BOVIE MEDICAL CORP
Form 10-Q
November 14, 2011

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

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended September 30, 2011

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Period from _____ to _____

Commission file number 0-12183

BOVIE MEDICAL CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	11-2644611
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

734 Walt Whitman Rd., Melville, New York 11747
(Address of principal executive offices)

(631) 421-5452
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the 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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

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

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

The number of shares of the registrant's $.001 par value common stock outstanding on the NYSE Amex exchange as of November 2, 2011 was 17,756,340.

BOVIE MEDICAL CORPORATION
INDEX TO FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2011

		Page
Part I.	Financial Information	3
Item 1.	Financial Statements	
	Consolidated Balance Sheets - September 30, 2011 and December 31, 2010	3
	Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2011 and 2010	5
	Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss) for the Year Ended December 31, 2010 and the Nine Months Ended September 30, 2011	6
	Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2011 and 2010	7
	Notes to Consolidated Financial Statements	8
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	14
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	23
Item 4.	Controls and Procedures	23
Part II.	Other Information	23
Item 1.	Legal Proceedings	23
Item 1A.	Risk Factors	24
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	24
Item 3.	Defaults Upon Senior Securities	25
Item 4.	(Removed and Reserved)	25
Item 5.	Other Information	25
Item 6.	Exhibits	25
	Signatures	25

Index

PART I. FINANCIAL INFORMATION

ITEM 1: CONSOLIDATED FINANCIAL STATEMENTS

BOVIE MEDICAL CORPORATION
CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2011 AND DECEMBER 31, 2010
(in thousands)

Assets

	(Unaudited) September 30, 2011	December 31, 2010
Current assets:		
Cash and cash equivalents	$ 5,408	$ 3,827
Trade accounts receivable, net	2,183	2,114
Inventories, net	7,658	7,605
Prepaid expenses and other current assets	620	966
Deferred income tax asset, net	500	400
Total current assets	16,369	14,912
Property and equipment, net	7,343	7,432
Brand name and trademark	1,510	1,510
Purchased technology, net	1,517	1,598
License rights, net	42	90
Deferred income tax asset, net	993	1,533
Other assets	780	711
Total assets	$ 28,554	$ 27,786

The accompanying notes are an integral part of the consolidated financial statements.

Index

BOVIE MEDICAL CORPORATION
CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2011 AND DECEMBER 31, 2010
(CONTINUED) (in thousands)

Liabilities and Stockholders' Equity

	(Unaudited) September 30, 2011	December 31, 2010
Current liabilities:		
Accounts payable	$ 710	$ 951
Accrued payroll	95	101
Accrued vacation	247	169
Current portion of bonds payable	144	140
Accrued and other liabilities	754	444
Total current liabilities	1,950	1,805
Bonds payable, net of current portion	3,491	3,600
Capital lease payable, net of current portion	112	112
Derivative liabilities	323	504
Total liabilities	5,876	6,021
Commitments and Contingencies (see Note 11)		
Stockholders' equity:		
Preferred stock, par value $.001; 10,000,000 shares authorized; none issued or outstanding	--	--
Common stock, par value $.001 par value; 40,000,000 shares authorized; 17,751,327 and 17,705,980 issued and 17,608,248 and 17,562,901 outstanding on September 30, 2011 and December 31, 2010, respectively	18	18
Additional paid-in capital	25,218	25,113
Accumulated other comprehensive loss	(176)	--
Deficit	(2,382)	(3,366)
Total stockholders' equity	22,678	21,765
Total liabilities and stockholders' equity	$ 28,554	$ 27,786

The accompanying notes are an integral part of the consolidated financial statements.

Index

BOVIE MEDICAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Sales	$ 6,256	$ 6,501	$ 19,252	$ 17,997
Cost of sales	3,650	3,797	11,167	10,692
Gross profit	2,606	2,704	8,085	7,305
Gain from settlement of litigation	--	--	750	--
Other costs and expenses:				
Research and development	288	442	924	1,466
Professional services	289	556	906	1,235
Salaries and related costs	785	782	2,391	2,386
Selling, general and administrative	996	1,039	3,231	3,456
Total other costs and expenses	2,358	2,819	7,452	8,543
Income (loss) from operations	248	(115)	1,383	(1,238)
Change in fair value of liabilities, net	(67)	182	181	799
Interest (expense) income, net	(42)	(58)	(141)	(169)
Income (loss) before income taxes	139	9	1,423	(608)
Provision for current income taxes	--	--	--	--
Benefit (provision) for deferred income taxes	(76)	(5)	(439)	442
Total benefit (provision) for income taxes - net	(76)	(5)	(439)	442
Net income (loss)	$ 63	$ 4	$ 984	$ (166)
Earnings (loss) per share				
Basic	$ -	$ -	$ 0.06	$ (0.01)
Diluted	$ -	$ -	$ 0.06	$ (0.01)
Weighted average number of shares outstanding- basic	17,601	17,557	17,592	17,301
Weighted average number of shares outstanding – dilutive	17,774	17,756	17,807	17,301

The accompanying notes are an integral part of the consolidated financial statements.

5

Index

BOVIE MEDICAL CORPORATION
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS)
FOR THE YEAR ENDED DECEMBER 31, 2010 AND THE PERIOD ENDED SEPTEMBER 30, 2011
(in thousands)

	Common Stock Shares	Common Stock Par Value	Additional Paid-in Capital	Accumulated Other Comprehensive Gain (Loss)	Deficit	Total
January 1, 2010	16,952	$17	$ 22,934	$ (89)	$(1,831)	$21,031
Options exercised	46	-	39	–	–	39
Stock based compensation	–	–	163	–	–	163
Stock swap to acquire options	(6)	-	(30)	–	–	(30)
Equity issuance	571	1	2,766			2,767
Change in fair value of liabilities			(799)			(799)
Tax benefit from share based payments			40			40
Net loss	–	–	–	–	(1,535)	(1,535)
Foreign currency re-measurement	–	–	–	89	–	89
Comprehensive loss	–	–	–	–	–	(1,446)
December 31, 2010	17,563	18	25,113	–	(3,366)	21,765
Options exercised	56	–	30	–	–	30
Stock based compensation	–	–	105	–	–	105
Stock swap to acquire options	(10)	–	(30)	–	–	(30)
Net income	–	–	–	–	984	984
Net change in fair value of interest rate swap	–	–	–	(176)	–	(176)
Comprehensive income						808

September 30, 2011 (unaudited)	17,609	$18	$ 25,218	$ (176)	$(2,382)	$22,678

The accompanying notes are an integral part of the consolidated financial statements

Index

BOVIE MEDICAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
(UNAUDITED) (in thousands)

	2011	2010
Cash flows from operating activities		
Net income (loss)	$ 984	$ (166)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	677	799
Provision for (recovery of) inventory obsolescence	34	(38)
Loss on disposal of property and equipment, net	1	67
Loss on impairment of intangible asset	--	67
Stock based compensation	105	118
Change in fair value of liabilities	(181)	(799)
Provision (benefit) for deferred taxes	439	(448)
Changes in current assets and liabilities:		
Trade receivables	(70)	(102)
Prepaid expenses	346	(108)
Inventories	(87)	(916)
Deposits and other assets	(68)	(176)
Accounts payable	(240)	547
Accrued and other liabilities	205	204
Deferred revenues	-	(3)
Net cash provided by (used in) operating activities	2,145	(954)
Cash flows from investing activities		
Purchases of property and equipment	(459)	(350)
Cash used in investing activities	(459)	(350)
Cash flows from financing activities		
Proceeds from escrow account	--	35
Proceeds from private placement (net of costs of $233)	--	2,767
Net change in line of credit	--	(1,000)
Repayments of long-term bond debt	(105)	(101)
Common shares issued	--	9
Net cash provided by (used in) financing activities	(105)	1,710
Effect of exchange rate changes on cash and cash equivalents	--	89
Net change in cash equivalents	1,581	495
Cash and cash equivalents, beginning of period	3,827	2,155
Cash and cash equivalents, end of period	$ 5,408	$ 2,650
Cash paid during the nine months ended September 30, 2011 and 2010 for:		
Interest	$ 141	$ 169

Income taxes	$ --	$ -

The accompanying notes are an integral part of the consolidated financial statements

Index

BOVIE MEDICAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
UNAUDITED

NOTE 1. BASIS OF PRESENTATION

Unless the context otherwise indicates, the terms “we,” “our,” “us,” “Bovie,” and similar terms refer to Bovie Medica Corporation and its consolidated subsidiaries.

