ALLEGHANY CORP /DE
Form 13F-HR
August 08, 2008

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

Form 13F

Form 13F COVER PAGE

Report for the Calendar Year or Quarter Ended: June 30, 2008

Check here if Amendment [ ]; Amendment Number: __________
This Amendment (Check only one): [ ] is a restatement.
[ ] adds new holdings entries.

Institutional Investment Manager Filing this Report:

Name: Alleghany Corporation
Address: 7 Times Square Tower, 17th Floor
New York, NY 10036

Form 13F File Number: 28-1590

The institutional investment manager filing this report and the person by whom it is signed hereby represent that the person signing the report is authorized to submit it, that all information contained herein is true, correct and complete, and that it is understood that all required items, statements, schedules, lists, and tables, are considered integral parts of this form.

Person Signing this Report on Behalf of Reporting Manager:

Name: Peter R. Sismondo
Title: Vice President
Phone: 212-752-1356

Signature, Place, and Date of Signing:

/s/ Peter R. Sismondo	New York, NY	August 7, 2008
[Signature]	[City, State]	[Date]

Report Type (Check only one):

[X] 13F HOLDINGS REPORT. (Check here if all holdings of this reporting manager are reported in this report.)

[ ] 13F NOTICE. (Check here if no holdings reported are in this report, and all holdings are reported by other reporting manager(s).)

[ ] 13F COMBINATION REPORT. (Check here if a portion of the holdings for this reporting manager are reported in this report and a portion are reported by other reporting manager(s).)

Form 13F SUMMARY PAGE

Report Summary:

Number of Other Included Managers: 2
Form 13F Information Table Entry Total: 90
Form 13F Information Table Value Total: $1,377,600 (thousands)

List of Other Included Managers:

No.	Form 13F File Number	Name
2		RSUI Indemnity Company
3		Alleghany Insurance Holdings LLC

SECURITIES AND EXCHANGE COMMISSIONS FORM 13F INFORMATION
PREPARED FOR ALLEGHANY CORPORATION
AS OF 06/30/08

COLUMN 1	COLUMN 2	COLUMN 3	COLUMN 4	COLUMN 5			COLUMN 6		
			MARKET VALUE				INVESTMENT DISCRETION		
NAME OF ISSUER	TITLE OF CLASS	CUSIP	(X 1000)	SHRS OR PRIN AMT	SH/ PRN	PUT/ CALL	SOLE (A)	SHRD (B)	OTH (C
NABORS INDUSTRIES LTD	SHS	G6359F103	41,599	845,000	SH			X	
NABORS INDUSTRIES LTD	SHS	G6359F103	7,877	160,000	SH			X	
WEATHERFORD INTERNATIONAL LT	COM	G95089101	7,530	151,840	SH			X	
WEATHERFORD INTERNATIONAL LT	COM	G95089101	8,926	180,000	SH			X	
AT&T INC	COM	00206R102	1,347	40,000	SH				X
AGILENT TECHNOLOGIES INC	COM	00846U101	1,088	30,600	SH				X
ALEXANDER & BALDWIN INC	COM	014482103	911	20,000	SH				X
AMERICAN EXPRESS CO	COM	025816109	1,386	36,800	SH				X
AMERICAN INTL GROUP INC	COM	026874107	624	23,600	SH				X
APPLERA CORP	COM AP BIO GRP	038080103	670	20,000	SH				X
APPLIED MATLS INC	COM	038222105	955	50,000	SH				X
AUTODESK INC	COM	052769106	1,014	30,000	SH				X
AUTOMATIC DATA PROCESSING IN	COM	053015103	838	20,000	SH				X
BERKSHIRE HATHAWAY INC DEL	CL B	084670207	1,605	400	SH				X
BOEING CO	COM	097023105	986	15,000	SH				X
BURLINGTON NORTHN SANTA FE C	COM	12189T104	399,560	4,000,000	SH		X		
CAMECO CORP	COM	13321L108	2,144	50,000	SH			X	
CAMECO CORP	COM	13321L108	1,072	25,000	SH			X	
CATERPILLAR INC DEL	COM	149123101	1,846	25,000	SH				X
CHESAPEAKE ENERGY CORP	COM	165167101	3,298	50,000	SH			X	
CHESAPEAKE ENERGY CORP	COM	165167101	11,543	175,000	SH			X	
CHEVRON CORP NEW	COM	166764100	31,226	315,000	SH			X	
CHEVRON CORP NEW	COM	166764100	16,961	171,100	SH			X	
CHICAGO BRIDGE & IRON CO N V	NY REGISTRY SH	167250109	15,629	392,500	SH			X	
CHICAGO BRIDGE & IRON CO N V	NY REGISTRY SH	167250109	6,272	157,500	SH			X	
CHUBB CORP	COM	171232101	1,470	30,000	SH				X
COCA COLA CO	COM	191216100	1,310	25,200	SH				X
COMCAST CORP NEW	CL A	20030N101	260	13,700	SH			X	
CONOCOPHILLIPS	COM	20825C104	30,205	320,000	SH			X	
CONOCOPHILLIPS	COM	20825C104	61,920	656,000	SH			X	
COSTCO WHSL CORP NEW	COM	22160K105	2,104	30,000	SH				X
DARWIN PROFESSIONAL UNDERWRI	COM	237502109	288,630	9,371,096	SH			X	

