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# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# Form 10-K

(Mark One)

☑ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the fiscal year ended: March 31, 2008**

**OR**

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the transition period from to .**

**Commission File Number: 001-33216**

# OCULUS INNOVATIVE SCIENCES, INC.

*(Exact name of Registrant as specified in its charter)*

| **Delaware** | **68-0423298** |
|---|---|
| *(State or other jurisdiction of incorporation or organization)* | *(I.R.S. Employer Identification Number)* |
| **1129 N. McDowell Blvd. Petaluma, California** | **94954** |
| *(address of principal executive offices)* | *(zip code)* |

| **Title of Each Class** | **(707) 782-0792** | **Name of each Exchange on which Registered** |
|---|---|---|
| *Common Stock* | *(Registrant's telephone number, including area code)* | *The Nasdaq Stock Market LLC* |

*(Securities registered pursuant to Section 12(b) of the Act)*
*(Securities registered pursuant to Section 12(g) of the Act and Title of Class)*
**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☑

Indicate by check mark if the registrant is not required to file reports pursuant to Section 15(d) of the Act. Yes ☐ No ☑

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☑ No ☐

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

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

Large accelerated filer ☐ Accelerated filer ☑ Non-accelerated filer ☐ Smaller reporting company ☐
(Do not check if a smaller reporting company)

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

The registrant's common stock first traded on the NASDAQ Global Market on January 25, 2007. As of September 30, 2007, the aggregate market value of voting and non-voting common stock held by non-affiliates of the registrant was approximately $86.2 million, based on the closing price of the common stock as reported on the NASDAQ Global Market for that date.

There were 15,923,708 shares of the registrant's Common Stock issued and outstanding on June 2, 2008.

**DOCUMENTS INCORPORATED BY REFERENCE**

Item 10 (as to directors and Section 16(a) Beneficial Ownership Reporting Compliance), 11, 12, 13 and 14 of Part III incorporate by reference information from the registrant's proxy statement to be filed with the Securities and Exchange Commission in connection with the solicitation of proxies for the registrant's 2008 Annual Meeting of Stockholders to be held on August 27, 2008.

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**PART I**

*This Report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. When used in this Report, the words "expects," "anticipates," "suggests," "believes," "intends," "estimates," "plans," "projects," "continue," "ongoing," "potential," "expect," "predict," "believe," "intend," "may," "will," "should," "could," "would" and similar expressions are intended to identify forward-looking statements. These are statements that relate to future periods and include statements about, but not limited to: 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 cash reserves; 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 and our ability to address them; our expectations and capabilities relating to the sales and marketing of our current products and our product candidates; our ability to penetrate markets through our sales force, distribution network, and strategic business partners and generate attractive margins; the expansion of our sales force and distribution network; the establishment of strategic partnerships for the development or sale of products; the ability to attain specified revenue goals within a specified time frame, if at all, or to reduce costs; 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 and employees; 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 with respect to our microbiology contract testing laboratory; 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.*

*Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those projected. These risks and uncertainties include, but are not limited to, those risks discussed below, as well as our ability to develop and commercialize new products; the risk of unanticipated delays in research and development efforts; the risk that we may not obtain reimbursement for our existing test and any future products we may develop; the risks and uncertainties associated with the regulation of our products by the U.S. Food and Drug Administration; the ability to compete against third parties; our ability to obtain capital when needed; our history of operating losses and the risks set forth under "Risks Related to our Business." These forward-looking statements speak only as of the date hereof. The Company expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in the Company's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.*

**ITEM 1.** ***Business***

**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 December 2006, we reincorporated 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. We also have a subsidiary, Oculus Innovative Sciences Japan, KK., organized under Japanese law. Our website is *www.oculusis.com.*

**Overview**

We have developed, and we manufacture and market, a family of products intended to prevent and treat infections in chronic and acute wounds while concurrently enhancing wound healing through modes of action unrelated to the treatment of infection. 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 proprietary solution of electrically charged oxychlorine small molecules that is designed to treat a wide range of organisms that cause disease, (pathogens), including viruses, fungi, spores and antibiotic-resistant strains of bacteria, such as Methicillin-resistant *Staphylococcus aureus*, ("MRSA"), and Vancomycin-resistant *Enterococcus,* ("VRE"), in wounds. We do not have the necessary regulatory approvals to market Microcyn in the United States as a drug, nor do we have the necessary regulatory clearance or approval to market Microcyn in the U.S. as a medical device for an antimicrobial or wound healing indication. However, our device product is cleared for sale in the United States as a medical device for wound cleaning, debridement, lubricating, moistening and dressing; is a device under CE Mark in Europe; is approved by the SFDA in China as a technology that reduces the propagation of microbes in wounds and creates a moist environment for wound healing; and is approved as a drug in India and Mexico.

Clinical testing we conducted in connection with our submissions to the FDA, as well as physician clinical studies, suggest that our Microcyn-based product may help reduce a wide range of pathogens from acute and chronic wounds while curing or improving infection and concurrently enhancing wound healing through modes of action unrelated to the treatment of infection. These physician clinical studies suggest that our Microcyn-based product is safe, easy to use and complementary to many existing treatment methods in wound care. Physician clinical studies and usage in the United States suggest that our 510(k) product may shorten hospital stays, lower aggregate patient care costs and, in certain cases, reduce the need for systemic antibiotics. We are also pursuing the use of our Microcyn platform technology in other markets outside of wound care, including in the respiratory, ophthalmology and dermatology markets.

In 2005, 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. We believe our addressable market for the treatment of skin ulcers is approximately $1.3 billion, $300 million for the treatment of burns and $700 million for the treatment of surgical and trauma wounds. 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 be less 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 is the only known stable, anti-infective therapeutic available in the world today that simultaneously cures or improves infection while also promoting wound healing through increased blood flow to the wound bed and reduction of inflammation. Also, 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, debridement, prevention and treatment of infections and wound healing. Unlike antibiotics, antiseptics, growth regulators and other advanced wound care products, we believe that Microcyn is the only wound care solution that is safe as saline, that cures infection while simultaneously accelerating wound healing. Also, 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 as the standard of care in the treatment of open wounds. We currently have, and intend to seek additional, regulatory clearances and approvals to market our Microcyn-based products 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, India, Pakistan, China and Mexico have conducted more than 25 physician clinical studies assessing Microcyn's use in the treatment of infections in a variety of wound types, including hard-to-treat wounds

such as diabetic ulcers and burns. Most of 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 a new drug application, or NDA, submission to the FDA in that many did not necessarily include blinding, randomization, predefined clinical end points, use of placebo and active control groups or U.S. good clinical practices requirements. 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 microbial load. We received the CE Mark in November 2004 and additional international approvals in China, 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 the fourth quarter of 2007, we completed a Phase II randomized clinical trial, which was designed to evaluate the effectiveness of Microcyn in mildly infected diabetic foot ulcers with the primary endpoint of clinical cure or improvement in signs and symptoms of infection according to guidelines of Infectious Disease Society of America ("IDSA"). We used 15 clinical sites and enrolled 48 evaluable patients in three arms, using Microcyn alone, Microcyn plus an oral antibiotic and saline plus an oral antibiotic. We announced the results of our Phase II trial in March of this year. In the clinically evaluable population of the study, the clinical success rate at visit four (test of cure) for patients treated with Microcyn-alone was 93.3% compared to 56.3% for the levofloxacin plus saline-treated patients. This study was not statistically powered, but the high clinical success rate (93.3%) and the p-value (0.033) would suggest the difference is meaningfully positive for the Microcyn-treated patients. Also, for this set of data, the 95.0% confidence interval for the Microcyn only arm ranged from 80.7% to 100.0% while the 95.0% confidence interval for the levofloxacin and saline arm ranged from 31.9% to 80.6%; the confidence intervals do not overlap, indicating a favorable clinical success for Microcyn compared to Levofloxacin. At visit 3 (end of treatment) the clinical success rate for patients treated with Microcyn-alone was 77.8% compared to 61.1% for the levofloxacin plus saline-treated patients.

Following a review meeting with the FDA late summer 2008, we intend to initiate the pivotal trials in late 2008. These pivotal clinical trials are intended to provide the clinical basis for submission to the FDA of an NDA, for the treatment of mildly infected diabetic foot ulcers. In the event that we obtain drug approval from the FDA, we may seek clearance for treatment of other types of wounds. We are currently pursuing strategic partnerships to assess potential applications for Microcyn in several other markets and therapeutic categories, including respiratory, ophthalmology, dermatology, dental and veterinary markets. FDA or other governmental approvals will be required for any potential new products or new indications. We have reduced expenses in our international operations in order to focus our resources on our U.S. clinical trials.

We currently make Microcyn available under our three 510(k) clearances in the United States, primarily through our website and several regional distributors. We plan for a more aggressive commercialization initiative in the event we obtain drug approval from the FDA or sooner if our current market assessment study suggests we can develop a successful commericalzation strategy for our 510(k) clearances. Most of our current marketing efforts in the United States are test market in nature, designed to provide us with U.S. medical community feedback in terms of market perception of the Microcyn Technology, but we are exploring a broader U.S. commercialization strategy for Microcyn-based 510(k) products under these or additional 510(k) clearances. In addition, an OTC "first responder" pen application (MyClyns) with Microcyn is being marketed in the United States since January 2008, by our partner Union Springs Pharmaceuticals (a subsidiary of DECA). Also in January, we announced an exclusive North American distribution agreement with Walco International, Inc., a subsidiary of Animal Health International, Inc. for our Microcyn-based Vetericyn Wound Spray for animals.

We currently rely on exclusive agreements with country-specific distributors for the sale of Microcyn-based products in Europe. In Mexico, we sell Microcyn through a network of distributors and through a contract sales force dedicated exclusively to selling Microcyn, including salespeople, nurses and clinical support staff. In India we sell through Alkem, the fifth largest pharmaceutical company in India. 2008 is the first full year of the product distribution of Microcyn in India. In China, we signed a distribution agreement with China Bao Tai, which, in March, secured marketing approval from the Chinese State Food and Drug Administration (SFDA). China Bao Tai intends to begin distribution of Microcyn-based products to hospitals, doctors and clinics through Sinopharm, the largest pharmaceutical group in China, and to retail pharmacies through Lianhua Supermarkets. Distribution is expected to begin in the fall of 2008.

Our goal for 2008 is to achieve the following milestones:

- Complete a meeting with FDA regarding our Phase II results and pivotal trial protocols
- Initiate pivotal trial for evaluating Dermacyn's effectiveness for treatment of infection in mildly infected diabetic foot ulcers
- Identify and execute when applicable distribution/partnership agreements for Microcyn outside of the United States
- Identify and initiate partnerships for Dermacyn drug formulation
- File additional INDs with FDA to expand label indications
- Conduct market feasibility study to identify additional product markets
- Seek additional 501(k) clearances for additional products
- Assist our partners in China with the launch of Dermacyn into strategic wound care facilities
- File and obtain additional patents on new formulations and drug delivery systems

We cannot guarantee that we will obtain on a timely basis, if at all, the necessary FDA approval and/or clearances to market Microcyn in the United States for the treatment of infection in diabetic foot ulcers, wound healing or otherwise. 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 have sufficient funds to conduct and complete our pivotal trials, 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.

We also operate a microbiology contract testing laboratory division that provides consulting and laboratory services to medical companies that design and manufacture biomedical devices and drugs, as well as testing on our products and potential products. Our testing laboratory complies with U.S. good manufacturing practices and quality systems regulation.

**Industry Background**

***Wound Care Industry Overview***

According to Medtech Insight, a Division of Windhover Information, there were over 51 million incidents of invasive wounds in the United States during 2004. Of these, over 6 million were chronic wounds, including arterial, diabetic, pressure and venous ulcers. The remaining 45 million were acute wounds, which follow the normal process of healing and commonly include burns, traumatic wounds, and acute invasive surgeries

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 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, or CDC, one out of three children born in 2000 in the United States will develop diabetes. In 2004 there were 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, more than 30% of the United States adult population was obese in 2000, 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, 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 data from RID in 2005, post-surgical wound infections more than double a patient's hospital costs, and patients with Staph infections more than triple the average hospital costs. 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. These devices are designed to accelerate wound healing but generally are not designed to independently kill bacteria and cure infection.

***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:

- antibiotics and antiseptics can kill bacteria and cure infection but do not independently accelerate wound healing;
- 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;
- the increase in antibiotic resistant bacterial strains, such as MRSA and VRE, have compromised the effectiveness of some widely used topical and systemic antibiotics, including Neosporin and Bacitracin;
- Oral and systemic antibiotics often are not effective in treating topical infections especially if the patient does not have adequate blood flow to the wound and they can also cause serious side effects; and
- growth regulators, skin substitutes and vacuum assisted closure accelerate wound healing but do not cure infection.

**Our Solution**

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

- *Cures Infection.* Our phase II results and several physician based studies suggest that Microcyn may be effective in curing and improving the signs and symptoms of infections.
- *Accelerates Wound Healing.* Based on numerous physician based studies and usage feedback from doctors, we believe that Microcyn may accelerate the wound healing process independently of the benefits of curing the infection.
- *Wound Care Solution.* Our 510(k) product is cleared as a medical device for sale in the United States in wound cleaning, or debridement, lubricating, moistening and dressing. Although we do not have the necessary regulatory approvals to market Microcyn in the United States as a drug, laboratory testing and physician clinical studies further suggest that our 510(k) Microcyn product may be effective against a wide range of bacteria that causes 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, our 510(k) Microcyn product has been used in conjunction with other wound care therapeutic products. Data from these studies suggest that patients generally experienced less pain, improved mobility and physical activity levels and better quality of life.
- *Non-irritating.* Our 510(k) product label states that our 510(k) product, which is based on our Microcyn technology, is non-irritating and non-sensitizing to the skin and eyes. Throughout all our clinical trials and physician clinical studies to date and since our first commercial sale of Microcyn in Mexico in 2004, we have received no reports of serious adverse events related to the use of Microcyn products when used according to label instructions.
- *Ease of Use.* Our 510(k) product label states that our 510(k) product requires no special handling precautions. 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. Unlike other oxychlorine 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 designed to be 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 cure infection, accelerate healing time and, in certain cases, may help reduce the need for systemic antibiotics, reduce the need for amputation and lead to earlier hospital discharge, thereby lowering overall patient cost.

**Our Strategy**

Our goal is to become a worldwide leader and standard of care in the treatment of open wounds. We also intend to leverage our expertise in wound care into additional market opportunities. The key elements of our strategy include the following:

***Obtain drug 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. We have completed a proof-of-concept Phase II trial in the U.S., which demonstrated the effectiveness of Microcyn in mildly infected diabetic foot ulcers with the primary endpoint of clinical cure or improvement of the signs of infection. We used 15 clinical sites and enrolled 48 evaluable patients in three arms, using Microcyn alone, Microcyn plus an oral antibiotic and saline plus an oral antibiotic. We announced the results of our Phase II trial in March of this year. In the clinically evaluable population of the study, the clinical success rate at visit four (test of cure) for Microcyn-alone-treated patients was 93.3% compared to 56.3% for the levofloxacin plus saline-treated patients. This study was not statistically powered, but the high clinical success rate (93.3%) and the p-value (0.033) would suggest the difference is meaningfully positive for the Microcyn-treated patients. Also, for this set of data, the 95% confidence interval for the Microcyn only arm ranged from 80.7% to 100% while the 95.0% confidence interval for the levofloxacin and saline arm ranged from 31.9% to 80.6%; the confidence intervals do not overlap, indicating a favorable clinical success for Microcyn compared to Levofloxacin. At visit 3 (end of treatment) the clinical success rate for patients treated with Microcyn-alone was 77.8% compared to 61.1% for the levofloxacin plus saline-treated patients. Following a review meeting with the FDA, which we expect to conduct late summer 2008, we intend to initiate pivotal trials. These clinical trials are intended to provide the clinical basis for submission to the FDA of a new drug application, or NDA, for the treatment of mildly infected diabetic foot ulcers. We also intend to explore a broader U.S. commercialization strategy for our Microcyn-based products under our existing or additional 510(k) clearances.

***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 treat infections while also accelerating wound healing. We seek to drive adoption of Microcyn as the standard of care in the wound care market by establishing strong scientific, evidence-based rationale for its use as has been demonstrated in over 25 clinical studies to date. We intend to continue to maintain a marketing presence in key medical communities throughout the world through targeted direct marketing, publication in scientific journals, and sponsorships of physician presentations at medical conferences and seminars.

***Develop strategic collaborations and distribution in the acute and chronic wound care market***

Outside the United States and Mexico, we intend to pursue strategic relationships with respect to sales, marketing and distribution. To accelerate adoption of our products, we may enter into strategic relationships with healthcare companies that have product lines, a sales force and distribution channels that are complementary to ours. We believe collaborations allow us to leverage our resources and technology. We intend to pursue access to these markets through strategic partnerships. We have engaged an investment banker to assist us in identifying appropriate partners for development and commercialization of our products. These relationships may take the form of co-development, co-promotion, co-marketing or distribution agreements. For instance, in India we sell through Alkem Laboratories, the fifth largest pharmaceutical company in India. In Europe, we sell Microcyn through exclusive agreements with country-specific distributors. In China, we signed a distribution agreement with China Bao Tai, which in March 2008 secured marketing approval from the Chinese State Food and Drug Administration

(SFDA). China Bao Tai intends to begin distribution of Microcyn-based products to hospitals, doctors and clinics through Sinopharm, the largest pharmaceutical group in China, and to retail pharmacies through Lianhua Supermarkets.

We currently make Microcyn available under our 510(k) clearances in the United States primarily through our website and several regional distributors. We intend to explore a broader U.S. commercialization strategy for our Microcyn-based 510(k) product under existing or additional 510(k) clearances. We plan for a more aggressive commercialization and product launch in the event we obtain drug approval or sooner if our current market assessment study suggests we can develop a successful commericalzation strategy for our 510(k) clearances. We will assess the various options including the deployment of our own direct sales force or forming a strategic collaboration with a company that already has an existing sales force servicing the U.S. market.

***Develop strategic partnerships in numerous indications outside the wound care market***

We believe our products have potential applications in several other large therapeutic categories or markets, including respiratory, ophthalmology, 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 prevent infection and promote wound healing is based on its uniquely engineered chemistry. As a result of our proprietary manufacturing process, Microcyn is a proprietary solution of electrically charged oxychlorine molecules that, among other things, interacts with and inactivates surface proteins on cell walls and membranes of 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 the cell membrane to rupture, leading to cell death, which we believe is caused by increased membrane permeability and induced osmotic pressure imbalance. We continue to study the exact mechanisms by which protein and structural components of the bacterial cell walls and membranes, and the protein shell that surrounds a virus, are affected by Microcyn. 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, we believe the solution remains non-irritating to human tissues because human cells have unique protective mechanisms, are interlocked, and prevent Microcyn from targeting and surrounding single cells topically on the body. Our laboratory tests suggest that our solution does not penetrate and kill multi-cellular organisms and does not damage or affect human DNA.

In laboratory tests, Microcyn has been shown to destroy 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.

In recently published studies, Microcyn has been shown to significantly increase the dilation of capillaries in wounds as indicated by higher levels of oxygen at a wound site after the application of our product and also reduce inflammation by inhibiting certain inflammatory responses from allergy-producing mast cells. It is widely accepted that reducing inflammation surrounding an injury or wound is beneficial to wound healing. Our laboratory research suggests that Microcyn's interference with these cells is selective to only the inflammatory response and does not interfere with other functions of these cells.

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 our 510(k) product 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 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. |

| Region | Approval or Clearance Type | Year of Approval or Clearance | Summary Indication |
|---|---|---|---|
| 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. |
| China | Medical Device | 2008 | Reduces the propagation of microbes in wounds and creates a moist environment for wound healing. |

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

***Clinical Trials***

We have completed a proof-of-concept Phase II trial in the U.S., which demonstrated the effectiveness of Microcyn in mildly infected diabetic foot ulcers with the primary endpoint of clinical cure and improvement of infection. We used 15 clinical sites and enrolled 48 evaluable patients in three arms, using Microcyn alone, Microcyn plus an oral antibiotic and saline plus an oral antibiotic. We announced the results of our Phase II trial in March 2008. In the clinically evaluable population of the study, the clinical success rate at visit four (test of cure) for Microcyn-alone-treated patients was 93.3% compared to 56.3% for the levofloxacin plus saline-treated patients. This study was not statistically powered, but the high clinical success rate (93.3%) and the p-value (0.033) suggests the difference is meaningfully positive for the Microcyn-treated patients. Also, for this set of data, the 95.0% confidence interval for the Microcyn only arm ranged from 80.7% to 100% while the 95.0% confidence interval for the levofloxacin and saline arm ranged from 31.9% to 80.6%; the confidence intervals do not overlap, indicating a favorable clinical success for Microcyn compared to Levofloxacin. At visit 3 (end of treatment), the clinical success rate for patients treated with Microcyn-alone was 77.8% compared to 61.1% for the levofloxacin plus saline-treated patients. Following a review meeting with the FDA which we expect to conduct in late summer of 2008, we intend to initiate the pivotal trials. These clinical trials are intended to provide the clinical basis for submission to the FDA of a NDA for the treatment of infected diabetic foot ulcers.

***Physician Clinical Studies***

In addition to the Phase II trial mentioned above, several physicians and scientists have conducted more than twenty-five clinical studies of Microcyn generating data suggesting that the Microcyn technology is non-irritating to healthy tissue, reduces microbial load, accelerates wound healing, reduces pain, 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, paying expenses or providing honoraria. In some cases, the physicians who performed these studies also hold equity in our company. The studies were performed in the United States, Europe, India, Pakistan, China and Mexico, 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 necessarily 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 publications and presentations at peer — reviewed meetings 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, 18 (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, 18 (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. |
| | | 3 | Bongiovanni CM. Nonsurgical Management of Chronic Wounds in Patients with Diabetes. *Journal of Vascular Ultrasound*, 2006, 30: 215-218, |
| 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<br>Dalla Paola, L. Treating diabetic foot ulcers with super-oxidized water. *Wounds*, 2006, 18 (Suppl), 14-16 |
| Alberto Piagessi, M.D.(5) | Italy | 33 | Goretti C, Mazzurco S, Ambrosini Nobili L, Macchiarini S, Tedeschi A, Palumbo F, Scatena A, Rizzo L and Piaggesi A. Clinical Outcomes of Wide Postsurgical Lesions in the Infected Diabetic Foot Managed With 2 Different Local Treatment Tegimes Compared Using a Quasi-Experimental Study Design: A Preliminary Communication. *Int. J. Lower Extremity Wounds,* 2007 6: 22-27. |
| 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, 18 (Suppl), 17-19. |
| Lenka Veverkova, M.D.(3) | Czech Republic | 27 | Veverkova L, Jedlicka V, Vesely M, Tejkalova R, Zabranska S, Capov I, Votava M. Methicilin-resistent Staphylococcus aureus — problem in health care. *J Wound Healing* 2005, 2:201-202. |

| Physician | Country | Number of Patients | Publication |
|---|---|---|---|
| Elia Ricci M.D.(6) | Italy | 40 | Ricci E, Astolfi S, Cassino R. Clinical results about an antimicrobial solution (Dermacyn Wound Care) in the treatment of infected chronic wounds. 17th Conference. EWMA Meeting 2005. Glasgow, UK. May 2-4, 2007. In preparation for publication. |
| Alfredo Barrera MD(5) | Mexico | 40 | Barrera-Zavala A, Guillen-Rojas M, Escobedo-Anzures J, Rendon J, Ayala O & Gutiérrez AA. A pilot study on source control of peritonitis with a neutral pH — super oxidized solution16th World Congress of the International, Association of Surgeons and Gastroenterologists (IASG). Madrid, Spain. 25th-27th May, 2006. |
| D Peterson MD | US | 5 | Peterson D, Hermann K, Niezgoda J, Dermacyn Effective in Treatment of Chronic Wounds with Extensive Bioburden While Reducing Local Pain Levels. Symposium on Advanced Wound Care and Wound Healing Society, Tampa, FL, April 28-May 1, 2007. |
| Steenvoorde, P.M.D, Van Doorn, L.P., M.A., Jacobi, C.E, PhD & Oskam, J., M.D., PhD.(3) | Netherlands | 10 | An unexpected effect of Dermacyn on infected leg ulcers, *J Wound Care* 2007, 16: 60-61. |
| Fermin Martinez M.D. | Mexico | 45 | Martínez-De Jesús FR, Ramos-De la Medina A, Remes-Troche JM, Armstrong DG, Wu SC, Lázaro Martínez JL, Beneit-Montesinos JV. Efficacy and safety of neutral pH superoxidised solution in severe diabetic foot infections. *Int Wound J.* 2007, 4:353-362. |
| Hadi SF MD(3) | Pakistan | 100 | Hadi SF, Khaliq T, Bilal N, Sikandar I, Saaiq M, Zubair M, Aurangzeb S. Treating infected diabetic wounds with superoxidized water as anti-septic agent: a preliminary experience. *J Coll Physicians Surg Pak.* 2007, 17:740-743. |
| BT Monaghan DPM(3) | Ireland | 10 | Monaghan BT & Cundell JH. Dermacyn as the Local Treatment for Infected Diabetic Foot Wounds. A case series. 5th Int. Symp. On the Diabetic Foot. Noordwijkerhout. 2007, The Netherlands. May 9-12, 2007. |
| Fernando Uribe MD(6) | Mexico | 80 | Uribe F. Effect of neutral pH Superoxidized solution in the healing of diabetic foot ulcers. 47th ICAAC Meeting. Poster L-1144. Chicago, IL. USA. Sept 17-20, 2007. |

| Physician | Country | Number of Patients | Publication |
|---|---|---|---|
| Ning Fanggang MD(3) | China | 20 | Fanggang N, Guoan Z. The clinical efficacy of Dermacyn on deep partial thickness burn wounds. |
| Amar Pal Suri DPM(6) | India | 100 | Suri AP. The Effectiveness of Stable Neutral Super-oxidized Solution for the Treatment of Infected Diabetic Foot Wounds. Diabetic Foot Global Conference. Hollywood, CA. 13-15 March. 2008. Submitted for publication Jan, 2008. |
| Alberto Piaggesi M.D.(5) | Italy | 40 | Piaggesi A et al. Efficacy and safety of microcyn® technology in wide post-surgical lesions in the infected diabetic foot. Diabetic Foot Global Conference. Hollywood, Ca. 13-15 March. 2008. |
| Robert G. Frykberg, DPM, MPH(6) | US | 23 | RG. Frykberg, RG, Tallis A, Tierney, E.: Wound Healing in Chronic Lower Extremity Wounds Comparing Super-Oxidized Solution (SOS) vs. Saline. Diabetic Foot Global Conference. Hollywood, Ca. 13-15 March. 2008. |
| Matthew Regulski DPM(5) | US | 18 | Regulski M, Floros R, Petranto R, Migliori V, Alster H, Pfeiffer D. Efficacy and Compatibility of Combination Therapy with Super-Oxidized Solution and a Skin Substitute for Lower Extremity Wounds. Symposium on Advanced Wound Care and Wound Healing Society, San Diego, CA, April 24-28, 2008. |
| Adam Landsman DPM PhD,(5)<br>Andres A Gutierrez MD PhD(1) & Oculus Collaborative Group | US | 48 | Landsman A, Blume P, Palladino M, Jordan D, Vayser DJ, Halperin G, Gutierrez AA and Oculus Collaborative Group. An Open Label, Three Arm Study of the Safety and Clinical Efficacy of Topical Wound Care vs. Oral Levofloxacin vs. Combined Therapy for Mild Diabetic Foot Infections. Diabetic Foot Global Conference. Hollywood, CA. 13-15 March. 2008. |
| Christopher Gauland, DPM(3) | US | 5 | Gauland C., Sickle Cell Disease, Symposium on Advanced Wound Care and Wound Healing Society, San Diego, CA, April 24-28, 2008. |

Notes

(1) indicates that the physician is an investor and was a member of our Medical and Business Advisory Board which the Company dissolved in April 2007, a paid consultant and received research grants, expense payments, honorarium and Microcyn to complete the study.

(2) indicates that the physician was a paid consultant, received expenses in connection with corporate development and licensing evaluations and is a warrant holder.
(3) indicates that the physician received Microcyn to complete the study.
(4) indicates that the physician is a paid consultant, was a member of our Medical and Business Advisory Board, which the Company dissolved in April 2007, 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.
(6) indicates that the physician received reimbursement of travel expenses and received Microcyn to complete the study.

In addition to the above articles and publications, several additional papers on the basic science of the technology have been published or have been submitted for peer review and publication, including:

| Researchers | Country | Publication |
|---|---|---|
| Landa-Solis, González-Espinosa D., Guzman B, Snyder M, Reyes-Terán G., Torres K. and Gutiérrez A.A.(1) | México | Microcyn(tm) a novel super-oxidized water with neutral pH and disinfectant activity. *J Hosp Infect* (UK) 2005, 61: 291-299. |
| Gutiérrez, A.A.(1) | US | The science behind stable, super-oxidized water. Exploring the various applications of super-oxidized solutions. *Wounds,* 2006, 18 (Suppl), 7-10. |
| Dalla Paola L. and Faglia E.(2) | Italy | Treatment of diabetic foot ulcer: an overview. Strategies for clinical approach. *Current Diabetes Reviews,* 2006, 2, 431-447 431. |
| González-Espinosa D., Pérez-Romano L., Guzman Soriano B., Arias E., Bongiovanni, C.M. & Gutiérrez A.A.(1),(3) | Mexico US | Effects of neutral super-oxidized water on human dermal fibroblasts in vitro. *International Wound Journal*, 2007, 4: 241-250. |
| Medina-Tamayo J., Balleza-Tapia H., López, X., Cid, M.E., González-Espinosa, D. Gutiérrez A.A.., and González-Espinosa C.(1) | Mexico US | Super-oxidized water inhibits IgE-antigen- induced degranulation and cytokine release in mast cells. *International Immunopharmacology* 2007. 2007, 7:1013-1024. |
| Q LeDuc. | UK | Le Duc Q, Breetveld M, Middelkoop E, Scheper RJ, Ulrich MMW, Gibbs S. A cytotoxic analysis of antiseptic medication on skin substitutes and autograft. *Br J Dermatology*. 2007, 157:33-40. |
| B McCurdy | US | McCurdy B. Emerging Innovations in Treatment. *Podiatry Today* 2006, 19: 40-48. |
| Zahumensky E. | Czech Republic | Infections and diabetic foot syndrome in field practice. *Vnitr Lek.* 2006;52:411-416. |
| Rose R., Setlow B., Monroe A., Mallozzi M., Driks A., Setlow P.(5) | US | Comparison of the properties of Bacillus subtilis spores made in liquid or on agar plates. Submitted 2008. |
| Paul M., Setlow B. and Setlow P.(5) | US | The killing of spores of *Bacillus subtilis* by Microcyn(tm), a stable superoxided water. Submitted 2008. |
| Eileen Thatcher(4) & Andres A Gutierrez(1) | US | Thatcher E & Gutiérrez AA. The Anti-Bacterial Efficacy of a New Super-Oxidized Solution. 47th ICAAC Meeting. Chicago, IL. USA. Sept 17-20, 2007. |

| Researchers | Country | Publication |
|---|---|---|
| Michael Taketa-Graham(5), Gutierrez AA(1), Thatcher E.(4) | US | Taketa-Graham M, Gutierrez AA, Thatcher E. The Anti-Viral Efficacy of a New Super-Oxidized Solution.. 47th ICAAC Meeting. Poster L-1144. Chicago, IL. USA. Sept 17-20, 2007. |
| Dardine J, Martinez C, & Thatcher E.(4) | US | Dardine J, Martinez C, & Thatcher E. Activity of a pH Neutral Super-Oxidized Solution Against Bacteria Selected for Sodium Hypochlorite Resistance. 47th ICAAC Meeting. Poster L-1144. Chicago, IL. USA. Sept 17-20, 2007. |
| Sauer K, Vazquez G., Thatcher E., Northey R. and Gutierrez A.A.(1),(4),(5) | US | Neutral super-oxidized solution is effective in killing *P. aeruginosa* biofilms. Submitted 2007. |

Notes

(1) Dr. Gutierrez is our Director of Medical Affairs and conducted the study during his employment by the Company.