The accompanying unaudited consolidated financial statements have been prepared based upon SEC rules that permit reduced disclosure for interim periods. For a more complete discussion of significant accounting policies and certain other information, please refer to the financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2010. These financial statements reflect all adjustments that are necessary for a fair presentation of results of operations and financial condition for the interim periods shown, including normal recurring accruals and other items. The results for the interim periods are not necessarily indicative of results for the full year.

Certain amounts in the September 30, 2010 and December 31, 2010 financial statements have been reclassified to conform to the presentation in the September 30, 2011 financial statements.

NOTE 2. INVENTORIES

Inventories are stated at the lower of cost or market. Cost is determined principally on the average cost method. Inventories at September 30, 2011 and December 31, 2010 were as follows (in thousands):

	September 30, 2011	December 31, 2010
Raw materials	$ 4,472	$ 4,586
Work in process	2,316	2,315
Finished goods	1,419	1,218
Gross inventories	8,207	8,119
Less: reserve for obsolescence	(549)	(514)
Net inventories	$ 7,658	$ 7,605

NOTE 3. INTANGIBLE ASSETS

At September 30, 2011 and December 31, 2010 intangible assets consisted of the following (in thousands):

	September 30, 2011	December 31, 2010
Trade name (life indefinite)	$ 1,510	$ 1,510
Purchased technology (9-17 yr life)	$ 2,251	$ 2,251
Less: accumulated amortization	(734)	(653)

Net carrying amount	$	1,517	$	1,598
License rights (5 yr life)	$	316	$	316
Less accumulated amortization		(274)		(226)
Net carrying amount	$	42	$	90

Amortization of intangibles, which is included in depreciation and amortization in the accompanying statements of cash flows was approximately $129,000 and $205,000 during the respective nine month periods ended September 30, 2011 and 2010.

Index

NOTE 4. NEW ACCOUNTING PRONOUNCEMENTS

In June 2011, the FASB issued Accounting Standards Update ("ASU") No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income which requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of stockholders' equity. The amendments in ASU 2011-05 do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. ASU 2011-05 is effective for our fiscal years beginning January 1, 2012. Early adoption is permitted. We are currently assessing the implementation of this new guidance, however these changes will only affect our presentation and will not have an impact on our consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurements and Disclosures (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements, mainly for level 3 fair value measurements. ASU 2011-04 is effective for our fiscal years beginning January 1, 2012. Early adoption is not permitted. We are currently evaluating the impact of this new guidance, but we do not expect it to have a material impact on our consolidated financial statements.

In September 2011, the FASB issued ASU No. 2011-08, Intangibles-Goodwill and Other an update that amends the accounting guidance on goodwill impairment testing. The amendments in this accounting standard update are intended to reduce complexity and costs by allowing an entity the option to first assess qualitative factors in its evaluation about the likelihood of goodwill impairment to determine whether it is necessary to perform the two-step quantitative goodwill impairment test of a reporting unit. In addition the amendments include a number of events and circumstances for an entity to consider in conducting the qualitative assessment. ASU No. 2011-08 is effective for our fiscal years beginning after December 15, 2011 with early adoption permitted. We do not expect it to have a material impact on our consolidated financial statements.

NOTE 5. FAIR VALUE MEASUREMENTS

Certain assets and liabilities that are measured at fair value on a recurring basis as of September 30, 2011 are measured in accordance with FASB ASC Topic 820-10-05, Fair Value Measurements. FASB ASC Topic 820-10-05 defines fair value, establishes a framework for measuring fair value and expands the disclosure requirements regarding fair value measurements for financial assets and liabilities as well as for non-financial assets and liabilities that are recognized or disclosed at fair value on a recurring basis in the financial statements.

The statement requires fair value measurement be classified and disclosed in one of the following three categories:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2: Quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability; and

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

Index

The following table summarizes our financial instruments measured at fair value as of September 30, 2011 (in thousands):

		September 30, 2011 Fair Value Measurements		
	Total	Level 1	Level 2	Level 3
Assets:				
Cash and equivalents – United States	$ 5,385	$ 5,385	$ –	$ –
Cash and equivalents - Foreign currency	23	23	–	–
Total assets	$ 5,408	$ 5,408	$ –	$ –
Liabilities:				
Warrant liability (1)	$ 169	$ –	$ –	$ 169
Derivative interest rate swap (Note 7)	176	–	176	–
Due to Lican (2)	153	–	–	153
Total liabilities	$ 498	$ –	$ 176	$ 322

The following table summarizes our financial instruments measured at fair value as of December 31, 2010 (in thousands):

		December 31, 2010 Fair Value Measurements		
	Total	Level 1	Level 2	Level 3
Assets:				
Cash and equivalents – United States	$3,788	$3,788	$–	$–
Cash and equivalents - Foreign currency	39	39	–	–
Total assets	$3,827	$3,827	$–	$–
Liabilities:				
Warrant liability (1)	$332	$–	$–	$332
Due to Lican (2)	172	–	–	172
Total liabilities	$504	$–	$–	$504

(1) Refer to Warrants and Stockholders' Equity (Note 6) for valuation assumptions.

(2) This amount is based upon the probable realization of 75,000 out of a possible 150,000 contingent shares related to the Lican Developments Ltd. Asset Purchase Agreement, which was valued at the adjusted current fair value market share price.

Activity in our Level 3 Assets was as follows (in thousands):

Description	September 30, 2011	December 31, 2010

Beginning balance	$ 504	$ 218
Purchases, issuances, and settlements (Note 6)	-	799
Total gain included in earnings (3)	(181)	(513)
Ending Balance	$ 323	$ 504

(3) Gains for the periods related to the revaluation of equity based liabilities. These gains are included in our consolidated statements of operations.

Index

NOTE 6. WARRANTS AND STOCKHOLDERS' EQUITY

On April 18, 2010, we entered into a securities purchase agreement with purchasers named therein to raise approximately $3 million in the aggregate in a private placement of common stock and warrants pursuant to Section 4(2) of the Securities Act of 1933, as amended, and/or Regulation D promulgated thereunder. Upon closing of the transaction, we entered into a registration rights agreement with the purchasers and issued to the purchasers an aggregate of 571,429 shares of common stock at a per share price of $5.25, and warrants to acquire additional shares of common stock of up to fifty (50%) percent of the common shares acquired by each respective purchaser at an exercise price of $6.00 per share.

The warrants are immediately exercisable and will terminate on April 18, 2015. The exercise price of the warrants is subject to adjustment so that, among other things, if we issue any shares of common stock (including options and warrants, with standard exceptions), at a price that is lower than the exercise price then in effect, the exercise price then in effect will be reduced to such lower price.

In connection with the private placement, we paid certain cash fees and issued a warrant to the placement agent, Rodman & Renshaw, LLC, for the purchase of 42,857 shares of Common Stock at an exercise price of $6.00 per share for its activity engaged on behalf of us. In addition, we paid certain cash fees and issued a warrant to Gilford Securities Incorporated for the purchase of 10,000 shares of common stock at an exercise price of $6.00 per share for its activity engaged on behalf of us.

The warrants issued contained provisions for a net cash settlement in the event that there is a fundamental transaction (contractually defined as a merger, sale of substantially all assets, tender offer or share exchange). Due to this contingent redemption provision, the warrants require liability classification according to FASB ASC 480-10, "Distinguishing Liabilities from Equity" and must be recorded at fair value each reporting period. These warrants required classification as liabilities at inception and ongoing measurement at fair value each reporting period thereafter.

The warrants are valued using a binomial lattice valuation methodology because that model embodies all of the relevant assumptions that address the features underlying these instruments. Significant assumptions used in this model at inception and as of September 30, 2011 included an expected life of 4 years remaining, an expected dividend yield of zero, estimated volatility range between 41%- 42%, and risk-free rates of return range between 1.7 - 1.8%, For the risk-free rates of return, we use the published yields on zero-coupon Treasury Securities with maturities consistent with the remaining term of the warrants and volatility is based on a weighted average of the historical volatility of our stock price and peer company stock price volatility. We also take into consideration a probability assumption for anti-dilution.