DEERE & CO	COM	244199105	2,164	30,000	SH				X
DEVON ENERGY CORP NEW	COM	25179M103	53,171	442,500	SH			X	
DEVON ENERGY CORP NEW	COM	25179M103	16,822	140,000	SH			X	
DISNEY WALT CO	COM DISNEY	254687106	1,404	45,000	SH				X
DOMTAR CORP	COM	257559104	2,376	436,000	SH			X	
DOMTAR CORP	COM	257559104	894	164,000	SH			X	
DU PONT EI DE NEMOURS & CO	COM	263534109	1,287	30,000	SH				X
EOG RES INC	COM	26875P101	6,298	48,000	SH			X	
EOG RES INC	COM	26875P101	2,230	17,000	SH			X	
EXXON MOBIL CORP	COM	30231G102	2,644	30,000	SH				X
FPL GROUP INC	COM	302571104	9,575	146,000	SH			X	
FPL GROUP INC	COM	302571104	3,541	54,000	SH			X	
FEDEX CORP	COM	31428X106	1,182	15,000	SH				X
FIDELITY NATL FINANCIAL	CL A	31620R105	3,072	243,800	SH			X	
FIDELITY NATL FINANCIAL	CL A	31620R105	630	50,000	SH			X	
FLOTEK INDS INC DEL	COM	343389102	4,743	230,000	SH			X	
FLOTEK INDS INC DEL	COM	343389102	3,093	150,000	SH			X	
GENERAL ELECTRIC CO	COM	369604103	11,076	415,000	SH			X	
GENERAL ELECTRIC CO	COM	369604103	6,472	242,500	SH				X
GLOBAL INDS LTD	COM	379336100	15,689	875,000	SH			X	
GLOBAL INDS LTD	COM	379336100	5,827	325,000	SH			X	
HOME DEPOT INC	COM	437076102	468	20,000	SH				X
INTEL CORP	COM	458140100	1,504	70,000	SH				X
INTERNATIONAL BUSINESS MACHS	COM	459200101	1,482	12,500	SH				X
INTL PAPER CO	COM	460146103	11,068	475,000	SH			X	
INTL PAPER CO	COM	460146103	4,078	175,000	SH			X	
INTUIT	COM	461202103	551	20,000	SH				X
ISHARES INC	MSCI JAPAN	464286848	258	20,700	SH			X	
JOHNSON AND JOHNSON	COM	478160104	1,383	21,500	SH				X
KELLOGG	COM	487836108	960	20,000	SH				X
KEY ENERGY SVCS INC	COM	492914106	8,739	450,000	SH			X	
KEY ENERGY SVCS INC	COM	492914106	3,884	200,000	SH			X	
KRAFT FOODS INC	CL A	50075N104	8,413	295,700	SH			X	

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SECURITIES AND EXCHANGE COMMISSIONS FORM 13F INFORMATION
PREPARED FOR ALLEGHANY CORPORATION
AS OF 06/30/08

COLUMN 1	COLUMN 2	COLUMN 3	COLUMN 4	COLUMN 5			COLUMN 6		
							INVESTMENT DISCRETION		
NAME OF ISSUER	TITLE OF CLASS	CUSIP	MARKET VALUE (X 1000)	SHRS OR PRIN AMT	SH/ PRN	PUT/ CALL	SOLE (A)	SHRD (B)	OTH (C
KRAFT FOODS INC	CL A	50075N104	2,134	75,000	SH			X	
LAUDER ESTEE COS INC	CL A	518439104	1,161	25,000	SH				X
LEGGETT & PLATT INC	COM	524660107	28,257	1,685,000	SH			X	
LEGGETT & PLATT INC	COM	524660107	10,314	615,000	SH			X	
LILLY ELI & CO	COM	532457108	1,385	30,000	SH				X
LINCOLN NATIONAL CORP IND	COM	534187109	814	17,963	SH				X
MANPOWER INC	COM	56418H100	874	15,000	SH				X
MARRIOTT INTL INC NEW	CL A	571903202	918	35,000	SH				X
MCDERMOTT INTL INC	COM	580037109	5,261	85,000	SH			X	

MCDERMOTT INTL INC	COM	580037109	2,475	40,000	SH	X	
MEDTRONIC INC	COM	585055106	1,646	31,800	SH		X
MICROSOFT CORP	COM	594918104	2,124	77,200	SH		X
MILLIPORE CORP	COM	601073109	1,357	20,000	SH		X
MOTOROLA INC	COM	620076109	83	11,300	SH	X	
NEWS CORP	CL A	65248E104	1,053	70,000	SH		X
NOBLE ENERGY INC	COM	655044105	3,017	30,000	SH		X
NORDSTROM INC	COM	655664100	909	30,000	SH		X
NOVARTIS AG	SPONSORED ADR	66987V109	1,376	25,000	SH		X
NUSTAR ENERGY LP	UNIT COM	67058H102	1,478	31,190	SH	X	
NUSTAR ENERGY LP	UNIT COM	67058H102	1,592	33,600	SH	X	
OLD REP INTL CORP	COM	680223104	16,576	1,400,000	SH	X	
PHH CORP	COM	693320202	2,184	142,300	SH		X
PETROLEO BRASILEIRO SA PETRO	SPONSORED ADR	71654V408	10,164	143,500	SH	X	
PETROLEO BRASILEIRO SA PETRO	SPONSORED ADR	71654V408	4,002	56,500	SH	X	
PFIZER INC	COM	717081103	11,792	675,000	SH	X	
PFIZER INC	COM	717081103	5,678	325,000	SH	X	
PLAINS EXPL& PRODTN CO	COM	726505100	3,904	53,500	SH	X	
PLAINS EXPL& PRODTN CO	COM	726505100	2,299	31,500	SH	X	
PROCTER & GAMBLE CO	COM	742718109	1,879	30,900	SH		X
SPDR TR	UNIT SER 1	78462F103	307	2,400	SH	X	
SCHLUMBERGER LTD	COM	806857108	2,686	25,000	SH		X
SIGMA ALDRICH CORP	COM	826552101	1,616	30,000	SH		X
SONY CORP	ADR NEW	835699307	1,094	25,000	SH		X
STATE STR CORP	COM	857477103	960	15,000	SH		X
STATOILHYDRO ASA	SPONSORED ADR	85771P102	4,579	122,500	SH	X	
STATOILHYDRO ASA	SPONSORED ADR	85771P102	1,589	42,500	SH	X	
SYSCO CORP	COM	871829107	825	30,000	SH		X
TESORO CORP	COM	881609101	8,402	425,000	SH	X	
TEXAS INSTRS INC	COM	882508104	597	21,200	SH		X
3M CO	COM	88579Y101	1,531	22,000	SH		X
TRICO MARINE SERVICES INC	COM NEW	896106200	10,835	297,500	SH	X	
TRICO MARINE SERVICES INC	COM NEW	896106200	4,279	117,500	SH	X	
VALERO ENERGY CORP NEW	COM	91913Y100	12,766	310,000	SH	X	
VALERO ENERGY CORP NEW	COM	91913Y100	6,589	160,000	SH	X	
WACHOVIA CORP 2ND NEW	COM	929903102	627	40,400	SH		X
WAL MART STORES INC	COM	931142103	2,529	45,000	SH		X
WASHINGTON POST CO	CL B	939640108	880	1,500	SH		X
WELLS FARGO & CO NEW	COM	949746101	603	25,400	SH		X
WEYERHAUSER CO	COM	962166104	1,023	20,000	SH		X
WYETH	COM	983024100	9,112	190,000	SH	X	
WYETH	COM	983024100	4,077	85,000	SH	X	
XTO ENERGY INC	COM	98385X106	2,364	34,500	SH	X	
XTO ENERGY INC	COM	98385X106	1,062	15,500	SH	X	
ZENITH NATL INS CORP	COM	989390109	20,178	573,879	SH	X	
GRAND TOTAL			1,377,600	31,857,568			