(2) Dr. Dalla Paola was a member of our Medical and Business Advisory Board, which the Company dissolved in April 2007, and received expense payments and Microcyn to complete the study.

(3) Dr. Bongiovanni received Microcyn to complete the study.

(4) Dr. Thatcher is a full-time consultant to us, holds shares of our stock, previously served on our board of directors, and received Microcyn to complete the study.

(5) Dr. Northey is our Director of Research & Development and conducted the study during his employment by the Company.

**Sales and Marketing**

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. We currently make Microcyn available under our three 510(k) clearances in the United States, primarily through our website and several regional distributors for use in accordance with those clearances. We plan for a more aggressive commercialization initiative in the event we obtain drug approval from the FDA or sooner if our current market assessment study suggests we can develop a successful commericalzation strategy for our 510(k) clearances. Our current marketing efforts in the United States are test market in nature, designed to provide us with U.S. medical community feedback in terms of market perception of the Microcyn technology, how used and for what types of indications, but we are exploring a broader U.S. commercialization strategy for Microcyn-based 510(k) products under these or additional 510(k) clearances. In addition, an OTC “first responder” pen application (MyClyns) with Microcyn has been marketed in the United States since January 2008 by our partner, Union Springs Pharmaceuticals (a subsidiary of DECA). Also in January, we announced an exclusive North American distribution agreement with Walco International, Inc., a subsidiary of Animal Health International, Inc. for our Microcyn-based Vetericyn Wound Spray for animals.

In Europe, we currently have distribution agreements with distributors in Germany, Italy, and the Czech Republic for distribution of our Microcyn-based products in those countries.

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 pharmacies.

In India, we entered into an exclusive agreement with Alkem Laboratories, a large pharmaceutical company in India, for the sale of Microcyn-based products in India and Nepal.

In China, we entered into an exclusive distribution agreement with China Bao Tai Investment Company, Ltd., or China Bao Tai, for the sale of Microcyn wound care solution in China, Hong Kong, Macau and Taiwan. China Bao Tai intends to distribute and sell Microcyn to hospitals and pharmacies through Sinopharm, the largest pharmaceutical group in China, and through Lianhua Supermarkets for supermarket distribution. We expect sales of Microcyn wound care solution under this agreement to commence in the fall of 2008, now that China Bao Tai has received Chinese State Food and Drug Administration marketing approval.

Throughout the rest of the world, we intend to use strategic partners and distributors, who have a significant sales, marketing and distribution presence in their respective countries. We have established partners and distribution channels for our wound care products in Bangladesh, Pakistan, Singapore, United Arab Emirates and Saudi Arabia.

**Other Market Opportunities**

We are seeking strategic partnerships and wound care applications in markets where Microcyn Technology has competitive advantages over antibiotics in numerous medical indications outside of the acute and surgical wound market. 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 acute and chronic rhinosinusitis, or inflammation of the nasal sinuses. In animal studies, Microcyn has been shown to kill the bacteria that causes rhinosinusitis. We have conducted pre-clinical animal studies that suggest the efficacy and safety of this product candidate.

***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***

We believe that our Microcyn technology may be used both as a mouthwash and a dental rinse. Early data from physician studies suggest that it is safe for use in oral surgery.

***Ophthalmology***

We believe that our technology may be used to treat and prevent eye infections such as conjunctivitis. We have conducted in vitro and animal laboratory testing that suggests that our product is safe when placed in the eye.

***Veterinary Medicine***

Our animal wound care product is based on Microcyn technology, Vetericyn, is available for use in the United States, and we have entered into an exclusive North American distribution agreement with Walco International, Inc., a subsidiary of Animal Health International, Inc., for distribution of the company's Microcyn-based Vetericyn Wound Spray for animals.

**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 relating to 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. Significant efforts are also being directed toward extending our understanding of the unique chemistry of our products.

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

- Modification of the physical properties of our product to improve efficiency in unique antimicrobial applications;
- Development of new formulations and delivery systems that extend the stability of the product;
- Development of a surgical irrigant to control infections during and after surgery; and
- Alteration of current formulation for sinus treatments.

Currently, the main focus of our engineering staff is the construction or procurement of a U.S. Good Manufacturing Practices, or cGMP, compliant manufacturing system for our drug product. This entails significant upgrades to our raw material, manufacturing and bottling systems.

Our technology may have application in other non-medical markets. We intend to pursue opportunities in these markets with third parties as they arise. 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, we believe, is the basis for our technology's effectiveness and safety. Our manufacturing process produces very little waste, which is disposed of as water after a simple non-toxic chemical treatment.

We have a research and development pilot plant in Petaluma, CA, we manufacture our products in 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. 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 and is also ISO certified.

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 May 31, 2008, we own one issued U.S. patent, two issued European patents, one issued Japanese patent, 12 pending U.S. patent applications and 44 foreign pending patent applications generally relating to super-oxidized

water. These applications include four international PCT applications for which the time to file counterpart phase applications has not yet expired. Our portfolio of issued and pending applications can be divided into two groups. The first group includes one U.S. issued patent, two issued European patents, one issued Japanese patent, three pending U.S. patent applications and four 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 and 40 foreign patent applications (including international PCT applications) that relate to Microcyn, the method and apparatus for manufacturing Microcyn, and its uses.

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. For example, a competitor filed a Notice of Opposition in the Opposition Division of the European Patent Office to our recently issued European patent. 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, Canada, certain countries in Central and South America, including Mexico and Brazil, and certain countries in Asia, including Japan, China, the Republic of Korea, India 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 whom 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 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, Mupirocin 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 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 VACTherapy System 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 oxychlorine formulations, their products, unlike ours, typically become unstable after 48 hours. One such company, PuriCore, sells electrolysis machines used to manufacture brine-based oxidized water primarily as a sterilant. Additionally, we believe that Microcyn is the only stable anti-infective therapeutic available in the world today that simultaneously cures or improves infection while also accelerating wound healing through increased blood flow to the wound bed and reduction of inflammation.

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 or clearance 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 clearances, 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***

Microcyn has received three 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. Any future product candidates or new applications using Microcyn that are classified as medical devices will need approval or clearance by the FDA.

New medical devices, such as Microcyn, are subject to FDA clearance 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 clearance 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***

We have two pharmaceutical product candidates that are regulated by the FDA and will require approval before we can market or sell them as drugs. Any future product candidates or new applications using Microcyn that are classified as drugs will need approval by the FDA.

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.

- *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 manufactures 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 March 31, 2008**,** we had 79 full-time employees, including 4 in manufacturing, 22 in research and development, 11 in regulatory and clinical, seven in sales and marketing and 19 in executive or administrative functions in the United States, three in administrative functions in Europe, five in administrative functions in Mexico, seven in our services business and one in an information technology function. None of our employees is covered by collective bargaining arrangements, and we consider our relationship with our employees to be good.

**Available Information**

Our website is located at www.oculusis.com. We make available free of charge on our website our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports, as soon as reasonably practicable after we electronically file or furnish such materials to the Securities and Exchange Commission. Our website and the information contained therein or connected thereto are not intended to be incorporated into this Annual Report on Form 10-K.

**ITEM 1A:** ***Risk Factors***

**Factors that May Affect Results**

**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 losses in each fiscal year since our inception, including net loss from continuing operations of $20.3 million, $19.8 million and $23.1 million for the years ended March 31, 2008, 2007 and 2006 respectively. Our accumulated deficit as of March 31, 2008 was $90.8 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:

- 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;
- establish additional and expand existing manufacturing facilities; and
- grow our sales and marketing capabilities in the United States and internationally.

As a result of these activities, we will need to generate significant revenue in order to achieve profitability and may never become profitable.

Without raising additional capital, we would curtail certain operational activities, including regulatory trials, in order to reduce costs. 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 been selling our products since July 2004, and substantially all of our historical product revenues have been from sales of Microcyn in Mexico prior to 2007. 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 fiscal year 2007. For example, product revenues from countries outside of Mexico were just 9% of our product revenues for the year ended March 31, 2006. However, for the years ended March 31, 2008 and 2007, the percentage of product revenues from outside of Mexico increased to 26% and 32%, respectively. 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. We recently decreased our sales and marketing activities in Europe and Mexico, which could materially affect our revenues in the geographic areas in the future.

***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 conduct regulatory trials, commercialize our products and expand our infrastructure. 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:

- fund our clinical trials and preclinical studies;
- sustain commercialization of our current products or new products;
- expand our manufacturing capabilities;
- increase our sales and marketing efforts to drive market adoption and address competitive developments;
- 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.

***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, Europe, Pakistan, India and China, 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.

***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:

- insufficient funds to continue our clinical trials;
- the 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; and
- governmental regulations or administrative actions are changed.

We do not know whether 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. In addition, further studies and trials could show different results. For example, after an Environmental Protection Agency, or 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, Cidalcyn, as a hospital grade disinfectant. However, the EPA conducted subsequent tests and informed us that Cidalcyn did not meet efficacy standards when tested against three specific pathogens. In response to this test, we voluntarily recalled samples of the product previously distributed and later entered into a Consent Agreement and Final Order with the EPA, allowing us to amend our EPA registration and pay a $20,800 fine without admitting or denying any wrongdoing. In addition, in an independent physician study of 10 patients in which procedures were not fully delineated, published in February 2007, four patients discontinued treatment with Dermacyn due to pain, and beneficial change in wound microbiology was found in only one of the six remaining patients. In our Phase II trial, one patient reported a burning sensation which physicians indicated was probably attributable to Microcyn. 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.

The FDA and other regulatory bodies may also change standards and acceptable trial procedures required for a showing of safety and efficacy. For example, until recently, the FDA accepted non-inferiority clinical trials, or clinical trials that show that a new treatment is equivalent to standard treatment, as the standard for anti-infective drug approvals. On October 12, 2007, the FDA released draft guidance entitled Antibacterial Drug Products: Use of

Noninferiority Studies to Support Approval. This new agency guidance requires either placebo-controlled or superiority trial designs, which are designed to test whether, and to what extent, a new treatment is better than the placebo. The uncertainty of clinical trial protocols and changes within FDA guidelines could have a negative impact on the timelines and milestones for our clinical program.

***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 recently concluded a Phase II study and are planning to conduct a pilot study of Microcyn for the treatment of wound infections. 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, changes to formulation 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 plan 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 change the name under which we market our products in Mexico. We have marketed our products in Mexico under the brand name of Microcyn60 since 2004. During the years ended March 31, 2008 and 2007, the percentage of our product revenues derived from Mexico was 75% and 68%, respectively. 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. We cannot assure you that the reserve we have taken will be sufficient to offset the losses we may incur as a result of changing our brand name.

***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.

***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 or maintaining a direct sales force in each market. We may incur significant costs in the use of third parties to identify and assist in establishing relationships with potential collaborators.

To penetrate our target markets, we may need to enter into additional collaborative agreements to assist in the development and commercialization of 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 choose 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 and may have the potential to provide collaborators with access to our key intellectual property filings and next generation formations. 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 are unable to expand our direct domestic sales force, we may not be able to successfully sell our products in the United States.***

We have very limited commercialization capability and make Microcyn-based products available primarily through our website, and several regional distributors. We plan for a more aggressive commercialization and product launch in the event we obtain drug approval from the FDA or obtain other clearance or approval with would healing claims. 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. 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.

***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 from 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 gathered records for review to determine if there might have been any problems in production of the lot tested by the EPA. 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 clinical tests 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, including our intellectual property if our unrestricted cash reserves drop below the average of our expenses over a six-month period, under a loan and security agreement. 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 U.S. 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. For example, a competitor filed a Notice of Opposition with the Opposition Division of the European Patent Office in February 2008 opposing our recently issued European patent.

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 in the United States, or 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 brought a claim against Nofil Corporation in the U.S. District Court for the Northern District of California, and an order granting our motion to dismiss Nofil's cross-complaint was granted in November 2007. 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 leaks of confidential data into the public domain or to third parties could allow our competitors to learn our trade secrets.

***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.***

On occasion, 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. For example, in June 2006, we received written notice from Coherent Technologies, the licensor of exclusive licenses to six issued Japanese patents and five Japanese published pending patent applications, advising us that our patent license from Coherent Technologies was terminated, citing various reasons with which we disagree. Since that time, we have engaged in discussions with Coherent Technologies 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. Some claims received from third parties may lead to litigation. We cannot predict whether 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. In addition, the outcome of such litigation may be unpredictable. 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 exclude 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 changed the name under which we market our products in Mexico. 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, which may impair our ability to enforce our trademark rights against infringers in those countries. 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 Microcyn 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. During the years ended March 31, 2008, 2007 and 2006, approximately 70%, 78% and 72%, of our total revenues were 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 market and sell our products 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 operations 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. 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 a member of our board of directors, and Robert Northey, our Director of Research and Development. 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.

The growth of our business may involve entry into complex business transactions. If we are unable to implement and maintain proper internal controls and recognize in advance the consequences that may arise out of complex business transactions, we may not obtain the intended benefits of such transactions, and we could be subject to adverse consequences, including being subject to fines and penalties. In the past, we entered into a series of agreements with Quimica Pasteur, or OP, a Mexico-based distributor of pharmaceutical products to hospitals and health care entities owned or operated by the Mexican Ministry of Health, or MOH. The consequences of these agreements showed us that we needed to better plan for complex transactions and the applications of complex accounting principals relating to those transactions and to better identify potentially improper practices. As a result of these agreements, we were required to consolidate OP's operations with our financial results for a portion of our year ended March 31, 2006. In connection with our audit of OP's financial statements in late 2005, we were made aware of a number of facts that suggested that OP or its principals may have engaged in some form of tax avoidance practices in Mexico prior to the execution of the agreements between our company and OP, and we did not discover these facts prior to our execution of these agreements or for several months thereafter. Although we do not believe that we are responsible for any tax avoidance practices of OP'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 action for fraud, is five years from March 31, 2006. If we are unable to implement and maintain adequate internal controls, we could be subject to fines and penalties.

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.***

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 conduct 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. If we need third party assistance in identifying and negotiating one or more acceptable arrangements, it might be costly. 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 current stockholders' 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 current stockholders' 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 previously had agreements to pay compensation to our advisory board members and physicians who conducted clinical trials or provided 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 to accommodate growth of our business and organization and to satisfy public company reporting requirements, which will increase our costs and require additional management resources.***

As a public reporting company, we are 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. Section 404 of the Sarbanes-Oxley Act of 2002, or Section 404, requires our management to perform an annual assessment of our internal control over financial reporting, and our independent auditors to attest to the effectiveness of our internal controls beginning with our fiscal year ended March 31, 2008. Compliance with Section 404 and other requirements of doing business as a public company have and will continue to increase our costs and require additional management resources to implement an ongoing program to perform system and process evaluation and testing of our internal controls. In the past, we entered into transactions that resulted in accounting consequences that we did not identify at the time of the transactions. As a result, 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. In calendar 2006, our current independent auditors recommended certain changes which, in addition to other changes in our financial reporting and management structure, have been implemented at additional cost. We have upgraded our 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 reporting requirements. If our management is unable to conclude that our internal controls are adequate, if we are unable to maintain the required Section 404 assessment as was complied with as of our second Annual Report on Form 10-K for which compliance was 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**

***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;
- costs associated with collaborations and new product candidates;
- 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 price you paid for it.***

Although our common stock is listed on the NASDAQ Global Market, an active and liquid trading market for our common stock has not yet and may not ever develop or be sustained. You may not be able to sell your shares quickly or at or above the price you paid for our stock if trading in our stock is not active.

***We do not expect to pay dividends in the foreseeable future.***

We do not anticipate paying cash dividends on our common stock in the foreseeable future. Any payment of cash dividends will depend on our financial condition, results of operations, capital requirements and other factors and will be at the discretion of our board of directors. In addition, under our secured loan, we may not pay any dividends without our secured lender's prior written consent for as long as we have any outstanding obligations to the secured lender. 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.

***Anti-takeover provisions in our charter and by-laws and under Delaware law may make it more difficult for stockholders 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 convertible 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 meeting of stockholders.

These provisions might discourage, delay or prevent a change of control 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.

***Our stockholders may experience substantial dilution in the value of their investment if we issue additional shares of our capital stock.***

Our charter allows 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 convertible 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 convertible preferred stock, these securities may provide for rights, preferences or privileges senior to those of holders of our common stock.

**ITEM 1B:** ***Unresolved Staff Comments***

None.

**ITEM 2.** ***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 research and development under the lease agreement. The lease was scheduled to expire on September 30, 2007. On September 13, 2007, we entered into Amendment No. 4 to the property lease agreement for our facility in Petaluma, California. The amendment extends the lease expiration date to September 30, 2010.

We lease approximately 12,000 square feet of office and manufacturing space and approximately 5,000 square feet of warehouse space in Zapopan, Mexico, under leases that expires in April 2011 and 2009, respectively. 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 a lease that was scheduled to expire on January 31, 2009. On February 15, 2008, we extended this lease to January 2011. As we expand, we may need to establish manufacturing facilities in other countries.

We believe that our properties will be adequate to meet our needs through March 2009.

**ITEM 3.** ***Legal Proceedings***

The Company, on occasion, 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.

**ITEM 4.** ***Submission of Matters to a Vote of Security Holders***

None.

## PART II

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

(a) Our common stock is traded on the NASDAQ Global Market under the symbol "OCLS" and has been trading since our initial public offering on January 25, 2007. The following table sets forth the range of high and low sale prices for our common stock, based on the last daily sale, in each of the quarters since our stock began trading:

| | Year Ended March 31, 2008 | | | |
|---|---|---|---|---|
| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
| Stock price-high | $ 8.75 | $11.48 | $ 7.86 | $ 7.29 |
| Stock price-low | $ 5.66 | $ 4.84 | $ 3.71 | $ 3.20 |

| | Year Ended March 31, 2007 | | | |
|---|---|---|---|---|
| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
| Stock price-high | n/a | n/a | n/a | $ 8.00 |
| Stock price-low | n/a | n/a | n/a | $ 5.95 |

According to the records of our transfer agent, we had 654 stockholders of record as of June 2, 2008.

(b) We have never declared or paid any cash dividends on our capital stock, and we do not currently intend to pay any cash dividends on our common stock in the foreseeable future. Pursuant to our Loan and Security Agreement dated June 14, 2006 with Venture Lending & Leasing IV, Inc., as amended, we will not pay any dividends without our secured lenders' prior written consent for so long as we have any outstanding obligations to the secured lenders.

(c) Information regarding the securities authorized for issuance under our equity compensation plans can be found under Item 12 of Part III of this Report.

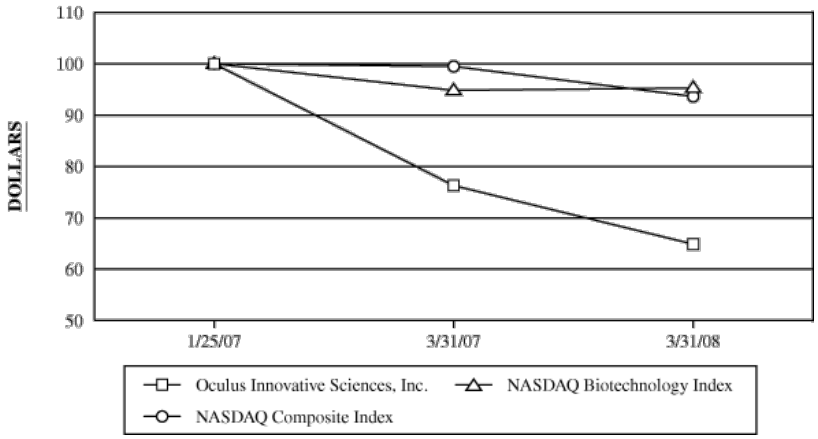
(d) During the three months ended March 31, 2008, we did not sell any equity securities that were not registered with the Securities Act, nor did we purchase any of our equity securities. However, during the fiscal year ended March 31, 2008 the period covered by this report, we had sales of unregistered equity securities. On August 13, 2007, the Company completed a private placement of 1,262,500 shares of common stock to certain accredited investors at a price of $8.00 per share pursuant to the terms of Securities Purchase Agreements dated August 7, 2007. In addition, the investors received warrants to purchase an aggregate of 416,622 additional shares of common stock at an exercise price of $9.50 per share. Gross proceeds from the private placement were $10,100,000 and net proceeds were $9,124,000 (after the placement agent's commission and other offering expenses). Pursuant to the terms of a Registration Rights Agreement dated August 7, 2007, the shares of common stock issued to the investors in the private placement and the shares of common stock to be issued upon the exercise of the warrants issued in the private placement were registered on a Form S-1 (File No. 333-145810), which was declared effective on September 12, 2007. The Company also issued a warrant to purchase 88,375 shares of common stock to a placement agent in connection with the private placement (described below). The warrant has the same terms, including exercise price and registration rights, as the warrants issued in the private placement. Pursuant to the warrant agreements issued in connection with the private placement, the subsequent issuance of shares in our registered direct offering in March 2008 triggered the adjustment of the exercise price of the warrants to $8.63. The investor warrants are now exercisable for an additional 41,977 shares, and the placement agent warrants are now exercisable for an additional 8,909 shares.

(e) Stock Performance Graph

The following information is not deemed to be "soliciting material" or to be "filed" with the Securities and Exchange Commission or subject to Regulation 14A or 14C under the Securities Exchange Act of 1934 or to the liabilities of Section 18 of the Securities Exchange Act of 1934, and will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent we specifically incorporate it by reference into such a filing.

Set forth below is a line graph showing the cumulative total stockholder return (change in stock price plus reinvested dividends) assuming the investment of $100 on January 25, 2007 (the day of our initial public offering) in each of our common stock, the NASDAQ Market Index and the NASDAQ Biotechnology Index for the period commencing on January 25, 2007 and ending on March 31, 2008. The comparisons in the table are required by the Securities and Exchange Commission and are not intended to forecast or be indicative of future performance of our common stock.

**COMPARISON OF CUMULATIVE TOTAL RETURN**
**AMONG OCULUS INNOVATIVE SCIENCES, INC.,**
**NASDAQ COMPOSITE AND NASDAQ BIOTECH INDEX**




| | 1/25/07 | 3/31/07 | 3/31/08 |
|---|---|---|---|
| Oculus Innovative Sciences, Inc. | $ 100.00 | $ 76.28 | $ 64.87 |
| NASDAQ Biotechnology Index | $ 100.00 | $ 94.81 | $ 95.29 |
| NASDAQ Composite Index | $ 100.00 | $ 99.48 | $ 93.63 |

**ITEM 6.** ***Selected 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 Form 10-K. The selected consolidated statement of operations data for each of the years ended March 31, 2008, 2007 and 2006 and the selected consolidated balance sheet data as of March 31, 2008 and 2007 have been derived from our audited consolidated financial statements and related notes included elsewhere in this Form 10-K. The selected consolidated statements of operations data for the years ended March 31, 2005 and 2004 and the selected consolidated balance sheet data as of March 31, 2006, 2005 and 2004 have been derived from our consolidated financial statements and related notes not included in this Annual Report on Form 10-K. Our historical results are not necessarily indicative of the results that may be expected in the future.

| | Year Ended March 31, | | | | |
|---|---|---|---|---|---|
| | 2008 | 2007 | 2006 | 2005 | 2004 |
| **Consolidated statement of operations data (in thousands, except per share data):** | | | | | |
| Revenues | | | | | |
| Product | $ 2,881 | $ 3,679 | $ 1,966 | $ 473 | $ 95 |
| Service | 954 | 864 | 618 | 883 | 807 |
| Total revenues | 3,835 | 4,543 | 2,584 | 1,356 | 902 |
| Cost of revenues | | | | | |
| Product(1) | 1,774 | 2,104 | 3,899 | 2,211 | 1,403 |
| Service(1) | 977 | 895 | 1,003 | 1,311 | 1,265 |
| Total cost of revenues | 2,751 | 2,999 | 4,902 | 3,522 | 2,668 |
| Gross profit (loss) | 1,084 | 1,544 | (2,318) | (2,166) | (1,766) |
| Operating expenses | | | | | |
| Research and development(1) | 9,778 | 4,508 | 2,600 | 1,654 | 1,413 |
| Selling, general and administrative(1) | 13,731 | 16,520 | 15,933 | 12,492 | 3,918 |
| Total operating expenses | 23,509 | 21,028 | 18,533 | 14,146 | 5,331 |
| Loss from operations | (22,425) | (19,484) | (20,851) | (16,312) | (7,097) |
| Interest expense | (1,016) | (956) | (172) | (372) | (178) |
| Interest income | 630 | 312 | 282 | 8 | 3 |
| Other income (expense), net | 2,472 | 345 | (377) | 146 | (26) |
| Net loss from continuing operations | (20,339) | (19,783) | (21,118) | (16,530) | (7,298) |
| Loss from operations of discontinued business | — | — | (818) | — | — |
| Loss on disposal of discontinued business | — | — | (1,163) | — | — |
| Loss on discontinued operations | — | — | (1,981) | — | — |
| Net loss | (20,339) | (19,783) | (23,099) | (16,530) | (7,298) |
| Preferred stock dividends | — | (404) | (121) | — | — |
| Net loss available to common stockholders | $ (20,339) | $ (20,187) | $ (23,220) | $ (16,530) | $ (7,298) |
| Net loss per common share: basic and diluted | | | | | |
| Continuing operations | $ (1.60) | $ (3.71) | $ (5.12) | $ (4.22) | $ (1.87) |
| Discontinued operations | — | — | (0.48) | — | — |
| | $ (1.60) | $ (3.71) | $ (5.60) | $ (4.22) | $ (1.87) |
| Weighted-average number of shares used in per common share calculations: | | | | | |
| Basic and diluted | 12,737 | 5,448 | 4,150 | 3,914 | 3,911 |

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

| | Year Ended March 31, | | | | |
|---|---|---|---|---|---|
| | 2008 | 2007 | 2006 | 2005 | 2004 |
| Cost of revenues | | | | | |
| Product | $ — | $ — | $ 2 | $ 2 | $ — |
| Service | 10 | 4 | 1 | 3 | 10 |
| Operating expenses | | | | | |
| Research and development | 177 | 70 | 52 | 5 | 56 |
| Selling, general and administrative | 1,152 | 1,508 | 542 | 2,339 | 358 |
| | 1,339 | 1,582 | 597 | 2,349 | 424 |

| | Year Ended March 31, | | | | |
|---|---|---|---|---|---|
| | 2008 | 2007 | 2006 | 2005 | 2004 |
| **Consolidated Balance Sheet Data (in thousands):** | | | | | |
| Cash and cash equivalents | $ 18,823 | $ 19,050 | $ 7,448 | $ 3,287 | $ 869 |
| Working capital | 13,500 | 13,834 | 5,127 | 663 | (1,186) |
| Total assets | 23,612 | 26,950 | 12,689 | 6,940 | 2,992 |
| Total liabilities | 8,184 | 12,049 | 5,351 | 4,738 | 3,374 |
| Total stockholders' equity (deficit) | 15,428 | 14,901 | 7,338 | 2,202 | (382) |

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

***Business Overview***

Oculus Innovative Sciences is a biopharmaceutical company that develops, manufactures and markets a family of products, based on its platform technology called Microcyn, intended to help prevent and treat infections in chronic and acute wounds. Microcyn is a non-irritating oxychlorine compound designed to treat a wide range of pathogens, including antibiotic-resistant strains of bacteria, viruses, fungi and spores.

***Financial Operations Overview***

*Revenues*

We derive our revenues from product sales and service arrangements. Product revenues are generated from the sale of Microcyn products 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.

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.

*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, 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 to operations 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.

**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 consolidated 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, 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:

*Stock-based compensation*

Prior to April 1, 2006, we 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.” We used the minimum value method to measure the fair value of awards issued prior to April 1, 2006 with respect to our application of the disclosure requirements under SFAS No. 123.

Effective April 1, 2006, we adopted SFAS No. 123(R) “Share Based Payment” (“SFAS 123(R)”) using the prospective method. This statement is a revision of SFAS 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.

We 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. We 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.

*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.

***Comparison of Years Ended March 31, 2008 and 2007***

*Overview*

Our strategy this past year was first and foremost to focus on the clinical program in the United States, the largest addressable market in the world for Microcyn. Last year we made a strategic decision to focus our resources on the U.S. clinical process and to dramatically reduce international expenses. We achieved both objectives by completing the Phase II trial with good results and reducing our international expenses by $4 million, compared to last year. The emphasis in Mexico was to break even, which occurred in the last month of the fiscal year 2008, with a reduction in operating expenses of $2.6 million on a full year basis.

*Revenues*

Our total revenues were $3.8 million for the year ended March 31, 2008, a 16% decline from the prior year level of $4.5 million. The $798,000, or 22%, decline in product revenues was primarily due to $521,000, or 86%, lower sales to our customer Alkem Laboratories Limited, in India, and a $395,000, or 16%, decline in Mexico sales. Alkem is responsible for bottling, labeling, shipping and selling their Microcyn product called "Oxum" through their own sales force in India. Sales to Alkem in the prior year were driven by large initial stocking orders of samples used during their initial product launch. Although the large initial stocking orders did not recur in the year ended March 31, 2008, Alkem continues to sell and ship product to doctors and patients in India in steadily growing volumes. Sales in Mexico have also declined $395,000 over the prior year, a result of the reduction in our sales force in Mexico as we executed our strategy of lowering expenses in our international subsidiaries and focusing our resources on U.S. clinical and development initiatives. More specifically, with the reduction of the sales force in Mexico from 70 to 30 people, we have focused on the growth of sales to pharmacies and not sales to hospitals due to the higher profitability and higher sales price attainable from pharmacies. Consequently, the decline in hospital sales was partially offset by 37% growth in sales to pharmacies compared to the prior year.

The following table shows our product revenues by country (note that sales in India are reported as part of our European operating segment):

| | Year Ended March 31, | |
|---|---|---|
| | 2008 | 2007 |
| | (In thousands) | |
| U.S. | $ 197 | $ 140 |
| Mexico | 2,118 | 2,513 |
| India | 83 | 604 |
| Europe | 483 | 422 |
| Total | $ 2,881 | $ 3,679 |

The $90,000, or 10%, increase in service revenues was due primarily to an increase in the number of tests performed by our services business.

*Gross Profit/Loss*

We reported gross profit from our products business of $1.1 million, or 38% of product revenues, during the fiscal year ended March 31, 2008, compared to a gross profit of $1.6 million, or 43%, in the year ago period. This decrease is due primarily to the lower sales volumes in India, and the relatively high fixed cost component in our European facility where this product is produced. Margins in Mexico have also decreased from year to year due to lower sales volumns, and a slight increase in the cost of production in the current year. We reported losses from our services business of $23,000 for the year ended March 31, 2008, compared to a $31,000 loss in the prior year.