During the nine months ended September 30, 2011, we issued 45,347 common shares in exchange for 55,750 employee and non-employee stock options and 10,403 common shares (via a stock swap). Net proceeds from the issuance of common shares along with the shares received in the stock swap exercises were zero for the nine-month period ended September 30, 2011.

NOTE 7. DERIVATIVE INTEREST RATE SWAP

We are a party to an interest rate swap agreement to limit our exposure to market rate fluctuations that effectively converts our variable rate interest payments related to our industrial revenue bonds to a fixed rate. Our interest rate swap agreement is designated as a cash flow hedge and is required to be measured at fair value on a recurring basis. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty in exchange for us making fixed-rate payments over the life of the agreements without exchange of the underlying

notional amount. The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in accumulated other comprehensive income (loss) and is subsequently reclassified into earnings through interest expense in the period that the hedged forecasted transaction affects earnings.

Our swap agreement requires us to pay the counterparty a stream of fixed interest payments at a rate of 3.6%, and in turn, receive variable interest payments based on the SIFMA Municipal Index, which is the identical variable interest payment outflow on our bonds. Both the industrial revenue bonds and the interest rate swap are based on the same initial $4 million declining notional amount, are amortized over a 20-year term, and have the same termination date of December 1, 2018. The swap contains a margin spread of 0.1% which is recorded in interest expense during the period that it is recognized.

Our interest rate swap is valued based on quoted data from various direct and indirect observable sources and market data combined with some estimates based on historical patterns, which, combined, are deemed to be a Level 2 input in the fair value hierarchy. At September 30, 2011, our liability related to this derivative on our consolidated balance sheet included $176,000 under accrued expenses for the approximate fair value of the swap. The effective portion of the related unrealized loss on the swap is deferred in accumulated other comprehensive loss and will be recognized as interest expense as the interest payments become due. No ineffectiveness was recorded in the consolidated statements of income during the nine months ended September 30, 2011. The counterparty to this swap is RBC Bank and from time to time we assess our potential credit risk. As of September 30, 2011, we were in a liability position to RBC Bank and therefore had limited counterparty credit risk. (See NOTE 5. FAIR VALUE MEASUREMENTS)

Index

Subsequently, on October 31, 2011, we refinanced the industrial revenue bonds with PNC Bank which included embedding an interest rate derivative to provide a fixed interest rate throughout the maturity date of the bonds, and eliminates our accumulated other comprehensive loss balance in future periods with no impact to our consolidated financial statements.

NOTE 8. EARNINGS PER SHARE (in thousands, except EPS)

We compute basic earnings (loss) per share ("basic EPS") by dividing net income (loss) by the weighted average number of common shares outstanding for the reporting period. Diluted earnings (loss) per share ("diluted EPS") gives effect to all dilutive potential shares outstanding (primarily stock options). The following table provides the computation of basic and diluted earnings (loss) per share for the three month and nine month periods ending September 30, 2011 and 2010.

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands, except EPS)	2011	2010	2011	2010
Net income (loss)	$63	$4	$984	$(166)
Basic weighted average shares outstanding	17,601	17,557	17,592	17,301
Effect of potential dilutive securities	173	199	215	n/a
Diluted weighted average shares outstanding	17,774	17,756	17,807	17,301
Basic EPS	$-	$-	$0.06	$(0.01)
Diluted EPS	$-	$-	$0.06	$(0.01)

For the nine months ended September 30, 2011 and 2010, options and warrants to purchase approximately 1.3 million shares of common stock were excluded from the computation of diluted earnings (loss) per share because their effects were anti-dilutive.

NOTE 9. STOCK-BASED COMPENSATION

Under our stock option plan, our board of directors may grant options to purchase common shares to our key employees, officers, directors and consultants. We account for stock options in accordance with FASB ASC Topic 718, Compensation – Stock Compensation, with option expense amortized over the vesting period based on the binomial lattice option-pricing model fair value on the grant date, which includes a number of estimates that affect the amount of our expense. During the nine months ended September 30, 2011, we expensed $104,988 in stock-based compensation.

Activity in our stock options during the period ended September 30, 2011 was as follows:

	Number Of Options (in thousands)	Weighted Average Exercise Price
Outstanding at December 31, 2010	1,948	$3.79

Granted	25	$2.81
Exercised	(56)	$0.54
Cancelled	(197)	$2.16
Outstanding at September 30, 2011	1,720	$4.07

The grant date fair value of options granted in 2011 were estimated on the grant date using a binomial lattice option-pricing model and the following assumptions: expected volatility range between 41- 42%, expected term of 7 years, risk-free interest rate range between 1.8 - 2.6%, and expected dividend yield of 0%.

Expected volatility is based on a weighted average of the historical volatility of our stock price and peer company stock price volatilities. The average expected life was calculated using the simplified method under SAB 107. The risk-free rate is based on the rate of U.S. Treasury zero-coupon issues with a remaining term equal to the expected life of the options. We use historical data to estimate pre-vesting forfeiture rates.

Index

NOTE 10. INCOME TAXES

While we are subject to U.S. federal income tax as well as income tax of certain state jurisdictions, during the three and nine months ended September 30, 2011, our current provisions were zero because the net effect of our permanent and temporary differences resulted in us recognizing losses for tax purposes. At September 30, 2011, we have remaining net operating loss carryforwards of approximately $3.4 million to reduce any future taxable income earned in various years through the tax year 2030. Our effective tax rate of 30.9% for the nine months ended September 30, 2011 was less than the statutory tax rates primarily because we recognized certain gains from fair value adjustments for financial statement purposes that are not expected to reverse (i.e. they are considered permanent differences).

NOTE 11. COMMITMENTS AND CONTINGENCIES

We are obligated under various operating leases for our facilities and certain equipment, most notably a lease for a manufacturing and warehouse facility in St. Petersburg, Florida that requires monthly payments of approximately $13,000 and expires on October 31, 2013. The following is a schedule of approximate future minimum lease payments under operating leases having remaining terms in excess of one year for the three months ended December 31, 2011 and the calendar years ended December 31, 2012, 2013, 2014 and 2015 (in thousands):

2011	$	62
2012		251
2013		227
2014		12
2015		--
Total	$	552

Rent expense approximated $148,000 and $152,000 for the nine month periods ending September 30, 2011 and 2010, respectively.

On March 3, 2011 we entered into a settlement agreement related to the legal action with Salient Surgical Technologies, Inc. and Medtronic, Inc. The settlement called for us and related parties to immediately exit and not enter into the monopolar and bipolar saline-enhanced RF device business (including SEER™ and BOSS™) worldwide through February 2015. In exchange, the Plaintiffs made a one-time payment to us of $750,000. As a condition, we will not be able to sell certain finished products, which as of the settlement date amounted to approximately $100,000 of our inventory. We reserved for approximately $87,000 of our inventory related to the products in this settlement in the first quarter of 2011. The terms also include a provision outlining a possible OEM contract manufacturing relationship between Salient and our Company. We currently already have a longstanding OEM contract manufacturing agreement with Medtronic for advanced electrosurgical generators. We have given Medtronic notice that the agreement will terminate at December 31, 2011, with final deliveries occurring in 2012. We will continue to service the generators sold during this contract for the next five years. We anticipate sales of accessories and spare parts to continue into the future.

On July 9, 2010, we filed a complaint in the United States District for the Middle District of Florida (Tampa division) naming Steven Livneh, who at the time was a director of the Company, and two of his related entities as defendants. In our complaint, we are seeking, among other things, a declaratory judgment from the Court concerning our rights under certain agreements entered into with the defendants in 2006 in connection with our acquisition of certain assets and technology, including intellectual property relating to our Seal-N-Cut™ product. We are also seeking damages for breach of contract, breach of fiduciary duty by Mr. Livneh relating to his service as an officer and director of the Company, tortious interference with contractual relations, defamation, slander of title and injunctive relief. Mr.