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ght: normal; vertical-align: text-bottom; font-weight: bold; font-size: 8pt; text-align: center" ROWSPAN=1 COLSPAN=3> Gross sales $20,159,902 $18,525,485 $1,634,417 8.8% Sales adjustments (2,550,103) (2,645,876) 95,773 (3.6%) Net sales 17,609,799 15,879,609 1,730,190 10.9% Cost of sales 11,411,224 11,252,794 158,430 1.4% Gross profit 6,198,575 4,626,815 1,571,760 34.0% Selling, general and administrative expense 9,229,184 4,945,322 4,283,862 86.6% Research and development expense 1,515,329 150,566 1,364,763 (906.4%) Interest (income) expense (5,771) 121,800 (127,571) (104.7%) Other expense (income), net 56,069 (41,321) 97,390 235.6% Total expenses 10,794,811 5,176,367 5,618,444 108.5% Loss before income taxes (4,596,236) (549,552) (4,046,684) (736.3%) Income tax (benefit) expense (1,804,187) 1,743 (1,805,930) Net loss $(2,792,049) $(551,295) $(2,240,754) 406.4%

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Gross to Net Sales Adjustments

Gross to net sales adjustments were comprised of the following:

	Quarter Ended June 30, 2012	2011
Gross sales	$ 20,159,902	$ 18,525,485
Trade rebates	(1,856,329)	(1,927,797)
Distributor fees	(323,431)	(339,958)
Sales incentives	(149,391)	(200,716)
Returns and allowances	(92,318)	(54,242)
Cash discounts	(128,634)	(123,163)
Total adjustments	(2,550,103)	(2,645,876)
Net sales	$ 17,609,799	$ 15,879,609

Trade rebates decreased in 2012 versus 2011 principally due to lower sales in Canada, partially offset by an increase in the rebate percentage due to a change in product mix towards higher rebated products. The decrease in distribution fee expense was commensurate with the decrease in Canadian sales upon which it is based, partially offset by a cost increase due to higher fuel surcharges. The decrease in sales incentive expense reflected discontinuation of a sales incentive program with a major customer in the second quarter of 2011. The sales returns and allowances change reflects higher sales returns during the second quarter 2012 versus 2011 due to timing. The increase in cash discounts principally reflected an increase in U.S. sales to customers who took the cash discount.

Rebate Reserve Roll-Forward

A roll-forward of the trade rebate accruals for the three months ended June 30, 2012 and 2011 were as follows:

	June 30, 2012	2011
Beginning balance April 1	$ 2,057,381	$ 2,527,995
Rebates paid	(1,897,233)	(2,072,528)
Rebates accrued	1,856,329	1,927,797
Ending balance June 30	$ 2,016,477	$ 2,383,264

The $40,904 decrease in the trade rebate reserve balance at June 30, 2012 from March 31, 2012 principally reflects a decrease in sales subject to rebate in Canada. There has been no other significant change in the nature of our business during 2012 as it relates to the accrual and subsequent payment of rebates.

Net Sales and Gross Margin

The following table highlights the net sales and gross margin for the three months ended June 30, 2012 versus 2011:

	Quarter Ended June 30, 2012	2011	Variance		
Net Sales	$ 17,609,799	$ 15,879,609	$ 1,730,190	10.9	%
Cost of sales	11,411,224	11,252,794	158,430	1.4	%
Gross Profit	$ 6,198,575	$ 4,626,815	$ 1,571,760	34.0	%

Gross Profit %	35.2	%	29.1	%

Net sales increased $1,730,190, or 10.9% (12.0% adjusted for exchange), in 2012 versus 2011. Advanced wound care sales increased $1,992,060, or 52.3%, to $5,800,152 in 2012 from $3,808,092 in 2011. Traditional wound care sales decreased $261,870, or 2.2%, to $11,809,647 in 2012 from $12,071,517 in 2011.