We expect gross profits to increase as a percentage of sales in future periods as we grow our Microcyn-based products business.

*Research and Development Expense*

Research and development expense increased $5.3 million, or 117%, to $9.8 million for the year ended March 31, 2008, from $4.5 million for the year ended March 31, 2007. This increase was primarily the result of $3.1 million higher clinical development costs from $894,000 during the year ended March 31, 2007 to $4.0 million during the year ended March 31, 2008. These clinical development costs included $489,000 and $2.9 million in contract research organization fees related to our Phase II clinical trials in the years ended March 31, 2007 and 2008 respectively. In addition, our other research and development expenses increased as we grew the product development team, expanded the scope of our new product development initiatives, and continued to enhance our cGMP manufacturing capabilities at our U.S. research and development facility.

We expect research and development expenses to increase in future periods as we incur the costs associated with clinical trials and as we continue to expand our new product development programs.

*Selling, General and Administrative Expense*

Selling, general and administrative expense decreased $2.8 million, or 17%, to $13.7 million for the year ended March 31, 2008, from $16.5 million for the year ended March 31, 2007. Primarily this decrease was due to $4.0 million lower selling, general and administrative expenses in our Europe and Mexico subsidiaries as we executed our strategy of shifting our company resources away from expanding markets internationally through a reduction in force in these subsidiaries.

This decrease was offset in part by a $1.2 million increase in our U.S. selling, general, and administrative expenses, primarily the result higher outside service expenses as compared to the year ago period. Outside service expenses were $1.2 million higher than the prior year, primarily due to $350,000 higher legal fees as Oculus has relied more on outside counsel for both public company related SEC filings and IP protection work, $259,000 higher accounting fees, and $228,000 higher fees related to Sarbanes Oxley compliance and other finance projects. Bonus expense also increased $577,000 to $837,000 during the year ended March 31, 2008, as the compensation plans for executives and employees were increased to more closely correspond to market levels. Insurance expense also increased $315,000 over the prior year due to the new directors and officers liability insurance initiated following our IPO in January 2007. These increases were offset in part by $245,000 lower travel expense as the executive team was not required to travel to Mexico and Europe as often as they had in the prior year, and $357,000 lower stock compensation expense.

We expect that selling, general and administrative expenses will stay relatively constant in future periods. We are, however, currently assessing strategies for initiating a sales and marketing launch in the United States of our Dermacyn Wound Care product using current or additional 510(k) claims that, if initiated, will lead to higher sales and marketing expenses as early as the year ending March 31, 2009.

*Interest income and expense and other income and expense*

Interest expense increased $60,000 to $1.0 million for the year ended March 31, 2008, from $956,000 in the year ago period, primarily due to higher average debt balance during the year ended March 31, 2008 as compared to the year ago period. Interest income increased $318,000 to $630,000 for the year ended March 31, 2008, from $312,000 in the year ago period, primarily due to higher interest bearing investments in the current year.

Other income and expense primarily consists of non-cash charges due to the fluctuation of foreign exchange rates, and the resulting gain or loss booked for the revaluation of our intercompany notes payable denominated in non-local currencies. During the year ended March 31, 2008, the U.S. dollar became weaker in relation to the Mexican peso and the Euro, and a net $2,594,000 gain on foreign exchange was recorded accordingly. During the year ended March 31, 2007, the U.S. Dollar became weaker in relation to the Mexican Peso and the Euro, and a $407,000 gain on foreign exchange was recorded.

We expect that interest expense will decrease in future periods as we continue to pay down our current debt balance, and interest income will fluctuate in proportion to our interest bearing investments.

***Comparison of Years Ended March 31, 2007 and 2006***

*Revenues*

We experienced growth in revenues in both our product and services businesses resulting in reported revenues of $4.5 million in the year ended March 31, 2007, an increase of 76% from the prior year level of $2.6 million.

The $1.7 million, or 87%, increase in product revenues was due primarily to higher sales volumes in Mexico and Europe, and sales to a new customer, Alkem Laboratories Limited, in India. The following table shows our product revenues by country (note that sales to India are reported as part of our European operating segment):

| | Year Ended March 31, | |
|---|---|---|
| | 2007 | 2006 |
| | (In thousands) | |
| U.S | $ 140 | $ 109 |
| Mexico | 2,513 | 1,788 |
| India | 604 | — |
| Europe | 422 | 69 |
| Total | $ 3,679 | $ 1,966 |

The $246,000, or 40%, increase in service revenues was due primarily to an increase in the number of tests performed by our services business.

*Gross Profit/Loss*

We reported gross profit from our Microcyn products business of $1.6 million, or 43% of product revenues, in the year ended March 31, 2007, compared to the prior year reported gross loss of $1.9 million, or -98% of product revenues. The gross loss in the year ended March 31, 2006 was adversely affected by $1.0 million of non-recurring inventory write-downs and approximately $200,000 of non-recurring charges associated with the relocation of our Mexico manufacturing facility during the year. Excluding these charges, our gross loss from product sales in the year ended March 31, 2006 would have been $685,000, or -35% of product revenues. The increase in product gross margin, excluding these non-recurring charges, from -35% in the year ended March 31, 2006, to 43% in the year ended March 31, 2007, was primarily due to improvements in manufacturing efficiencies through the consolidation of our worldwide manufacturing from three sites to two during the year. In April 2006, we transitioned the United States facility from a product manufacturing site into a research and development facility, and began producing all products for sales outside of Mexico in our facility in Europe. The remaining improvements in gross profits were due to a full year of benefit from the relocation of our Mexican manufacturing site during the year ended March 31, 2006 from Morelia, Mexico into a lower-cost manufacturing facility in Zapopan, Mexico.

We reported a gross loss from our services business of $31,000, or -4% of service revenues, in the year ended March 31, 2007, compared to the prior year reported gross loss of $385,000, or -62% of service revenues. This improvement in margin from -62% to -4% was due primarily to the growth in sales volume of our services which moved our service revenues closer to exceeding the relatively high fixed cost of our laboratory facility. Additionally, we discontinued our consulting service business during the year ended March 31, 2006 which had a positive impact on our services margin.

*Research and Development Expense*

Research and development expense increased $1.9 million, or 73%, to $4.5 million for the year ended March 31, 2007, from $2.6 million for the year ended March 31, 2006. This increase was primarily the result of higher personnel costs associated with the expansion of our research and development teams. The expansion of these teams was through both an internal shift in our U.S. operations from product manufacturing to research and development, as well as through the hiring of outside personnel. The expansion of the research and development teams helps support our increased attention to product development and the management of regulatory trials designed to obtain FDA drug approvals for our Microcyn products.

*Selling, General and Administrative Expense*

Selling, general and administrative expense increased $587,000, or 4%, to $16.5 million for the year ended March 31, 2007, from $15.9 million for the year ended March 31, 2006. This increase was primarily due to a $966,000 increase in non-cash stock-based compensation expense recorded during the year ended March 31, 2007. This increase in stock compensation charges was primarily the result of charges incurred for the options issued to a new board member, which are amortized over the two-year agreement, and for the warrants issued for the settlement of litigation with a past employee. This increase was offset in the current year by lower outside service expenses, primarily in legal and accounting fees.

*Interest income and expense and other income and expense*

Interest expense increased $784,000 to $956,000 for the year ended March 31, 2007, from $172,000 in the year ended March 31, 2006, primarily due to the issuance of $8.2 million of new debt during the year. The new debt had amortized debt issuance costs booked as non-cash interest of $402,000, and normal interest expense of $441,000 during the year ended March 31, 2007.

Other income and expense primarily consists of non-cash charges due to the fluctuation of foreign exchange rates, and the resulting gain or loss booked for the revaluation of our intercompany notes payable denominated in non-local currencies. During the year ended March 31, 2007, the U.S. dollar became weaker in relation to the Mexican peso and the Euro, and a net $407,000 gain on foreign exchange was recorded accordingly. In comparison, during the year ended March 31, 2006, the U.S. Dollar became stronger in relation to the Mexican Peso and the Euro, and a $283,000 loss on foreign exchange was recorded. Additionally, during the year ended March 31, 2006, we incurred $113,000 in loss on the disposal of assets.

**Liquidity and Capital Resources**

Since our inception, we have incurred significant losses and, as of March 31, 2008, we had an accumulated deficit of $90.8 million. We have not yet achieved profitability, and we will need to generate significant product revenues to achieve profitability in the future.

***Sources of Liquidity***

Since our inception, substantially all of our operations have been financed through the sale of $99 million of our common and convertible preferred stock. These net proceeds include $21.9 million raised in our initial public offering in January 2007, and net proceeds of $21.7 million raised from the sale of common stock sold during the year ended March 31, 2008 in offerings described further below. We have received additional funding through various debt and financing transactions, as described further below. We have also used our revenues to date as a source of additional liquidity. As of March 31, 2008, we had unrestricted cash and cash equivalents of $18.8 million.

In June 2006, we entered into a loan and security agreement with a financial institution to borrow a maximum of $5.0 million. Under this facility we borrowed $4.2 million, and paid back $2.4 million in principal as of March 31, 2008. The terms of this facility include monthly principal payments over three years, plus interest payments of 8.5% per annum. Pursuant to provisions of the loan and security agreement, we no longer have the ability to borrow under this facility.

On November 7, 2006, we signed a loan agreement with Robert Burlingame, under which Mr. Burlingame advanced to us $4.0 million, which funded on November 10, 2006, accruing interest at an annual rate of 7%. The principal and all accrued interest under the loan agreement were to be paid promptly after the closure of a private placement of securities, such as our private placement in August 2007. In August 2007, we paid all principal and outstanding interest under this loan agreement from cash, including $2.0 million of restricted cash.

On August 13, 2007, we closed the private placement of 1,262,500 shares of our common stock at a purchase price of $8.00 per share, and warrants to purchase an aggregate of 416,622 shares of common stock at an exercise price of $9.50 per share for gross proceeds of $10.1 million and net proceeds of $9.1 million (after deducting the placement agent's commission and other offering expenses). The exercise price for the warrants was adjusted to

$8.63 in March 2008, after the anti-dilution provisions of the warrants were triggered by our registered direct offering. The investor warrants are now exercisable for an additional 41,977 shares.

On February 13, 2008, we filed a shelf registration statement, which was declared effective on February 26, 2008. In connection with this S-3, we may, from time to time, offer and sell preferred stock, either separately or represented by depositary shares, common stock or warrants, either separately or in units, in one or more offerings. The preferred stock and warrants may be convertible into or exercisable or exchangeable for common. The aggregate initial offering price of all securities sold under the shelf registration statement will not exceed $75,000,000. We may offer these securities independently or together in any combination for sale directly to investors or through underwriters, dealers or agents. We will set forth the names of any underwriters, dealers or agents and their compensation in supplements to the prospectus.

On March 31, 2008, we closed the registered direct placement of 2,634,578 shares of our common stock at a purchase price of $5.25 per share, and warrants to purchase an aggregate of 1,317,278 shares of common stock at an exercise price of $6.85 per share for gross proceeds of $13.3 million and net proceeds of $12.6 million (after deducting the placement agent's commission and other offering expenses). On April 1, 2008, there was a second closing of the same offering of 18,095 shares of its common stock at a purchase price of $5.25 per share, and warrants to purchase an aggregate of 9,047 shares of common stock at an exercise price of $6.85 per share for gross proceeds of $95,000.

***Cash Flows***

As of March 31, 2008, we had cash and cash equivalents of $18.8 million, compared to $19.1 million at March 31, 2007 and $7.4 million at March 31, 2006.

Net cash used in operating activities during the year ended March 31, 2008 was $17.4 million, primarily due to the $20.3 million net loss for the period. This use of cash was offset in part by a $1.5 million increase in accrued expenses, due primarily to the discretionary bonus amounts accrued during the year, and other non-cash charges, including $1.3 million of stock-based compensation, $740,000 of depreciation and amortization and $522,000 of non-cash interest expense, and to a lesser extent the $637,000 decrease in accounts receivable, resulting primarily from improved collections from customers in our Mexico subsidiary. Net cash used during the year ended March 31, 2007 was $18.1 million, primarily due to the $19.8 million net loss for the period and to a lesser extent due to a $433,000 decrease in accrued liabilities due to the payment on accrued clinical expenses related to our Phase II trial on treatment of diabetic foot ulcers, a $287,000 increase in accounts receivable due to the timing of payments made from our customers, and a $245,000 decrease in accounts payable due to the timing of payments made to our vendors. These uses of cash during the year ended March 31, 2007 were offset in part by non-cash charges of $1.6 million of stock-based compensation, $672,000 of depreciation and $547,000 of non-cash interest expense. Net cash used in operating activities during the year ended March 31, 2006 was $19.7 million, primarily due to the $21.1 million net loss for the period, and to a lesser extent the $849,000 increase in accounts receivables due to slow collections from customers of our Mexico subsidiary, and an $887,000 increase in our prepaid expenses. These uses of cash were offset in part by a $1.9 million increase in accounts payable as several large accounts for legal and accounting expenses were outstanding at the fiscal year end, and non-cash charges including $651,000 of depreciation and amortization, and $597,000 of stock based compensation.

Net cash used in investing activities was $617,000, $877,000, and $419,000 for the years ended March 31, 2008, 2007 and 2006, respectively. Primarily this cash was used during the year ended March 31, 2008 for upgrading our U.S. research and clinical facility to cGMP compliance, the purchase of equipment to support increased personnel in our United States facility, and to buy laboratory equipment to further our research and development capacities. In the years ended March 31, 2007 and 2006, net cash for investing activities were used primarily for investment in fixed assets and other capital expenditures to support increased personnel and manufacturing facility expansion in Europe and Mexico.

Net cash provided by financing activities was $17.8 million, $30.6 million, and $26.1 million for the years ended March 31, 2008, 2007 and 2006, respectively. The net cash provided by financing activities during the year ended March 31, 2008 was primarily related to the sale of common stock of $21.7 million during the year ended March 31, 2008 consisting of $9.1 million net cash raised in a private placement in August 2007, and the $12.6 million net cash

raised in a registered direct offering in March 2008. The net amounts received from financing were decreased by $2.0 million in restricted cash released for the repayment of the $4.0 million loan from Bob Burlingame. These cash increases were offset in part by $6.1 million in debt payments including the entire repayment of the $4.0 loan from Bob Burlingame. The net cash provided by financing activities during the year ended March 31, 2007 was primarily related to our initial public offering which raised net cash of $21.9 million in January 2007, and to a lesser extent the $9.1 million in proceeds from the issuance of debt during the year, including $4.0 Burlingame note and $4.2 million in debt from a financial institution, and $2.9 million of net proceeds raised from our Series C sale of convertible preferred stock. These cash additions were offset in part by $2.0 million of cash restricted for the payment of the Bob Burlingame loan, and $1.7 million of principal payments made on outstanding debt. The net cash provided by financing activities during the year ended March 31, 2006 was primarily related to $27.0 million of net proceeds raised from our Series B sale of convertible preferred stock, offset in part by $953,000 of principal payments made on outstanding debt.

***Contractual Obligations***

As of March 31, 2008, 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 |
| Long-term debt | $ 2,199 | $ 1,994 | $ 170 | $ 35 | $ — |
| Capital leases | 25 | 19 | 6 | — | — |
| Operating leases | 1,347 | 520 | 819 | 8 | — |
| Total | $ 3,571 | $ 2,533 | $ 995 | $ 43 | $ — |

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 research and development under the lease agreement. The lease was scheduled to expire on September 30, 2007. On September 13, 2007, we entered into Amendment No. 4 to the property lease agreement for our facility in Petaluma, California. The amendment extends the lease expiration date to September 30, 2010.

We lease approximately 12,000 square feet of office and manufacturing space and approximately 5,000 square feet of warehouse space in Zapopan, Mexico, under a lease that expires in April 2011 and 2009. 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 a lease that was scheduled to expire on January 31, 2009. On February 15, 2008, we extended this lease to January 2011. As we expand, we may need to establish manufacturing facilities in other countries.

We believe that our properties will be adequate to meet our needs through March 2009.

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 as we continue our FDA clinical trials on our Microcyn technology to treat diabetic foot ulcers, and the subsequent commercialization of an FDA approved drug. We can not assure that such approvals will be obtained, but if we do obtain them, it will take at least several years to obtain the necessary regulatory approvals to commercialize Microcyn as a drug in the United States.

We currently anticipate that our cash and cash equivalents together with our future revenues and interest we earn on these balances will be sufficient to meet our anticipated cash requirements to continue our sales and marketing and some research and development activities through March 2009.

However, in order to fund the pivotal clinical trials, execute our product development strategy, and to commercialize Microcyn as a drug product in the United States, we anticipate a need to raise additional funds prior

to March 31, 2009, and in periods following, through public or private equity offerings, debt financings, corporate collaborations or other means. The sale of additional equity or convertible debt securities would 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 to 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.

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.

***Use of Estimates***

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles 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 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.

***Recent Accounting Pronouncements***

In February 2007, FASB issued Statement of Financial Accounting Standards No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities” (“SFAS 159”). SFAS 159, which includes an amendment to Statement of Financial Accounting Standards No. 115, “Accounting for Certain Investments in Debt and Equity Securities” (“SFAS 115”), permits entities the option to measure many financial instruments and certain other items at fair value. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company is in the process of determining the impact that SFAS 159 will have on its financial condition, results of operations and cash flows.

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements-an amendment of Accounting Research Bulletin No. 51” (“SFAS 160”). SFAS 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent’s ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS 160 is effective as of the beginning of an

entity's fiscal year that begins after December 15, 2008. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS 160 on its financial condition and results of operations.

In December 2007, the SEC issued SAB No. 110, Certain Assumptions Used in Valuation Methods — Expected Term ("SAB 110") According to SAB 110, under certain circumstances the SEC staff will continue to accept beyond December 31, 2007 the use of the simplified method in developing an estimate term of share options that possess certain characteristics in accordance with SFAS 123(R) beyond December 31, 2007. We adopted SAB 110 effective January 1, 2008 and continue to use the simplified method in developing the expected term used for our valuation of stock-based compensation.

In February 2008, SFAS 157 was amended by FSP 157-2, "Effective Date of FASB Statement No. 157: Fair Value Measurements" ("FSP 157-2"). As such, SFAS 157 (as amended) is partially effective for measurements and disclosures of financial assets and liabilities for fiscal years beginning after November 15, 2007 and is fully effective for measurement and disclosure provisions on all applicable assets and liabilities for fiscal years beginning after November 15, 2008. We are currently evaluating the impact that FSP 157-2 will have on our consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities ("SFAS 161"). SFAS 161 is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. SFAS 161 achieves these improvements by requiring disclosure of the fair values of derivative instruments and their gains and losses in a tabular format. It also provides more information about an entity's liquidity by requiring disclosure of derivative features that are credit risk-related. Finally, it requires cross-referencing within footnotes to enable financial statement users to locate important information about derivative instruments. SFAS 161 will be effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, will be adopted by the Company beginning in the first quarter of 2009. The Company does not expect there to be any significant impact of adopting SFAS 161 on its financial position, cash flows and results of operations.

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.

**ITEM 7A.** ***Quantitative and Qualitative Disclosures About Market Risk***

**Interest Rate Market Risk**

Our exposure to interest rate risk is confined to our excess cash in highly liquid money market funds denominated in U.S. dollars. 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.

**Foreign Currency Market Risks**

We have two significant subsidiaries, one each in Europe and Mexico. Revenues and expenses associated with these subsidiaries are denominated in foreign currency. Accordingly, our operating results are affected by exchange rate fluctuations between the U.S. dollar and these foreign currencies. 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 also exposed to foreign currency risk related to the Euro denominated and U.S. dollar denominated intercompany receivables. Because our intercompany receivables are accounted for in Euros and U.S. dollars, any appreciation of the Euro or Mexican Peso will result in a gain or loss to the consolidated statements of operations.

We do not currently enter into forward exchange contracts to hedge exposure denominated in foreign currencies or any other derivative financial instrument for trading or speculative purposes. In the future, if we believe our currency exposure merits, we may consider entering into transactions to help mitigate the risk.

**ITEM 8.** ***Consolidated Financial Statements and Supplementary Data***

**Oculus Innovative Sciences, Inc.**
**Index to Consolidated Financial Statements**

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Audit Committee of the
Board of Directors and Shareholders 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, 2008 and 2007, and the related consolidated related statements of operations, stockholders' equity and cash flows for each of the three years in the period ended March 31, 2008. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Oculus Innovative Sciences, Inc. and Subsidiaries as of March 31, 2008 and 2007, and the consolidated results of their operations and cash flows for each of the three years in the period ended March 31, 2008 in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Oculus Innovative Sciences, Inc. and Subsidiaries' internal control over financial reporting as of March 31, 2008, based on the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated, June 11, 2008, expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ Marcum & Kliegman LLP

New York, New York
June 11, 2008

**OCULUS INNOVATIVE SCIENCES, INC. AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

| | March 31, 2008 | March 31, 2007 |
|---|---|---|
| | (In thousands, except share and per share amounts) | |
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 18,823 | $ 19,050 |
| Restricted cash | — | 2,000 |
| Accounts receivable, net | 770 | 1,364 |
| Inventory | 259 | 282 |
| Prepaid expenses and other current assets | 1,098 | 1,172 |
| Total current assets | 20,950 | 23,868 |
| Property and equipment, net | 2,303 | 2,207 |
| Restricted cash | 55 | 49 |
| Debt issuance costs, net | 304 | 826 |
| Total assets | $ 23,612 | $ 26,950 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 2,977 | $ 2,551 |
| Accrued expenses and other current liabilities | 2,460 | 1,421 |
| Current portion of long-term debt | 1,994 | 6,045 |
| Current portion of capital lease obligations | 19 | 17 |
| Total current liabilities | 7,450 | 10,034 |
| Deferred revenue | 523 | — |
| Long-term debt, less current portion | 205 | 1,990 |
| Capital lease obligations, less current portion | 6 | 25 |
| Total liabilities | 8,184 | 12,049 |
| Commitments and Contingencies | | |
| Stockholders' Equity | | |
| Convertible preferred stock, $0.0001 par value; 5,000,000 shares authorized, none issued and outstanding at March 31, 2008 and 2007 | — | — |
| Common stock, $0.0001 par value; 100,000,000 shares authorized, 15,905,613 and 11,844,411 shares issued and outstanding at March 31, 2008 and 2007, respectively | 2 | 1 |
| Additional paid-in capital | 109,027 | 85,751 |
| Accumulated other comprehensive loss | (2,775) | (364) |
| Accumulated deficit | (90,826) | (70,487) |
| Total stockholders' equity | 15,428 | 14,901 |
| Total liabilities and stockholders' equity | $ 23,612 | $ 26,950 |

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

**OCULUS INNOVATIVE SCIENCES, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS**

| | Year Ended March 31, | | |
|---|---|---|---|
| | 2008 | 2007 | 2006 |
| | (In thousands, except per share amounts) | | |
| Revenues | | | |
| Product | $ 2,881 | $ 3,679 | $ 1,966 |
| Service | 954 | 864 | 618 |
| Total revenues | 3,835 | 4,543 | 2,584 |
| Cost of revenues | | | |
| Product | 1,774 | 2,104 | 3,899 |
| Service | 977 | 895 | 1,003 |
| Total cost of revenues | 2,751 | 2,999 | 4,902 |
| Gross profit (loss) | 1,084 | 1,544 | (2,318) |
| Operating expenses | | | |
| Research and development | 9,778 | 4,508 | 2,600 |
| Selling, general and administrative | 13,731 | 16,520 | 15,933 |
| Total operating expenses | 23,509 | 21,028 | 18,533 |
| Loss from operations | (22,425) | (19,484) | (20,851) |
| Interest expense | (1,016) | (956) | (172) |
| Interest income | 630 | 312 | 282 |
| Other income (expense), net | 2,472 | 345 | (377) |
| Net loss from continuing operations | (20,339) | (19,783) | (21,118) |
| Loss from operations of discontinued business | — | — | (818) |
| Loss on disposal of discontinued business | — | — | (1,163) |
| Loss on discontinued operations | — | — | (1,981) |
| Net loss | (20,339) | (19,783) | (23,099) |
| Preferred stock dividends | — | (404) | (121) |
| Net loss available to common stockholders | $ (20,339) | $ (20,187) | $ (23,220) |
| Net loss per common share: basic and diluted | | | |
| Continuing operations | $ (1.60) | $ (3.71) | $ (5.12) |
| Discontinued operations | — | — | (0.48) |
| | $ (1.60) | $ (3.71) | $ (5.60) |
| Weighted-average number of shares used in per common share calculations: | | | |
| Basic and diluted | 12,737 | 5,448 | 4,150 |
| Other comprehensive loss, net of tax | | | |
| Net loss | $ (20,339) | $ (19,783) | $ (23,099) |
| Foreign currency translation adjustments | (2,411) | (367) | 144 |
| Comprehensive loss | $ (22,750) | $ (20,150) | $ (22,955) |

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

**OCULUS INNOVATIVE SCIENCES, INC.**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

| | Convertible Preferred Stock | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Series A ($0.0001 par Value) | | Series B ($0.0001 par Value) | | Series C ($0.0001 par Value) | | Common Stock ($0.0001 par Value) | | Additional Paid in Capital | Deferred Stock-Based Compensation | Accumulated Other Comprehensive Income (Loss) | Accumulated Deficit | Total |
| | Shares | Amount | Shares | Amount | Shares | Amount | Shares | Amount | | | | | |
| | (In thousands, except share and per share amounts) | | | | | | | | | | | | |
| Balance, 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 of common stock purchase warrants issued to non-employees | — | — | — | — | — | — | — | — | 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 |
| Issuance of Series A convertible preferred stock in connections with convertible debt | 10,000 | 40 | — | — | — | — | — | — | — | — | — | — | 40 |
| Dividend payable to Series A convertible preferred stockholders | — | — | — | — | — | — | — | — | — | — | — | (121) | (121) |
| Foreign currency 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.**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY — (Continued)**

| | Convertible Preferred Stock | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Series A ($0.0001 par Value) | | Series B ($0.0001 par Value) | | Series C ($0.0001 par Value) | | Common Stock ($0.0001 par Value) | | Additional Paid in Capital | Deferred Stock-Based Compensation | Accumulated Other Comprehensive Income (Loss) | Accumulated Deficit | Total |
| | Shares | Amount | Shares | Amount | Shares | Amount | Shares | Amount | | | | | |
| | (In thousands, except share and per share amounts) | | | | | | | | | | | | |
| Issuance of common stock in connection with IPO and exercise of over-allotment, net of discounts, commissions, expenses and other offering costs | | | | | | | 3,353,550 | | 21,936 | — | — | — | 21,936 |
| Issuance of common stock in connection with exercise of warrants | — | — | — | — | — | — | 4,138 | — | 21 | — | — | — | 21 |
| Issuance of common stock in connection with services rendered | — | — | — | — | — | — | 3,750 | — | 43 | — | — | — | 43 |
| Issuance of Series C convertible preferred stock, net of offering costs | — | — | — | — | 193,045 | 2,903 | — | — | — | — | — | — | 2,903 |
| Conversion of convertible preferred stock into common stock at the closing of the IPO on January 30, 2007 | (1,347,709) | (6,668) | (2,635,744) | (43,722) | (193,045) | (2,903) | 4,176,498 | — | 53,293 | — | — | — | — |
| Reclassification to APIC in connection with Delaware reincorporation due to change in par value | — | — | — | — | — | — | — | (3,398) | 3,398 | — | — | — | — |
| Reclassification of deferred stock-based compensation | — | — | — | — | — | — | — | — | (798) | 798 | — | — | — |
| Amortization of stock-based compensation | — | — | — | — | — | — | — | — | 158 | — | — | — | 158 |
| Non-employee stock-based compensation | — | — | — | — | — | — | — | — | 11 | — | — | — | 11 |
| Employee stock-based compensation expense recognized under SFAS No. 123R, net of forfeitures | — | — | — | — | — | — | — | — | 815 | — | — | — | 815 |
| Fair value of common stock purchase warrants issued to non-employees | — | — | — | — | — | — | — | — | 555 | — | — | — | 555 |
| Issuance of common warrants in connection with debt financing transactions | — | — | — | — | — | — | — | — | 1,150 | — | — | — | 1,150 |
| Dividend payable to Series A convertible preferred stockholders | — | — | — | — | — | — | — | — | — | — | — | (404) | (404) |
| Common stock dividend paid to Series A convertible preferred stockholders | | — | — | — | — | — | — | 87,494 | 525 | — | — | | 525 |
| Foreign currency translation adjustment | | | — | — | — | — | — | — | — | | — | | (367) |
| Net loss | — | — | — | — | — | — | — | — | — | — | — | (19,783) | (19,783) |
| Balance, March 31, 2007 | — | — | — | — | — | — | 11,844,411 | $ 1 | $ 85,751 | — | $ (364) | $ (70,487) | $ 14,901 |

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

**OCULUS INNOVATIVE SCIENCES, INC.**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY — (Continued)**

| | Convertible Preferred Stock | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Series A ($0.0001 par Value) | | Series B ($0.0001 par Value) | | Series C ($0.0001 par Value) | | Common Stock ($0.0001 par Value) | | Additional Paid in Capital | Deferred Stock-Based Compensation | Accumulated Other Comprehensive Income (Loss) | Accumulated Deficit | Total |
| | Shares | Amount | Shares | Amount | Shares | Amount | Shares | Amount | | | | | |
| | (In thousands, except share and per share amounts) | | | | | | | | | | | | |
| Issuance of common stock in connection with August 13, 2007 offering, net of commissions, expenses and other offering costs | — | — | — | — | — | — | 1,262,500 | — | 9,124 | — | — | — | 9,124 |
| Issuance of common stock in connection with March 31, 2008 offering, net of commissions, expenses and other offering costs | — | — | — | — | — | — | 2,634,578 | — | 12,613 | — | — | — | 12,613 |
| Issuance of common stock in connection with exercise of stock options | — | — | — | — | — | — | 119,375 | — | 67 | — | — | — | 67 |
| Issuance of common stock in connection with exercise of warrants | — | — | — | — | — | — | 44,749 | 1 | 134 | — | — | — | 135 |
| Amortization of stock-based compensation | — | — | — | — | — | — | — | — | 148 | — | — | — | 148 |
| Non-employee stock-based compensation | — | — | — | — | — | — | — | — | 7 | — | — | — | 7 |
| Employee stock-based compensation expense recognized under SFAS No. 123R, net of forfeitures | — | — | — | — | — | — | — | — | 1,006 | — | — | — | 1,006 |
| Fair value of common stock purchase warrants issued to non-employees | — | — | — | — | — | — | — | — | 177 | — | — | — | 177 |
| Foreign currency translation adjustment | — | — | — | — | — | — | — | — | | — | (2,411) | | (2,411) |
| Net loss | — | — | — | — | — | — | — | — | — | — | — | (20,339) | (20,339) |
| Balance, March 31, 2008 | — | — | — | — | — | — | 15,905,613 | $ 2 | $ 109,027 | — | $ (2,775) | $ (90,826) | $ 15,428 |

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

**OCULUS INNOVATIVE SCIENCES, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

| | Year Ended March 31, | | |
|---|---|---|---|
| | 2008 | 2007 | 2006 |
| | | (In thousands) | |
| **Cash flows from operating activities** | | | |
| Net loss from continuing operations | $ (20,339) | $ (19,783) | $ (21,118) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | | |
| Depreciation and amortization | 740 | 672 | 651 |
| Provision for doubtful accounts | 57 | 284 | 90 |
| Provision for obsolete inventory | 230 | 102 | 1,074 |
| Stock-based compensation | 1,339 | 1,582 | 597 |
| Non-cash interest expense | 522 | 547 | 21 |
| Foreign currency transaction gains | (2,594) | (407) | — |
| Loss on disposal of assets | 5 | — | 113 |
| Changes in operating assets and liabilities: | | | |
| Accounts receivable | 580 | (571) | (939) |
| Inventories | (180) | (49) | (523) |
| Prepaid expenses and other current assets | 282 | 219 | (887) |
| Accounts payable | 393 | (245) | 1,868 |
| Accrued expenses and other liabilities | 1,519 | (433) | (649) |
| Net cash used in operating activities | (17,446) | (18,082) | (19,702) |
| **Cash flows from investing activities:** | | | |
| Purchases of property and equipment | (617) | (873) | (475) |
| Issuance of note receivable | — | — | 55 |
| Changes in restricted cash | — | (4) | 1 |
| Net cash used in investing activities | (617) | (877) | (419) |
| **Cash flows from financing activities:** | | | |
| Deferred offering costs | — | 478 | (478) |
| Proceeds from issuance of common stock, net of offering costs | 21,737 | 21,936 | — |
| Proceeds from issuance of common stock upon exercise of stock options and warrants | 202 | 21 | 298 |
| Proceeds from issuance of convertible preferred stock | — | 2,903 | 27,026 |
| Debt issuance costs | — | (77) | — |
| Cash restricted for repayment of debt | 2,000 | (2,000) | — |
| Proceeds from issuance of debt | — | 9,056 | 257 |
| Principal payments on debt | (6,090) | (1,734) | (953) |
| Payments on capital lease obligations | (17) | (15) | (31) |
| Net cash provided by financing activities | 17,832 | 30,568 | 26,119 |
| **Cash flows from discontinued operations** | | | |
| Operating cash flows | — | — | (818) |
| Investing cash flows | — | — | (1,163) |
| Net cash used in discontinued operations | — | — | (1,981) |
| Effect of exchange rate on cash and cash equivalents | 4 | (7) | 144 |
| Net increase (decrease) in cash and cash equivalents | (227) | 11,602 | 4,161 |
| Cash and cash equivalents, beginning of year | 19,050 | 7,448 | 3,287 |
| Cash and cash equivalents, end of year | $ 18,823 | $ 19,050 | $ 7,448 |
| **Supplemental disclosure of cash flow information:** | | | |
| Cash paid for interest | $ 591 | $ 391 | $ 125 |
| **Non-cash investing and financing activities:** | | | |
| Equipment and insurance premiums financed | $ 253 | — | — |
| Conversion of note payable into Series A convertible preferred stock | — | — | $ 40 |
| Fair value of warrants issued in connection with debt | — | $ 1,150 | — |

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

**OCULUS INNOVATIVE SCIENCES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

## NOTE 1 — The Company

***Organization***

Oculus Innovative Sciences, Inc. (the "Company") was incorporated under the laws of the State of California in April 1999 and was reincorporated under the laws of the State of Delaware in December 2006. The Company's principal office is located in Petaluma, California. The Company develops, manufactures and markets a family of products intended to prevent and treat infections in chronic and acute wounds. The Company's platform technology, called Microcyn, is a proprietary oxychlorine small molecule formulation 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. The Company conducts its business worldwide, with significant operating subsidiaries in Europe and Mexico.