Livneh filed a motion seeking to (a) dismiss the complaint or, in the alternative, to (b) transfer venue. On December 20, 2010 the court issued an order dismissing without prejudice five of our fifteen claims, due to New York being defined in the forum selection clauses in two of the underlying contracts with Mr. Livneh. The Company re-filed these five claims in federal court in New York. Mr. Livneh's motion to dismiss the remaining claims in Florida was denied and the venue was not transferred.

On January 10, 2011 defendant Livneh filed a counter-complaint/third party complaint against us, our CEO, and our COO, alleging fraud, fraud in the inducement, fraudulent misrepresentation, breach of fiduciary duty, negligent misrepresentation, innocent misrepresentation, breach of contract, tortuous interference, shareholder derivative, defamation, breach of good faith and fair dealing, violation of the Uniform Trade Secrets Act, and violation of the Florida Whistleblower's Act, and seeking rescission and a declaratory judgment. In addition to the foregoing relief, defendant also seeks reinstatement of Mr. Livneh to the Company's board of directors, issuance of certain shares of unrestricted stock, compensatory, actual and/or special damages, punitive and/or exemplary damages, and attorney's fees and costs. The outcome of this matter is uncertain and accordingly no effect has been given to any loss that may result from the resolution of this matter in the accompanying consolidated financial statements.

Index

NOTE 11. COMMITMENTS AND CONTINGENCIES (CONTINUED)

On June 10, 2011 we signed a settlement agreement related to the legal action involving Dr. David Eisenstein, MD under which we paid $53,500 to Dr. Eisenstein and an additional $20,000 directly to his legal counsel for legal fees. In exchange, Dr. Eisenstein surrendered his 5,000 stock options and both parties signed a general release and dismissal.

In September 2011, we were served in a purported stockholder derivative action that was filed in the United State District Court for the Middle District of Florida against the Company and certain of its present and former officers and directors. The complaint asserts, among other things, breach of fiduciary duties and bad faith in relation to the management of the Company. The complaint seeks, among other things, unspecified compensatory damages and various forms of equitable relief. The allegations in the derivative action appear to be based largely on the January 10, 2011 Steven Livneh counterclaim described above. We are reviewing the allegations in the complaint and investigating whether there is a collusive connection between the newly-filed derivative action and the pending lawsuit with Mr. Livneh. We believe the allegations to be frivolous and without merit and we intend to defend the action vigorously. The outcome of this matter is uncertain and accordingly no effect has been given to any loss that may result from the resolution of this matter in the accompanying consolidated financial statements.

NOTE 12. RELATED PARTY TRANSACTION

During the nine months ended September 30, 2011, we paid consulting fees of approximately $60,000 to an entity owned by one of our directors and $22,500 to another director.

End of financial information

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Cautionary Notes Regarding "Forward-Looking" Statements

This report contains statements that we believe to be "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange act of 1934, as amended. Forward-looking statements give our current expectations or forecasts of future events. Forward-looking statements generally can be identified by the use of forward-looking terminology such as "may," "will," "expect," "intend," "estimate," "anticipate," "believe," "project," or "continue," or similar words or the negative thereof. From time to time, we a may provide oral or written forward-looking statements in other materials we release to the public. Any or all of our forward-looking statements in this report and in any public statements we make could be materially different from actual results. They can be affected by assumptions we might make or by known or unknown risks or uncertainties. Consequently, we cannot guarantee any forward-looking statements. Investors are cautioned not to place undue reliance on any forward-looking statements. Investors should also understand that it is not possible to predict or identify all such factors and should not consider the following list to be a complete statement of all potential risks and uncertainties. The following factors and those discussed in ITEM 1A, Risk Factors, included in our Annual Report on Form 10-K for the year ended December 31, 2010, may affect the achievement of forward-looking statements:

- general economic and political conditions, such as political instability, credit market uncertainty, the rate of economic growth or decline in our principal geographic or product markets or fluctuations in exchange rates;

continued deterioration in or stabilization of the global economy;

changes in general economic and industry conditions in markets in which we participate, such as:

deterioration in or destabilization of the global economy;

the strength of product demand and the markets we serve;

the intensity of competition, including that from foreign competitors;

pricing pressures;

the financial condition of our customers;

market acceptance of new product introductions and enhancements;

the introduction of new products and enhancements by competitors;

our ability to maintain and expand relationships with large customers;

our ability to source raw material commodities from our suppliers without interruption and at reasonable prices; and

our ability to source components from third parties, in particular from foreign manufacturers, without interruption and at reasonable prices;

Index

our ability to access capital markets and obtain anticipated financing under favorable terms;
our ability to identify, complete and integrate acquisitions successfully and to realize expected synergies on our anticipated timetable;
changes in our business strategies, including acquisition, divestiture and restructuring activities;
changes in operating factors, such as continued improvement in manufacturing activities, the achievement of related efficiencies and inventory risks due to shifts in market demand;
our ability to generate savings from our cost reduction actions;
unanticipated developments that could occur with respect to contingencies such as litigation, intellectual property matters, product liability exposures and environmental matters; and
our ability to accurately evaluate the effects of contingent liabilities.

The foregoing factors are not exhaustive, and new factors may emerge or changes to the foregoing factors may occur that would impact our business. We assume no obligation, and disclaim any duty, to update the forward-looking statements in this report. Past performance is no guaranty of future results.

Executive Level Overview

We are a medical device company engaged in manufacturing and marketing of electrosurgical devices. Our medical products include a wide range of devices including electrosurgical generators and accessories, cauteries, medical lighting, nerve locators and other products.

We internally divide our operations into three product lines. Electrosurgical products, battery-operated cauteries and other products. The electrosurgical line sells electrosurgical products which include desiccators, generators, electrodes, electrosurgical pencils and various ancillary disposable products. These products are used in surgery for the cutting and coagulation of tissue. Battery-operated cauteries are used for precise hemostasis (to stop bleeding) in ophthalmology and in other fields. Our other revenues are derived from nerve locators, disposable and reusable penlights, medical lighting, license fees, development fees and other miscellaneous income.

Most of our products currently are marketed through medical distributors, which distribute to more than 6,000 hospitals, and to doctors and other health-care facilities. New distributors are contacted through responses to our advertising in international and domestic medical journals and domestic or international trade shows. International sales represented 22.9% of total revenues for the first nine months of 2011, as compared with 20.9% for the first nine months of 2010. Our products are sold in more than 150 countries mainly through local dealers which are coordinated by sales and marketing personnel at the Clearwater, Florida facility. In addition, for the launch of our new surgical suite product lines, we have established the use of a network of approximately 50 commission-based independent direct sales contractors to market these products. Our business is generally not seasonal in nature.

Results of Operations –Three and Nine Months Ended September 30, 2011 Compared to Three and Nine Months Ended September 30, 2010

Sales

Sales by Product Line (in thousands)	Three months ended September 30,		Percent change	Nine months ended September 30,		Percent change
	2011	2010		2011	2010	
Electrosurgical	$3,989	$4,300	(7.2 %)	$12,905	$11,759	9.7 %
Cauteries	1,577	1,651	(4.5 %)	4,720	4,763	(0.9 %)
Other	690	550	25.5 %	1,627	1,475	10.3 %

Total	$6,256	$6,501	(3.8 | %)	$19,252	$17,997	7.0	%

Sales by Domestic and International (in thousands)	Three months ended September 30,		Percent		Nine months ended September 30,		Percent	
Domestic	$5,024	$5,259	(4.5	%)	$14,835	$14,230	4.3	%
International	1,232	1,242	(0.8	%)	4,417	3,767	17.3	%
Total	$6,256	$6,501	(3.8	%)	$19,252	$17,997	7.0	%

Index

Our sales for the nine months ended September 30, 2011 continue to outpace sales for the same period in 2010 by approximately $1.3 million, even though our third quarter 2011 sales decreased 3.8% or approximately $245,000 from the same period in 2010. The nine month sales increase has been driven mainly by increased demand for our electrosurgical generators both domestically and internationally which amounted to an approximate increase of $1 million or 10.6% or for the nine months ended September 30, 2011 compared to the same period in 2010. Sales of our new distribution products released this year, coated blades which are categorized as electrosurgical and medical lighting systems which are categorized as other products, amounted to increases of approximately $597,000 and $152,000 respectively for the nine months ended compared to the same period in 2010. However, increases in electrosurgical sales were offset by an approximate decrease of $425,000 related to discontinued sales of an OEM disposable electrosurgical device for the nine months ended compared to the same period in 2010. Cautery sales were down fractionally by approximately $40,000 for the nine months ended compared to the same period in 2010.