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Sales from U.S. distribution points increased $2,307,002, or 20.3%, to $13,688,173 in 2012 from $11,381,171 in 2011. The increase was driven by higher advanced wound care sales of $1,950,278, or 61.5%, and traditional wound care sales of $356,724, or 4.3%. Excluding incremental TCC sales of $1,083,544, related to the MedEfficiency acquisition in April 2012, U.S. advanced wound care sales increased $866,734, or 27.3%, led by sales of Medihoney and Xtrasorb. The traditional wound care sales increase was driven by higher first aid products sales and higher private label sales. Sales from our Canadian location decreased $653,193, or 16.3% (12.1% adjusted for exchange) to $3,344,576 in 2012 from $3,997,769 in 2011. This decrease was driven by lower end user demand of 7.9% from 2011 and distributor demand of 3.2% from 2011, as well as unfavorable exchange of $168,444 associated with a 4.4% weakening of the Canadian dollar. The lower demand principally reflected the impact of lost business and a reduction in the amount of inventory being carried by our exclusive Canadian distributor. International sales increased $76,381, or 15.3% (18.1% adjusted for exchange), to $577,050 in 2012 from $500,669 in 2011. The increase was driven by higher advanced wound care sales of $56,317 and traditional wound care sales of $20,064. The increase in advanced wound care sales continues to reflect our expanded sales and marketing efforts to grow these products.

Gross profit increased $1,571,760, or 34.0%, in 2012 versus 2011. Advanced wound care gross profit increased $1,294,088, or 70.6%, to $3,127,521 in 2012 from $1,833,433 in 2011. Traditional wound care gross profit increased $277,672, or 10.0%, to $3,071,054 in 2012 from $2,793,382 in 2011. The overall gross profit margin percentage increased to 35.2% in 2012 from 29.1% in 2011. The increase in gross profit dollars reflects higher sales, coupled with the higher gross profit margin percentage. The higher gross margin percentage principally reflects the impact of a change in the product sales mix in both advanced wound care sales and traditional wound care sales to higher margined products and a decrease in Canadian manufacturing costs due to greater efficiencies, partially offset by higher product costs.

Selling, General and Administrative Expenses

The following table highlights selling, general and administrative expenses by type for the three months ended June 30, 2012 versus 2011:

	Quarter Ended June 30,		Variance		
	2012	2011			
Distribution	$ 511,949	$ 453,817	$ 58,132	12.8	%
Marketing	1,100,114	613,238	486,876	79.4	%
Sales	3,657,147	1,871,815	1,785,332	95.4	%
General and administrative	3,959,974	2,006,452	1,953,522	97.4	%
Total	$ 9,229,184	$ 4,945,322	$ 4,283,862	86.6	%

Selling, general and administrative expenses increased $4,283,862, or 86.6% (87.5% adjusted for exchange), in 2012 versus 2011, which included a decrease of $41,821 attributable to exchange.

Distribution expense increased $58,132, or 12.8% (13.5% adjusted for exchange), in 2012 versus 2011, including a decrease of $3,290 due to exchange. The increase reflects higher operating and maintenance costs of the Houston and Canadian facilities.

Marketing expense increased $486,876, or 79.4% (79.7% adjusted for exchange), in 2012 versus 2011, including a decrease of $1,923 due to exchange. Excluding incremental marketing costs of $100,144 associated with the MedEfficiency operations, marketing costs increased $386,732 or 63.0%. The increase was attributable to higher U.S. related compensation and benefit and travel expense associated with new marketing and clinical personnel added in 2012 and promotion expense in support of our advanced wound care growth initiatives.

Sales expense increased $1,785,332, or 95.4% (96.2% adjusted for exchange), in 2012 versus 2011. Expenses in the U.S. increased $1,686,873. Excluding incremental sales expenses of $384,337 associated with the MedEfficiency operations, U.S. sales costs increased $1,400,995 or 74.8%. This increase was principally attributable to incremental costs consisting of compensation and benefits, commission, travel, recruiting and sample expenses associated with the expansion of the advanced wound care sales force from 20 to 38 representatives that began in the third quarter of 2011. Incremental MedEfficiency sales costs consisted of compensation and benefits, commission, travel, recruiting and sample expenses associated with five regional

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sales specialists and a Vice President of National Accounts incurred since the April 16, 2012 acquisition. Expenses in Canada increased $795 (including a $11,201 decrease related to exchange) due to higher compensation and benefit and travel expense due to the addition of a sales representative partially offset by lower group purchasing organization fees due to lower related sales on which it is based. International expenses increased $97,664 (including a $4,478 decrease related to exchange) due principally to higher compensation and benefit and travel expense associated with new sales personnel associated with the build-up of our international sales force in the second half of 2011 and first half of 2012.

General and administrative expenses increased $1,953,522, or 97.4% (98.4% adjusted for exchange), in 2012 versus 2011. Expenses in the U.S. increased $1,764,077. MedEfficiency transaction and integration related expenses of $787,208 and $296,395 of other general and administrative expenses contributed to the U.S. general and administrative expense increase during the quarter. Excluding the incremental MedEfficiency general and administrative expenses of $1,083,603, U.S. general and administrative costs increased $680,474 or 33.9%. This increase reflected compensation and benefit expenses due to annual increases and the addition of two finance positions and a human resource position, coupled with higher equity based compensation and executive bonuses, professional services, board, and investor relations expenses, which were partially offset by lower amortization and travel expenses. Expenses in Canada increased $195,099 (including a $20,315 decrease related to exchange). Net of exchange, expenses increased $215,414 due principally to higher compensation and benefit due to annual increases and the addition of a materials management position in the fourth quarter of 2011, equity based compensation and computer and professional services expenses. International expenses decreased $5,654 (including a $614 decrease related to exchange).