***Delaware Reincorporation***

On December 15, 2006, the Company merged into OIS Reincorporation Sub, Inc., a Delaware corporation (the Delaware Company). Pursuant to the Merger Agreement, an amendment to the certificate of incorporation was filed pursuant to which (i) each four shares of outstanding Company common stock were converted into one share of the Delaware Company's common stock ($0.0001 par value), (ii) each four shares of the Company's outstanding Series A convertible preferred stock were converted into one share of the Delaware Company's Series A convertible preferred stock ($0.0001 par value), (iii) each four shares of the Company's outstanding Series B convertible preferred stock were converted into one share of the Delaware Company's Series B convertible preferred stock ($0.0001 par value), and (iv) each four shares of the California Company's outstanding Series C convertible preferred stock were converted into one share of the Delaware Company's Series C convertible preferred stock ($0.0001 par value). In addition, all options, warrants or rights to purchase shares of Company common stock or Company convertible preferred stock outstanding immediately prior to the Reincorporation were converted into options, warrants or rights to purchase an equivalent number of shares of the Delaware Company's common stock or convertible preferred stock, as the case may be, and those securities are continuing to vest upon the same terms and conditions that existed immediately prior to the Reincorporation.

***Reverse Stock Split***

On December 15, 2006, the Company effected a 1-for-4 reverse split of its common stock and convertible preferred stock. All common and convertible preferred shares and per share amounts have been retroactively restated in the accompanying consolidated financial statements and notes for all periods presented.

## NOTE 2 — Liquidity and Financial Condition

The Company incurred net losses of $20,339,000, $19,783,000, and $23,099,000 for the years ended March 31, 2008, 2007 and 2006, respectively. At March 31, 2008, the Company's accumulated deficit amounted to $90,826,000. The Company had working capital of $13,500,000 as of March 31, 2008.

Through March 31, 2008, the Company raised, net of offering costs, an aggregate of approximately $99,325,000, including $21,737,000 raised during the year ended March 31, 2008, 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. As described in Note 13, on August 13, 2007, the Company closed the private placement of 1,262,500 shares of its common stock at a purchase price of $8.00 per share, and warrants to purchase an aggregate of 416,622 shares of common stock at an exercise price of $9.50 per share for gross proceeds of $10,100,000 and net proceeds of $9,124,000 (after deducting the placement agent's commission and other offering expenses). The exercise price for the investor warrants was adjusted to $8.63 in March 2008, after the anti-dilution provisions of the warrants were triggered by our registered direct offering. The investor warrants are now exercisable for an additional 41,977 shares. Pursuant to the terms of a Registration Rights Agreement, dated

August 7, 2007, the shares of common stock issued to the investors in the private placement and the shares of common stock to be issued upon the exercise of the warrants issued in the private placement were registered on a Form S-1 (File No. 333-145810), which was declared effective on September 12, 2007.

Additionally, in connection with the above offering the placement received a placement fee equal to 7%, or $707,000, of the gross proceeds as well as warrants to purchase 88,375 shares of Common Stock at an exercise price of $9.50 per share. These placement agent warrants may be exercised at any time and from time to time on or after February 8, 2008 and through and including February 8, 2013. The exercise price for the warrants was adjusted to $8.63 in March 2008, after the anti-dilution provisions of the warrants were triggered by our registered direct offering. The placement agent warrants are now exercisable for an additional 8,909 shares.

Additionally, pursuant to Amendment No. 1 to the Burlingame loan agreement (Note 3), subsequent to the close of this private placement on August 13, 2007, the Company was required to promptly repay the $4,000,000 outstanding note balance and interest. The note was originally scheduled to be repaid on November 7, 2007. The note was repaid in full by August 31, 2007.

Additionally, on February 13, 2008, the Company filed a shelf registration statement on Form S-3 (File No. 333-149223), which was declared effective on February 26, 2008. In connection with this S-3, the Company may from time to time, offer and sell preferred stock, either separately or represented by depositary shares, common stock or warrants, either separately or in units, in one or more offerings. The preferred stock and warrants may be convertible into or exercisable or exchangeable for common or preferred stock. The Company will specify in an accompanying prospectus supplement more specific information about any such offering. The aggregate initial offering price of all securities sold under the shelf registration statement will not exceed $75,000,000. The Company may offer these securities independently or together in any combination for sale directly to investors or through underwriters, dealers or agents. The Company will set forth the names of any underwriters, dealers or agents and their compensation in a prospectus or prospectus supplement.

As described in Note 13, on March 31, 2008, the Company closed the registered direct placement of 2,634,578 shares of its common stock at a purchase price of $5.25 per share, and warrants to purchase an aggregate of 1,317,278 shares of common stock at an exercise price of $6.85 per share for gross proceeds of $13,832,000 and net proceeds of $12,613,000 (after deducting the placement agent's commission and other offering expenses). On April 1, 2008, the Company conducted a second closing of an additional 18,095 shares of its common stock at a purchase price of $5.25 per share, and warrants to purchase an aggregate of 9,047 shares of common stock at an exercise price of $6.85 per share for gross proceeds of $95,000. Both closings were part of the same offering.

The Company currently intends to use the proceeds of the offerings described above principally to fund clinical trials and related research and its sales and marketing activities. The remaining proceeds are to be used for general corporate purposes, including working capital. The Company has incurred, and anticipates that it will continue to incur, significant costs in connection with Sarbanes-Oxley compliance and other costs associated with reporting as a public entity.

The Company currently anticipates that its cash and cash equivalents, together with revenues it expects to generate and interest it expects to earn on invested funds, will be sufficient to meet its anticipated cash requirements to continue its sales and marketing and some research and development through March 2009. However, in order to fund pivotal clinical trials, execute our product development strategy, and to commercialize Microcyn as a drug product in the United States, we anticipate a need to raise additional funds prior to March 31, 2009, and in periods following, through public or private equity offerings, debt financings, corporate collaborations or other means. The Company also expects to continue incurring losses for the foreseeable future and must raise substantial additional capital during the year ending March 31, 2009 to pursue its product development initiatives, fund clinical trials and penetrate markets for the sale of its products. The Company is currently planning to commence a pivotal trial related to its Microcyn products during fiscal year 2009. Management considers the execution and eventual completion of these trials to be a critical milestone in the development of the business. These clinical trials are likely to be lengthy

and expensive and cannot be commenced during the year ending March 31, 2009 unless the Company raises additional capital. These clinical trials must also be completed in order for the Company to commercialize Microcyn as a drug product in the United States.

Management believes that the Company has access to capital resources through possible public or private equity offerings, debt financings, corporate collaborations or other means; however, the Company has not secured any commitment for new financing at this time, nor can it provide any assurance that new financing will be available on commercially acceptable terms, if at all. If the Company is unable to secure additional capital, it will be required to curtail its research and development initiatives, delay clinical trials and take additional measures to reduce costs in order to conserve its cash. These measures could cause significant delays in the Company's efforts to commercialize its products in the United States, which is critical to the realization of its business plan and the future operations of the Company.

**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 S.A. de C.V. ("OTM"), Oculus Innovative Sciences Netherlands, B.V. ("OIS Europe"), and Oculus Innovative Sciences K.K. ("OIS Japan"). All significant intercompany accounts and transactions have been eliminated in consolidation.

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 been deemed to be the primary beneficiary of these investee entities. As described in Note 18, the Company's consolidated financial statements for the year ended March 31, 2006 included 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," ("SFAS 144").

***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. Significant estimates and assumptions include 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.

***Revenue Recognition***

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

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 reasonably 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 purchase orders.

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, 2008, 2007 and 2006.

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 payment is received. The Company maintains a reserve for amounts which may not be collectible due to risk of credit losses.

Additionally, the Company's treatment for recognizing revenue related to distributors' that have the inability to provide inventory or product sell-through reports on a timely basis, is to defer and recognize revenue when payment is received. The Company believes the receipt of payment is the best indication of product sell-through.

During the year ended March 31, 2008, approximately $379,000 of sales in Mexico was 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 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.

License revenue is generated through agreements with strategic partners for the commercialization of Microcyn products. The terms of the agreements typically include non-refundable upfront fees. In accordance with Emerging Issues Task Force ("EITF") Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables", the Company analyzes multiple element arrangements to determine whether the elements can be separated. Analysis is performed at the inception of the arrangement and as each product is delivered. If a product or service is not separable, the combined deliverables are accounted for as a single unit of accounting and recognized over the performance obligation period.

Assuming the elements meet the EITF No. 00-21 criteria for separation and the SAB 104 requirements for recognition, the revenue recognition methodology prescribed for each unit of accounting is summarized below:

When appropriate, the Company defers recognition of non-refundable upfront fees. If it has continuing performance obligations then such up-front fees are deferred and recognized over the period of continuing involvement.

The Company recognizes royalty revenues from licensed products upon the sale of the related products.

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.

***Sales Tax and Value Added Taxes***

In accordance with the guidance of EITF Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement" (EITF 06-3), the Company accounts for sales taxes and value added taxes imposed on its goods and services on a net basis in the consolidated statement of operations.

***Cash and Cash Equivalents***

The Company considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents. Cash equivalents may be invested in money market funds, commercial paper, variable rate demand instruments, and certificates of deposits. Cash equivalents are carried at cost, which approximates fair value.

***Restricted Cash***

On March 29, 2007, the Company entered into Amendment No. 1 to the Bridge Loan with Mr. Robert Burlingame, one of the Company's directors. Pursuant to the Amendment, the Company deposited $2,000,000 into a segregated interest-bearing account, which is presented as restricted cash in the current assets section of the accompanying consolidated balance sheet at March 31, 2007 (Note 10).

In connection with certain operating lease agreements (Note 12), the Company is required to maintain cash deposits in a restricted account. Restricted cash held as security under these arrangement amounted to $55,000 and $49,000 at March 31, 2008 and 2007, respectively and is reported in non-current assets in the accompanying consolidated balance sheets as restricted cash.

***Concentration of Credit Risk and Major Customers***

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, The Netherlands and Japan. 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. Cash and cash equivalents held in foreign banks are intentionally kept at minimal levels, and therefore have minimal credit risk associated with them.

The Company grants credit to its business customers, which are primarily located in Mexico, Europe and the United States. Collateral is generally not required for trade receivables. The Company maintains allowances for potential credit losses. Two customers represented a total of 28% and one customer represented 12% of the net accounts receivable balance at March 31, 2008 and 2007, respectively. During the years ended March 31, 2008 and March 31, 2007, three customers represented 23% and one customer represented 13% of sales, respectively. During the year ended March 31, 2006, no customer represented 10% of revenue.

***Accounts Receivable***

Trade accounts receivable are recorded net of allowances for cash discounts for prompt payment, doubtful accounts, and sales returns. Estimates for cash discounts and sales returns are based on analysis of contractual terms and historical trends. 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 allowance for doubtful accounts at March 31, 2008 and 2007 represents probable credit losses in the amounts of $31,000 and $207,000, respectively.

***Inventories***

Inventories are stated at the lower of cost, cost being determined on a standard cost basis (which approximates actual cost on a first-in, first-out basis), or market.

Due to changing market conditions, estimated future requirements, age of the inventories on hand and production of new products, the Company regularly reviews inventory quantities on hand and records a provision to write down excess and obsolete inventory to its estimated net realizable value. The Company recorded reserves to reduce the carrying amounts of inventories to their net realizable value in the amounts of $208,000 and $94,000 for the years ended March 31, 2008 and 2007, respectively.

***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. Estimated useful asset life by classification is as follows:

| | Years |
|---|---|
| Office equipment | 3 |
| Manufacturing, lab and other equipment | 5 |
| Furniture and fixtures | 7 |

Upon retirement or sale, the cost and related accumulated depreciation are removed from the consolidated balance sheet and the resulting gain or loss is reflected in operations. Maintenance and repairs are charged to operations as incurred.

***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, clinical and regulatory services and supplies. For the years ended March 31, 2008, 2007 and 2006, research and development expense amounted to $9,778,000, $4,508,000 and $2,600,000 respectively.

***Advertising Costs***

Advertising costs are expensed as incurred. Advertising costs amounted to $130,000, $54,000 and $126,000, for the years ended March 31, 2008, 2007 and 2006, respectively. Advertising costs are included in selling, general and administrative expenses in the accompanying consolidated statements of operations.

***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 product revenues. To date, shipping and handling costs billed to customers have been insignificant.

***Foreign Currency Reporting***

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”). Accordingly, the Company’s subsidiary OTM uses the local currency (Mexican Pesos) as its functional currency, OIS Europe uses the local currency (Euro) as its functional currency and OIS Japan uses the local currency (Yen) 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 income (loss). The Company recorded foreign currency

translation gains (losses) for the years ended March 31, 2008, 2007 and 2006 of $(2,411,000), $(367,000) and $144,000, respectively.

Foreign currency transaction gains (losses) relate to working capital loans that the Company has made to its foreign subsidiaries. The Company recorded foreign currency transaction gains (losses) for the years ended March 31, 2008, 2007 and 2006 of $2,594,000, $407,000 and $(283,000), respectively. The related gains (losses) were recorded in other income (expense) in the accompanying consolidated statements of operations. Loans made to subsidiaries OTM and OIS Europe will be paid back to the Company in the future when subsidiaries begin to generate cash.

***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 No. 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 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 SFAS No. 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 were being recorded in accordance with the provisions of APB 25 and its related interpretive guidance.

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 accompanying consolidated statements of operations $148,000, $158,000 and $279,000 of stock-based compensation expense during the years ended March 31, 2008, 2007, and 2006 respectively, 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 accompanying consolidated statements of operations $1,006,000 and $815,000 of stock-based compensation expense during the years ended March 31, 2008 and 2007, respectively, which represents the amortization of the fair value of options granted subsequent to adoption of SFAS 123(R). During the year ended March 31, 2007, the Company reclassified certain components of its stockholders' equity to reflect the elimination of deferred

compensation arising from unvested share-based compensation pursuant to the requirements of Staff Accounting Bulletin No. 107, regarding SFAS 123(R). 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 had no effect on net loss 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.

In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), which became effective for the Company beginning April 1, 2007. FIN 48 addresses how tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, the tax benefit from an uncertain tax position can be recognized only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate resolution. The adoption of FIN 48 had no impact on the Company's financial condition, results of operations or cash flows.

***Comprehensive Loss***

Other comprehensive loss includes all changes in stockholders' equity during a period from non-owner sources and is reported in the consolidated statement of stockholders' equity. To date, other comprehensive loss consists of changes in accumulated foreign currency translation adjustments during the years. Accumulated other comprehensive (loss) at March 31, 2008 and 2007 was $(2,775,000) and $(364,000), respectively

***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, 2007, 2006 and 2005, excludes potentially dilutive securities because their inclusion would be anti-dilutive.

In addition to the above, the Securities and Exchange Commission ("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 (loss) per share as if they were, in substance, recapitalizations. The Company evaluated all of its issuances of equity securities prior to the completion of its IPO on January 30, 2007 (Note 13) 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 years presented.

| | Year Ended March 31, | | |
|---|---|---|---|
| | 2008 | 2007 | 2006 |
| | | (In thousands) | |
| **Anti-dilutive securities excluded from the computation of basic and diluted net loss per share are as follows:** | | | |
| Options to purchase common stock | 2,624 | 2,020 | 1,969 |
| Restricted stock units | 60 | — | — |
| Warrants to purchase common stock | 3,327 | 1,369 | 858 |
| Convertible preferred stock (if converted method) | — | — | 3,984 |
| Warrants to purchase convertible preferred stock (if converted method) | — | — | 17 |
| | 6,011 | 3,389 | 6,828 |

During the year ended March 31, 2008, the Company sold common stock in connection with a private placement offering, registered direct offering and issued stock in connection with the exercise of stock options and warrants. Additionally, during the year ended March 31, 2007, the Company issued common stock in connection with the conversion of its convertible preferred stock to common stock at the close of its initial public offering, sold common stock in its initial public offering, sold common stock in connection with its underwriter's partial exercise of their over-allotment option and issued common stock in connection with the exercise of warrants. These transactions resulted in significant additional dilution and are described in more detail in Note 13. On April 1, 2008, the Company issued an additional 9,047 common stock purchase warrants in connection with the second closing of the registered direct offering.

***Fair Value of Financial Instruments***

The carrying amounts reported in the consolidated balance sheet for cash and cash equivalents, 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.

***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 "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock" ("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). The Company assesses classification of its freestanding derivatives at each reporting date to determine whether a change in classification between assets and liabilities is required. The Company determined that its freestanding derivatives, which principally consists of warrants to purchase common stock satisfied the criteria for classification as equity instruments at March 31, 2008 and 2007.

***Recent Accounting Pronouncements***

In February 2007, FASB issued Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"). SFAS 159, which includes an amendment to Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS 115"), permits entities the option to measure many financial instruments and certain other items at fair value. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company is in the process of determining the impact that SFAS 159 will have on its consolidated financial condition, results of operations and cash flows.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements-an amendment of Accounting Research Bulletin No. 51" ("SFAS 160"). SFAS 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS 160 is effective as of the beginning of an entity's fiscal year that begins after December 15, 2008. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS 160 on its financial condition and results of operations.

In December 2007, the SEC issued SAB No. 110, Certain Assumptions Used in Valuation Methods — Expected Term ("SAB 110") According to SAB 110, under certain circumstances the SEC staff will continue to accept beyond December 31, 2007 the use of the simplified method in developing an estimate term of share options that possess certain characteristics in accordance with SFAS 123(R) beyond December 31, 2007. The Company adopted SAB 110 effective January 1, 2008 and continued to use the simplified method in developing the expected term used for its valuation of stock-based compensation.

In February 2008, SFAS 157 was amended by FSP 157-2, "Effective Date of FASB Statement No. 157: Fair Value Measurements" ("FSP 157-2"). As such, SFAS 157 (as amended) is partially effective for measurements and disclosures of financial assets and liabilities for fiscal years beginning after November 15, 2007 and is fully effective for measurement and disclosure provisions on all applicable assets and liabilities for fiscal years beginning after November 15, 2008. The Company is currently evaluating the impact that FSP 157-2 will have on its consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities ("SFAS 161"). SFAS 161 is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. SFAS 161 achieves these improvements by requiring disclosure of the fair values of derivative instruments and their gains and losses in a tabular format. It also provides more information about an entity's liquidity by requiring disclosure of derivative features that are credit risk-related. Finally, it requires cross-referencing within footnotes to enable financial statement users to locate important information about derivative instruments. SFAS 161 will be effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, will be adopted by the Company beginning in the first quarter of 2009. The Company does not expect there to be any significant impact of adopting SFAS 161 on its financial position, cash flows and results of operations.

OCULUS INNOVATIVE SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Other accounting standards that have been issued or proposed by the FASB, the EITF, the SEC and 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.

**NOTE 4 — Accounts Receivable**

Accounts receivable consists of the following (in thousands):

| | March 31, | |
|---|---|---|
| | 2008 | 2007 |
| Accounts receivable | $ 801 | $ 1,571 |
| Less: allowance for doubtful accounts | (31) | (207) |
| | $ 770 | $ 1,364 |

Allowance for doubtful accounts activities are as follows (in thousands):

| Year Ended March 31, | Balance at Beginning of Year | Additions Charged to Operating Expenses | Deductions Write-Offs | Balance at End of Year |
|---|---|---|---|---|
| 2007 | $ 90 | $ 284 | $ (167) | $ 207 |
| 2008 | $ 207 | $ 57 | $ (233) | $ 31 |

**NOTE 5 — Inventories**

Inventories consist of the following (in thousands):

| | March 31, | |
|---|---|---|
| | 2008 | 2007 |
| Raw materials | $ 361 | $311 |
| Finished goods | 106 | 65 |
| | 467 | 376 |
| Less: inventory allowances | (208) | (94) |
| | $ 259 | $282 |

Reserve for obsolete inventories activities are as follows (in thousands):

| Year Ended March 31, | Balance at Beginning of Year | Additions Charged to Cost of Product Revenues | Deductions Write-Offs | Balance at End of Year |
|---|---|---|---|---|
| 2007 | $ 996 | $ 102 | $ (1,004) | $ 94 |
| 2008 | $ 94 | $ 230 | $ (116) | $ 208 |

**NOTE 6 — Prepaid Expenses and Other Current Assets**

Prepaid expenses and other current assets consist of the following (in thousands):

| | March 31, 2008 | March 31, 2007 |
|---|---|---|
| Prepaid expenses | $ 691 | $ 976 |
| Value Added Tax receivable | 32 | 125 |
| Other current assets | 375 | 71 |
| | $ 1,098 | $ 1,172 |

**NOTE 7 — Debt Issuance Costs**

Debt issuance costs consists of the following (in thousands):

| | March 31, 2008 | March 31, 2007 |
|---|---|---|
| Fair value of common stock purchase warrants issued to Western Technologies, Inc. in connection with a Line of Credit (Note 10) | $ 1,046 | $ 1,046 |
| Fair value of common stock purchase warrants issued to Brookstreet Securities Corporation (“Brookstreet”) in connection with a Bridge Loan repaid on August 31, 2007 (Note 10) | — | 104 |
| Cash paid for debt offering expenses (March 31, 2007 includes $50,000 paid in connection with the Bridge Loan repaid on August 31, 2007) | 28 | 78 |
| | 1,074 | 1,228 |
| Less: accumulated amortization | (770) | (402) |
| | $ 304 | $ 826 |

During the years ended March 31, 2008, 2007 and 2006, the Company recorded $522,000, $402,000 and $0 of non-cash interest expense related to the amortization of debt issue costs, respectively. These amounts are included in interest expense in the accompanying consolidated statements of operations. Unamortized debt issuance costs of $28,000 related to the Bridge Loan was expensed at the time the note was repaid on August 31, 2007 (Note 10).

**NOTE 8 — Property and Equipment**

Property and equipment consists of the following (in thousands):

| | March 31, 2008 | March 31, 2007 |
|---|---|---|
| Manufacturing, lab, and other equipment | $ 3,387 | $ 2,738 |
| Office equipment | 555 | 716 |
| Furniture and fixtures | 201 | 219 |
| Leasehold improvements | 436 | 489 |
| | 4,579 | 4,162 |
| Less: accumulated depreciation and amortization | (2,276) | (1,955) |
| | $ 2,303 | $ 2,207 |

Property and equipment includes $186,000 of equipment purchases that were financed under capital lease obligations as of March 31, 2008 and 2007 (Note 11). The accumulated amortization on these assets amounted to $168,000 and $146,000 as of March 31, 2008 and 2007, respectively.

Depreciation and amortization expense (including amortization of leased assets) amounted to $740,000, $672,000 and $651,000 for the years ended March 31, 2008, 2007 and 2006, respectively.

**NOTE 9 — Accrued Expenses and Other Current Liabilities**

Accrued expenses and other current liabilities consist of the following (in thousands):

| | March 31 | |
|---|---|---|
| | 2008 | 2007 |
| Salaries and related costs | $ 1,339 | $ 525 |
| Professional fees | 592 | 524 |
| Estimated liability for pending litigation (Note 12) | — | 21 |
| Deferred revenue | 359 | 55 |
| Other | 170 | 296 |
| | $ 2,460 | $ 1,421 |

**NOTE 10 — Long-Term Debt**

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 $23,000 including accrued interest, is included in non-current portion of long-term debt in the accompanying consolidated balance sheet at March 31, 2008.

During 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 were 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 made principal payments on these notes which amounted to $19,000 and $332,000, during the years ended March 31, 2008 and 2007 respectively. Interest expense under these obligations amounted to $300, $25,000 and $73,000 for the years ended March 31, 2008, 2007, and 2006, respectively. The remaining principal balance and all outstanding interest was paid in full on May 1, 2007.

From February 2005 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% per annum. The proceeds of these notes were used to purchase automobiles and software. The Company made principal payments on these notes of $36,000 and $33,600, during the years ended March 31, 2008 and 2007, respectively. Aggregate interest expense under these obligations amounted to $8,100, $11,000 and $8,900 for the years ended March 31, 2008, 2007 and 2006, respectively. These notes are payable in aggregate monthly installments of $3,700 including interest through March 14, 2011. The remaining balance of these notes amounted to $87,000 at March 31, 2008, including $39,000 in the current portion of long-term debt in the accompanying consolidated balance sheet.

On June 14, 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. In June 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 1, 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 71,521 shares of its Series B convertible preferred stock upon originating the loan which automatically converted into warrants to purchase 71,521 shares of the Company's common stock at the closing of the Company's initial public offering on January 30, 2007. The aggregate fair value of all warrants issued to the lender under this arrangement amounted to $1,046,000 (Note 13). This amount was recorded as debt issuance costs in the March 31, 2008 consolidated balance sheet and is being amortized as interest expense over the term of the credit facility or 30 to 33 months.

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 The loan agreement contains various negative and affirmative covenants, including restrictions on paying dividends. 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. In connection with these notes, for the years ended March 31, 2008 and 2007, the Company made principal payments of $1,501,000 and $852,000, respectively. Additionally, for the years ended March 31, 2008 and 2007, the Company made interest payments of $331,000 and $333,000, respectively, and recorded $429,000 and $340,000 of non-cash interest expense related to the amortization of debt issue costs, respectively. The aggregate remaining principal balance under this facility amounted to $1,829,000, including $1,786,000 in the current portion of long term debt in the accompanying consolidated balance sheet at March 31, 2008. As of March 31, 2008, the Company no longer had the ability to draw additional funds on the various lines.

On March 29, 2007, the Company entered into Amendment No. 1 to the loan agreement described above. Pursuant to the amendment the lender and the Company agreed that the security interest in the Company's intellectual property would be removed and the lender's security interest in the Company's assets would not include the Company's intellectual property unless and until the Company's cash and cash equivalents fall below 600% of the Company's average monthly expenses less non-cash charges. At March 31, 2008, the Company's cash and cash equivalents position was in excess of 600% of its average monthly expenses and therefore no lien against its intellectual property was in place.

On May 5, 2006, the Company entered into a note agreement for $69,000 with interest at the 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 $9,800 and $7,400 during the year ended March 31, 2008 and 2007, respectively. Additionally, the Company made interest payments of $4,700 and $5,000 during the years ended March 31, 2008 and 2007, respectively. The remaining balance of this note amounted to $51,000 at March 31, 2008, including $10,800 in the current portion of long-term debt in the accompanying consolidated balance sheet.

From July 1, 2006 to March 25, 2007, the Company entered into note agreements for $805,000 with interest rates ranging from 7.0% to 9.7% per annum. The proceeds of these notes were used to finance insurance premiums. The remaining balance of these notes were payable in aggregate monthly installments of $66,000 through November 25, 2007. During the years ended March 31, 2008 and 2007, the Company made principal payments of $480,000 and $325,000, respectively. Additionally, during the years ended March 31, 2008 and 2007, the Company made interest payments of $15,000 and $10,500, respectively. On July 3, 2007, the Company paid all outstanding principal and interest under these financings.

On November 7, 2006, the Company signed a loan agreement with Robert Burlingame, one of the Company's directors, in the amount of $4,000,000, which was funded on November 10, 2006 and accrued interest at an annual

rate of 7%. Concurrently, Mr. Burlingame became a consultant to the Company under a two-year consulting agreement, and was appointed to fill a vacancy on the Company's board of directors. The principal and all accrued interest under the loan agreement was originally due and payable in full with interest on November 10, 2007. The loan was secured by all assets of the Company, other than intellectual property, and was subordinate to the security interest held by the Company's secured lender. At the time the principal was advanced to the Company, Brookstreet, who acted as the agent in this transaction, was paid a fee of $50,000 and was granted a warrant to purchase 25,000 shares of the Company's common stock at an exercise price of $18.00 per share. The aggregate fair value of all warrants issued to the agent under this arrangement amounted to $104,000 (Note 13). This amount in addition to the $50,000 cash payment was recorded as debt issuance costs in the March 31, 2007 consolidated balance sheet and was being amortized as interest expense over the term of the credit facility. During the year ended March 31, 2008 and 2007, the Company recorded $93,000 and $62,000, respectively, of non-cash interest expense related to the amortization of the debt issuance costs.