As mentioned above sales for the third quarter 2011 were lower by approximately $245,000 when compared to the same period 2010 mainly as a result of a decrease in demand for replaceable cauteries in the approximate amount of $74,000 coupled with the effect of us receiving and shipping a larger than usual order from one of our OEM customers in the third quarter 2010 for approximately $311,000. These quarterly decreases were offset by an increase in new distribution medical light products sales of approximately $141,000 in quarter ended September 30, 2011 compared to the same period 2010.

Gross Profit

	Three months ended September 30,		Percentage of sales		Percent	Nine months ended September 30,		Percentage of sales		Percent
(in thousands)	2011	2010	2011	2010	Change	2011	2010	2011	2010	Change
Cost of sales	$ 3,650	$ 3,797	58.3 %	58.4 %	(3.9 %)	$ 11,167	$ 10,692	58.0 %	59.4 %	4.4 %
Gross profit	$ 2,606	$ 2,704	41.7 %	41.6 %	(3.6 %)	$ 8,085	$ 7,305	42.0 %	40.6 %	10.7 %

We improved our gross profit margin on a dollar basis by 10.7% or approximately $780,000 during the nine months ended September 30, 2011 compared to the same period in 2010 as a result of a combination of increased sales mentioned above and a net reduction in some of our costs attributed to those sales. Our cost of sales as a percentage of sales decreased by 1.4% as a result of reductions approximating $160,000 in direct and indirect labor costs, $142,000 eliminated from our consolidating the Canadian facility, and $37,000 in material and freight cost savings. These reductions were offset by a $61,000 increase in material and subassembly manufacturing consulting costs related to some of our sophisticated components.

Our third quarter 2011 cost of sales as a percentage of sales also improved slightly by a 0.1% decrease compared to the same period in 2010 as we strive to continue the trend of reducing our cost of sales and improving gross margins even though there are many variables that can impact them.

Other Gain

On June 10, 2010, we received notice that an action had been commenced against us in the United States Court for the District of Delaware (Civil Action No. 1:10-cv-00494-UNA) by Salient Surgical Technologies, Inc. and Medtronic, Inc. (the “Plaintiffs”). In the complaint, the Plaintiffs alleged that the sale and use of our SEER™ (Saline Enhanced Electrosurgical Resection) fluid-assisted electrosurgical devices infringed on an issued United States patent presently owned by Medtronic and licensed to Salient. The Plaintiffs were demanding a permanent injunction restraining us, and our affiliates, and any person acting in privity or in concert or participation with us from the continued

infringement of the patent as well as unspecified monetary damages.

Subsequently, on March 3, 2011 we signed a settlement agreement related to the above-mentioned action with Salient Surgical Technologies, Inc. and Medtronic, Inc. The settlement called for us and related parties to immediately exit and not enter into the monopolar and bipolar saline-enhanced RF device business (including SEER™ and BOSS™) worldwide through February 2015. In exchange, the Plaintiffs made a one-time payment to us of $750,000. We have recognized the full amount as a gain in the first quarter of 2011 as it is economic benefit received for our inventory on hand, some development costs and some reimbursement to offset legal fees incurred in defending this lawsuit. We also reserved for approximately $87,000 of our inventory in the first quarter of 2011. The terms also include a provision outlining a possible OEM contract manufacturing relationship between Salient and our Company. We currently already have a longstanding OEM contract manufacturing agreement with Medtronic for advanced electrosurgical generators. We have given Medtronic notice that the agreement will terminate at December 31, 2011, with final deliveries occurring in 2012. We will continue to service the generators sold during this contract for the next five years. We anticipate sales of accessories and spare parts to continue into the future.

Index

Research and Development Expense

(in thousands)	Three months ended September 30, 2011	2010	Percentage of sales 2011	2010	Percent Change	Nine months ended September 30, 2011	2010	Percentage of sales 2011	2010	Percent Change
R & D expense	$ 288	$ 442	4.6 %	6.8 %	(34.8 %)	$ 924	$ 1,466	4.8 %	8.1 %	(37.0 %)

We experienced a 34.8% decrease in research and development expense or approximately $154,000 in the third quarter of 2011 compared to the same period in 2010. This decrease was primarily the result of a reduction of $120,000 in R&D engineering costs and $45,000 in R&D labs and materials all related to the sintered steel product line which in March of this year as part of our legal settlement with Salient Surgical Technologies, Inc. we agreed to exit and not enter into the monopolar and bipolar saline-enhanced RF device business (SEER™ and BOSS™) worldwide through February 2015. Our reductions were partially offset by an increase of approximately $11,000 related to additional consulting costs associated with some of our new products under development.

During the nine month period ending September 30, 2011 as compared to the same period in 2010 we had a decrease in research and development expense of 37.0% amounting to approximately $542,000. A large portion of these decreased costs, $320,000 for R&D engineering costs and $112,000 in R&D labs and materials, was attributed to the above mentioned exit out of the monopolar and bipolar saline-enhanced RF device business until February 2015 as part of the Salient Surgical Technologies, Inc. settlement. We also experienced decreased costs related to the vessel sealing product line and the consolidation of that project to our Florida facility from Canada which consisted of approximately $93,000 of reduced R&D consulting costs and $17,000 in other development costs.

Professional Fees

(in thousands)	Three months ended September 30, 2011	2010	Percentage of sales 2011	2010	Percent Change	Nine months ended September 30, 2011	2010	Percentage of sales 2011	2010	Percent Change
Professional services	$ 289	$ 556	4.6 %	8.6 %	(48.0 %)	$ 906	$ 1,235	4.7 %	6.9 %	(26.6 %)

Our professional costs decreased by 48.0% or approximately $267,000 in the third quarter of 2011 compared to the same period in 2010, due mainly to a reduction in legal fees of approximately $163,000 related to settled cases. In addition our tax consulting fees were reduced by approximately $81,000 due to the closing of our IRS audit earlier this year and we had a savings of approximately $23,000 in other consulting costs with our nonrenewal of Growthink which we used in 2010 to support the marketing of new products

For the nine months ended September 30, 2011 as compared to the same period in 2010 we had similar reductions in costs as mentioned above amounting to a 26.6% decrease in professional services expense or approximately $329,000. Theses cost reductions consisted of an approximate $149,000 reduction in legal fees, an approximate $73,000 reduction in tax consulting related to the closed IRS audit, $78,000 reduction in Growthink consulting costs, and a $28,000 reduction in other consulting costs that were incurred in 2010 related to the Canadian facility.

Salaries

	Three months ended September 30,	Percentage of sales	Percent	Nine months ended September 30,	Percentage of sales	Percent

(in thousands)	2011	2010	2011	2010	Change	2011	2010	2011	2010	Change
Salaries & related cost	$ 785	$ 782	12.5 %	12.0 %	0.4 %	$ 2,391	$ 2,386	12.4 %	13.3 %	0.2 %

Index

Our salaries and related costs remained relatively constant, increasing only 0.4% or approximately $3,000 in the third quarter of 2011 compared to the same period in 2010. Although we experienced an increase in our health insurance premiums of approximately $20,000, this increase was offset by a reduction in salaries related to the elimination of a marketing position for the sintered steel product line that we agreed to exit out of as part of the Salient Surgical Technologies, Inc. settlement.

For the nine month period ending September 30, 2011 as compared to the same period in 2010, we experienced similar offsetting increases and decreases as mentioned above in our salaries and related costs resulting in a slight 0.2% increase, or approximately $5,000. In the past nine months our health insurance costs increased by $39,000 over the first nine months of 2010, and we expect yearly increases for this cost will be the trend in the future. A reduction of an employee position in the marketing department for the sintered steel suspended product line and a decrease associated with consolidating the Canadian operations amounted to offsetting savings of $32,000 and $2,000 respectively.