Research and Development Expense

Research and development expense increased $1,364,763 to $1,515,329 in 2012 from $150,566 in 2011. The increase reflected the ongoing ramp up of DSC127 Phase 3 preparation related expenses.

Interest (Income) Expense

Interest (income) expense decreased $127,571 from an expense of $121,800 in 2011 to income of $5,771 in 2012. The change was attributable to the payoff of our line of credit balance in July 2011 coupled with interest income generated in 2012 from investments.

Other (Income) Expense, net

Other income decreased $97,390 to an expense of $56,069 in 2012 from income of $41,321 in 2011 due principally to a reduction in exchange gains.

Income Taxes

Income tax expense decreased $1,805,930 to a benefit of $1,804,187 in 2012 from an expense $1,743 in 2011. The income tax benefit for the three months ended June 30, 2012, principally reflected a $1,887,383 deferred tax benefit associated with the reduction in the Company s U.S. valuation allowance. This benefit reflected the adjustment to record the deferred tax asset and liability (principally related to the non-deductible intangible assets acquired) associated with the acquisition of MedEfficiency at the effective tax rates for the period in which the deferred tax asset and liability are expected to reverse. In addition, deferred income tax expense for 2012 and 2011 related to indefinite lived intangibles and an income tax expense for 2012 and benefit for 2011 related to foreign operations that was recognized.

Net Loss

We generated a net loss of $2,792,049, or $0.23 per share (basic and diluted), in 2012 compared to a net loss of $551,295, or $0.07 per share (basic and diluted), in 2011.

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Six Months Ended June 30, 2012 Compared to Six Months Ended June 30, 2011

Overview

Operating Results of Six Months Ended June 30, 2012 and 2011

The following table highlights the operating results of the six months ended June 30, 2012 and 2011:

	Six Months Ended June 30,		Variance	
	2012	2011		
Gross sales	$37,703,008	$35,647,682	$2,055,326	5.8 %
Sales adjustments	(4,815,843)	(5,396,803)	580,960	(10.8 %)
Net sales	32,887,165	30,250,879	2,636,286	8.7 %
Cost of sales	21,812,430	21,195,683	616,747	2.9 %
Gross profit	11,074,735	9,055,196	2,019,539	22.3 %
Selling, general and administrative expense	15,588,274	9,683,339	5,904,935	61.0 %
Research and development expense	2,630,027	294,394	2,335,633	793.3 %
Interest (income) expense	(10,850)	215,429	(226,279)	(105.0 %)
Other expense (income), net	1,185	(114,750)	115,935	101.0 %
Total expenses	18,208,636	10,078,412	8,130,224	80.7 %
Loss before income taxes	(7,133,901)	(1,023,216)	(6,110,685)	597.2 %
Income tax (benefit) expense	(1,802,951)	75,142	(1,878,093)	
Net loss	$(5,330,950)	$(1,098,358)	$(4,232,592)	385.3 %

Gross to Net Sales Adjustments

Gross to net sales adjustments comprise the following:

	Six Months Ended June 30,	
	2012	2011
Gross sales	$37,703,008	$35,647,682
Trade rebates	(3,500,491)	(3,961,465)
Distributor fees	(627,702)	(690,506)
Sales incentives	(253,656)	(373,228)
Returns and allowances	(177,573)	(118,599)
Cash discounts	(256,421)	(253,005)
Total adjustments	(4,815,843)	(5,396,803)
Net sales	$32,887,165	$30,250,879

Trade rebates decreased in 2012 versus 2011 principally due to lower sales in Canada, partially offset by an increase in the rebate percentage due to a change in the product mix towards higher rebated products. The decrease in distribution fee expense was commensurate with the decrease in Canadian sales upon which it is based, partially offset by an increase in cost due to higher fuel surcharges. The decrease in sales incentive expense reflected discontinuation of a sales incentive program with a major customer in the second quarter of 2011. The sales returns and allowances change reflected higher sales returns during 2012 versus 2011 due to timing. The increase in cash discounts principally reflects an increase in U.S. sales to customers who took the cash discount.

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Rebate Reserve Roll-Forward

A roll-forward of the trade rebate accruals for the six months ended June 30, 2012 and 2011 were as follows:

	June 30, 2012	2011
Beginning balance January 1	$ 2,195,006	$ 3,033,091
Rebates paid	(3,679,020)	(4,611,292)
Rebates accrued	3,500,491	3,961,465
Ending balance June 30	$ 2,016,477	$ 2,383,264

The $178,529 decrease in the trade rebate reserve balance at June 30, 2012 from December 31, 2011 principally reflected a decrease in sales subject to rebate in Canada. There has been no other significant change in the nature of our business during 2012 as it relates to the accrual and subsequent payment of rebates.

Net Sales and Gross Margin

The following table highlights the net sales and gross margin for the six months ended June 30, 2012 versus 2011:

	Six Months Ended June 30, 2012	2011	Variance	
Net Sales	$ 32,887,165	$ 30,250,879	$ 2,636,286	8.7 %
Cost of sales	21,812,430	21,195,683	616,747	2.9 %
Gross Profit	$ 11,074,735	$ 9,055,196	$ 2,019,539	22.3 %
Gross Profit %	33.7 %	29.9 %		

Net sales increased $2,636,286, or 8.7% (9.5% adjusted for exchange), in 2012 versus 2011. Advanced wound care sales increased $2,903,942, or 39.3%, to $10,297,206 in 2012 from $7,393,264 in 2011. Traditional wound care sales decreased $267,656, or 1.2%, to $22,589,959 in 2012 from $22,857,615 in 2011.