On March 29, 2007, the Company entered into Amendment No. 1 to the loan agreement described above. Pursuant to the Amendment, the Company agreed to make monthly interest payments on the $4,000,000 principal of the original promissory note and on May 10, 2007 deposited $2,000,000 into a segregated interest-bearing restricted cash account that was used to repay the note as described below.

On August 13, 2007, after the closure of the $10,100,000 million private placement of the Company's common stock described in Note 13, the Company became obligated to repay outstanding amounts under the terms of the Amendment No. 1 to the Burlingame loan agreement. The Company paid $2,000,000 under the loan agreement on August 15, 2007, and the remaining $2,000,000 and accrued interest from the restricted cash account on August 31, 2007. During the year ended March 31, 2008, the Company paid $222,000 of interest expense related to this note of which $109,000 was accrued at March 31, 2007.

On April 12, 2007, the Company entered into a note agreement to purchase an automobile for $75,800 with interest at the rate of 7.75% percent per annum. This note is payable in monthly installments of $1,500 through April 2012. During the year ended March 31, 2008, the Company made principal payments of $11,600. Additionally, during the year ended March 31, 2008, the Company made interest payments of $5,300. The remaining balance of this note amounted to $64,000 at March 31, 2008, including $14,000 in the current portion of long-term debt in the accompanying condensed consolidated balance sheet.

On March 1, 2008, the Company entered into a note agreement for $176,000 with an interest rate of 5.6% per annum. The note was used to finance insurance premiums. The note is payable in monthly installments of $14,800 through January 1, 2009. The remaining balance of this note at March 31, 2008 amounted to $144,000 and is included in the current portion of long-term debt in the accompanying consolidated balance sheet.

A summary of principal payments due in years subsequent to March 31, 2008 is as follows (in thousands):

| For Years Ending March 31, | |
|---|---|
| 2009 | $ 1,994 |
| 2010 | 131 |
| 2011 | 39 |
| 2012 | 31 |
| 2013 | 4 |
| Total principal payments | 2,199 |
| Less: current portion | (1,994) |
| Long-term portion | $ 205 |

**NOTE 11 — Capital Lease Obligations**

During the period 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 ranging from 13% to 18%. Lease payments, including amounts representing interest, amounted to $12,000, $12,000 and $11,000 for the years ended March 31, 2008, 2007 and 2006, respectively. The remaining principal balance on these obligations amounted to $11,000 at March 31, 2008 which is included in the current portion of capital lease obligations in the accompanying consolidated 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 $9,000, $9,300 and $8,500 for the years ended March 31, 2008, 2007 and 2006, respectively. The remaining principal balance on this obligation amounted to $14,000 at March 31, 2008, including $8,000 included in the current portion of capital lease obligations in the accompanying consolidated balance sheet.

The Company recorded interest expense in connection with these lease agreements in the amounts of $4,500, $6,700 and $8,900 for the years ended March 31, 2008, 2007 and 2006, respectively.

Minimum lease payments due in years subsequent to March 31, 2008 are as follows (in thousands):

| For Years Ending March 31, | |
|---|---|
| 2009 | $ 21 |
| 2010 | 6 |
| Total minimum lease payments | 27 |
| Less: amounts representing interest | (2) |
| Present value of minimum lease payments | 25 |
| Less: current portion | (19) |
| Long-term portion | $ 6 |

**NOTE 12 — Commitments and Contingencies**

***Lease Commitments***

The Company has entered into various non-cancelable operating leases, primarily for office facility space, that expire at various times through April 2011.

On September 13, 2007, the Company entered into Amendment No. 4 to the property lease agreement for its facility in Petaluma, California. The amendment extends the lease expiration date to September 30, 2010. Lease payments pursuant to the amendment amounts to $902,000, with $123,000 paid in the fiscal year ended March 31, 2008, $302,000 to be paid in the fiscal year ending March 31, 2009, $315,000 to be paid in the fiscal year ending March 31, 2010 and $161,000 to be paid thereafter.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Minimum lease payments for non-cancelable operating leases, including the effects of the lease extension described above, are as follows (in thousands):

| For Years Ending March 31, | |
|---|---|
| 2009 | $ 520 |
| 2010 | 491 |
| 2011 | 328 |
| 2012 | 8 |
| Total minimum lease payments | $ 1,347 |

Rent expense amounted to $676,000, $590,000 and $535,000 for the years ended March 31, 2008, 2007, and 2006, respectively.

***Legal Matters***

In November 2005, the Company identified a possible criminal misappropriation of its technology in Mexico, and notified the Mexican Attorney General's office of the matter. The Company believes the Mexican Attorney General is currently conducting an investigation.

In March 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, alleging that defendants had wrongfully infringed the Company's intellectual property rights in its Microcyn technology. Defendants later asserted counter-claims against the Company. On November 15, 2007 the Court granted the Company's Motion to Dismiss the claims against the Company. Additionally, the Court issued an Order finding that defendants had violated key terms of both an Exclusive Purchase Agreement and a Non-Disclosure Agreement by contacting and working with a competitor in Mexico. The Court also permanently enjoined defendants from any further misuse of the Company's Microcyn technology. On January 23, 2008, after an evidentiary hearing, the Court ordered the defendants to pay the Company $6,644,000 in damages for lost profits as a result of defendants' breach of the Exclusive Purchase Agreement and the Non -Disclosure Agreement. The Company does not expect an appeal and will seek to collect on this judgment from defendants. The Company notes that collection may be impeded or delayed by the fact that defendants are a non-U.S. corporation and citizen, respectively, with unknown assets.

The Company settled a trademark matter 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 of the company alleging confusion, the Company has agreed with the party to market its product in Mexico under a different name. The Company settled this matter with the party and believes that the name change will satisfy an assertion of confusion and during the year ended March 31, 2008, the Company paid $70,000 related to this 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's 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 our financial position or results of operations.

In February 2007, the Company's Mexico subsidiary served Quimica Pasteur ("QP"), a former distributor of the Company's products in Mexico, with a claim alleging breach of contract under a note made by QP. A trial date has not yet been set.

The Company, from time to time, is involved in legal matters arising in the ordinary course of its business including matters involving proprietary technology. While management believes that such matters are currently not material, 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.

***Other Matters***

On September 16, 2005, the Company entered into a series of agreements with 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, the Company was concurrently 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. 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 without having exercised the option.

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 consolidated financial statements for the period of September 16, 2005 through March 26, 2006, the effective termination date of the distribution and related agreement, without such option having been exercised.

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.

Based on an opinion of Mexico counsel, the Company's 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.

***Employment Agreements***

The Company has entered into employment agreements with five of its key executives. The agreements provide, among other things, for the payment of twelve to twenty-four months of severance compensation for terminations under certain circumstances. Aggregate potential severance compensation amounted to $1,545,000 at March 31, 2008.

At March 31, 2008, aggregate salaries related to these agreements amounted to $1,065,000. Effective April 1, 2008, these salaries were adjusted as described in Note 20. Additionally, described in Note 20, on April 1, 2008, the Company entered into an employment agreement with one of its key employees.

***Board Compensation***

On April 26, 2007, the board of directors of the Company adopted a Board Compensation Package (the "Compensation Package") to provide members of the Board and its committees with regular compensation. The Compensation Package provides for cash payments of $25,000 in two equal installments to each of the non-employee members of the board of directors. Directors who are members (but not the chairman) of the audit committee receives an additional $5,000 per year. Directors who are members (but not the chairman) of the compensation committee receive an additional $2,000 per year. The chair person of the board of directors receives $15,000 annually, the Lead Director (if different from the chair person) receives $10,000 annually, the chairperson of the Audit Committee receives $10,000 annually, and the chair person of each other committee receives $5,000 annually. During the year ended March 31, 2008, the Company made payments to its non-employee directors amounting to $181,000 which is included in selling, general and administrative expenses in the accompanying condensed consolidated statements of operations.

The compensation committee also recommended to the Board the amendment and restatement of the Company's 2006 Stock Incentive Plan to include provisions concerning automatic grants to non-employee directors; the Board adopted such changes and the changes were approved by the stockholders. The Compensation Package provides for the grant of options to each non-employee director under the restated Stock Incentive Plan. Each new director will receive an initial option grant to purchase 50,000 shares of the Company's common stock, which will vest over three years, and each non-employee director will receive an annual grant of an option to purchase 15,000 shares of the Company's common stock, which will vest monthly over a period of one year. During the year ended March 31, 2008 the Company granted 175,000 options in connection with the compensation package see Note 14 for weighted average fair value assumptions used in the calculation of fair values during the year ended March 31, 2008.

***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. The Company paid and recorded expense related to this agreement in the amount of $146,000, $146,000 and $73,000 which is included in selling, general and administrative expense in the consolidated statements of operations for the years ended March 31, 2008, 2007 and 2006, respectively. During the year ended March 31, 2008, the Company extended the agreement for an additional one-year term and continued to make the monthly payments.

On November 7, 2006, the Company entered into a two year consulting agreement with Mr. Robert Burlingame, one of the Company's directors who also provided the Company with a $4,000,000 Bridge Loan (Note 10). In connection with this agreement, the director received 75,000 common stock purchase warrants at an exercise price of $8.00 per share. During the years ended March 31, 2008 and 2007, the amortized fair value of the warrants amounted to $175,000 and $70,000 and was recorded as selling, general and administrative expense in the accompanying consolidated statements of operations (Note 13). The unamortized fair value at March 31, 2008 related to this warrant was $106,000 and will be amortized over the remaining term of the agreement which expires on November 7, 2008.

***Commercial Agreements***

On May 8, 2007, and June 11, 2007, the Company entered into separate commercial agreements with two unrelated customers granting such customers the exclusive rights to sell the Company's products in specified territories or for specific uses. Both customers are required to maintain certain minimum levels of purchases of the Company's products in order to maintain exclusivity. Up-front payments amounting to $625,000 paid under these agreements have been recorded as deferred revenue of which $523,000 is classified as long-term deferred revenue in the accompanying consolidated balance sheet at March 31, 2008. The up-front fees will be amortized on a straight-line basis over the terms of the underlying agreements. The Company met certain milestones related to

these agreements and amortized approximately $5,000 of deferred revenue which is included in product revenue in the accompanying consolidated statement of operations for the year ended March 31, 2008.

**NOTE 13 — Stockholders' Equity**

***Authorized Capital***

The Company is authorized to issue up to 100,000,000 shares of common stock with a par value of $0.0001 per share and 5,000,000 shares of convertible preferred stock with a par value of $0.0001 per share.

***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.

***Convertible Preferred Stock***

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 principal balance of the note was converted into 10,000 shares of convertible series A preferred stock in June 2005.

The Company issued in a private placement transaction an aggregate of 1,621,651 shares of its Series B convertible preferred stock for net proceeds of $27,026,000 during the year ended March 31, 2006.

Additionally, the Company issued in a private placement transaction an aggregate of 193,045 shares of its Series C convertible preferred stock for net proceeds of $2,903,000 (gross proceeds of $3,474,000 less offering costs of $571,000) during the year ended March 31, 2007.

Pursuant to the Company's Amended and Restated Articles of Incorporation, the Series A, Series B and Series C convertible preferred shares were automatically convertible into shares of the Company's common stock, at the then applicable conversion price, upon the closing of the firm commitment underwritten public offering of shares of common stock of the Company which yielded aggregate proceeds in excess of $20 million (before deduction of underwriters commissions and expenses). At the close of the Company's initial public offering on January 30, 2007, all 4,176,498 outstanding shares of Series A, Series B, and Series C convertible preferred stock automatically converted into an equal number of shares of common stock.

***Initial Public Offering***

The Company's Registration Statement on Form S-1, Amendment No. 7, (File No. 333-135584) related to its IPO was declared effective by the SEC on January 24, 2007. A total of 3,025,000 shares of the Company's common stock were registered with the SEC. All of these shares were registered on the Company's behalf. The offering commenced on January 25, 2007 and 3,025,000 shares of common stock offered were sold on January 30, 2007 for an aggregate offering price of $24,200,000 through the managing underwriters: Roth Capital Partners, Maxim LLC and Brookstreet Securities Corporation.

On February 16, 2007 the underwriters of the Company's initial public offering exercised a portion of their over-allotment option and purchased 328,550 shares of the Company's common stock in accordance with the terms of the underwriting agreement for an aggregate offering price of $2,628,000 through the managing underwriters: Roth Capital Partners, Maxim LLC and Brookstreet Securities Corporation.

The Company paid to the underwriters underwriting discounts, commissions and non-accountable expenses totaling $2,146,000 in connection with the initial public offering and the underwriters' exercise of the over-

allotment shares. In addition, the Company incurred additional expenses of approximately $2,746,000 in connection with the initial public offering, which when added to the underwriting discounts, commissions and non-accountable expenses paid by the Company amounts to total expenses of $4,892,000. Thus the net offering proceeds to the Company (after deducting underwriting discounts and commissions and offering expenses) were approximately $21,936,000.

***Dividend Payment in Common Stock***

On February 15, 2007 the board of directors authorized payment of dividends to the persons who were holders of the Series A convertible preferred stock immediately prior to the close of the IPO. The Company issued 87,494 shares of common stock in payment of the dividend on March 21, 2007. In connection with the accrued dividend, the Company's net loss available to common stockholders increased by $404,000 and $121,000 for the years ended March 31, 2007, and 2006, respectively.

***Common Stock Issued in Private Placement***

On August 13, 2007, the Company completed a private placement of 1,262,500 shares of common stock to certain accredited investors at a price of $8.00 per share pursuant to the terms of a Securities Purchase Agreement, dated August 7, 2007. In addition, the investors received warrants to purchase an aggregate of 416,622 additional shares of common stock at an exercise price of $9.50 per share (described below). The exercise price for the investor warrants was adjusted to $8.63 in March 2008, after the anti-dilution provisions of the warrants were triggered by our registered direct offering. The investor warrants are now exercisable for an additional 41,977 shares. Gross proceeds from the private placement were $10,100,000 and net proceeds of $9,124,000 (after the placement agent's commission and other offering expenses). Pursuant to the terms of a Registration Rights Agreement, dated August 7, 2007, the shares of common stock issued to the investors in the private placement and the shares of common stock to be issued upon the exercise of the warrants issued in the private placement were registered on a Form S-1 (File No. 333-145810), which was declared effective on September 12, 2007. If the Registration Statement ceases to remain continuously effective, or the Holders of the Registrable Securities are not permitted to utilize the related Prospectus to resell the securities registered under the Registration Statement for more than ten consecutive calendar days, or more than a total of fifteen calendar days in any twelve month period, the Company will be required to pay the security holders, until cured, partial liquidated damages in cash equal to 1% monthly, up to a maximum of 15%, of the aggregate purchase price paid pursuant to the terms of the Securities Purchase Agreement. If the Company is required to pay liquidated damages and payments are not made seven days from the due date, the holders will become entitled to interest payments of 18% per annum on the amount due. The Company, after having evaluated the registration payment arrangement, has determined that it is unlikely to incur any mandatory liability based on its past experience in filing registration statements. Accordingly, the Company does not believe it is necessary to record any reserves for contingent transfer of consideration in accordance with EITF FSP 00-19-2, "Accounting for Registration Payment Arrangements".

The securities issued in the private placement were issued pursuant to an exemption under Section 4(2) of the Securities Act of 1933 and the rules and regulations promulgated thereunder. The securities offered were not registered under the Securities Act of 1933 or any state securities laws at the time of issuance and unless sold pursuant to the registration statement referenced above, the securities may not be offered or sold in the United States (or to a U.S. person) except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act of 1933 and applicable state securities laws. The Company also issued a warrant to purchase 88,375 shares of common stock to a placement agent in connection with the private placement (described below). The warrant has the same terms, including exercise price and registration rights, as the warrants issued in the private placement. The exercise price for the warrants was adjusted to $8.63 in March 2008, after the anti-dilution provisions of the warrants were triggered by our registered direct offering. The placement agent warrants are now exercisable for an additional 8,909 shares.

***Registered Direct Offering***

On February 13, 2008, the Company filed a shelf registration statement on Form S-3 (File No. 333-149223), which was declared effective on February 26, 2008. In connection with this S-3, the Company may from time to time, offer and sell preferred stock, either separately or represented by depositary shares, common stock or warrants, either separately or in units, in one or more offerings. The preferred stock and warrants may be convertible into or exercisable or exchangeable for common or preferred stock. The aggregate initial offering price of all securities sold under the shelf registration statement will not exceed $75,000,000. The Company may offer these securities independently or together in any combination for sale directly to investors or through underwriters, dealers or agents. The Company will set forth the names of any underwriters, dealers or agents and their compensation in a prospectus or prospectus supplement.

On March 31, 2008, the Company closed the registered direct placement of 2,634,578 shares of its common stock at a purchase price of $5.25 per share, and warrants to purchase an aggregate of 1,317,278 shares of common stock at an exercise price of $6.85 per share for gross proceeds of $13,297,000 and net proceeds of $12,613,000 (after deducting the placement agent's commission and other offering expenses). On April 1, 2008, the Company had a second closing of an additional 18,095 shares of its common stock at a purchase price of $5.25 per share, and warrants to purchase an aggregate of 9,047 shares of common stock at an exercise price of $6.85 per share for gross proceeds of $95,000. Both closings were part of the same offering. Additionally, the Company issued a warrant to purchase 130,000 shares of common stock at an exercise price of $6.30 per share to the placement agent related to this offering.

***Stock Purchase Warrants Issued in Financing Transactions***

On October 27, 2005, the Company issued a warrant to purchase 329,483 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.

On June 14, 2006, the Company issued warrants to purchase 71,521 shares of Series B convertible preferred stock at an exercise price of $18.00 per share in connection with a financing facility described in Note 10. These warrants were automatically converted to warrants to purchase 71,521 shares of common stock at the closing of the Company's IPO on January 30, 2007. 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 10 years; dividend yield of 0%; and volatility of 70%. The fair value of the warrants, which amounted to $1,046,000, was recorded as deferred debt issuance costs and is being amortized as interest expense over the term of the credit facility. Amortization of these costs amounted to $332,000 and is included as a component of interest expense in the accompanying consolidated statement of operations for the year ended March 31, 2007.

On September 20, 2006 and October 14, 2006, the Company issued a warrant to purchase 10,567 and 13,560 shares of common stock, respectively, at an exercise price of $18.00 per share to the placement agent of the Series C stock offering. Additionally, on September 20, 2006 and October 14, 2006 the Company issued five year warrants to purchase 16,907 and 21,696 shares of common stock, respectively, at an exercise price of $18.00 per share to investors in conjunction with the purchase of Series C stock units. The warrants require settlement in shares of the Company's common stock. 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. Based on the provisions of EITF 00-19, the Company classified the warrants as equity.

On November 10, 2006, Brookstreet Securities Corporation was granted a warrant to purchase 25,000 shares of the Company's common stock at an exercise price of $18.00 per share in connection with a finder's fee for the Robert Burlingame Bridge Loan, which funded on November 10, 2006 (Note 10). The warrants were valued using the Black-Scholes pricing model using the following assumptions: Fair value of the underlying stock $18.00; risk-

free interest rate 4.70% percent; contractual life of 5 years; dividend yield of 0%; and volatility of 70%. The fair value of the warrants, which amounted to $104,000 was recorded as debt issue costs in the accompanying consolidated balance sheet as of March 31, 2007. The Company amortized $62,000 and $42,000 of interest expense related to the warrants during the year ended March 31, 2008 and 2007, respectively. Unamortized debt issue costs of $19,000 related to the warrants was expensed at the time the note was repaid on August 31, 2007.

On January 30, 2007, under the terms of the Underwriting Agreement and in connection with the closing of the Company's IPO, the Company issued to the underwriter's warrants to purchase an aggregate of 211,750 shares of common stock at an exercise price of $13.20. On February 16, 2007, under the terms of the Underwriting Agreement and in connection with the closing of the partial exercise of the underwriters' over-allotment option, the Company issued to the underwriters warrants to purchase an aggregate of 22,998 shares of the common stock of the Company at an exercise price of $13.20. The warrants were fully exercisable at the date of issuance with no future performance obligations by the underwriters and expire on January 29, 2012 and February 15, 2012, respectively.

On August 13, 2007 the Company issued warrants to purchase 416,622 shares of common stock at an exercise price of $9.50 per share to investors in conjunction with the private placement of common stock described above. The Warrants became exercisable on February 8, 2008, and have a term of five years. The exercise price for the investor warrants was adjusted to $8.63 in March 2008, after the anti-dilution provisions of the warrants were triggered by our registered direct offering. The investor warrants are now exercisable for an additional 41,997 shares. The warrants are subject to adjustment in certain circumstances and require settlement in shares of the Company's common stock. The Company accounted for the issuance of the common stock purchase warrants in accordance with the provisions of EITF 00-19. Based on the provisions of EITF 00-19, the Company classified the warrants as equity. The securities that are issuable upon exercise of the warrants issued in the private placement were registered on a Form S-1 (File No. 333-145810), which was declared effective on September 12, 2007.

On August 20, 2007, the Company issued a warrant to purchase 88,375 shares of common stock at an exercise price of $9.50 per share to the placement agent for the private placement described above. The warrants became exercisable on February 8, 2008, and have a term of five years. The exercise price for the warrants was adjusted to $8.63 in March 2008, after the anti-dilution provisions of the warrants were triggered by our registered direct offering. The placement agent warrants are now exercisable for an additional 8,909 shares. The warrant has the same terms as the warrants issued in the private placement and was accounted for in accordance with the provisions of EITF 00-19. The securities underlying the warrant were registered on the same registration statement.

On March 31, 2008, the Company issued warrants to purchase 1,317,278 shares of common stock at an exercise price of $6.85 per share to investors in conjunction with the registered direct placement of common stock described above. The Warrants become exercisable on September 28, 2008, and have a term of five years. The warrants are subject to adjustment in certain circumstances and require settlement in shares of the Company's common stock. The Company accounted for the issuance of the common stock purchase warrants in accordance with the provisions of EITF 00-19. Based on the provisions of EITF 00-19, the Company classified the warrants as equity.

On March 31, 2008, the Company issued a warrant to purchase 130,000 shares of common stock at an exercise price of $6.30 per share to the placement agent for the private placement described above. The warrant has the same terms as the warrants issued to investors in the registered direct placement described above and were accounted for in accordance with the provisions of EITF 00-19. Based on the provisions of EITF 00-19, the Company classified the warrants as equity.

***Anti-dilution adjustment***

Pursuant to the anti-dilution provisions contained in the private placement investor and placement agent warrant agreements, following the close of the registered direct offering on March 31, 2008, the Company adjusted the conversion price of the private placement warrants. As a result, the exercise price for the warrants was adjusted

from $9.50 to $8.63. The adjustment to the exercise price results in the outstanding warrants held by the PIPE investors being exercisable for an additional 41,977 shares of common stock, and the outstanding warrant held by the PIPE placement agent being exercisable for an additional 8,909 shares of common stock.

***Common Stock and Common Stock Purchase Warrants Issued to Non-Employees For Services***

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 stock was valued at $10.16 per share on the date the shares were issued. 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.

At various dates 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 $119,000 and $153,000 and was recorded as a selling, general and administrative expense in the accompanying consolidated statements of operations for the years ended March 31, 2007 and 2006, respectively.

On June 1, 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 consolidated statement of operations for the year March 31, 2007.

On November 10, 2006, the Company entered into a 2 year consulting agreement with its new director, Robert Burlingame. Under the terms of the agreement, the Company issued to the director a warrant to purchase 75,000 shares of its common stock, exercisable at a price equal to the Company's common stock in its initial public offering in consideration of corporate advisory services. The warrants were fully exercisable and non-forfeitable at their date of issuance. The warrants were valued using the Black-Scholes option pricing model. Assumptions used were as follows: Fair value of the underlying stock of $9.00, risk-free interest rate of 4.70%; contractual life of 5 years; dividend yield of 0%; and volatility of 70%. The adjusted fair value of the warrant amounted to $350,000. Following the guidance enumerated in Issue 2 of EITF 96-18, the Company is amortizing the fair value of the warrants over the two year term of the consulting agreement which is consistent with its treatment of similar cash transactions. During the years ended March 31, 2008 and 2007, the amortized fair value of the warrants amounted to $175,000 and $71,000 and was recorded as selling, general and administrative expense in the accompanying consolidated statements of operations (Note 13). The unamortized fair value at March 31, 2008 related to this warrant was $105,000 which will be amortized over the remaining term of the agreement which expires on November 7, 2008.

On December 22, 2006, the Company issued a warrant to purchase 50,000 shares of the Company's common stock at an exercise price of $3.00 per share in connection with a settlement agreement with a former director and chief operating officer. The warrants were fully exercisable and non-forfeitable at date of issuance. The warrants were valued using the Black-Scholes option pricing model. Assumptions used were as follows: Fair value of the underlying stock $9.00; risk-free interest rate 4.70%; contractual life of 5 years; dividend yield of 0%; and volatility of 70%. The fair value of the warrants amounted to $365,000 and was recorded as selling, general and administrative expense in the accompanying consolidated statement of operations for the year ended March 31, 2007.

The Company accounted for its issuance of stock-based compensation to non-employees for services using the measurement date guidelines enumerated in SFAS 123(R) and EITF 96-18. Accordingly, the value of any awards that were fully exercisable 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.

In April 2007, the Company terminated certain advisory consulting contracts and made all unvested warrants issued to the consultants available for immediate exercise. In addition, the Company extended the exercise period through April 13, 2009. The Company recorded a $2,000 charge related to the modification.

The warrants were adjusted to fair value at each reporting date using the following weighted average assumptions:

| | Year Ended March 31, | |
|---|---|---|
| | 2008 | 2007 |
| Estimated life | 2.66 years | 5.33 years |
| Risk-free interest rate | 4.03% | 4.71% |
| Dividend yield | 0.00% | 0.00% |
| Volatility | 70% | 70% |

***Valuation of Common Stock***

In June 2006 and July 2005, the Company undertook two separate valuation studies to determine the fair value of its common stock. The fair value of the Company's common stock, based on the June 2006 and July 2005 valuation studies, was determined to be $11.28 and $10.16 per share, respectively. The fair value of the Company's common stock underlying substantially all common equity transactions completed during the year ended March 31, 2007 was based on the these valuation studies. The results of these studies 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 issued to unrelated parties for cash and intervening events reflected in the price of the Company's stock. The Company also considered (as appropriate) the estimated mid-point of its then proposed IPO price range, which was determined in November 2006 to be $13.00 per share (subsequently reduced in January 2007 to mid-point of $9.00 per share) and a negotiated exercise price of $18.00 per share for warrants issued to the placement agent for the Series C convertible preferred stock offering.

**NOTE 14 — Stock-Based Compensation**

***Reverse Stock Split***

On December 15, 2006, the Company effected an equity restructuring through a 1-for-4 reverse stock split of its common stock. The Company split adjusted both the exercise price and number of shares underlying its outstanding employee stock options in accordance with stock plan equity restructuring provisions, which include adjustments for stock splits, contained in the Company's stock option plans. The Company applied the guidance specified in paragraph 54 and the related implementation guidance included in Appendix A of SFAS 123(R) to evaluate whether the equity restructuring and modification of awards resulted in an increase in the fair value of such awards and whether additional compensation cost should be recognized. In accordance with SFAS 123(R) awards that are modified in equity restructurings pursuant to existing anti-dilution provisions generally do not result in the recognition of additional compensation cost. The Company evaluated the effect of the reverse-split on the fair value of existing stock options before and after the equity restructuring in accordance with the equity restructuring guidelines. As a result, the Company determined that it is not required to record additional stock-based compensation cost.

***1999, 2000, 2003 and 2004 Stock Option Plans***

The 1999, 2000, 2003 and 2004 Stock Option Plans became effective May 1999, June 2000, July 2003 and July 2004, 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.

In accordance with the Plans, stated exercise price may 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 Plans generally have a ten-year term and generally became exercisable over a five-year period.

As of June 29, 2006, the compensation committee of the Company's board of directors resolved that it would not approve any further grants under its 1999, 2000, and 2003 Plans.

In connection with the reincorporation in Delaware, no future options will be granted under the 2004 Plan.

As of March 31, 2008, there were 313,250, 39,500, 166,452 and 880,562 options outstanding in the 1999, 2000, 2003, and 2004 Stock Option Plans.

Additionally, as of March 31, 2008 there are 300,000 options outstanding that were granted outside of the stock option plans.

***2006 Stock 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 ("the 2006 Plan"), which was previously adopted by the board of directors in August 2006. On December 14, 2006 the stockholders approved the Company's 2006 Plan which became effective at the close of the Company's initial public offering. The Plan was amended by resolution of the Board on April 26, 2007, and the amendments were subsequently approved by the stockholders.

The 2006 Plan provides for the granting of incentive stock options to employees and the granting of nonstatutory stock options to employees, non-employee directors, advisors, and consultants. The 2006 Plan also provides for grants of restricted stock, stock appreciation rights and stock unit awards to employees, non-employee directors, advisors and consultants.

In accordance with the 2006 Plan, the stated exercise price may 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% stockholder, 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 2006 Plan generally have a ten-year term and generally become exercisable over a five-year period.

Shares subject to awards that expire unexercised or are forfeited or terminated will again become available for issuance under the 2006 Plan. No participant in the 2006 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.

As provided under the 2006 Plan, the aggregate number of shares authorized for issuance as awards under the 2006 Plan may increase each April 1 by the lesser of 1,750,000 options, or 5% of outstanding shares on last day of the preceding fiscal year, or a lesser number determined by the board of directors. On April 1, 2007, shares authorized for issuance as awards under the 2006 Plan were increased by 592,220 shares (which number constitutes 5% of the outstanding shares on the last day of the fiscal year ended year ended March 31, 2007).

As of March 31, 2008, 857,969 shares remain authorized for issuance under the 2006 Plan. As described above, the number of shares authorized for issuance will be subject to adjustment on April 1, 2008 (Note 20).

As of March 31, 2008, there were 924,251 options and 60,000 restricted stock awards outstanding in the 2006 Stock Option Plans.

Options and restricted stock units outstanding at March 31, 2008 under the various plans is as follows (in thousands):

| Plan | Number of Options | Number of Restricted Stock Units | Total Number of Options and Restricted Stock Units Outstanding in Plan |
|---|---|---|---|
| 1999 Plan | 313 | — | 313 |
| 2000 Plan | 40 | — | 40 |
| 2003 Plan | 166 | — | 166 |
| 2004 Plan | 881 | — | 881 |
| 2006 Plan | 924 | 60 | 984 |
| Granted Outside Plans | 300 | — | 300 |
| | 2,624 | 60 | 2,824 |

***Options Subject to Repurchase***

During 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 of 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. During the year ended March 31, 2006, the Company reclassified $257,000 related to the liability instruments to permanent equity at which time the statute of limitations lapsed and the holder could no longer control settlement of the award in cash.

Additionally, during the year ended March 31, 2006 the Company recorded $22,000 of stock compensation expense related to these options which is included in the accompanying consolidated statements of operations.