Selling, General & Administrative Expenses

(in thousands)	Three months ended September 30		Percentage of sales		Percent	Nine months ended September 30,		Percentage of sales		Percent
	2011	2010	2011	2010	Change	2011	2010	2011	2010	Change
SG & A costs	$ 996	$ 1,039	15.9 %	16.0 %	(4.1 %)	$ 3,231	$ 3,456	16.8 %	19.2 %	(6.5 %)

Our selling, general and administrative costs decreased by 4.1% overall or approximately $43,000 in the third quarter of 2011 compared to the same period in 2010. We continue to increase sales of our new distribution product lines, coated electrodes and medical lighting systems, and to introduce other new products under development and as a result we had increases in selling costs of $28,000 for advertising, $26,000 for commission expense, and $22,000 for show costs. These selling costs were offset by an approximate $59,000 reduction in travel costs related to the suspension of the sintered steel product line as part of the Salient Surgical Technologies, Inc. settlement. Other components included in the 4.2% overall reduction mentioned above were related to general overhead costs which included approximately $26,000 decrease in amortization expense attributable to the suspension of the sintered steel product line, $23,000 decrease in utilities and facility maintenance costs, $14,000 decrease in regulatory testing costs as a result of our developing products being closer to the end phase than in the prior year, and a $10,000 decrease in loss on disposition of assets which were incurred in the third quarter of 2010. These general overhead decreases were offset by approximate increases when compared to the same period in 2010 of $8,000 in foreign currency loss from the fluctuation in the Euro and a $5,000 increase in costs related to being a public company.

During the nine months ended September 30, 2011 as compared to the same period in 2010 we decreased our selling, general and administrative costs overall by 6.5% or approximately $225,000 which stemmed from several components. One area of cost reductions related to the suspension of the sintered steel product line which resulted in cost savings of approximately $202,000 in marketing, consulting and travel related costs, and the elimination of approximately $76,000 in amortization costs related to the previously impaired patent in 2010, all of which were offset by a reserve for obsolescence cost of $59,000. In addition, we recognized cost savings related to our decision in 2010 to consolidate our Canadian operations to our Florida facility of approximately $267,000, which are offset by our legal settlement cost of approximately $74,000 associated with the Dr. Eisenstein lawsuit. As we experienced in our 2011 third quarter, we similarly had increased selling and marketing expenses for our new distribution and other products of approximately $206,000 for the first nine months of 2011 as compared to the same period in 2010. Other general overhead approximate reductions included $66,000 in utilities and facility costs and $26,000 in foreign

currency exchange costs due to the elimination of our exposure to the Canadian dollar fluctuations, while also incurring other general overhead approximate increases of $56,000 in insurance premiums, $9,000 in rents, and $7,000 in public company related costs.

Other Income (expense)

	Three months ended September 30		Percentage of sales		Percent	Nine months ended September 30,		Percentage of sales		Percent
(in thousands)	2011	2010	2011	2010	change	2011	2010	2011	2010	change
Interest income (expense)	$(42)	$(58)	(0.7%)	(0.9%)	(27.6%)	$(141)	$(169)	(0.7%)	(0.9%)	(16.6%)
Change in fair value of liabilities, net	$(67)	$182	(1.1%)	2.8%	(136.8%)	$181	$799	0.9%	4.4%	(77.3%)

Index

Our net interest expense decreased by approximately $16,000 or 27.6% in the three months ended September 30, 2011 and decreased by $28,000 or 16.6% for the nine-month period ended September 30, 2011 as compared to the same respective periods in 2010. Our monthly bond principal payments, which are held in a sinking fund until disbursed and applied against the principal balance one time annually, results in a decrease as the effective fixed interest rate is calculated against significantly different principle balances throughout each of the comparative years.

As a result of the change in fair value of the warrants associated with the equity issuance in April of 2010, we recorded a noncash loss of approximately $51,000 for the 2011 third quarter and noncash income of approximately $162,000 for the nine month period ended September 30, 2011. The derivative warrant liability was valued at approximately $332,000 at December 31, 2010 and was valued at approximately $169,000 at September 30, 2011.

Additional changes in fair value were recognized related to the Lican liability, for which we recorded a noncash loss of approximately $16,000 for the 2011 third quarter and noncash income of approximately $19,000 for the nine months ended September 30, 2011. The fair value of the Lican liability as of December 31, 2010 was $172,200 and the fair value as of September 30, 2011 is $153,300.

Income Taxes

(in thousands)	Three months ended September 30,		Percent of sales		Percent	Nine months ended September 30,		Percent of sales		Percent
	2011	2010	2011	2010	change	2011	2010	2011	2010	hange
Income before inc. taxes	$139	$9	2.2 %	0.1 %	1,444 %	$1,423	$(608)	7.4 %	(3.4 %)	334 %
Benefit (Provision) taxes	$(76)	$(5)	(1.2 %)	(0.1 %)	1,420 %	$(439)	$442	(2.3 %)	2.5 %	(199 %)
Effective tax rate	54.0 %	55.5 %				30.9 %	--			

While we are subject to U.S. federal income tax as well as income tax of certain state jurisdictions, during the three and nine months ended September 30, 2011, our current provisions were zero because the net effect of our permanent and temporary differences resulted in us recognizing losses for tax purposes. At September 30, 2011, we have remaining net operating loss carryforward of approximately $3.3 million to reduce any future taxable income earned in various years through the tax year 2030. Our effective tax rate of 30.9% for the nine months ended September 30, 2011 was less than the statutory tax rates primarily because we recognized certain gains from fair value adjustments for financial statement purposes that are not expected to reverse (i.e. they are considered permanent differences).

Net Income (loss)

(in thousands)	Three months ended September 30,		Percent of sales		Percent change	Nine months ended September 30,		Percent of sales		Percent change
	2011	2010	2011	2010		2011	2010	2011	2010	
Net income (loss)	$ 63	$ 4	1.0%	0.1%	1,475%	$ 984	$ (166)	5.1%	(0.9)%	693%

Product Development

We have developed most of our products and product improvements internally. Funds for this development have come primarily from our internal cash flow, equity issuance and from the proceeds of the exercise of stock options. We maintain close working relationships with physicians and medical personnel in hospitals and universities who assist in product research and development. New and improved products play a critical role in our sales growth. We continue to emphasize the development of proprietary products and product improvements to complement and expand our existing product lines. We have a centralized research and development focus in Florida for new product development and product improvements. Our research, development and engineering units at the manufacturing locations maintain relationships with distribution locations and customers to provide an understanding of changes in the market and product needs. During 2011, we continued to invest in the ICON GS™ (J-Plasma™ technology), ICON VS™, vessel sealing technology, and Aaron™ 1450. We intend to pay the ongoing costs for this development from operating cash flows.

At this time, we do not contemplate any material purchase or acquisition of assets during the next twelve months that our ordinary cash flow and/or credit line would be unable to sustain.

Index

Reliance on Collaborative, Manufacturing and Selling Arrangements

We depend on certain contractual OEM customers for product development. In these situations, we plan to manufacture the products developed. The customer has no legal obligation, however, to purchase the developed products. If the collaborative customer fails to give us purchase orders for the product after development, our future business and value of related assets could be negatively affected. Furthermore, we can give no assurance that a collaborative customer may give sufficient high priority to our products. In addition, disagreements or disputes may arise between us and our contractual customers, which could adversely affect production of our products. We also have informal collaborative arrangements with two foreign suppliers in which we request the development of certain items and components, and we purchase them pursuant to purchase orders. Our purchase orders are never longer than one year and are supported by orders from our customers.

Liquidity and Capital Resources

Our working capital at September 30, 2011 increased by approximately $1.3 million to $14.4 million compared to approximately $13.1 million at December 31, 2010. This increase was mainly the result of an increase in cash due to the $750,000 received from the Salient and Medtronic settlement (See below Part II, Item 1. Legal Proceedings) and increased sales, as well as an improvement in our average accounts receivable turnover. Accounts receivable days sales outstanding were 34.8 days and 46.3 days at September 30, 2011 and 2010, respectively. The number of days worth of sales in inventory, which is the total inventory available for production divided by the 12 month average cost of materials, decreased 17 days to 239 days equating to an inventory turn ratio of 1.3 at September 30, 2011 from 256 days and an inventory turn ratio of 1.3 at December 31, 2010. The lower number of days worth of sales is mainly due to the increased conversion of long lead time raw materials to accommodate the nine month period increased sales.