Sales from U.S. distribution points increased $3,534,775, or 16.4%, to $25,117,892 in 2012 from $21,583,117 in 2011. The increase was driven by higher advanced wound care sales of $2,543,582, or 41.1%, and traditional wound care sales of $991,193, or 6.4%. Excluding incremental TCC sales of $1,083,544 related to the MedEfficiency acquisition in April 2012, advance wound care sales increased $1,460,038, or 23.6%, led by sales of Medihoney and Xtrasorb. The traditional wound care sales increase was driven by higher first aid products sales and higher private label sales. Sales from our Canadian location decreased $1,151,805, or 15.0%, to $6,531,775 in 2012 from $7,683,580 in 2011. This decrease was driven by lower end user demand of 4.8% from 2011 and distributor demand of 7.4% from 2011, as well as, unfavorable exchange of $223,100 associated with a 3.0% weakening of the Canadian dollar. The lower demand principally reflected the impact of lost business and a reduction in the amount of inventory being carried by our exclusive Canadian distributor. International sales increased $253,316, or 25.7% (28.4% adjusted for exchange), to $1,237,498 in 2012 from $984,182 in 2011. The increase was driven by higher advanced wound care sales of $219,731 and traditional wound care sales of $33,585. The increase in advanced wound care sales continues to reflect our expanded sales and marketing efforts to grow these products.

Gross profit increased $2,019,539, or 22.3%, in 2012 versus 2011. Advanced wound care gross profit increased $1,781,825, or 51.6%, to $5,230,227 in 2012 from $3,448,402 in 2011. Traditional wound care gross profit increased $237,714, or 4.3%, to $5,844,508 in 2012 from $5,606,794 in 2011. The overall gross profit margin percentage increased to 33.7% in 2012 from 29.9% in 2011. The increase in gross profit dollars reflected higher sales, coupled with the higher gross profit margin percentage. The higher gross margin percentage principally reflected the impact of a change in the product sales mix in both advanced wound care sales and traditional wound care sales to higher margined products and a decrease in Canadian manufacturing costs due to greater efficiencies, partially offset by higher product costs.

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Selling, General and Administrative Expenses

The following table highlights selling, general and administrative expenses by type for the six months ended June 30, 2012 versus 2011:

	Six Months Ended June 30, 2012	2011	Variance		
Distribution	$ 1,008,200	$ 919,128	$ 89,072	9.7	%
Marketing	1,707,436	1,039,578	667,858	64.2	%
Sales	6,612,557	3,709,027	2,903,530	78.3	%
General and administrative	6,260,081	4,015,606	2,244,475	55.9	%
Total	$ 15,588,274	$ 9,683,339	$ 5,904,935	61.0	%

Selling, general and administrative expenses increased $5,904,935, or 61.0% (61.6% adjusted for exchange), in 2012 versus 2011, including a decrease of $57,492 attributable to exchange.

Distribution expense increased $89,072, or 9.7% (10.2% adjusted for exchange), in 2012 versus 2011, which included a decrease of $4,524 due to exchange. The increase reflected higher operating and maintenance costs of the Houston and Canadian facilities.

Marketing expense increased $667,858, or 64.2% (64.6% adjusted for exchange), in 2012 versus 2011, including a decrease of $2,836 due to exchange. Excluding incremental marketing costs of $100,144 associated with the MedEfficiency operations, marketing costs increased $567,714 or 54.6%. The increase was attributable to higher U.S. related compensation and benefit, recruiting and travel expense associated with new marketing and clinical personnel added in 2012 and promotion expense in support of our advanced wound care growth initiatives.

Sales expense increased $2,903,530, or 78.3% (78.9% adjusted for exchange), in 2012 versus 2011. Expenses in the U.S. increased $2,740,592. Excluding incremental sales expenses of $384,337 associated with the MedEfficiency operations, U.S. sales costs increased $2,356,255 or 63.5%. This increase was principally attributable to incremental costs consisting of compensation and benefits, commission, travel, recruiting and sample expenses associated with the expansion of the advanced wound care sales force from 20 to 38 representatives that began in the third quarter of 2011. Incremental MedEfficiency sales costs consisted of compensation and benefits, commission, travel, recruiting and sample expenses associated with five regional sales specialists and a Vice President of National Accounts incurred since the acquisition of MedEfficiency on April 16, 2012. Expenses in Canada increased $8,475 (including a $14,582 decrease related to exchange) as a result of higher compensation and benefit and travel expense due to the addition of a sales representative, partially offset by lower group purchasing organization fees due to lower related sales on which it is based. International expenses increased $154,463 (including a $7,431 decrease related to exchange) due principally to higher compensation and benefit and travel expense associated with new sales personnel related to the build-up of our international sales force in the second half of 2011 and first half of 2012.

General and administrative expenses increased $2,244,475, or 55.9% (56.6% adjusted for exchange), in 2012 versus 2011. Expenses in the U.S. increased $1,953,804. Excluding incremental MedEfficiency general and administrative expenses of $1,197,274, U.S. general and administrative costs increased $756,530 or 18.8%. MedEfficiency incremental general and administrative expenses include transaction and integration related expenses of $900,879 and $296,395 of other general and administrative expenses. Additional U.S. general and administrative cost increases reflected higher compensation and benefit expenses due to annual increases and the addition of two finance positions and a human resource position, coupled with higher equity based compensation and executive bonuses, professional services, board, and investor relations expenses, which were partially offset by lower amortization and travel expenses. Expenses in Canada increased $298,910 (including a $27,241 decrease related to exchange). Net of exchange, expenses increased $326,151 due principally to higher compensation and benefit due to annual increases, and the addition of a materials management position in the fourth quarter of 2011, equity based compensation and computer and professional services expenses. International expenses decreased $8,239 (including a $877 decrease related to exchange).

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Research and Development Expense

Research and development expense increased $2,335,633 to $2,630,027 in 2012 from $294,394 in 2011. The increase reflected the ongoing ramp up of DSC127 Phase 3 preparation related expenses.