A summary of activity under all option Plans for the years ended March 31, 2008, 2007 and 2006 is presented below (in thousands, except per share data):

| | Number of Shares | Weighted-Average Exercise Price | Weighted-Average Contractual Term | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding at March 31, 2005 | 1,640 | $ 1.46 | | |
| Options granted | 787 | 9.20 | | |
| Options exercised | (292) | 1.02 | | |
| Options forfeited or expired | (166) | 6.17 | | |
| Outstanding at March 31, 2006 | 1,969 | 4.22 | | |
| Options granted | 380 | 9.20 | | |
| Options forfeited or expired | (329) | 5.76 | | |
| Outstanding at March 31, 2007 | 2,020 | 4.91 | | |
| Options granted | 912 | 6.97 | | |
| Options exercised | (119) | 0.56 | | |
| Options forfeited or expired | (189) | 7.04 | | |
| Outstanding at March 31, 2008 | 2,624 | $ 5.67 | 6.92 | $ 3,783 |
| Exercisable at March 31, 2008 | 1,456 | $ 4.00 | 5.49 | $ 869 |
| Options available for grant as of March 31, 2008 | 858 | | | |

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 ($5.06) for stock options that are in-the-money as of March 31, 2008.

***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.

**OCULUS INNOVATIVE SCIENCES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

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):

| | 2006 |
|---|---|
| Net loss available to common stockholders, as reported | $ (23,220) |
| Add: Total stock-based employee compensation expenses included in net loss | 279 |
| Deduct: Total stock-based employee compensation determined under the fair-value based method for all awards | (503) |
| Net loss available to common stockholders, pro forma | $ (23,444) |
| Net loss per common share, basic and diluted: | |
| As reported | $ (5.60) |
| Pro forma | $ (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, 2006 |
|---|---|
| Estimated life | 6 yrs |
| Risk-free interest rate | 4.27% |
| Dividend yield | 0.00% |

The weighted-average estimated minimum values of options granted was $3.12 for the year ended March 31, 2006.

At March 31, 2008, there was $179,000 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 1.51 years.

***Stock-Based Compensation After Adoption of SFAS 123(R)***

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 consolidated financial statements as of and for the years ended March 31, 2008 and 2007 reflect the impact of SFAS No. 123(R). In accordance with the prospective transition method, the Company's consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123(R).

OCULUS INNOVATIVE SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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) is as follows (in thousands, except per share amounts):

| | Impact from SFAS No. 123(R) Provisions for the Year Ended March 31, 2008 | Impact from SFAS No. 123(R) Provisions for the Year Ended March 31, 2007 |
|---|---|---|
| Cost of revenues service | $ 10 | $ 3 |
| Research and development | 145 | — |
| Selling, general and administrative | 851 | 812 |
| Total stock-based compensation | $ 1,006 | $ 815 |
| Effect on basic and diluted net loss per common share | $ 0.08 | $ 0.15 |

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 year ended March 31, 2008 and 2007, respectively.

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 periods of the respective awards. The fair value of employee stock options was estimated using the following weighted-average assumptions:

| | Year Ended March 31, | |
|---|---|---|
| | 2008 | 2007 |
| Fair value of common stock | $ 6.97 | $ 9.20 |
| Expected Term | 5.67yrs | 3.95yrs |
| Risk-free interest rate | 4.51% | 4.60% |
| Dividend yield | 0.00% | 0.00% |
| Volatility | 73.0% | 70.0% |

The weighted-average fair values of options granted during the years ended March 31, 2008 and 2007 were $4.53 and 5.81, respectively.

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 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 well as the trading history for the Company’s common stock. The Company will continue to analyze the stock price volatility and expected term assumptions as more data for the Company’s common stock and exercise patterns 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 at 5% based on historical experience. Prior to the adoption of SFAS No. 123(R), the Company accounted for forfeitures as they occurred.

At March 31, 2008, there was $179,000 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 1.51 years.

At March 31, 2008, there was unrecognized compensation costs of $4,179,000 related to stock options accounted for in accordance with the provisions of SFAS 123(R). The cost is expected to be recognized over a weighted-average amortization period of 3.68 years.

On April 26, 2007, the Company modified a stock option grant to its Chief Financial Officer. The Company cancelled the original stock option grant to purchase 60,000 shares of the Company's common stock and replaced the grant with a restricted stock grant with similar terms to the original grant. The modification of this award did not result in incremental fair value or an additional charge to Company's consolidated statements of operations for the year ended March 31, 2008.

On December 15, 2007, the Company modified stock options granted to employees and non-employees under share based arrangements in connection with the reverse-stock split equity restructuring. As described previously, the Company was not required to record any additional compensation in connection with the reverse-stock split. In addition, the Company modified an option grant to a Board Member, Robert Burlingame. In accordance with his agreement with the Company, the exercise price of the 75,000 options granted would be equal to the IPO price of $8.00. On January 25, 2007, the Company cancelled and regranted the options at the price of $8.00. The Company treated the cancellation and regrant as a modification to the original grant and recorded incremental compensation cost of $22,000 which is reflected in selling, general and administrative expenses in the accompanying consolidated statement of operations for the year ended March 31, 2007.

The Company did not capitalize any cost associated with stock-based compensation.

The Company issues new shares of common stock upon exercise of stock options.

***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, | | |
|---|---|---|---|
| | 2008 | 2007 | 2006 |
| Estimated life | 2.58yrs | 8.83yrs | 8.67yrs |
| Risk-free interest rate | 4.03% | 4.29% | 4.27% |
| Dividend yield | 0.00% | 0.00% | 0.00% |
| Volatility | 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, $11,000 and $32,000 of stock-based compensation expense during the years ended March 31, 2008, 2007 and 2006, respectively.

OCULUS INNOVATIVE SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

**NOTE 15 — Income Taxes**

The Company has the following net deferred tax assets (in thousands):

| | March 31, 2008 | March 31, 2007 |
|---|---|---|
| Deferred tax assets: | | |
| Net operating loss carryforwards | $ 28,124 | $ 21,482 |
| Research and development tax credit carryforwards | 858 | 420 |
| Stock-based compensation | 1,960 | 1,664 |
| Reserves and accruals | 349 | 1,013 |
| Other deferred tax assets | 3 | 173 |
| Total deferred tax assets | $ 31,294 | $ 24,752 |
| Deferred tax liabilities: | | |
| Basis difference in assets | (27) | (20) |
| Net deferred tax asset | 31,267 | 24,732 |
| Valuation allowance | (31,267) | (24,732) |
| Net deferred tax asset | $ — | $ — |

The Company's recorded income tax benefit, net of the change in the valuation allowance, for each of the periods presented is as follows:

| | Years Ended March 31, 2008 | 2007 | 2006 |
|---|---|---|---|
| Income tax benefit | $ 6,535 | $ 6,949 | $ 8,107 |
| Change in valuation allowance | (6,535) | (6,949) | (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:

| | Years Ended March 31, 2008 | 2007 | 2006 |
|---|---|---|---|
| Expected federal statutory rate | (34.0)% | (34.0)% | (34.0)% |
| State income taxes, net of federal benefit | (2.4)% | (5.8)% | (3.3)% |
| Research and Development Credit | (1.7)% | (0.7)% | — |
| Foreign earnings taxed at different rates | 1.5% | 2.8% | 1.8% |
| Recognition of change in estimate of State NOL Carryforwards Benefit | 3.6% | — | — |
| Effect of permanent differences | 0.9% | 2.6% | 0.3% |
| | (32.1)% | (35.1)% | (35.2)% |
| Change in valuation allowance | 32.1% | 35.1% | 35.2% |
| Totals | 0.0% | 0.0% | 0.0% |

At March 31, 2008, the Company had net operating loss carryforwards for federal, state and foreign income tax purposes of approximately $56,892,000, $49,281,000 and $22,303,000, respectively. The carryforwards expire at various times beginning March 31, 2010. The Company also had, at March 31, 2008, federal and state research and development credit carryforwards of approximately $442,000 and $416,000, respectively. The federal credits expire beginning March 31, 2024 and the state credits do not expire.

The Company has completed a study to assess whether a change in control has occurred or whether there have been multiple changes of control since the Company's formation. The study concluded that no change in control occurred for purposes of Internal Revenue Code section 382. 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 year ended March 31, 2008. 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.

In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), which became effective for the Company beginning April 1, 2007. FIN 48 addresses how tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, the tax benefit from an uncertain tax position can be recognized only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate resolution. The adoption of FIN 48 had no impact on the Company's financial condition, results of operations or cash flows.

The Company has identified its federal tax return and its state tax return in California as major tax jurisdictions. The Company is also subject to certain other foreign jurisdictions principally Mexico and The Netherlands. The Company's evaluation of FIN 48 tax matters was performed for tax years ended through March 31, 2008. Generally, the Company is subject to audit for the years ended March 31, 2007, 2006 and 2005 and maybe be subject to audit for amounts reltating to net operating loss carryforwards generated in periods prior to March 31, 2005. The Company has elected to retain its existing accounting policy with respect to the treatment of interest and penalties attributable to income taxes in accordance with FIN 48, and continues to reflect interest and penalties attributable to income taxes, to the extent they arise, as a component of its income tax provision or benefit as well as its outstanding income tax assets and liabilities. The Company believes that its income tax positions and deductions would be sustained on audit and does not anticipate any adjustments, other than those identified above that would result in a material change to its financial position.

**NOTE 16 — Employee Benefit Plan**

The Company has a program to contribute and administer individual Simple IRA 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 $79,000, $66,000 and $53,000 to the program for the years ended March 31, 2008, 2007 and 2006, respectively.

**NOTE 17 — 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.

OCULUS INNOVATIVE SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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 segments which are segregated by geography. Oculus Japan is insignificant with respect to the Company's consolidated operating results for the year ended March 31, 2008 and therefore has been included in the U.S. segment.

| | U.S. | Europe | Mexico | Total |
|---|---|---|---|---|
| **Year Ended March 31, 2008:** | | | | |
| Product revenues | $ 197 | $ 566 | $ 2,118 | $ 2,881 |
| Service revenues | 954 | — | — | 954 |
| Total revenues | 1,151 | 566 | 2,118 | 3,835 |
| Depreciation and amortization expense | 420 | 227 | 93 | 740 |
| Loss from operations | (19,567) | (1,586) | (1,272) | (22,425) |
| Interest expense | (1,016) | — | — | (1,016) |
| Interest income | 630 | — | — | 630 |

| | U.S. | Europe | Mexico | Total |
|---|---|---|---|---|
| **Year Ended March 31, 2007:** | | | | |
| Product revenues | $ 140 | $ 1,026 | $ 2,513 | $ 3,679 |
| Service revenues | 864 | — | — | 864 |
| Total revenues | 1,004 | 1,026 | 2,513 | 4,543 |
| Depreciation and amortization expense | 377 | 203 | 92 | 672 |
| Loss from operations | (13,066) | (2,905) | (3,513) | (19,484) |
| Interest expense | (956) | — | — | (956) |
| Interest income | 312 | — | — | 312 |

| | U.S. | Europe | Mexico | Total |
|---|---|---|---|---|
| **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 and amortization expense | 463 | 96 | 92 | 651 |
| Loss from operations | (12,621) | (2,685) | (5,545) | (20,851) |
| Interest expense | (172) | — | — | (172) |
| Interest income | 282 | — | — | 282 |

For the years ended March 31, 2008 and 2007, sales to a customer in India were $83,000 and $604,000, respectively. These sales are reported as part of the Europe segment. There were no sales to this customer during the year ended March 31, 2006.

The following table shows property and equipment balances by segment (in thousands):

| | March 31, | |
|---|---|---|
| | 2008 | 2007 |
| U.S | $ 1,193 | $ 904 |
| Europe | 754 | 901 |
| Mexico | 356 | 402 |
| | $ 2,303 | $ 2,207 |

The following table shows total asset balances by segment (in thousands):

| | March 31, | |
|---|---|---|
| | 2008 | 2007 |
| U.S | $ 20,974 | $ 23,437 |
| Europe | 1,271 | 1,367 |
| Mexico | 1,367 | 2,146 |
| | $ 23,612 | $ 26,950 |

**NOTE 18 — 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. 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 consolidated 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.

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 19 — Selected Quarterly Financial Data (unaudited)**

The Company believes that the following information reflects all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the information for the periods presented. The operating results for any quarter are not necessarily indicative of results for any future periods.

The following table contains selected unaudited statements of operations information for each of the quarters for the years ended March 31, 2008 and 2007 (in thousands, except per share data):

| | Quarter Ended | | | |
|---|---|---|---|---|
| | March 31, 2008 | December 31, 2007 | September 30, 2007 | June 30, 2007 |
| Revenue | $ 926 | $ 1,066 | $ 977 | $ 866 |
| Gross profit | 223 | 325 | 287 | 249 |
| Net loss available to common stockholders | (4,475) | (5,304) | (5,542) | (5,018) |
| Basic and diluted net loss per common share | $ (0.34) | $ (0.40) | $ (0.44) | $ (0.42) |

| | Quarter Ended | | | |
|---|---|---|---|---|
| | March 31, 2007 | December 31, 2006 | September 30, 2006 | June 30, 2006 |
| Revenue | $ 1,162 | $ 1,052 | $ 1,252 | $ 1,077 |
| Gross profit | 388 | 292 | 492 | 372 |
| Net loss available to common stockholders | (6,332) | (4,948) | (4,489) | (4,418) |
| Basic and diluted net loss per common share | $ (0.69) | $ (1.17) | $ (1.06) | $ (1.05) |

Basic and diluted net loss per common share for each of the quarters and full years have been calculated separately. Accordingly, quarterly amounts do not add to the annual amount because of differences in the weighted average common shares outstanding during each period principally due to the effect of the Company's issuing shares of its common stock during the year.

Diluted and basic net loss per common share are identical since common equivalent shares are excluded from the calculation, as their effect would be anti-dilutive.

**NOTE 20 — Subsequent Events**

***Second Closing of Registered Direct Offering***

On April 1, 2008, the Company conducted a second closing of an additional 18,095 shares of its common stock at a purchase price of $5.25 per share, and warrants to purchase an aggregate of 9,047 shares of common stock at an exercise price of $6.85 per share for gross proceeds of $95,000.

***Increase in Number of Shares Authorized in 2006 Plan***

As provided under the 2006 Plan, the aggregate number of shares authorized for issuance as awards under the 2006 Plan automatically increased on April 1, 2008 by 795,280 shares (which number constitutes 5% of the outstanding shares on the last day of the year ended March 31, 2008). Total shares authorized for issuance subsequent to the increase is 1,653,249.

***Employment Agreement***

On April 1, 2008, the Company entered into an employment agreement with one of its existing non-executive key employees. Pursuant to the agreement, the employee will receive an annual base salary of $175,000 and a bonus of $50,000 to be paid upon achievement of mutually agreed upon milestones. Additionally, under certain circumstances upon termination the employee may receive severance compensation in the amount of six months salary.

***New Hire***

The Company hired a vice president regulatory and clinical trials, employment commenced on April 21, 2008. The base salary for the vice president regulatory and clinical trials for fiscal 2009 is $235,000. Additionally the vice president of regulatory received a $10,000 signing bonus, will receive a $100,000 guaranteed bonus for fiscal year 2009, payable after the end of fiscal 2009, and was granted an option to purchase 100,000 shares of the Company's common stock at an exercise price of $5.01 per share which was granted at the fair market value of our common stock on the date of grant.

***Renegotiation of Intercompany Loans and Accounting for Foreign Exchange Transaction Gains and Losses***

Subsequent to March 31, 2008, the Company re-evaluated the operating plans and liquidity circumstances of each of its operating subsidiaries in the Netherlands and Mexico. As a result, the Company renegotiated the terms of its notes with its Mexico and Netherlands subsidiaries. The Companies board of directors memorialized the loans at a board meeting on May 29, 2008. The terms of the new loan agreements extend the maturity date of the loans plus all accrued interest to five years from April 1, 2008. In the event the loans cannot be settled at the maturity date, the loans will automatically renew for indefinite periods of five years. The Company and its subsidiaries have agreed interest will compound and accrued at the interest rate prescribed by the IRS.

The renegotiation of the loans resulted from the Company's and its Mexico and Netherlands subsidiaries' assessment that the subsidiaries lack the ability to foresee repayment of the outstanding balances of their respective intercompany loans. Due to the renegotiation of the loans, and the lack of ability to predict that the loans will be settled in the foreseeable future, the Company believes it is appropriate to evaluate its treatment of foreign exchange gains and losses resulting from the translation of the loans from local currency to U.S. Dollars. In accordance with the provisions of SFAS 52, if it cannot be determined an intercompany loan will be repaid in the foreseeable future, foreign exchange gains and losses related to the translation of the loans from local currency to U.S. Dollars should be classified as other comprehensive income and loss. The Company believes given the inability to foresee settlement of the loans and the mechanism which automatically extends the loans indefinitely, it is appropriate, effective April 1, 2008 to classify exchange gains and losses related to the loans to other comprehensive income and loss.

***Executive Officer 2009 Salaries***

On June 11, 2008, the compensation committee of the Company's board of directors approved the following salaries for its executive officers, based upon each of the executive officer's performance for the year ended March 31, 2008: chief executive officer — $375,000; chief operating officer — $275,000; chief financial officer — $250,000; vice president operations and international sales — $225,000; vice president corporate development and general counsel — $250,000.

***Bonus Plans***

Pursuant to the Company's 2008 bonus plan, on May 22, 2008 the compensation committee of the board of directors approved bonus payments to employees and executive officers for achievement of milestones during the year ended March 31, 2008. The total bonus payments amounted to $863,000. This amount is included in accrued expenses and other current liabilities in the accompanying March 31, 2008 consolidated balance sheet.

On June 11, 2008, the compensation committee of the board of directors approved a bonus plan for fiscal year 2009 (the "Bonus Plan"), under which all of our employees, including executive officers, are eligible for bonus awards. In determining whether a company-wide bonus pool will be established and, if so, in what amount, the compensation committee will assess whether the company has attained specified targeted company goals. Bonuses, if awarded, are payable in cash or, at the determination of the compensation committee no later than April 7, 2009, as necessary to preserve our cash reserves, in part or in whole in grants of stock options under our 2006 Amended and Restated Stock Incentive Plan. Any stock options will be valued by reference to the Black Scholes option pricing calculation at the fair market value of our common stock on June 5, 2009.

**ITEM 9.** ***Changes in and disagreements with Accountants on Accounting and Financials Disclosure***

None.

**ITEM 9A.** ***Controls and Procedures***

**Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our Chief Executive Officer, Hojabr Alimi, and Chief Financial Officer, Robert Miller, evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2008. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of March 31, 2008, the Company's chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

**Management's Annual Report on Internal Control over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) and 15d-15(f) promulgated under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles in the United States, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and board of directors of the company; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that

controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of the Company's internal control over financial reporting as of March 31, 2008. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in *Internal Control-Integrated Framework.*

Based on this assessment, management concluded that, as of March 31, 2008, our internal control over financial reporting is effective based on the COSO criteria set forth in *Internal Control — Integrated Framework*

Marcum & Kliegman LLP, an independent registered public accounting firm, that audited our consolidated financial statements included in this Annual Report on Form 10-K, has issued the following attestation report on management's assessment of the Company's internal control over financial reporting.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNITNG FIRM ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

To the Audit Committee of the
Board of Directors and Shareholders
of Oculus Innovative Sciences, Inc. and Subsidiaries

We have audited Oculus Innovative Sciences, Inc. and Subsidiaries ' (the "Company") internal control over financial reporting as of March 31, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying "Management Report on Internal Control over Financial Reporting". Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

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

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements. Because of the inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that degree of compliance with the policies or procedures may deteriorate.

In our opinion, Oculus Innovative Sciences, Inc. and Subsidiaries maintained, in all material aspects, effective internal control over financial reporting as of March 31, 2008, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets as of March 31, 2008 and 2007 and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended March 31, 2008 of the Company and our report dated June 11, 2008 expressed an unqualified opinion on those consolidated financial statements.

/s/ Marcum & Kliegman LLP

New York, New York
June 11, 2008

**Changes in Internal Control over Financial Reporting**

There were no changes in our internal control over financial reporting that occurred during the fiscal quarter ended March 31, 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**ITEM 9B.** ***Other Information***

(a) *Notice of Intent to Resign from Board of Directors.* On June 9, 2008, Mr. Akihisa Akao and Mr. Edward Brown each communicated his intent not to stand for re-election to the board of directors, and to resign from our board of directors effective June 13, 2008. Mr. Brown simultaneously communicated his intent to resign as a member of the nominating and corporate governance committee of our board of directors effective on the same date. Our board of directors accepted the resignations, expressing its thanks for the years of services to the Company, and it appointed Mr. Gregg H. Alton to fill the vacancy left by Mr. Brown as the chairman of the nominating and corporate governance committee.

(b) *Executive Officer 2009 Salaries.* On June 11, 2008, the compensation committee of our board of directors approved the following salaries for our executive officers, based upon each of the executive officer's performance for the year ended March 31, 2008: chief executive officer — $375,000; chief operating officer — $275,000; chief financial officer — $250,000; vice president operations and international sales — $225,000; vice president corporate development and general counsel — $250,000. We also hired a vice president regulatory and clinical trials, who commenced her employment on April 21, 2008. Her base salary for fiscal 2009 is $235,000.

(c) *2009 Bonus Plan.* On June 11, 2008, the compensation committee of the board of directors approved a bonus plan for fiscal year 2009 (the "Bonus Plan"), under which all of our employees, including our executive officers, are eligible for bonus awards. In determining whether a company-wide bonus pool will be established and, if so, in what amount, the compensation committee will assess whether the company has attained specified targeted company goals. Bonuses, if awarded, are payable in cash or, at the determination of the compensation committee no later than April 7, 2009, as necessary to preserve our cash reserves, in part or in whole in grants of stock options under our 2006 Stock Incentive Plan. Any stock options will be valued by reference to the Black Scholes option pricing calculation at the fair market value of our common stock on June 5, 2009. However, the compensation committee may not grant options exceeding the number of shares then authorized under the 2006 Amended and Restated Stock Incentive Plan less the number of shares we are contractually obligated to grant in fiscal year 2010. All bonuses, whether in cash or stock, will be paid on June 5, 2009.

The compensation committee has established in the bonus plan milestones for each executive officer and a range for each executive officer's potential bonus. In determining whether the compensation committee will make bonus payments to executive officers, the compensation committee will consider whether, and to what extent, the individual has met such milestones and whether, and to what extent, the company has achieved specified targeted revenue, expense targets, cash reserve targets and operational goals, including milestones for clinical trials, research and development, quality assurance and corporate development. The award of any bonus, other than the guaranteed cash bonus for 2009 in the amount of $100,000 to our newly-hired executive officer, and the $10,000 bonus for fiscal year 2008 specified in the bonus plan to one of our executive officers, is at the sole discretion of the compensation committee. All determinations of the compensation committee are final.

Based on individual and company performance in fiscal year 2009, the chief executive officer will be eligible to earn a bonus of 58% to 68% of his individual base salary; the chief operating officer, will be eligible to earn a bonus of 53% to 62% of his individual base salary; and the chief financial officer and the vice president corporate development and general counsel will be eligible to earn a bonus of 48% to 64% of his respective individual base salary. The vice president operations and international sales is eligible to receive up to $160,000 in bonus for fiscal year 2009, $60,000 of which will be paid quarterly, if awarded, and up to an additional $80,000 cash bonus payable following the end of the fiscal year, based on achievement of certain revenue and cost containment goals. Under the bonus plan, the compensation committee may modify the milestones or pay a bonus if milestones are not met if company management makes changes to its strategic goals that impact such milestones and ability to reach such milestones. The bonus plan also authorized the payment of a cash bonus in the amount of $10,000 to our vice president operations and international sales based upon his and the Company's performance in fiscal year 2008.

We hired a vice president regulatory and clinical trials who commenced her employment on April 21, 2008, and whose annual base salary is $235,000. The compensation committee has authorized a guaranteed cash bonus of $100,000 for fiscal year 2009 payable after the end of fiscal 2009. Under her agreement, the vice president regulatory and clinical trials was granted a stock option to purchase 100,000 shares of our common stock, which was granted at the fair market value of our common stock on the date of grant.

In determining whether the compensation committee will establish a bonus pool for non-executive employees, it will take into consideration whether, and to what extent, the company has achieved specified revenue targets, expense targets, cash reserve targets and operational goals, including milestones for clinical trials, research and development, quality assurance and corporate development. Based on the compensation committee's assessment, it may, but is not required to, establish a bonus pool.

If a bonus pool for non-executive employees is established, our management will first determine how the pool will be allocated among our groups or divisions. The bonus pool for each group or division, if established, will be 10% to 35% of the aggregate of all base salaries of employees in the group or division. Our chief executive officer, in consultation with the group supervisor, will determine how the bonus pool will be allocated among the employees in each group or division. In determining whether our management will make a bonus payment to an individual non-executive employee, management will consider whether, and to what extent, the individual has met the milestones set for him or her and the employee's contribution to the company's progress toward achieving its targeted revenue, expense targets, cash reserve targets and operational goals. The award of a bonus to any non-executive employee is at the sole discretion of our chief executive office and the employee's supervisor. All determinations of our chief executive officer and the employee's supervisor are final.

The summary of the bonus plan set forth above does not purport to be complete and is qualified in its entirety by reference to the bonus plan.

(d) *Amendment to Bylaws.* On June 11, 2008, our board of directors approved and made immediately effective an amendment to its bylaws clarifying the procedures by which a shareholder may nominate an individual for membership on the board of directors and make other proposals to be brought before a stockholder meeting. The amendment provides the timeframe within which notice of an intention to make such a nomination proposal must be made, the information which must accompany such a notice of intention and a provision providing that nominations or proposals not made in accordance with the procedures will be disregarded by the chairperson of the meeting at which a vote is taken on election of directors and that the inspector of election will disregard all votes cast for each such nominee. A copy of the amended and restated bylaws is attached as Exhibit 3.1(ii) to this report.

## PART III

**ITEM 10.** ***Directors, Executive Officers and Corporate Governance***

The information required by this Item is incorporated by reference to the definitive proxy statement for our 2008 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission within 120 days after the end of our fiscal year ended March 31, 2008 (the "2008 Proxy Statement").

Item 405 of Regulation S-K calls for disclosure of any known late filing or failure by an insider to file a report required by 16(a) of the Exchange Act. This disclosure is contained in the section entitled "Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement.

We have adopted a Code of Business Conduct that applies to all of our officers and employees, including our chief executive officer, president and chief operating officer, chief financial officer and other employees who perform financial or accounting functions. The Code of Business Conduct sets forth the basic principles that guide the business conduct of our employees. We have also adopted a Senior Financial Officers' Code of Ethics that specifically applies to our chief executive officer, president and chief operating officer, chief financial officer, and key management employees. Stockholders may request a free copy of our Code of Business Conduct and Ethics and our Senior Financial Officers' Code of Ethics by contacting Oculus Innovative Sciences, Inc., Attention: CFO, 1129 N. McDowell Blvd., Petaluma, California 94954.

To date, there have been no waivers under our Code of Business Conduct and Ethics or Senior Financial Officers' Code of Ethics. We intend to disclose future amendments to certain provisions of our Code of Business Conduct and Ethics or Senior Officers' Code of Ethics or any waivers, if and when granted, of our Code of Business Conduct and Ethics or Senior Officers' Code of Ethics on our website at *http://www.oculusis.com* within four business days following the date of such amendment or waiver.

Our board of directors has appointed an audit committee, comprised of Mr. Richard Conley, as chairman, Mr. Jay Birnbaum and Mr. Gregg Alton. The board of directors has determined that Mr. Conley qualifies as an audit committee financial expert under the definition outlined by the Securities and Exchange Commission. In addition, Mr. Conley, Mr. Birnbaum and Mr. Alton each qualifies as an "independent director" under the current rules of the NASDAQ Global Market and Securities and Exchange Commission rules and regulations.

**ITEM 11.** ***Executive Compensation***

The information required by this Item is incorporated by reference to the 2008 Proxy Statement.

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

The information required by this Item is incorporated by reference to the 2008 Proxy Statement.

Information about securities authorized for issuance under our equity compensation plans appears under the caption "Equity Compensation Plan Information" in the Proxy Statement. That portion of the Proxy Statement is incorporated by reference into this report.

**ITEM 13.** ***Certain Relationships, Related Transactions, and Director Independence***

The information required by this Item is incorporated by reference to the 2008 Proxy Statement.

**ITEM 14.** ***Principal Accounting Fees and Services***

The information required by this Item is incorporated by reference to the 2008 Proxy Statement.

**PART IV**

**ITEM 15.** ***Exhibits, Financial Statement Schedules***

**(a) Documents filed as part of this report**

***(1) Financial Statements***

Reference is made to the Index to Consolidated Financial Statements of Oculus Innovative Sciences, Inc. under Item 8 of Part II hereof.

***(2) Financial Statement Schedules***

Financial statement schedules have been omitted that are not applicable or not required or because the information is included elsewhere in the Consolidated Financial Statements or the Notes thereto.

***(3) Exhibits***

See Item 15(b) below. Each management contract or compensatory plan or arrangement required to be filed has been identified.