We generated cash from operations of approximately $2.1 million, which included a one time gain on a legal settlement of $750,000, for the nine months ended September 30, 2011, compared to cash used in operations of approximately $1.0 million for the same period of 2010, an increase of approximately $3.1 million.

In the nine month period ended September 30, 2011 we used approximately $459,000 for the purchase of property and equipment as compared to purchases amounting to approximately $350,000 for the same period in 2010.

We used cash from financing activities of approximately $105,000 during the first nine months of 2011, a decrease of approximately $1.9 million compared with the same period in 2010. The decrease in cash from financing resulted primarily from a 2010 private placement sale of our common shares of approximately $2.8 million net of placement costs reduced in the same period by $1 million which was used to pay off our line of credit balance.

We currently have approximately $3.6 million in debt outstanding, which was borrowed under industrial revenue bonds we originally used for the purchase and renovation of our Clearwater, Florida facility, and is collateralized by a mortgage. Subsequently on October 31, 2011 we established new credit facilities with PNC Bank which included a 100% purchase of the industrial revenue bonds by PNC Bank.

The bonds, which are being amortized over a 20-year term, have a balloon payment due upon maturity in December 2018 and bear interest at an effective fixed rate of 5.425% via an embedded derivative interest rate swap. Scheduled maturities of this indebtedness are approximately $70,000 remaining for 2011, and $145,000, $155,000, $160,000 and $165,000 for 2012, 2013, 2014 and 2015, respectively.

We had approximately $5.4 million in cash and cash equivalents at September 30, 2011. We believe our cash on hand, as well as anticipated cash flows from operations, will be sufficient to meet our operating cash commitments for the next year. Should additional funds be required, we have secured additional borrowing capacity with PNC Bank. (see

below)

As of October 31, 2011 we have secured a $6 million revolving line of credit facility with PNC Bank. Previous to this we had an $8 million secured revolving line of credit facility with RBC Bank (USA) which at September 30, 2011 had a zero balance. Advances under our new $6 million line of credit are due on demand and bear interest at a rate of LIBOR plus 1.75% and are secured by a perfected first security interest in our inventory, accounts receivable, and certain other business assets.

Index

In addition we have a separate additional credit facility with PNC Bank for up to $1 million specific to financing new equipment purchases. This credit facility provides for a one year draw up period followed by a 5-year term period and bears interest at LIBOR plus 2.25% and is secured by a perfected first security interest in the new equipment purchased. We also have the option of financing purchased equipment at 90% of the cost through either a traditional loan at the time of purchase.

Subsequent available borrowings for both these line of credit facilities with PNC Bank are subject to a borrowing base utilizing a percentage of eligible receivables, inventories, and any assigned cash along with certain financial ratios, specifically maintaining: a ratio of debt to tangible net worth of less than 2.0 to 1.0, a ratio of total funded debt to EBITDA of less than 3.25 to 1.0 excluding the industrial revenue bond note balance which had an original principal amount of $4.0 million, and a ratio of minimum debt service coverage of 1.5 to 1.0 measured on a rolling four quarter basis.

At September 30, 2011 we were in full compliance with the loan covenants and ratios of both the RBC credit facilities. According to our most recent borrowing base calculation, we had approximately $4.0 million total availability under both the previous $8 million RBC credit line and initially for our current PNC Bank credit line, of which we currently have a zero balance. We also have availability of the full $1 million under the equipment line of credit.

Our future contractual obligations for agreements with initial terms greater than one year and agreements to purchase materials in the normal course of business are summarized as follows (in thousands):

Description	Years Ending December 31,					
	2011	2012	2013	2014	2015	2016
Operating leases	$62	$251	$227	$12	-	-
Employment agreements	250	1,074	1,091	104	-	-
Purchase Commitments	4,357	-	-	-	-	-

Critical Accounting Estimates

In preparing the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”), we have adopted various accounting policies. Our most significant accounting policies are disclosed in Note 2 to the consolidated financial statements included in our report on Form 10-K for the year ended December 31, 2010 which we filed in March 2011.

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Our estimates and assumptions, including those related to inventories, intangible assets, property, plant and equipment, legal proceedings, research and development, warranty obligations, product liability, fair valued liabilities, sales returns and discounts, and income taxes are updated as appropriate, which in most cases is at least quarterly. We base our estimates on historical experience, or various assumptions that are believed to be reasonable under the circumstances and the results form the basis for making judgments about the reported values of assets, liabilities, revenues and expenses. Actual results may materially differ from these estimates.

Estimates are considered to be critical if they meet both of the following criteria: (1) the estimate requires assumptions about material matters that are uncertain at the time the accounting estimates are made, and (2) other materially different estimates could have been reasonably made or material changes in the estimates are reasonably likely to occur from period to period. Our critical accounting estimates include the following:

Inventory reserves

When necessary, we maintain reserves for excess and obsolete inventory resulting from the potential inability to sell our products at prices in excess of current carrying costs. The markets in which we operate are highly competitive, with new products and surgical procedures introduced on an ongoing basis. Such marketplace changes may cause our products to become obsolete. We make estimates regarding the future recoverability of the costs of these products and record a provision for excess and obsolete inventories based on historical experience, and expected future trends. If actual product life cycles, product demand or acceptance of new product introductions are less favorable than projected by management, additional inventory write-downs may be required, which would unfavorably affect future operating results.

Index

Long-lived assets

We review long-lived assets which are held and used, including property and equipment and intangible assets, for impairment whenever changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Such evaluations compare the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset over its expected useful life and are significantly impacted by estimates of future prices and volumes for our products, capital needs, economic trends and other factors that are inherently difficult to forecast. If the asset is considered to be impaired, we record an impairment charge equal to the amount by which the carrying value of the asset exceeds its fair value determined by either a quoted market price, if any, or a value determined by utilizing a discounted cash flow technique.

Liabilities valued at fair value

We have used derivative financial instruments to hedge exposures to cash-flow risks or market-risks (see Note 7). In addition, certain financial instruments, such as warrants, which are indexed to our common stock, are classified as liabilities when either (a) the holder possesses rights to net-cash settlement or (b) physical or net-share settlement is not within our control. In such instances, net-cash settlement is assumed for financial accounting and reporting purposes, even when the terms of the underlying contracts do not provide for net-cash settlement. Such financial instruments are initially recorded, and continuously carried, at fair value. (see Note 5)

Determining the fair value of these instruments involves judgment and the use of certain relevant assumptions including, but not limited to, interest rate risk, historical volatility and stock price, estimated life of the derivative, anti-dilution provisions, and conversion/redemption privileges. The use of different assumptions or changes in those assumptions could have a material effect on the estimated fair value amounts.

Share-based Compensation

Under our stock option plan, options to purchase common shares of common stock of the Company may be granted to our key employees, officers, directors and consultants by the Board of Directors. We account for stock options in accordance with FASB ASC Topic 718 Compensation-Stock Compensation with option expense amortized over the vesting period based on the binomial lattice option-pricing model fair value on the grant date, which includes a number of estimates that affect the amount of our expense.

Income Taxes

The provision for income taxes includes federal, foreign, state and local income taxes currently payable and those deferred because of temporary differences between the financial statement and tax bases of assets and liabilities. Deferred tax assets or liabilities are computed based on the difference between the financial statement and income tax bases of assets and liabilities using enacted marginal tax rates. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized. Deferred income tax expenses or credits are based on the changes in the asset or liability from period to period.

We have net operating loss and tax credit carry forwards available in certain jurisdictions to reduce future taxable income. Future tax benefits for net operating loss and tax credit carry forwards are recognized to the extent that realization of these benefits is considered more likely than not. This determination is based on the expectation that related operations will be sufficiently profitable or various taxes, business and other planning strategies will enable us to utilize the operating loss and tax credit carry forwards. We cannot be assured that we will be able to realize these future tax benefits or that future valuation allowances will not be required. To the extent that available evidence raises doubt about the realization of a deferred income tax asset, a valuation allowance is established.

It is our policy to provide for uncertain tax positions and the related interest and penalties based upon management's assessment of whether a tax benefit is more likely than not to be sustained upon examination by tax authorities. To the extent that the probable tax outcome of these uncertain tax positions changes, such changes in estimate will impact the income tax provision in the period in which such determination is made. At September 30, 2011, we believe we have appropriately accounted for any unrecognized tax benefits. To the extent we prevail in matters for which a liability for an unrecognized tax benefit is established or we are required to pay amounts in excess of the liability, our effective tax rate in a given financial statement period may be affected.