Interest (Income) Expense

Interest (income) expense decreased $226,279 from an expense of $215,429 in 2011 to income of $10,850 in 2012. The change was attributable to the payoff of our line of credit balance in July 2011 coupled with interest income generated in 2012 from investments.

Other (Income) Expense, net

Other (income) expense decreased $115,935 to an expense of $1,185 in 2012 from income of $114,750 in 2011 due principally to a reduction in exchange gains.

Income Taxes

Income tax expense decreased $1,878,093 to a benefit of $1,802,951 in 2012 from an expense of $75,142 in 2011. The income tax benefit for the six months ended June 30, 2012 principally reflected a $1,887,383 deferred tax benefit associated with the reduction in the Company s U.S. valuation allowance. This benefit reflected the adjustment to record the deferred tax asset and liability (principally related to the non-deductible intangible assets acquired) associated with the acquisition of MedEfficiency at the effective tax rates for the period in which the deferred tax asset and liability are expected to reverse. In addition, deferred income tax expense for 2012 and 2011 related to indefinite lived intangibles and an income tax expense for 2012 and benefit for 2011 related to foreign operations was recognized.

Net Loss

We generated a net loss of $5,330,950, or $0.46 per share (basic and diluted), in 2012 compared to a net loss of $1,098,358, or $0.16 per share (basic and diluted), in 2011.

Liquidity and Capital Resources

Cash Flow and Working Capital

At June 30, 2012 and December 31, 2011, we had cash and cash equivalents of $13,599,726 and $17,110,350, respectively. The $3,510,624 decrease in cash reflects net cash used in operating activities of $7,169,579 and cash used in investing activities of $14,499,522, partially offset by cash provided by investing activities of $18,117,610, together with a positive exchange rate effect of $40,867.

Net cash used in operating activities of $7,169,579 resulted from $4,622,225 cash used in operations (net loss plus non-cash items) together with $2,547,354 cash used associated with the change in operating assets and liabilities. Higher research and development expense associated with pre-Phase 3 preparation costs and the adverse timing impact of advanced wound care growth related expenses preceding revenue growth were the main contributors of the cash used in operations. Higher inventory partially offset by lower prepaid expenses and other current assets were the main drivers behind the net cash used in the change in operating assets and liabilities. The increase in inventory principally reflects support for business growth. The decrease in prepaid expenses and other current assets was due to receipt of miscellaneous receivables and the timing related expense recognition of prepaid research and development and insurance expenses.

Net cash used in investing activities of $14,499,522 reflects $14,382,578 net cash used to complete the MedEfficiency acquisition and $409,944 of year to date capital expenditures, partially offset by $250,000 of cash provided from the sale of investments and $43,000 from the sale of equipment. The majority of the capital expenditures are being made to upgrade and expand our manufacturing capabilities and purchase computer equipment for the expanded sales force.

Net cash provided by financing activities of $18,117,610 reflects net proceeds of $17,855,922 from the sale of 2,125,000 shares of common stock in April 2012 and $329,878, from the exercise of warrants and stock options, partially offset by the payment of payroll taxes related to stock compensation of $68,190 in connection with a net share settlement.

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Working capital decreased $618,064 at June 30, 2012 to $34,237,416 from $34,855,480 at December 31, 2011. This decrease principally reflects the net cash outflow from operating activities, partially offset by net infusion of cash associated with the proceeds from the April 2012 sale of common stock, less the cash used to acquire MedEfficiency.

In July 2012, the Company entered into an exclusive royalty bearing patent and technology license agreement with Quick-Med Technologies, Inc. (QMT) relating to their proprietary anti-microbial technology. The Company had previously been utilizing this technology in a series of wound care products under an earlier agreement that granted the Company the right to use the technology in the U.S. and Canada at higher royalty rates. In exchange for the worldwide rights (excluding India) to this technology and lower prospective royalty rates, the Company paid QMT an upfront payment of $1,300,000 and agreed to make certain milestone payments based upon the achievement of certain sales levels.

The next Medihoney milestone payment is due when sales exceed $10,000,000 on a trailing twelve month basis. Achievement of the next milestone is expected in the second half of 2012.

Management believes that it has sufficient working capital on hand to support our existing operations for the next twelve months.

Prospective Assessment

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

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

Our strategy for growth is:

1. Assuming the existing resources in place are generating the expected return, we will continue to expand our worldwide investment in sales and marketing resources in support of our higher margined advanced wound care products. In 2010, we in-licensed the worldwide rights to Medihoney. This has served as the catalyst for the expansion of our U.S., Canadian and international businesses. In 2012 we added 12 additional sales representatives for a total of 38, 5 TCC product specialists and a TCC VP National Accounts to the sales management team already in place in the U.S., and one additional sales representative in Canada and two in the UK. Additional sales representatives will continue to be added thereafter as needed to support the continued growth of the business. We have established a presence in Europe and the Middle East through a direct presence in the U.K. and distribution representatives in a number of other countries. We have established a presence in the Far East through a distribution representative in Australia and in Latin America through a local distribution representative. We plan to expand our

sales and marketing in this and other areas of the world employing a direct sale force or distributor model as the basis for conducting business, as circumstances dictate.