**(b) Exhibits**

**Exhibit Index**

| Exhibit Number | Description |
|---|---|
| 3.1(i) | Restated Certificate of Incorporation of Registrant (incorporated by reference to the exhibit of the same number filed with the Company's Annual Report on Form 10-K (File No. 001-3216) for the year ended March 31, 2007). |
| 3.1(ii)* | Amended and Restated Bylaws of Registrant, as amended effective on June 11, 2008. |
| 4.1 | Specimen Common Stock Certificate (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.2 | Warrant to Purchase Series A Preferred Stock of Registrant by and between Registrant and Venture Lending & Leasing III, Inc., dated April 21, 2004 (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.3 | Warrant to Purchase Series B Preferred Stock of Registrant by and between Registrant and Venture Lending & Leasing IV, Inc., dated June 14, 2006 (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.4 | Form of Warrant to Purchase Common Stock of Registrant (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.5 | Form of Warrant to Purchase Common Stock of Registrant (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.6 | Amended and Restated Investors Rights Agreement, effective as of September 14, 2006 (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.7 | Form of Promissory Note issued to Venture Lending & Leasing III, Inc. (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.8 | Form of Promissory Note (Equipment and Soft Cost Loans) issued to Venture Lending & Leasing IV, Inc. (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.9 | Form of Promissory Note (Growth Capital Loans) issued to Venture Lending & Leasing IV, Inc. (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.10 | Form of Promissory Note (Working Capital Loans) issued to Venture Lending & Leasing IV, Inc. (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.11 | Form of Warrant to Purchase Common Stock of Registrant (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.12 | Form of Warrant to Purchase Common Stock of Registrant (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.13 | Form of Warrant to Purchase Common Stock of Registrant (incorporated by reference to exhibit 10.3 to the Company's Current Report on Form 8-K filed August 13, 2007). |
| 4.14 | Form of Warrant to Purchase Common Stock of Registrant (incorporated by reference to exhibit 4.1 to the Company's Current Report on Form 8-K filed March 28, 2008). |

| Exhibit Number | Description |
|---|---|
| 10.1# | Form of Indemnification Agreement between Registrant and its officers and directors (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.2# | 1999 Stock Plan and related form stock option plan agreements (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.3# | 2000 Stock Plan and related form stock option plan agreements (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.4# | 2003 Stock Plan and related form stock option plan agreements (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.5# | 2004 Stock Plan and related form stock option plan agreements (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.6# | Form of 2006 Stock Incentive Plan and related form stock option plan agreements (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.7# | 2006 Stock Incentive Plan Notice of Stock Unit Award and Stock and Stock Unit Agreement issued to Robert Miller (incorporated by reference to the exhibit of the same number filed with the Company's Annual Report on Form 10-K (File No. 001-3216) for the year ended March 31, 2007). |
| 10.8 | Office Lease Agreement, dated October 26, 1999, between Registrant and RNM Lakeville, L.P. (incorporated by reference to exhibit 10.7 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.9 | Amendment to Office Lease No. 1, dated September 15, 2000, between Registrant and RNM Lakeville L.P. (incorporated by reference to exhibit 10.8 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.10 | Amendment to Office Lease No. 2, dated July 29, 2005, between Registrant and RNM Lakeville L.P. (incorporated by reference to exhibit 10.9 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.11 | Amendment No. 3 to Lease, dated August 23, 2006, between Registrant and RNM Lakeville L.P. (incorporated by reference to exhibit 10.23 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.12 | 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) (incorporated by reference to exhibit 10.10 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.13 | Office Lease Agreement, dated July 2003, between Oculus Innovative Sciences, B.V. and Artikona Holding B.V. (translated from Dutch) (incorporated by reference to exhibit 10.11 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.14 | Loan and Security Agreement, dated March 25, 2004, between Registrant and Venture Lending & Leasing III, Inc. (incorporated by reference to exhibit 10.12 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.15 | Loan and Security Agreement, dated June 14, 2006, between Registrant and Venture Lending & Leasing IV, Inc. (incorporated by reference to exhibit 10.13 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.16 | Amendment No. 1 to Supplement to Loan and Security Agreement, dated March 29, 2007, between Registrant and Venture Lending & Leasing IV, Inc. (incorporated by reference to the exhibit of the same number filed with the Company's Annual Report on Form 10-K (File No. 001-3216) for the year ended March 31, 2007). |

| Exhibit Number | Description |
|---|---|
| 10.17# | Employment Agreement, dated January 1, 2004, between Registrant and Hojabr Alimi (incorporated by reference to exhibit 10.14 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.18# | Employment Agreement, dated January 1, 2004, between Registrant and Jim Schutz (incorporated by reference to exhibit 10.15 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.19# | Employment Agreement, dated June 1, 2004, between Registrant and Robert Miller (incorporated by reference to exhibit 10.16 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.20# | Employment Agreement, dated June 1, 2005, between Registrant and Bruce Thornton (incorporated by reference to exhibit 10.17 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.21# | Employment Agreement, dated June 10, 2006, between Registrant and Mike Wokasch (incorporated by reference to exhibit 10.19 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.22# | Form of Director Agreement (incorporated by reference to exhibit 10.20 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.23# | Consultant Agreement, dated October 1, 2005, by and between Registrant and White Moon Medical (incorporated by reference to exhibit 10.21 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.24 | 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. (incorporated by reference to exhibit 10.22 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.25 | Stock Purchase Agreement, dated June 16, 2005, between Registrant, Quimica Pasteur, S de R.L., Francisco Javier Orozco Gutierrez and Jorge Paulino Hermosillo Martin (incorporated by reference to exhibit 10.24 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.26 | Framework Agreement, dated June 16, 2005, between Javier Orozco Gutierrez, Quimica Pasteur, S de R.L., Jorge Paulino Hermosillo Martin, Registrant and Oculus Technologies de Mexico, S.A. de C.V. (incorporated by reference to exhibit 10.25 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.27 | 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 (incorporated by reference to exhibit 10.26 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.28 | Partnership Interest Purchase Option Agreement, dated June 16, 2005, between Registrant and Javier Orozco Gutierrez (incorporated by reference to exhibit 10.27 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.29 | 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) (incorporated by reference to exhibit 10.28 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.30 | 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) (incorporated by reference to exhibit 10.29 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.31 | Loan and Security Agreement, dated November 7, 2006, between Registrant and Robert Burlingame (incorporated by reference to exhibit 10.30 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |

| Exhibit Number | Description |
|---|---|
| 10.32 | Non-Negotiable Secured Promissory Note, dated November 10, 2006, between Registrant and Robert Burlingame (incorporated by reference to exhibit 10.31 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.33 | Amendment No. 1 to Non-Negotiable Secured Promissory Note, dated March 29, 2007, between Registrant and Robert Burlingame (incorporated by reference to the exhibit of the same number filed with the Company's Annual Report on Form 10-K (File No. 001-3216) for the year ended March 31, 2007). |
| 10.34 | Subordination Agreement, dated November 7, 2006, by and among Registrant, Robert Burlingame, Venture Lending & Leasing III, LLC, and Venture Lending & Leasing IV, LLC (incorporated by reference to exhibit 10.32 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.35 | Amendment No. 1 to Subordination Agreement, dated March 29, 2007, by and among Registrant, Robert Burlingame, Venture Lending & Leasing III, LLC, and Venture Lending & Leasing IV, LLC. (incorporated by reference to the exhibit of the same number filed with the Company's Annual Report on Form 10-K (File No. 001-3216) for the year ended March 31, 2007). |
| 10.36# | Consulting Agreement, effective November 9, 2006, by and between Registrant and Robert Burlingame (incorporated by reference to exhibit 10.33 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.37# | Director Agreement, dated November 8, 2006, by and between Registrant and Robert Burlingame (incorporated by reference to exhibit 10.34 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.38† | Exclusive Marketing Agreement, dated December 5, 2005, by and between Registrant and Alkem Laboratories Ltd (incorporated by reference to exhibit 10.35 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.39 | Settlement Agreement, effective September 21, 2006, by and among Registrant and Messrs. Jorge Ahumada Ayala and Fernando Ahumada Ayala (incorporated by reference to exhibit 10.36 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.40 | Settlement Agreement, dated October 25, 2006, by and between Registrant and Mr. Kim Kelderman (incorporated by reference to exhibit 10.37 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.41 | Securities Purchase Agreement, dated August 7, 2007, by and between Registrant and purchasers identified on the signatures pages thereto (incorporated by reference to exhibit 10.1 to the Company's Current Report on Form 8-K filed August 13, 2007). |
| 10.42 | Registration Rights Agreement, dated August 7, 2007, by and between Registrant and purchasers identified on signatures pages thereto (incorporated by reference to exhibit 10.2 to the Company's Current Report on Form 8-K filed August 13, 2007). |
| 10.43* | Amendment No. 4 to Lease, dated September 13, 2007, between Registrant and RNM Lakeville L.P. |
| 10.44* | Amendment to Office Lease Agreement, effective February 15, 2008, between Oculus Innovative Sciences Netherlands B.V. and Artikona Holding B.V. (translated from Dutch). |
| 10.45 | Form of Securities Purchase Agreement, dated March 27, 2008, by and between Registrant and each investor signatory thereto (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed March 23, 2008). |
| 21.1 | List of Subsidiaries (incorporated by reference to the exhibit of the same number filed with the Company's Annual Report on Form 10-K (File No. 001-3216) for the year ended March 31, 2007). |
| 23.1* | Consent of Marcum & Kliegman LLP, independent registered public accounting firm. |
| 24.1* | Power of Attorney (included on page 115). |
| 31.1* | Certification of Chief Executive Officer pursuant to Securities Exchange Act Rule 13a — 14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |

| Exhibit Number | Description |
|---|---|
| 31.2* | Certification of Chief Financial Officer pursuant to Securities Exchange Act Rule 13a — 14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1** | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1250, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2** | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1250, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

* Filed herewith.

** In accordance with Item 60(b)(32)(ii) of Regulation S-K and SEC Release Nos. 33-8238 and 34-47986, Final Rule: Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, the certifications furnished in Exhibits 32.1 and 32.2 hereto are deemed to accompany this Form 10-K and will not be deemed "filed" for purposes of Section 18 of the Exchange Act. Such certifications will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the Company specifically incorporates it by reference.

† Confidential treatment has been granted with respect to certain portions of this agreement.

# Indicates management contract or compensatory plan or arrangement.

Copies of above exhibits not contained herein are available to any stockholder, upon payment of a reasonable per page fee, upon written request to: Chief Financial Officer, Oculus Innovative Sciences, Inc., 1129 N. McDowell Blvd., Petaluma, California 94954.

**(c) Financial Statements and Schedules**

Reference is made to Item 15(a)(2) above.

**SIGNATURES**

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

OCULUS INNOVATIVE SCIENCES, INC.

By: /s/ Hojabr Alimi
Hojabr Alimi
President, Chief Executive Officer and
Chairman of the Board
(Principal Executive Officer)

Date: June 13, 2008

**POWER OF ATTORNEY**

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Hojabr Alimi and James J. Schutz, and each of them, his true and lawful attorneys-in-fact, each with full power of substitution, for him or her in any and all capacities, to sign any amendments to this report on Form 10-K and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact or their substitute or substitutes may do or cause to be done by virtue hereof.

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

| Signature | Title | Date |
|---|---|---|
| /s/ Hojabr Alimi<br>Hojabr Alimi | President, Chief Executive Officer and Chairman of the Board (Principal Executive Officer) | June 13, 2008 |
| /s/ Robert E. Miller<br>Robert E. Miller | Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer) | June 13, 2008 |
| /s/ Akihisa Akao<br>Akihisa Akao | Director | June 13, 2008 |
| /s/ Gregg Alton<br>Gregg Alton | Director | June 13, 2008 |
| /s/ Jay Edward Birnbaum<br>Jay Edward Birnbaum | Director | June 13, 2008 |
| /s/ Edward M. Brown<br>Edward M. Brown | Director | June 13, 2008 |

| Signature | Title | Date |
|---|---|---|
| /s/ Robert Burlingame<br>Robert Burlingame | Director | June 13, 2008 |
| /s/ Richard Conley<br>Richard Conley | Director | June 13, 2008 |
| /s/ Gregory M. French<br>Gregory M. French | Director | June 13, 2008 |
| /s/ James Schutz<br>James Schutz | Director | June 13, 2008 |

## EXHIBIT INDEX

| Exhibit Number | Description |
|---|---|
| 3.1(i) | Restated Certificate of Incorporation of Registrant (incorporated by reference to the exhibit of the same number filed with the Company's Annual Report on Form 10-K (File No. 001-3216) for the year ended March 31, 2007). |
| 3.1(ii)* | Amended and Restated Bylaws of Registrant, as amended effective June 11, 2008. |
| 4.1 | Specimen Common Stock Certificate (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.2 | Warrant to Purchase Series A Preferred Stock of Registrant by and between Registrant and Venture Lending & Leasing III, Inc., dated April 21, 2004 (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.3 | Warrant to Purchase Series B Preferred Stock of Registrant by and between Registrant and Venture Lending & Leasing IV, Inc., dated June 14, 2006 (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.4 | Form of Warrant to Purchase Common Stock of Registrant (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.5 | Form of Warrant to Purchase Common Stock of Registrant (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.6 | Amended and Restated Investors Rights Agreement, effective as of September 14, 2006 (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.7 | Form of Promissory Note issued to Venture Lending & Leasing III, Inc. (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.8 | Form of Promissory Note (Equipment and Soft Cost Loans) issued to Venture Lending & Leasing IV, Inc. (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.9 | Form of Promissory Note (Growth Capital Loans) issued to Venture Lending & Leasing IV, Inc. (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.10 | Form of Promissory Note (Working Capital Loans) issued to Venture Lending & Leasing IV, Inc. (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.11 | Form of Warrant to Purchase Common Stock of Registrant (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.12 | Form of Warrant to Purchase Common Stock of Registrant (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 4.13 | Form of Warrant to Purchase Common Stock of Registrant (incorporated by reference to exhibit 10.3 to the Company's Current Report on Form 8-K filed August 13, 2007). |
| 4.14 | Form of Warrant to Purchase Common Stock of Registrant (incorporated by reference to exhibit 4.1 to the Company's Current Report on Form 8-K filed March 28, 2008). |
| 10.1# | Form of Indemnification Agreement between Registrant and its officers and directors (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.2 | 1999 Stock Plan and related form stock option plan agreements (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |

| Exhibit Number | Description |
|---|---|
| 10.3# | 2000 Stock Plan and related form stock option plan agreements (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.4# | 2003 Stock Plan and related form stock option plan agreements (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.5# | 2004 Stock Plan and related form stock option plan agreements (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.6# | Form of 2006 Stock Incentive Plan and related form stock option plan agreements (incorporated by reference to the exhibit of the same number filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.7# | 2006 Stock Incentive Plan Notice of Stock Unit Award and Stock and Stock Unit Agreement issued to Robert Miller (incorporated by reference to the exhibit of the same number filed with the Company's Annual Report on Form 10-K (File No. 001-3216) for the year ended March 31, 2007). |
| 10.8 | Office Lease Agreement, dated October 26, 1999, between Registrant and RNM Lakeville, L.P. (incorporated by reference to exhibit 10.7 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.9 | Amendment to Office Lease No. 1, dated September 15, 2000, between Registrant and RNM Lakeville L.P. (incorporated by reference to exhibit 10.8 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.10 | Amendment to Office Lease No. 2, dated July 29, 2005, between Registrant and RNM Lakeville L.P. (incorporated by reference to exhibit 10.9 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.11 | Amendment No. 3 to Lease, dated August 23, 2006, between Registrant and RNM Lakeville L.P. (incorporated by reference to exhibit 10.23 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.12 | 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) (incorporated by reference to exhibit 10.10 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.13 | Office Lease Agreement, dated July 2003, between Oculus Innovative Sciences, B.V. and Artikona Holding B.V. (translated from Dutch) (incorporated by reference to exhibit 10.11 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.14 | Loan and Security Agreement, dated March 25, 2004, between Registrant and Venture Lending & Leasing III, Inc. (incorporated by reference to exhibit 10.12 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.15 | Loan and Security Agreement, dated June 14, 2006, between Registrant and Venture Lending & Leasing IV, Inc. (incorporated by reference to exhibit 10.13 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.16 | Amendment No. 1 to Supplement to Loan and Security Agreement, dated March 29, 2007, between Registrant and Venture Lending & Leasing IV, Inc. (incorporated by reference to the exhibit of the same number filed with the Company's Annual Report on Form 10-K (File No. 001-3216) for the year ended March 31, 2007). |
| 10.17# | Employment Agreement, dated January 1, 2004, between Registrant and Hojabr Alimi (incorporated by reference to exhibit 10.14 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.18# | Employment Agreement, dated January 1, 2004, between Registrant and Jim Schutz (incorporated by reference to exhibit 10.15 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007) |
| 10.19# | Employment Agreement, dated June 1, 2004, between Registrant and Robert Miller (incorporated by reference to exhibit 10.16 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |

| Exhibit Number | Description |
|---|---|
| 10.20# | Employment Agreement, dated June 1, 2005, between Registrant and Bruce Thornton (incorporated by reference to exhibit 10.17 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.21# | Employment Agreement, dated June 10, 2006, between Registrant and Mike Wokasch (incorporated by reference to exhibit 10.19 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.22# | Form of Director Agreement (incorporated by reference to exhibit 10.20 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.23# | Consultant Agreement, dated October 1, 2005, by and between Registrant and White Moon Medical (incorporated by reference to exhibit 10.21 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.24 | 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. (incorporated by reference to exhibit 10.22 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.25 | Stock Purchase Agreement, dated June 16, 2005, between Registrant, Quimica Pasteur, S de R.L., Francisco Javier Orozco Gutierrez and Jorge Paulino Hermosillo Martin (incorporated by reference to exhibit 10.24 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.26 | Framework Agreement, dated June 16, 2005, between Javier Orozco Gutierrez, Quimica Pasteur, S de R.L., Jorge Paulino Hermosillo Martin, Registrant and Oculus Technologies de Mexico, S.A. de C.V. (incorporated by reference to exhibit 10.25 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.27 | 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 (incorporated by reference to exhibit 10.26 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.28 | Partnership Interest Purchase Option Agreement, dated June 16, 2005, between Registrant and Javier Orozco Gutierrez (incorporated by reference to exhibit 10.27 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.29 | 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) (incorporated by reference to exhibit 10.28 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.30 | 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) (incorporated by reference to exhibit 10.29 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.31 | Loan and Security Agreement, dated November 7, 2006, between Registrant and Robert Burlingame (incorporated by reference to exhibit 10.30 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.32 | Non-Negotiable Secured Promissory Note, dated November 10, 2006, between Registrant and Robert Burlingame (incorporated by reference to exhibit 10.31 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.33 | Amendment No. 1 to Non-Negotiable Secured Promissory Note, dated March 29, 2007, between Registrant and Robert Burlingame (incorporated by reference to the exhibit of the same number filed with the Company's Annual Report on Form 10-K (File No. 001-3216) for the year ended March 31, 2007). |
| 10.34 | Subordination Agreement, dated November 7, 2006, by and among Registrant, Robert Burlingame, Venture Lending & Leasing III, LLC, and Venture Lending & Leasing IV, LLC (incorporated by reference to exhibit 10.32 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |

| Exhibit Number | Description |
|---|---|
| 10.35 | Amendment No. 1 to Subordination Agreement, dated March 29, 2007, by and among Registrant, Robert Burlingame, Venture Lending & Leasing III, LLC, and Venture Lending & Leasing IV, LLC. (incorporated by reference to the exhibit of the same number filed with the Company's Annual Report on Form 10-K (File No. 001-3216) for the year ended March 31, 2007). |
| 10.36# | Consulting Agreement, effective November 9, 2006, by and between Registrant and Robert Burlingame (incorporated by reference to exhibit 10.33 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.37# | Director Agreement, dated November 8, 2006, by and between Registrant and Robert Burlingame (incorporated by reference to exhibit 10.34 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.38† | Exclusive Marketing Agreement, dated December 5, 2005, by and between Registrant and Alkem Laboratories Ltd (incorporated by reference to exhibit 10.35 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.39 | Settlement Agreement, effective September 21, 2006, by and among Registrant and Messrs. Jorge Ahumada Ayala and Fernando Ahumada Ayala (incorporated by reference to exhibit 10.36 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
| 10.40 | Settlement Agreement, dated October 25, 2006, by and between Registrant and Mr. Kim Kelderman (incorporated by reference to exhibit 10.37 filed with Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007). |
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| 32.2** | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1250, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

* Filed herewith.

** In accordance with Item 60(b)(32)(ii) of Regulation S-K and SEC Release Nos. 33-8238 and 34-47986, Final Rule: Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, the certifications furnished in Exhibits 32.1 and 32.2 hereto are deemed to accompany this Form 10-K and will not be deemed "filed" for purposes of Section 18 of the Exchange Act. Such certifications will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the Company specifically incorporates it by reference.

† Confidential treatment has been granted with respect to certain portions of this agreement.

# Indicates management contract or compensatory plan or arrangement.

**Exhibit 3.1(ii)**

# AMENDED AND RESTATED
# BYLAWS
# OF
# OCULUS INNOVATIVE SCIENCES, INC.
**(a Delaware corporation)**

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**AMENDED AND RESTATED**

**BYLAWS**

**OF**

**OCULUS INNOVATIVE SCIENCES, INC.**
**(a Delaware corporation)**

ARTICLE 1

Offices

1.1 Registered Office. The registered office of the corporation shall be set forth in the certificate of incorporation of the corporation.

1.2 Other Offices. The corporation may also have offices at such other places, either within or without the State of Delaware, as the Board of Directors of the corporation (the "Board") may from time to time designate or the business of the corporation may require.

ARTICLE 2

Meeting of Stockholders

2.1 Place of Meeting. Meetings of stockholders may be held at such place, either within or without of the State of Delaware, as may be designated by or in the manner provided in these bylaws, or, if not so designated, at the registered office of the corporation or the principal executive offices of the corporation.

2.2 Annual Meeting. Annual meetings of stockholders shall be held each year at such date and time as shall be designated from time to time by the Board or the Chief Executive Officer and stated in the notice of the meeting. At each such annual meeting, the stockholders shall elect by a plurality vote the number of directors equal to the number of directors of the class whose term expires at such meeting (or, if fewer, the number of directors properly nominated and qualified for election) to hold office until the third succeeding annual meeting of stockholders after their election. The stockholders shall also transact such other business as may properly be brought before the meeting.

To be properly brought before the annual meeting, business must be (a) specified in the notice of meeting (or any supplement thereto) given by or at the direction of the Board or the Chief Executive Officer, (b) otherwise properly brought before the meeting by or at the direction of the Board or the Chief Executive Officer, or (c) otherwise properly brought before the meeting by a stockholder of record. A motion related to business proposed to be brought before any stockholders' meeting may be made by any stockholder entitled to vote if the business proposed is otherwise proper to be brought before the meeting. However, any such stockholder may propose business to be brought before a meeting only if such stockholder has, in accordance with

the provisions of Section 2.3, given timely notice to the Secretary of the corporation in proper written form of the stockholder's intent to propose such business.

2.3 Stockholder Proposals.

(a) Stockholder Proposals Relating to Nominations for and Election of Directors.

(i) Nominations by a stockholder of candidates for election to the Board by stockholders at any meeting of stockholders may be made only if the stockholder complies with the procedures set forth in this Section 2.3(a), and any candidate proposed by a stockholder not nominated in accordance with such provisions shall not be considered or acted upon for execution at such meeting of stockholders. A proposal by a stockholder for the nomination of a candidate for election by stockholders as a director at any meeting of stockholders at which directors are to be elected may be made only by notice in writing, delivered by a nationally recognized courier service or mailed by first class United States mail, postage or delivery charges prepaid, within the time limits specified in Section 2.3(c).

(ii) A stockholder's notice to the Secretary shall set forth (A) as to each person whom the stockholder proposes to nominate for election or reelection as a director: (I) the name, age, business address and, if known, residence address of each such person, (II) the principal occupation or employment of each such person for the past five years, (III) the class, series and number of shares of the corporation that are beneficially owned and of record by each such person and beneficial owner, and the earliest date of acquisition of any such capital stock, (IV) a description of any arrangement or understanding between each such person and the stockholder making such nomination with respect to such person's proposal for nomination and election as a director and actions to be proposed or taken by such person if elected a director, (V) the written consent of each person so proposed to serve as a director if nominated and elected as a director and (VI) any other information that would be required to be provided by the stockholder pursuant to the Securities Exchange Act of 1934 and the rules and regulations promulgated thereunder (collectively, the "1934 Act") in such stockholder's capacity as a proponent of a stockholder proposal if proxies were to be solicited for the election as a director of each person whom the stockholder proposes; and (B) as to the stockholder giving notice, (I) the name and record address of such stockholder and the beneficial owner, if any, on whose behalf the proposal is made and (II) the class, series and number of shares of the corporation that are owned beneficially and of record by the stockholder and such beneficial owner.

(b) Stockholder Proposals Relating to Matters Other Than Nominations for and Elections of Directors.

(i) A stockholder of the corporation may bring such business (other than a nomination of a candidate for election as a director, which is covered by Section 2.3(a)) (a "Stockholder Matter") before any meeting of stockholders only if such Stockholder Matter is a proper matter for stockholder action and such stockholder shall have provided notice in writing, delivered by a nationally recognized courier service or mailed by first class United States mail, postage or delivery charges prepaid, within the time limits specified in Section 2.3(c); *provided, however*, that a proposal submitted by a stockholder for inclusion in the corporation's proxy statement for an annual meeting that is appropriate for inclusion therein and otherwise complies

with the provisions of Rule 14a-8 under the 1934 Act (including timeliness) shall be deemed to have also been submitted on a timely basis pursuant to this Section 2.3.

(ii) A stockholder's notice to the Secretary of a proposal of a Stockholder Matter shall set forth (A) as to each matter the stockholder proposes to bring before the meeting a brief description of the business desired to be brought before the meeting, (I) the text of the proposal or business (including the text of any resolutions proposed for consideration and in the event that such business includes a proposal to amend these bylaws of the corporation, the language of the proposed amendment), (II) the reasons for conducting such business at the meeting and (III) any other information that would be required to be provided by the stockholder pursuant to Section 14 of the 1934 Act in such stockholder's capacity as a proponent of a stockholder proposal if proxies were solicited for stockholder consideration of such Stockholder Matter at a meeting of stockholders, and (B) as to the stockholder giving Notice, (I) the name and record address of the stockholder proposing such business and the beneficial owner, if any, on whose behalf the proposal is made, (II) the class, series and number of shares of the corporation that are owned beneficially and of record by the stockholder and such beneficial owner and (III) any material interest of the stockholder in such business.

(c) Time for Notice of Stockholder Proposals Relating to Nominations or Stockholder Matters.

(i) In the case of an annual meeting of stockholders, to be timely, any written proposal of a nomination or of a Stockholder Matter must be received at the principal executive offices of the corporation addressed to the attention of the Secretary of the corporation not earlier than ninety (90) days nor more than one hundred twenty (120) days in advance of the one-year anniversary of the date the corporation's proxy statement was released to the stockholders in connection with the previous year's annual meeting of stockholders; *provided, however*, that in the event that no annual meeting was held in the previous year or the date of the annual meeting has been changed by more than thirty (30) days from the date contemplated at the time of the previous year's proxy statement, notice by the stockholder must be received by the Secretary of the corporation not later than the close of business on the later of (x) the ninetieth (90th) day prior to such annual meeting and (y) the seventh (7th) day following the day on which public announcement of the date of such meeting is first made (or, in the case of (x) and (y), if such day is not a business day, then the close of the next business day). For the purposes of these bylaws, "public announcement" shall mean disclosure in a press release reported by the Dow Jones News Service, Associated Press or a comparable national news service or in a document publicly filed by the corporation with the Securities and Exchange Commission. In no event shall the public announcement of an adjournment or postponement of any meeting of stockholders commence a new time period (or extend any time period) for the giving of stockholder's notice as described in these bylaws.

(ii) In the case of a special meeting of stockholders, to be timely, any written proposal of a nomination or of a Stockholder Matter must be delivered by a nationally recognized courier service or mailed by first class United States mail, postage or delivery charges prepaid, and received at the principal executive offices of the corporation addressed to the attention of the Secretary of the corporation not later than the close of business on the seventh (7th) day following the earlier of (x) the date that the corporation mailed notice to its

stockholders that a special meeting of stockholders will be held and (y) the date on which public announcement of the date of such meeting is first made (or, in the case of (x) or (y), if such day is not a business day, then the close of the next business day).

(d) Determination of Defective Notice. Notwithstanding anything in these bylaws to the contrary, no nomination or Stockholder Matter shall be presented at a meeting of stockholders except in accordance with the procedures set forth in this Section 2.3, and any nomination or Stockholder Matter not submitted in accordance with such provisions shall not be considered or acted upon at any meeting of stockholders. The Chairman of the Board (or such other person presiding at a meeting of stockholders in accordance with these bylaws) shall, if the facts warrant, determine and declare to a meeting of stockholders that a proposal of a nomination or of a Stockholder Matter was not properly brought before the meeting in accordance with the provisions of this Section 2.3, and if he or she should so determine, he or she shall so declare to the meeting and any such defective nomination or Stockholder Matter shall be disregarded.

2.4 Special Meetings. Special meetings of the stockholders may be called for any purpose or purposes, unless otherwise prescribed by statute or by the certificate of incorporation, by the Secretary only at the request of the Chairman of the Board, the Chief Executive Officer or by a resolution duly adopted by the affirmative vote of a majority of the Board. Such request shall state the purpose or purposes of the proposed meeting. Business transacted at any special meeting shall be limited to matters relating to the purpose or purposes stated in the notice of meeting.

2.5 Notice of Meetings. Except as otherwise provided by law, written notice of each meeting of stockholders, annual or special, stating the place, if any, date and time of the meeting, the means of remote communications, if any, by which stockholders and proxy holders may be deemed to be present in person and vote at such meeting, and, in the case of a special meeting, the purpose or purposes for which such special 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 before the date of the meeting.

When a meeting is adjourned to another place, date or time, 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, if any, date, time and means of remote communications, if any, of the adjourned meeting shall be given in conformity herewith. At any adjourned meeting, any business may be transacted that might have been transacted at the original meeting.

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, for a period of at least ten days prior to the meeting, (i) on a reasonably accessible electronic network, provided that the information

required to gain access to such list is provided with the notice of the meeting, or (ii) during ordinary business hours, at the principal place of business of the corporation. If the meeting is to be held at a place, then the list shall also be produced and kept at the time and place of the meeting during the whole time thereof, and may be inspected by any stockholder who is present. If the meeting is to be held solely by means of remote communication, then the list shall also be open to the examination of any stockholder during the whole time of the meeting on a reasonably accessible electronic network, and the information required to gain access to such list shall be provided with the notice of the meeting.

2.7 Organization and Conduct of Business. The Chairman of the Board or, in his or her absence, the Chief Executive Officer or 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 of the meeting 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. Except where otherwise provided by law or the certificate of incorporation of the corporation or these bylaws, the holders of a majority of the stock issued and outstanding and entitled to vote, present in person or represented in proxy, shall constitute a quorum at all meetings of the stockholders.

2.9 Adjournments. Any meeting of stockholders may be adjourned from time to time to any other time and to any other place at which a meeting of stockholders may be held under these bylaws, which time and place shall be announced at the meeting, by a majority of the stockholders present in person or represented by proxy at the meeting and entitled to vote, though less than a quorum, or, if no stockholder is present or represented by proxy, by any officer entitled to preside at or to act as secretary of such meeting, without notice other than announcement at the meeting, until a quorum shall be present or represented. At such adjourned meeting at which a quorum shall be present or represented, any business may be transacted which might have been transacted at the original meeting. If the adjournment is for more than thirty days, or if after the adjournment a new record date is fixed for the adjourned meeting, a notice of the adjourned meeting shall be given to each stockholder of record entitled to vote at the meeting.

2.10 Voting Rights. Unless otherwise provided in the certificate of incorporation of the corporation, each stockholder shall at every meeting of the stockholders be entitled to one vote for each share of the capital stock having voting power held by such stockholder.

2.11 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 of the corporation or of

these bylaws, a different vote is required in which case such express provision shall govern and control the decision of such question.

2.12 Record Date for Stockholder Notice and Voting. For purposes of determining the stockholders entitled to notice of, or to vote at, any meeting of stockholders or any adjournment thereof, or entitled to receive payment of any dividend or other distribution or allotment of any rights, or 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 fewer than ten (10) days before the date of any such meeting nor more than sixty (60) days before any other action to which the record date relates. A determination of stockholders of record entitled to notice of 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. 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. The record date for determining stockholders for any other purpose shall be at the close of business on the day on which the Board adopts the resolution relating to such purpose.

2.13 Proxies. Each stockholder entitled to vote at a meeting of stockholders, or to express consent or dissent to corporate action in writing without a meeting, may authorize another person or persons to act for such stockholder by proxy, but no such proxy shall be voted or acted upon after three years from its date, unless the proxy provides for a longer period. All proxies must be filed with the Secretary of the corporation at the beginning of each meeting in order to be counted in any vote at the meeting. Subject to the limitation set forth in the last clause of the first sentence of this Section 2.13, a duly executed proxy that does not state that it is irrevocable shall continue in full force and effect unless (i) 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, or attendance at the meeting and voting in person by, the person executing the proxy, or (ii) 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.

2.14 Inspectors of Election. The corporation shall, in advance of any meeting of stockholders, appoint one or more inspectors of election to act at the meeting and make a written report thereof. The corporation may designate one or more persons to act as alternate inspectors to replace any inspector who fails to act. If no inspector or alternate is able to act at a meeting of stockholders, the person presiding at the meeting shall appoint one or more inspectors to act at the meeting. Each inspector, before entering upon the discharge of his or her duties, shall take and sign an oath faithfully to execute the duties of inspector with strict impartiality and according to the best of his or her ability.

