $80,000) during February 2003. These notes were convertible into a fixed number of preferred shares at fixed conversion prices with no reset provision. These notes were issued with a beneficial conversion feature that amounted to $80,000, which the Registrant recorded as non-cash interest prior to the expiration of the notes. One of these notes was redeemed for cash in the year ended March 31, 2005 and the other was converted into shares of Series A preferred in the year ended March 31, 2006.

The Registrant does not deem either of these issuances of convertible securities to be significant to its financial statements in any of the reporting periods presented.

Note 11 — Commitments, Contingencies and Other Matters, page F-29

Legal Matters, page F-29

19. *We see that you entered into a settlement agreement in November 2006 with a former employee which provides for the issuance of a warrant to purchase 50,000 shares of common stock at $3.00 per share. Please revise to disclose the accounting treatment and the expense expected to be recognized from the issuances of the warrants. We note that the exercise price is significantly lower than the mid-point of the IPO filing range.*

Response: The Registrant has revised the disclosure to include the accounting treatment and the expected expense to be recognized upon issuance of the warrants.

20. *Please revise to disclose the amount, if any, accrued for the recall of Cidalcyn. If no amounts are accrued as of September 30, 2006 for the recall, please tell us why you do not believe a liability is necessary.*

Response: The Registrant has revised the disclosure to indicate that no amounts have been accrued for the recall of Cidalcyn. The Registrant applied the guidance in SFAS 5 in assessing whether to accrue a loss contingency. The Registrant is currently unable to estimate a range of loss, if any; however, the Registrant believes that any possible loss would be insignificant because the product was not commercialized, the number of samples it recalled was minimal and the cost of recalling the samples was not material.

Note 12 — Stockholders' Equity, page F-28

Stock Purchase Warrants Issued in Financing Transactions, page F-34

21. *We see that the exercise price on warrants issued with financing is equal to the lesser of a stated exercise price or the price offered to any other investor in subsequent stock offerings prior to the expiration dale of the warrants. Please tell us how this impacted your assessment of whether the warrant liability should be*

bifurcated since it appears the number of shares issuable upon conversion of the convertible instrument is variable. Additionally, please tell us whether there is a cap on the number of shares which could be issued. If there is no explicit limit on the number of shares that are to be delivered upon exercise of the conversion feature, you would not be able to assert that you will have sufficient authorized and unissued shares to settle the conversion option. As a result, the conversion feature would be accounted for as a derivative liability, with changes in fair value recorded in earnings each period. Refer to paragraphs 20-24 of EITF 00-19.

Response: The Registrant notes the Staff's observation that the exercise price of the warrants referred to on page F-34 is equal to the lesser of a stated exercise price or the price offered to any other investor in subsequent stock offerings prior to the expiration date of the warrants. The Registrant would like to clarify that the warrants do not feature any terms that provide for settlement in a variable number of shares. The provision referred to on page F-34 is an anti-dilution provision that becomes effective only if the Registrant, in its sole discretion, subsequently completes financing transactions in which it issues equity securities at prices that are lower than the exercise price of the warrants. Moreover, the Registrants policy (in accordance with EITF 00-19) is to assess the classification of all derivatives at each balance sheet date to determine their proper classification. The Registrant assesses, among other things, whether it has sufficient authorized but unissued shares available to net share settle its derivatives and convertible instruments. Under this circumstance, the Registrant is able to determine the amount of authorized but unissued shares available to complete subsequent financing transactions. The Registrant, with the assistance of its securities counsel, also updates its analysis of its capitalization prior to completing any financing transactions to ensure (on a fully diluted basis) that it will not exceed its authorized capital.

Based on the above, the Registrant has determined that the number of shares issuable to the warrant holders is fixed at all times based upon the fact that they are exercisable at a fixed price that is subject to change based solely on the actions of Registrant (within its sole discretion). The Registrant will modify its disclosure to clearly state the exercise price of the warrants and that the exercise price is subject to adjustment only in the event that it (in its sole discretion) subsequently issues equity at prices lower than the exercise price of the warrants.

Valuation of Common Stock, page F-31

22. *We see your response to prior comment 10 in our letter dated October 12, 2006. Please further demonstrate why you believe that there was no change in the fair value of your stock from the valuation received in July 2005 for options issued through January 2006. Please reference significant events or changes in your business to support your conclusion.*

Response: The Registrant notes the Staff's comment and, in response thereto, has revisited its review of its performance and any significant events that may have occurred for the period of July 2005 through January 2006.

Based on this review, the Registrant is confident with the accuracy of its previous conclusion that no significant events occurred to materially influenced the price of its stock (positively or negatively) during the period. To this end, the Registrant would like to clarify the following:

- The Registrant did not experience a significant increase in revenue growth or achievement of any significant business milestones from the period of July 2005 to January 2006.
- The Registrant did not yield any significant results with regard to its clinical studies during the period of July 2005 through January 2006.
- The Registrant issued Series B Preferred (in succeeding closings) at $18.00 per share (split-adjusted) from July 2005 through October 25, 2005, the date of its final closing of the Series B financing.

In addition, the Registrant received initial feedback in early 2006 relating to the valuation for additional funding following the completion of its Series B financing. The Registrant was advised that the per share issuance price of its new securities would be approximately the same or possibly less than the per share offering price of its Series B shares. In addition, the Registrant would like to clarify that the Series C Preferred was priced in May 2006 at $18.00 (split-adjusted) per share, the same price as that of its Series B shares. Finally, the Registrant obtained a second independent valuation dated June 2006 at $11.28 (split-adjusted), slightly up from the independent valuation dated July 2005 of $10.16 (split-adjusted).

23. *On page F-35, you disclose that warrants issued during the six month period ended September 30, 2006 were valued using a fair value of underlying stock of*

$18.00 per share. Yet, on page F-36, you disclose that all equity transactions completed during the six months ended September 30, 2006 were based on a fair value of $13.00 per share, the mid point of the IPO filing range. Please explain this discrepancy.

Response: The Registrant respectfully notes the Staff's observation and has modified Note 12 "Valuation of Common Stock" disclosure to include discussion of the range of fair values used to value equity transactions during the six month period ended September 30, 2006.

Note 13 — Stock Compensation Plans page F-37

Stock-Based Compensation Before Adoption of SFAS No. 123(R), page F-38

24. *Please revise to disclose the weighted average fair value of options granted during each year for which an income statement is provided, as required by paragraph 47(b) of SFAS 123.*

Response: The weighted average fair value (in the case of the Registrant the minimum value) of options granted during each year for which an income statement is provided and has been disclosed on page F-39.

25. *Please revise to remove the pro forma disclosures of the effect on net loss if you had applied the fair value provisions of SFAS 123 to stock-based compensation arrangements for the six months ended September 30, 2005 and 2006. Refer to paragraph 85 of SFAS 123(R).*

Response: The Registrant has revised and removed the pro forma disclosures on F-39 in accordance with paragraph 85 of SFAS 123(R).

Item 15. Recent Sales of Unregistered Securities, page II-1

26. *Please revise your disclosure to include all of the information required by Item 701 of Regulation S-K for the debt transaction referenced on page 4.*

Response: The Registrant has revised the Registration Statement as requested.

* * * * *

Questions or comments regarding any matters with respect to the Registration Statement may be directed to the undersigned at (650) 233-4606. Comments can also be sent via facsimile at (650) 233-4545.

Very truly yours,

/s/ Sylvia K. Burks

Sylvia K. Burks

cc: Hojabr Alimi
G. A. Lombardi
N.A. Matteson