2. While the commercial launch of DSC127 is estimated to be three to four years away, we believe the market potential of this product for diabetic foot ulcers and other indications that we have the rights to are significant. In February and May 2011, we reported positive top-line results for our DSC127 Phase 2 trial. In February 2012, we met with the FDA to discuss the results of our Phase 2 study and the design of our Phase 3 study. The Company plans to meet with the FDA in the fourth quarter

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2012 for its formal end of Phase 2 meeting and, pending the FDA review process, to receive approval to proceed with our Phase 3 study. A separate meeting with the FDA is planned for 2013 to ensure everything is in place and being done to secure drug approval from a Chemistry, Manufacturing and Control (CMC) perspective. With the funds raised from our private placement sale of common stock and warrants in June 2011, as well as the funds from our recent offering in April 2012, we have started a number of initiatives to prepare for initiation of the Phase 3 program. Our toxicology and CMC programs are proceeding as planned. Significant progress has been made on drug active and drug product development and preparations for the manufacture and distribution of the clinical trial drug product supplies. Agreements have been signed and initial work orders approved with the Clinical Research Organization selected to manage the Phase 3 study and all major related service providers. The agreements signed to date are generally cancellable with 30 days notice. Should everything go according to plan, we will commence the Phase 3 study by the end of 2012. The cost of the preparation for Phase 3 along with the Phase 3 trial and bringing the product to market are presently estimated to be approximately $30 to $40 million. With available funds on-hand and those expected to be generated prospectively from ongoing operations, we do not anticipate the need at this time for additional capital to complete the Phase 3 trial for diabetic foot ulcers and to bring the product to market.

3. We will continue to nurture our traditional wound care business in an effort to sustain it and grow it where possible, utilizing the appropriate amount of human and financial resources to achieve our objectives. While this area of our business presently represents a significant (albeit diminishing) percentage of our sales and realizes lower gross profit margins, it generates positive cash flow as it does not require extensive sales and marketing resources to sustain it. Maintenance and growth of this business is important to us as we utilize this cash flow to help support our advanced wound care and pharmaceutical wound care growth initiatives.

With the planned improvement in operations, expected working capital requirements and cash on-hand as of June 30, 2012, we anticipate having sufficient liquidity to meet our existing operating and product development needs for at least the next twelve months. Further, if needed, we believe the continued success of our advanced wound care business and the development of DSC127 (especially given the recent issuance of two new patents which extend protection through 2032) will serve to improve our ability to raise equity or generate capital from the sale of licensing rights going forward to fund prospective growth initiatives.

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

Additional Financial Information

Off-Balance Sheet Arrangements

As of June 30, 2012, we had no off-balance sheet arrangements.

Critical Accounting Policies

There have been no changes in critical accounting policies from those disclosed in the December 31, 2011 Form 10-K.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Not Applicable.

Item 4. Controls and Procedures.

The Company s management, with the participation of the Company s Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securites Exchange Act of 1934 (the Exchange Act)) as of June 30, 2012. Based on this evaluation, the Company s Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) are effective for gathering, analyzing and disclosing the information the Company is required to disclose in the reports it files under the Exchange Act, within the time periods specified in the Commission s rules and forms.

During the six months ended June 30, 2012, there was no change in the Company s internal controls over financial reporting that materially affected, or is reasonably likely to materially affect, the Company s internal controls over financial reporting.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings.

None.

Item 1A. Risk Factors.

The following risk factors update the related risk factors set forth in the Company s Annual Report on Form 10-K filed with the Commission:

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

We incurred losses of $5,330,950 in the six months ended June 30, 2012 (unaudited), $4,340,411 for the year ended December 31, 2011, and additional losses in previous years. At June 30, 2012, we had an accumulated deficit of $33,467,277. We expect to incur losses for the next several years as we continue to develop DSC127, and cannot offer any assurance that we will be able to generate sustained or significant future earnings.

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

As of June 30, 2012, up to 4,908,085 shares of our common stock are potentially issuable upon the conversion, exercise or vesting of outstanding convertible preferred stock, warrants, options and restricted stock units (dilutive securities). The shares of common stock potentially issuable upon conversion, exercise or vesting of dilutive securities are substantial compared to the 12,837,441 shares of common stock outstanding as of June 30, 2012.

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

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

Historically, the market price of our common stock has been volatile. The high and low stock prices for the years 2007 through 2011 and the first six months of 2012 are set forth in the table below:

Derma Sciences, Inc.
Trading Range Common Stock

Year	Low	High
2007	$ 4.64	$ 11.20
2008	$ 1.60	$ 10.80
2009	$ 1.92	$ 6.80

2010	$ 4.40	$ 9.00
2011	$ 4.50	$ 12.72
2012*	$ 6.94	$ 10.21

(*) January 1 through June 30.

Events that may affect our common stock price include:

- Results from further development of DSC127;
- Quarter to quarter variations in our operating results;
- Changes in earnings estimates by securities analysts;
- Changes in interest rates, exchange rates or other general economic conditions;
- Changes in market conditions in the wound care industry;
- Fluctuations in stock market prices and trading volumes of similar companies;

Discussion of us or our stock price by the financial and scientific press and in online investor communities;
Additions or departures of key personnel;
Changes in third party reimbursement policies;
The introduction of new products either by us or by our competitors; and
The loss of a major customer.

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

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibit	Description
10.1*	Patent and Technology License Agreement, dated July 12, 2012, between the Company and Quick-Med Technologies, Inc.
31.1	Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of the Principal Executive Officer pursuant to U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Principal Financial Officer pursuant to U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS#	XBRL Instance Document
101.SCH#	XBRL Taxonomy Extension Schema Document
101.CAL#	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB#	XBRL Taxonomy Extension Labels Linkbase Document

101.PRE#	XBRL Taxonomy Extension Presentation Linkbase Document

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

Pursuant to Rule 405(a)(2) of Regulation S-T, the Company will furnish the XBRL Interactive Data Files with detailed footnote tagging as Exhibit 101 in an amendment to this Form 10-Q within the permitted 30-day grace period for the first quarterly period in which detailed footnote tagging is required after the filing date of this Form 10-Q.

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Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DERMA SCIENCES, INC.
By:

Dated: August 13, 2012

/s/ John E. Yetter
John E. Yetter, CPA
Chief Financial Officer

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