2.15 Action Without a Meeting. No action required or permitted to be taken at any annual or special meeting of the stockholders of the corporation may be taken without a meeting and the power of the stockholders to consent in writing, without a meeting, to the taking of any action is specifically denied.

ARTICLE 3

Directors

3.1 Number, Election, Tenure and Qualifications. The number of directors that shall constitute the entire Board shall not be less than five (5) nor more than nine (9), and initially shall be set at seven (7); *provided, however*, that the number of directors that shall constitute the entire Board shall be fixed from time to time by resolution adopted by a majority of the entire Board. The classes of directors that shall constitute the entire Board shall be as provided in the certificate of incorporation of the corporation.

The directors shall be elected at the annual meetings of the stockholders, except as otherwise provided in Section 3.2, and each director elected shall hold office until such director's successor is elected and qualified or until such director's earlier resignation, removal, death or incapacity.

Subject to the rights of holders of any class or series of stock having a preference over the common stock as to dividends or upon liquidation, nominations of persons for election to the Board by or at the direction of the Board may be made by any nominating committee or person appointed by the Board; nominations may also be made by any stockholder of record of the corporation entitled to vote for the election of directors at the applicable meeting who complies with the notice procedures set forth in Section 2.3(a). Such nominations, other than those made by or at the direction of the Board, shall be made within the time limits specified in Section 2.3(c). Such stockholder's notice to the Secretary shall set forth the information specified in Section 2.3(a)(ii).

3.2 Enlargement and Vacancies. The number of members of the Board may be increased at any time as provided in Section 3.1 above. Sole power to fill vacancies and newly created directorships resulting from any increase in the authorized number of directors shall be vested in the Board through action by a majority of the directors then in office, though less than a quorum, or by a sole remaining director, and each director so chosen shall hold office until the next annual election at which the term of the class to which they have been elected expires and until such director's successor is duly elected and qualified or until such director's earlier resignation, removal from office, death or incapacity. If there are no directors in office, then an election of directors may be held in the manner provided by statute. In the event of a vacancy in the Board, the remaining directors, except as otherwise provided by law or these bylaws, may exercise the powers of the full board until the vacancy is filled.

3.3 Resignation and Removal. Any director may resign at any time upon written notice to the corporation at its principal place of business or to the Chief Executive Officer or the Secretary. Such resignation shall be effective upon receipt of such notice unless the notice specifies such resignation to be effective at some other time or upon the happening of some other event. Any director or the entire Board may be removed by the holders of a majority of the shares then entitled to vote at an election of directors, unless otherwise specified by law or the certificate of incorporation of the corporation.

3.4 Composition. The corporation shall use commercially reasonable efforts to ensure that a majority of the members of the Board qualify as "independent directors" (each an "Independent Director") under the then current rules and regulations of the United States Securities and Exchange Commission and the primary stock exchange, stock market or quotation system on which the corporation's stock is then listed or quoted, as applicable.

3.5 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 as are not by statute or by the certificate of incorporation of the corporation or by these bylaws directed or required to be exercised or done by the stockholders.

3.6 Chairman of the Board. If the Board appoints a Chairman of the Board, such Chairman shall, when present, preside at all meetings of the stockholders and the Board. The Chairman shall perform such duties and possess such powers as are customarily vested in the office of the Chairman of the Board or as may be vested in the Chairman by the Board.

3.7 Place of Meetings. The Board may hold meetings, both regular and special, either within or without the State of Delaware.

3.8 Annual Meetings. The annual meetings 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, or shall be held at the next regularly scheduled meeting of the Board or at such other date, time and place as shall be designated from time to time by the Board and stated in the notice of the meeting. The annual meetings shall be for the purposes of organization, and an election of officers and the transaction of other business.

3.9 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; provided that any director who is absent when such a determination is made shall be given prompt notice of such determination.

3.10 Special Meetings. Special meetings of the Board may be called by the Chairman of the Board, the Chief Executive Officer, the President or the Secretary, or on the written request of two or more directors, or by one director in the event that there is only one director in office. Notice of the time and place, if any, of special meetings shall be delivered personally or by telephone to each director, or sent by first-class mail or commercial delivery service, facsimile transmission, or by electronic mail or other electronic means, charges prepaid, sent to such director's business or home address as they appear upon the records of the corporation. In case such notice is mailed, it shall be deposited in the United States mail at least four (4) days prior to the time of holding of the meeting. In case such notice is delivered personally or by telephone or by commercial delivery service, facsimile transmission, or electronic mail or other electronic means, it shall be so delivered at least twenty-four (24) hours prior to the time of the holding of the meeting. A notice or waiver of notice of a meeting of the Board need not specify the purposes of the meeting.

3.11 Quorum, Action at Meeting, Adjournments. At all meetings of the Board, a majority of directors then in office, but in no event less than one-third (1/3) of the entire Board,

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 be otherwise specifically provided by law or by the certificate of incorporation of the corporation. For purposes of this Section, the term "entire Board" shall mean the number of directors last fixed by directors in accordance with these bylaws; *provided, however*, that if fewer than all the number of directors so fixed have been elected (by the stockholders or the Board), the "entire Board" shall mean the greatest number of directors so elected to hold office at any one time pursuant to such authorization. If a quorum shall not be present at any meeting of the board of directors, a majority of the directors present thereat may adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum shall be present.

3.12 Action Without Meeting. Unless otherwise restricted by the certificate of incorporation of the corporation or 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 or by electronic transmission, and the writing or writings or electronic transmission or transmissions are filed with the minutes of proceedings of the Board or committee.

3.13 Telephone Meetings. Unless otherwise restricted by the certificate of incorporation of the corporation or these bylaws, any member of the Board or any committee thereof may participate in a meeting of the Board or of any committee, as the case may be, by means of conference telephone or by any form of 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.

3.14 Committees. The Board may, by resolution passed by a majority of the whole 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 present at any meeting and not disqualified from voting, whether or not the member or members present 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. Any such committee, to the extent provided in the resolution of the Board, shall have and may exercise all 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 (i) approving or adopting, or recommending to the stockholders, any action or matter expressly required by the DGCL to be submitted to stockholders for approval or (ii) adopting, amending or repealing any of these bylaws. Such committee or committees shall have such name or names as may be determined from time to time by resolution adopted by the Board. Each committee shall keep regular minutes of its meetings and make such reports to the Board as the Board may request. Except as the Board may otherwise determine, any committee may make rules for the conduct of its business, but unless otherwise provided by the directors or in such rules, its business shall be conducted as nearly as possible in the same manner as is provided in these bylaws for the conduct of its business by the Board.

3.15 Fees and Compensation of Directors. Unless otherwise restricted by the certificate of incorporation of the corporation or 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.

3.16 Rights of Inspection. Any director shall have the right to examine the corporation's stock ledger, a list of its stockholders and its other books and records for a purpose reasonably related to his or her position as a director.

## ARTICLE 4

## Officers

4.1 Officers Designated. The officers of the corporation shall be chosen by the Board and shall be a Chief Executive Officer, a President, a Secretary and a Chief Financial Officer or Treasurer. The Board may also choose a Chief Operating Officer, one or more Vice Presidents, and one or more assistant Secretaries or assistant Treasurers. Any number of offices may be held by the same person, unless the certificate of incorporation of the corporation or these bylaws otherwise provide.

4.2 Election. The Board at its first meeting after each annual meeting of stockholders shall choose a Chief Executive Officer, a President, a Secretary and a Chief Financial Officer or Treasurer. Other officers may be appointed by the Board of Directors at such meeting, at any other meeting, or by written consent or may be appointed by the Chief Executive Officer pursuant to a delegation of authority from the Board.

4.3 Tenure. Each officer of the corporation shall hold office until such officer's successor is elected and qualified, unless a different term is specified in the vote choosing or appointing such officer, or until such officer's earlier death, resignation, removal or incapacity. Any officer elected or appointed by the Board or by the Chief Executive Officer may be removed with or without cause at any time by the affirmative vote of a majority of the Board or a committee duly authorized to do so, except that any officer appointed by the Chief Executive Officer may also be removed at any time by the Chief Executive Officer. Any vacancy occurring in any office of the corporation may be filled by the Board, at its discretion. Any officer may resign by delivering such officer's written resignation to the corporation at its principal place of business or to the Chief Executive Officer or the Secretary. Such resignation shall be effective upon receipt unless it is specified to be effective at some other time or upon the happening of some other event.

4.4 The Chief Executive Officer. Subject to such supervisory powers, if any, as may be given by the Board to the Chairman of the Board, the Chief Executive Officer 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.

4.5 The President. The President shall, in the event there be no Chief Executive Officer or in the absence of the Chief Executive Officer or in the event of his or her disability or refusal to act, perform the duties of the Chief Executive Officer, and when so acting, shall have the powers of and be subject to all the restrictions upon the Chief Executive Officer. The President shall perform such other duties and have such other powers as may from time to time be prescribed for such person by the Board, the Chairman of the Board, the Chief Executive Officer or these bylaws.

4.6 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 or her 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 them by the Board, the President, the Chairman of the Board or these bylaws.

4.7 The Secretary. The Secretary shall attend all meetings of the Board and 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 Chief Executive Officer, 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.

4.8 The Assistant Secretary. The Assistant Secretary, or if there be more than one, any Assistant Secretaries in the order designated by the Board (or in the absence of any designation, in the order of their election) shall assist the Secretary in the performance of his or her duties and, 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.

4.9 The Chief Financial Officer . The Chief Financial Officer 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 Chief Financial Officer 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 Chief Executive Officer and the Board, at its regular meetings, or when the Board so requires, an account of all his or her transactions as Chief Financial Officer and of the financial condition of the corporation. The Chief Financial Officer shall perform such other duties and have other powers as may from time to time be prescribed by the Board of Directors or the Chief Executive Officer.

4.10 The Treasurer and Assistant Treasurers. The Treasurer (if one is appointed) shall have such duties as may be specified by the Chief Financial Officer to assist the Chief Financial Officer in the performance of his or her duties and to perform such other duties and have other powers as may from time to time be prescribed by the Board or the Chief Executive Officer. It shall be the duty of any Assistant Treasurers to assist the Treasurer in the performance of his or her duties and to perform such other duties and have other powers as may from time to time be prescribed by the Board or the Chief Executive Officer.

4.11 Bond. If required by the Board, any officer shall give the corporation a bond in such sum and with such surety or sureties and upon such terms and conditions as shall be satisfactory to the Board, including without limitation a bond for the faithful performance of the duties of such officer's office and for the restoration to the corporation of all books, papers, vouchers, money and other property of whatever kind in such officer's possession or under such officer's control and belonging to the corporation.

4.12 Delegation of Authority. The Board may from time to time delegate the powers or duties of any officer to any other officers or agents, notwithstanding any provision hereof.

## ARTICLE 5

## Notices

5.1 Delivery . Whenever, under the provisions of law, or of the certificate of incorporation of the corporation or these bylaws, written notice is required to be given to any director or stockholder, such notice may be given by mail, addressed to such director or stockholder, at such person's 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 or delivered to a nationally recognized courier service. Unless written notice by mail is required by law, written notice may also be given by commercial delivery service, facsimile transmission, electronic means or similar means addressed to such director or stockholder at such person's address as it appears on the records of the corporation, in which case such notice shall be deemed to be given when delivered into the control of the persons charged with effecting such transmission, the transmission charge to be paid by the corporation or the person sending such notice and not by the addressee. Oral notice or other in-hand delivery, in person or by telephone, shall be deemed given at the time it is actually given.

5.2 Waiver of Notice. Whenever any notice is required to be given under the provisions of law or of the certificate of incorporation of the corporation or of these bylaws, a written waiver, signed by the person entitled to notice, or a waiver by electronic transmission by the person entitled to notice, whether before or after the time stated therein, shall be deemed equivalent to notice. Attendance of a person at a meeting shall constitute a waiver of notice of such meeting, except when the person attends a meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened. Neither the business to be transacted at, nor the purpose of, any regular or special meeting of the stockholders, directors or members of a committee of directors need be specified in any written waiver of notice or any waiver by electronic transmission unless so required by the certificate of incorporation or these bylaws.

## ARTICLE 6

## Indemnification and Insurance

6.1 Indemnification.

(a) Each person who was or is made a party or is threatened to be made a party to or is involved (including, without limitation, as a witness) in any actual or threatened action, suit or proceeding, whether civil, criminal, administrative or investigative (hereinafter a "proceeding"), by reason of the fact that he or she or a person of whom he or she is the legal representative is or was a director or officer of the corporation (or any predecessor), or is or was serving at the request of the corporation (or any predecessor) as a director, officer, employee or agent of another corporation or of a partnership, limited liability company, joint venture, trust, employee benefit plan sponsored or maintained by the corporation, or other enterprise (or any predecessor of any of such entities) (hereinafter an "Indemnitee"), shall be indemnified and held harmless by the corporation to the fullest extent authorized by the General Corporation Law of the State of Delaware (the "DGCL"), 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 said law permitted the corporation to provide prior to such amendment), or by other applicable law as then in effect, against all expense, liability and loss (including attorneys' fees and related disbursements, judgments, fines, excise taxes or penalties under the Employee Retirement Income Security Act of 1974, as amended from time to time, penalties and amounts paid or to be paid in settlement) actually and reasonably incurred or suffered by such Indemnitee in connection therewith. Each person who is or was serving as a director, officer, employee or agent of a subsidiary of the corporation shall be deemed to be serving, or have served, at the request of the corporation. The right to indemnification conferred in this Section 6.1 shall be a contract right.

(b) Any indemnification (but not advancement of expenses) under this Article 6 (unless ordered by a court) shall be made by the corporation only as authorized in the specific case upon a determination that indemnification of the director or officer is proper in the circumstances because he or she has met the applicable standard of conduct set forth in the DGCL, as the same exists or hereafter may 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 said law permitted the corporation to provide prior to such amendment). Such determination shall be made with respect to a person who is a director or officer at the time of such determination (A) by a majority vote of the directors who are not or were not parties to the proceeding in respect of which indemnification is being sought by Indemnitee (the "Disinterested Directors"), even though less than a quorum, (B) by a committee of Disinterested Directors designated by a majority vote of the Disinterested Directors, even though less than a quorum, (C) if there are no such Disinterested Directors, or if the Disinterested Directors so direct, by independent legal counsel in a written opinion to the Board, a copy of which shall be delivered to Indemnitee, or (D) by the stockholders.

6.2 Advance Payment. The right to indemnification under this Article 6 shall include the right to be paid by the corporation the expenses incurred in defending any such proceeding in advance of its final disposition, such advances to be paid by the corporation within thirty (30) days after the receipt by the corporation of a statement or statements from the claimant requesting such advance or advances from time to time; *provided, however*, that if the DGCL requires, the payment of such expenses incurred by a director or officer 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 person while a director or officer, including, without limitation, service to an employee benefit plan) in advance of the final disposition of a proceeding, shall be made only upon delivery to the corporation of an undertaking by or on behalf of such director or officer to repay all amounts so advanced if it shall ultimately be determined that such director or officer is not entitled to be indemnified under Section 6.1 or otherwise.

Notwithstanding the foregoing, unless otherwise determined pursuant to this Article 6, no advance shall be made by the corporation to an officer of the corporation (except by reason of the fact that such officer is or was a director of the corporation, in which event this paragraph shall not apply) in any action, suit or proceeding, whether civil, criminal, administrative or investigative, if a determination is reasonably and promptly made (i) by the Board by a majority vote of the Disinterested Directors, even though less than a quorum, or (B) by a committee of Disinterested Directors designated by majority vote of the Disinterested Directors, even though less than a quorum, or (C) if there are no Disinterested Directors or the Disinterested Directors so direct, by independent legal counsel in a written opinion to the Board, a copy of which shall be delivered to the claimant, that the facts known to the decision-making party at the time such determination is made demonstrate clearly and convincingly that such person acted in bad faith or in a manner that such person did not believe to be in or not opposed to the best interests of the corporation.

6.3 Non-Exclusivity and Survival of Rights; Amendments. The right to indemnification and the payment of expenses incurred in defending a proceeding in advance of its final disposition conferred in this Article 6 shall not be deemed exclusive of any other right which any person may have or hereafter acquire under any statute, provision of the certificate of incorporation of the corporation, bylaws, agreement, vote of stockholders or Disinterested Directors or otherwise, and shall continue as to a person who has ceased to be a director, officer, employee or agent of the corporation and shall inure to the benefit of the heirs, executors and administrators of such a person. Any repeal or modification of the provisions of this Article 6 shall not in any way diminish or adversely affect the rights of any director, officer, employee or

agent of the corporation hereunder in respect of any occurrence or matter arising prior to any such repeal or modification.

6.4 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 is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust, employee benefit plan or other enterprise against any expense, liability or loss asserted against such person and incurred by such person in any such capacity, or arising out of such person's status as such, whether or not the corporation would have the power to indemnify such person against such liability under the DGCL.

6.5 Reliance. Persons who after the date of the adoption of this provision become or remain directors or officers of the corporation shall be conclusively presumed to have relied on the rights to indemnity, advance of expenses and other rights contained in this Article 6 in entering into or continuing such service. The rights to indemnification and to the advance of expenses conferred in this Article 6 shall apply to claims made against an Indemnitee arising out of acts or omissions that occurred or occur both prior and subsequent to the adoption hereof.

6.6 Severability. If any word, clause, provision or provisions of this Article 6 shall be held to be invalid, illegal or unenforceable for any reason whatsoever: (i) the validity, legality and enforceability of the remaining provisions of this Article 6 (including, without limitation, each portion of any section or paragraph of this Article 6 containing any such provision held to be invalid, illegal or unenforceable, that is not itself held to be invalid, illegal or unenforceable) shall not in any way be affected or impaired thereby; and (ii) to the fullest extent possible, the provisions of this Article 6 (including, without limitation, each such portion of any section or paragraph of this Article 6 containing any such provision held to be invalid, illegal or unenforceable) shall be construed so as to give effect to the intent manifested by the provision held invalid, illegal or unenforceable.

## ARTICLE 7

## Capital Stock

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 in the name of the corporation by, the Chairman of the Board, the Chief Executive Officer, the President or a Vice President and by the Chief Financial Officer, the Treasurer or an Assistant Treasure, or the Secretary or an Assistant Secretary of the corporation. Certificates may be issued for partly paid shares and in such case upon the face or back of the certificates issued to represent any such partly paid shares, the total amount of the consideration to be paid therefor, and the amount paid thereon shall be specified.

Within a reasonable time after the issuance or transfer of uncertificated stock, the corporation shall send to the registered owner thereof a written notice containing the information required by the DGCL 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 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, and proper evidence of compliance or other conditions to rightful transfer, it shall be the duty of the corporation to issue a new certificate to the person entitled thereto, cancel the old certificate and record the transaction upon its books. Upon receipt of proper transfer instructions, and proper evidence of compliance or other conditions to rightful transfer, from the registered owner of uncertificated share, 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 person 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 Lost, Stolen or Destroyed Certificates. The corporation 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 corporation may require. When authorizing the issue of a new certificate or certificates, the corporation 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, to indemnify the corporation in such manner as it may require, and/or to give the corporation a bond or other adequate security 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

## Certain Transactions

8.1 Transactions with Interested Parties. No contract or transaction between the corporation and one or more of its directors or officers, or between the corporation and any other corporation, partnership, association or other organization in which one or more of its directors

or officers are directors or have a financial interest, shall be void or voidable solely for this reason, or solely because the director or officer is present at or participates in the meeting of the board or committee thereof which authorizes the contract or transaction or solely because the vote or votes of such director or officer are counted for such purpose, if:

(a) the material facts as to such director's or officer's relationship or interest and as to the contract or transaction are disclosed or are known to the Board or the committee, and the Board or committee in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors, even though the disinterested directors be less than a quorum; or

(b) the material facts as to such director's or officer's relationship or interest and as to the contract or transaction are disclosed or are known to the stockholders entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the stockholders; or

(c) the contract or transaction is fair as to the corporation as of the time it is authorized, approved or ratified, by the Board, a committee thereof or the stockholders.

8.2 Quorum. Common or interested directors may be counted in determining the presence of a quorum at a meeting of the Board or of a committee which authorizes the contract or transaction.

## ARTICLE 9

## General Provisions

9.1 Dividends. Dividends upon the capital stock of the corporation, subject to any restrictions contained in the DGCL or the provisions of the certificate of incorporation of the corporation, if any, may be declared by the Board at any regular or special meeting or by unanimous written consent. Dividends may be paid in cash, in property or in shares of capital stock, subject to the provisions of the certificate of incorporation of the corporation.

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 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.

9.4 Corporate Seal. The Board of Directors may, by resolution, adopt a corporate seal. The corporate seal shall have inscribed thereon the name of the corporation, the year of its organization and the word "Delaware." The seal may be used by causing it or a facsimile thereof

to be impressed or affixed or otherwise reproduced. The seal may be altered from time to time by the Board.

9.5 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.

9.6 Representation of Shares of Other Corporations. The Chief Executive Officer, the President or any Vice President, the Chief Financial Officer or the Treasurer or any Assistant Treasurer, or the Secretary or any Assistant Secretary of the corporation is authorized to vote, represent and exercise on behalf of the corporation all rights incident to any and all shares of any corporation or corporations standing in the name of the corporation. The authority herein granted to said officers to vote or represent on behalf of the corporation any and all shares held by the corporation in any other corporation or corporations may be exercised either by such officers in person or by any other person authorized so to do by proxy or power of attorney duly executed by said officers.

## ARTICLE 10

## Amendments

The Board is expressly empowered to adopt, amend or repeal these bylaws; *provided, however*, that any adoption, amendment or repeal of these bylaws by the Board shall require the approval of at least sixty-six and two-thirds percent of the total number of directors then in office. The stockholders shall also have power to adopt, amend or repeal these bylaws at any regular or special meeting of stockholders; *provided, however*, that in addition to any vote of the holders of any class or series of stock of the corporation required by law or by the certificate of incorporation of the corporation, the affirmative vote of the holders of at least sixty-six and two-thirds percent of the voting power of all of the then outstanding shares of the stock of the corporation entitled to vote generally in the election of directors, voting together as a single class, shall be required for such adoption, amendment or repeal by the stockholders of any provision of these bylaws and notice of such adoption, amendment or repeal shall be contained in the notice of such meeting.

**SECRETARY'S CERTIFICATE OF ADOPTION OF THE AMENDED AND RESTATED BYLAWS OF**

**OCULUS INNOVATIVE SCIENCES, INC.**

I, the undersigned, do hereby certify:

1. That I am the duly elected and acting Secretary of Oculus Innovative Sciences, Inc., a Delaware corporation; and

2. That the foregoing is a full, true and correct copy of the Amended and Restated Bylaws of the corporation as adopted by the directors of said corporation and to become effective as of June 11, 2008.

IN WITNESS WHEREOF, I have hereunto subscribed my name this 11th day of June 2008.

/s/ Jim Schutz
Jim Schutz
Secretary

**Exhibit 10.43**

**AMENDMENT NO. 4**
**TO LEASE**

**This Amendment No. 4 to Lease** is made and entered into as of September 13, 2007, by and between **RNM Lakeville, LLC**, a Delaware limited liability company (successor to RNM Lakeville, L.P.) ("Landlord"), and **Oculus Innovative Sciences, Inc.** (f/k/a MicroMed Laboratories, Inc.), a California corporation ("Tenant").

**Recitals**

**A.** Landlord and Tenant are parties to that certain Lease dated as of October 26, 1999, as amended by Amendment No. 1 to Lease dated as of September 15, 2000, Amendment No. 2 to Lease dated as of July 29, 2005 and Amendment No. 3 to Lease dated as of August 23, 2006 (collectively the "Lease"), pursuant to which Landlord leases to Tenant, and Tenant leases from Landlord, certain Premises in Petaluma, California. Unless otherwise defined herein, all capitalized terms shall have the meanings assigned to them in the Lease.

**B.** The term of the Lease expires on September 30, 2007.

**D.** The parties wish to amend the Lease to extend the Lease Term as provided herein.

**Therefore**, for consideration, the adequacy and receipt of which are hereby acknowledged, the parties agree as follows:

**1. Term.** The Termination Date of the Lease is hereby extended to September 30, 2010.

**2. Base Rent.** Commencing October 1, 2007, Base Rent for the Premises per month shall be as follows:

| Months | Base Rent |
|---|---|
| Oct 2007 | $0 (abated) |
| Nov 1 2007 to Sept 30, 2008 | $24,611.40 |
| Oct 1, 2008 to Sept 30, 2009 | $25,730.10 |
| Oct 1, 2009 to Sept 30, 2010 | $26,848.80 |

**Improvement Allowance.** Landlord shall reimburse Tenant up to $20,000.00 for the cost of installing additional HVAC capacity and backup power generator equipment for the Premises, all in connection with Alterations to be performed by Tenant to improve and convert the existing warehouse portion of the Premises to laboratory uses. To qualify for such reimbursement, such funds shall be expended by Tenant no later than March 31, 2008, and Tenant must submit to Landlord, no later than April 30, 2008, receipts, evidence of payment and lien releases relating to such Alterations and as are reasonably acceptable to Landlord. All such

HVAC and backup generator equipment shall become part of the Building upon installation and shall become the property of Landlord upon termination of the Lease without further compensation to Tenant. The foregoing shall not be deemed the approval of Landlord to such Alterations, and the design and installation of such Alterations shall be subject to the provisions of the Lease, including without limitation the provisions of Section 10.2 of the Lease.

**3. Conditions of Transfer.** Notwithstanding the provisions of Section 19 of the Lease, Landlord's consent to a Transfer will not be unreasonably withheld and may be conditioned only on Landlord's determination that (a) the proposed business and operations of the Transferee at the Premises will be hazardous to, or will significantly interfere with the conduct of the business of other tenants in the Project as such business is currently conducted, or (b) the Transferee's financial condition is weaker than the financial condition of Tenant as of the date this Amendment is executed.

**4. Leasing Commissions.** Each party hereby warrants to the other party that it has had no dealing with any finder, broker or agent in connection with this Amendment and the extension of the Lease. Each party hereby agrees that it shall indemnify, defend and hold harmless the other party from and against any and all costs, expenses (including attorney's fees and costs of suit), and liabilities for commissions or other compensation, charges or damages claimed by any other finder, broker or agent based upon dealings with the indemnifying party with respect to the renewal and renegotiation of the Lease.

**5. Confirmation of Lease.** Tenant hereby represents and warrants to Landlord that, as of the date hereof, (a) the Lease is in full force and effect and has not been modified except pursuant to this Amendment; (b) Tenant has not subleased or assigned any of its right, title and interest in and to the Lease and has full power and authority to enter into and perform its obligations hereunder, (c) Tenant is not in default under the Lease, and to the best of Tenant's knowledge, there are no defaults on the part of Landlord existing under the Lease; (d) to the best of Tenant's knowledge, there exists no valid abatements, causes of action, counterclaims, disputes, defenses, offsets, credits, deductions, or claims against the enforcement of any of the terms and conditions of the Lease; (e) this Amendment has been duly authorized, executed and delivered by Tenant and constitutes the legal, valid and binding obligation of Tenant; and (f) there are no actions, whether voluntary or otherwise, pending against Tenant under the bankruptcy or insolvency laws of the United States or any state thereof. Except as expressly modified herein, the Lease shall remain in full force and effect.

**In Witness Whereof,** the parties executed this Amendment No. 4 as of the date first written above.

**Landlord:**

**RNM Lakeville, LLC,**
a Delaware limited liability company

By: **RNM Petaluma, Inc.**,
a California corporation,
its Manager

Name: /s/ Paul B. Elmore
Paul B. Elmore, President

Date: 19 September 2007

**Tenant:**

**Oculus Innovative Sciences, Inc.**,
a California corporation

By: /s/ Michael Wokash

Its: Michael Wokash, COO

Date: 2007 Sep 13

**Exhibit 10.44**

# Amendment to lease agreement

Amendment to the period of lease of the facility at the Nusterweg 123, 6136 KT, Sittard, as mentioned in article 3.2 of the rental agreement (2004-01-19).

The period of lease has changed from 5 years into 2 years.

Article 3.2 says now as following:

“After expiring the in 3.1 mentioned period (2009-01-31), the agreement will be continued for unremitting periods of 2 years, hence until January 31st 2011.

This agreement will further be continued for unremitting periods of 2 years.”

Thus drawn up and signed in duplicate:

| | |
|---|---|
| Place: Maastricht | Place: Sittard |
| Date: 29-1-2008 | Date: 15-2-2008 |
| OPAM BV | Oculus Innovative Sciences Netherlands BV |
| M.M.H. Pollaert | B.H.J.H. de Brouwer |
| /s/ M.M.H. Pollaert | /s/ B.H.J.H. de Brouwer |

**Exhibit 23.1**

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM'S CONSENT

We consent to the incorporation by reference in the Registration Statement of Oculus Innovative Sciences, Inc. (the "Company") on Form S-3 (File No. 333-149223) and Form S-8 (File No. 333-141017) of our report dated June 11, 2008 with respect to our audits of the consolidated financial statements of Oculus Innovative Sciences, Inc. and Subsidiaries as of March 31, 2008 and 2007 and for the three years in the period ended March 31, 2008 and our report dated June 11, 2008 with respect to our audit of effectiveness of internal control over financial reporting of Oculus Innovative Sciences, Inc. and Subsidiaries as of March 31, 2008, which reports are included in this Annual Report on Form 10-K of the Company for the year ended March 31, 2008.

/s/ Marcum & Kliegman LLP

New York, New York
June 11, 2008

**Exhibit 31.1**

**CHIEF EXECUTIVE OFFICER SECTION 302 CERTIFICATION**

I, Hojabr Alimi, certify that:

1. I have reviewed this annual report on Form 10-K of Oculus Innovative Sciences, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

By: /s/ Hojabr Alimi

**Hojabr Alimi, Chief Executive Officer and President**

Date: June 13, 2008

**Exhibit 31.2**

**CHIEF FINANCIAL OFFICER SECTION 302 CERTIFICATION**

I, Robert Miller, certify that:

1. I have reviewed this annual report on Form 10-K of Oculus Innovative Sciences, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

By: /s/ Robert Miller

**Robert Miller**
**Chief Financial Officer**

Date: June 13, 2008

**Exhibit 32.1**

**STATEMENT OF CHIEF EXECUTIVE OFFICER UNDER 18 U.S.C. § 1350**

I, Hojabr Alimi, the chief executive officer of Oculus Innovative Sciences, Inc. (the "Company"), certify for the purposes of section 1350 of chapter 63 of title 18 of the United States Code that, to the best of my knowledge,

(i) the Annual Report of the Company on Form 10-K for the year ended March 31, 2008 (the "Report"), fully complies with the requirements of section 13(a) of the Securities Exchange Act of 1934, and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Hojabr Alimi

**Hojabr Alimi**
**Chief Executive Officer and President**

Date: June 13, 2008

**Exhibit 32.2**

**STATEMENT OF CHIEF FINANCIAL OFFICER UNDER 18 U.S.C. § 1350**

I, Robert Miller, the chief financial officer of Oculus Innovative Sciences, Inc. (the "Company"), certify for the purposes of section 1350 of chapter 63 of title 18 of the United States Code that, to the best of my knowledge,

(i) the Annual Report of the Company on Form 10-K for the year ended March 31, 2008 (the "Report"), fully complies with the requirements of section 13(a) of the Securities Exchange Act of 1934, and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Robert Miller

**Robert Miller**
**Chief Financial Officer**

Date: June 13, 2008