Since inception, we have been subject to tax by both federal and state taxing authorities. Until the respective statutes of limitations expire (which maybe as much as 20 years while we have unused net operating loss carryforwards), we are subject to income tax audits in the jurisdictions in which we operate.

Index

Inflation

Inflation has not materially impacted the operations of our company.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements at this time.

Recent Accounting Pronouncements

See Note 4.

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

Our short-term investments consist of cash, cash equivalents and overnight investments. Additionally, we have an embedded long term interest rate swap related to our subsequent refinancing of our industrial revenue bonds through PNC Bank, which mitigates our exposure to market rate fluctuations and effectively converts our variable rate interest payments on these bonds to a fixed rate. As such we do not believe we are exposed to significant interest rate risk while this interest rate swap remains in place. The primary objective of our investment activities is to preserve principal while at the same time maximizing yields without significantly increasing risk. To achieve this objective, we invest in highly liquid overnight money market investments or short term certificates of deposit. If a 10% change in interest rates were to have occurred on September 30, 2011, this change would not have had a material effect on the fair value of our investment portfolio nor our bond interest expense as of that date.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We have carried out an evaluation, under the supervision of and with the participation of our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended), as of September 30, 2011. Based upon that evaluation, our CEO and CFO concluded that, as of the end of that period, our disclosure controls and procedures are effective in providing reasonable assurance that (a) the information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and (b) such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, our management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Changes in Internal Controls

There were no changes in our internal control over financial reporting (as defined in Rules 13(a)-15(f) and 15(d)-15(f)) during the nine months ended September 30, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On March 3, 2011 we entered into a settlement agreement related to the legal action with Salient Surgical Technologies, Inc. and Medtronic, Inc. The settlement called for us and related parties to immediately exit and not enter into the monopolar and bipolar saline-enhanced RF device business (including SEER™ and BOSS™) worldwide through February 2015. In exchange, the Plaintiffs made a one-time payment to us of $750,000. As a condition, we will not be able to sell certain finished products, which as of the settlement date amounted to approximately $100,000 of our inventory. We have reserved for approximately $87,000 of our inventory related to the products in this settlement in the first quarter of 2011. The terms also include a provision outlining a possible OEM contract manufacturing relationship between Salient and our Company. We currently already have a longstanding OEM contract manufacturing agreement with Medtronic for advanced electrosurgical generators. We have given Medtronic notice that the agreement will terminate at December 31, 2011, with final deliveries occurring in 2012. We will continue to service the generators sold during this contract for the next five years. We anticipate sales of accessories and spare parts to continue into the future.

Index

On July 9, 2010, we filed a complaint in the United States District for the Middle District of Florida (Tampa division) naming Steven Livneh, who at the time was a director of the Company, and two of his related entities as defendants. In our complaint, we are seeking, among other things, a declaratory judgment from the Court concerning our rights under certain agreements entered into with the defendants in 2006 in connection with our acquisition of certain assets and technology, including intellectual property relating to our Seal-N-Cut™ product. We are also seeking damages for breach of contract, breach of fiduciary duty by Mr. Livneh relating to his service as an officer and director of the Company, tortious interference with contractual relations, defamation, slander of title and injunctive relief. Mr. Livneh filed a motion seeking to (a) dismiss the complaint or, in the alternative, to (b) transfer venue. On December 20, 2010 the court issued an order dismissing without prejudice five of our fifteen claims, due to New York being defined in the forum selection clauses in two of the underlying contracts with Mr. Livneh. The Company re-filed these five claims in federal court in New York. Mr. Livneh's motion to dismiss the remaining claims in Florida was denied and the venue was not transferred.

On January 10, 2011 defendant Livneh filed a counter-complaint/third party complaint against us, our CEO, and our COO, alleging fraud, fraud in the inducement, fraudulent misrepresentation, breach of fiduciary duty, negligent misrepresentation, innocent misrepresentation, breach of contract, tortuous interference, shareholder derivative, defamation, breach of good faith and fair dealing, violation of the Uniform Trade Secrets Act, and violation of the Florida Whistleblower's Act, and seeking rescission and a declaratory judgment. In addition to the foregoing relief, defendant also seeks reinstatement of Mr. Livneh to the Company's board of directors, issuance of certain shares of unrestricted stock, compensatory, actual and/or special damages, punitive and/or exemplary damages, and attorney's fees and costs. The outcome of this matter is uncertain and accordingly no effect has been given to any loss that may result from the resolution of this matter in the accompanying consolidated financial statements.

On June 10, 2011 we signed a settlement agreement related to the legal action involving Dr. David Eisenstein, MD under which we paid $53,500 to Dr. Eisenstein and an additional $20,000 directly to his legal counsel for legal fees. In exchange, Dr. Eisenstein surrendered his 5,000 stock options and both parties signed a general release and dismissal.

In September 2011, we were served in a purported stockholder derivative action that was filed in the United State District Court for the Middle District of Florida against the Company and certain of its present and former officers and directors. The complaint asserts, among other things, breach of fiduciary duties and bad faith in relation to the management of the Company. The complaint seeks, among other things, unspecified compensatory damages and various forms of equitable relief. The allegations in the derivative action appear to be based largely on the January 10, 2011 Steven Livneh counterclaim described above. We are reviewing the allegations in the complaint and investigating whether there is a collusive connection between the newly-filed derivative action and the pending lawsuit with Mr. Livneh. We believe the allegations to be frivolous and without merit and we intend to defend the action vigorously. The outcome of this matter is uncertain and accordingly no effect has been given to any loss that may result from the resolution of this matter in the accompanying consolidated financial statements.

In addition to the above, in the normal course of business, we are subject, from time to time, to legal proceedings, lawsuits and claims. Such matters are subject to many uncertainties, and outcomes are not predictable with assurance. Consequently, we are unable to ascertain the ultimate aggregate amount of monetary liability or financial impact with respect to these matters as of September 30, 2011. These matters could affect the operating results of any one or more quarter when resolved in future periods.

ITEM 1A. RISK FACTORS

Our Domestic and International Growth Is Subject to a Number of Economic Risks

Although there have been some recent positive economic indicators over the past nine months when compared to the significant downturn of 2008 and 2009, uncertainty still exists as to the overall rate and stability of the recovery. Global gross domestic product growth continues to be led by emerging markets, particularly in Brazil, Russia, India and China, while in established economies in Europe, the recovery remains sluggish due to the unwinding of fiscal stimuli, lingering high unemployment, concerns over European sovereign debt issues and the tightening of government budgets. As a result our revenues could be affected by further disruptions in Europe or in other economies including domestically.

In the U.S. since the economic downturn, unemployment still remains high and the housing market remains depressed. There can be no assurance that any of the recent economic improvements will be broad-based and sustainable, or that they will enhance conditions in markets relevant to us. Further, there can be no assurance that we will not experience further adverse effects that may be material to our cash flows, competitive position, financial condition, results of operations, or our ability to access capital. These economic developments have not impaired our ability to access credit markets and finance our operations to date, however there can be no assurance that conditions in the future will have not have an impact.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

Index

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. (Removed and Reserved)

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

31.1	Certifications of Andrew Makrides, President and Chief Executive Officer of Registrant pursuant to Rule 13a-14 adopted under the Securities Exchange Act of 1934, as amended, and Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certifications of Gary D. Pickett, Chief Financial Officer of Registrant pursuant to Rule 13a-14 adopted under the Securities Exchange Act of 1934, as amended, and Section 302 of the Sarbanes-Oxley act of 2002.
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.1	Financial Statements from the Quarterly Report on Form 10-Q of Bovie Medical Corporation for the three and nine months ended September 30, 2011, filed on November 14, 2011, formatted in XBRL.

SIGNATURES

Pursuant to the requirements 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.

Bovie Medical Corporation

Dated: November 14, 2011	By:	/s/ Andrew Makrides Andrew Makrides Chief Executive Officer
Dated: November 14, 2011	By:	/s/ Gary D. Pickett Gary D. Pickett Chief Financial Officer