

BOVIE MEDICAL CORP
Form 10-Q
November 14, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended September 30, 2012

OR

☐ 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
(State or other jurisdiction of incorporation or organization)

11-2644611
(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 ☒ No ☐

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 ☒ No ☐

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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 ☐

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☒

(Do not check if a smaller reporting company)

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

☐ No ☒

The number of shares of the registrant's common stock \$.001 par value outstanding as of November 1, 2012 was 17,779,962.

BOVIE MEDICAL CORPORATION

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FOR THE QUARTER ENDED SEPTEMBER 30, 2012

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PART I. FINANCIAL INFORMATION

ITEM 1: FINANCIAL STATEMENTS

BOVIE MEDICAL CORPORATION
CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2012 AND DECEMBER 31, 2011
(in thousands)

Assets

| | September 30, 2012 (Unaudited) | December 31, 2011 |
|---|---|-------------------------|
| Current assets: | | |
| Cash and cash equivalents | \$ 4,488 | \$ 4,880 |
| Trade accounts receivable, net | 2,638 | 2,216 |
| Inventories, net | 7,783 | 8,178 |
| Prepaid expenses and other current assets | 1,033 | 710 |
| Deferred income tax asset, net | 400 | 500 |
| Total current assets | 16,342 | 16,484 |
| Property and equipment, net | 7,120 | 7,176 |
| Brand name and trademark | 1,510 | 1,510 |
| Purchased technology, net | 686 | 752 |
| License rights, net | -- | 26 |
| Deferred income tax asset, net | 1,311 | 1,509 |
| Other assets | 1,071 | 783 |
| Total assets | \$ 28,040 | \$ 28,240 |

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

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BOVIE MEDICAL CORPORATION
CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2012 AND DECEMBER 31, 2011
(CONTINUED) (in thousands)

Liabilities and Stockholders' Equity

| | September 30, 2012 (Unaudited) | December 31, 2011 |
|--|---|-------------------------|
| Current liabilities: | | |
| Accounts payable | \$ 617 | \$ 1,085 |
| Accrued payroll | 105 | 88 |
| Accrued vacation | 241 | 149 |
| Current portion of mortgage note payable to bank | 135 | 130 |
| Current portion of settlement | 279 | 587 |
| Accrued and other liabilities | 553 | 350 |
| Total current liabilities | 1,930 | 2,389 |
| Bonds payable, net of current portion | 3,317 | 3,420 |
| Settlement liability, net of current portion | 23 | 209 |
| Derivative liabilities | 213 | 105 |
| Total liabilities | 5,483 | 6,123 |
| Commitments and Contingencies (see Note 10) | | |
| 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; 17,779,962 and 17,760,724 issued and 17,636,883 and 17,617,645 outstanding on September 30, 2012 and December 31, 2011, respectively | 18 | 18 |
| Additional paid-in capital | 25,465 | 25,356 |
| Deficit | (2,926) | (3,257) |
| Total stockholders' equity | 22,557 | 22,117 |
| Total liabilities and stockholders' equity | \$ 28,040 | \$ 28,240 |

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

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BOVIE MEDICAL CORPORATION
CONSOLIDATED STATEMENT OF OPERATIONS
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011
(unaudited) (in thousands except per share data)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|---------|------------------------------------|----------|
| | 2012 | 2011 | 2012 | 2011 |
| Sales | \$6,671 | \$6,256 | \$20,843 | \$19,252 |
| Cost of sales | 3,777 | 3,650 | 12,297 | 11,167 |
| Gross profit | 2,894 | 2,606 | 8,546 | 8,085 |
| Gain from settlement of litigation | -- | -- | -- | 750 |
| Other costs and expenses: | | | | |
| Research and development | 322 | 288 | 969 | 924 |
| Professional services | 408 | 289 | 1,061 | 906 |
| Salaries and related costs | 781 | 785 | 2,352 | 2,391 |
| Selling, general and administrative | 1,101 | 996 | 3,246 | 3,231 |
| Total other costs and expenses | 2,612 | 2,358 | 7,628 | 7,452 |
| Income from operations | 282 | 248 | 918 | 1,383 |
| Change in fair value of liabilities, net | (135) | (67) | (108) | 181 |
| Interest expense, net | (58) | (42) | (175) | (141) |
| Income before income taxes | 89 | 139 | 635 | 1,423 |
| Provision for income taxes, net | (96) | (76) | (304) | (439) |
| Net income (loss) | \$(7) | \$63 | \$331 | \$984 |
| Earnings (loss) per share | | | | |
| Basic | \$-- | \$-- | \$0.02 | \$0.06 |
| Diluted | \$-- | \$-- | \$0.02 | \$0.06 |
| Weighted average number of shares outstanding- basic | 17,634 | 17,601 | 17,628 | 17,592 |
| Weighted average number of shares outstanding – dilutive | 17,634 | 17,774 | 17,731 | 17,807 |

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

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BOVIE MEDICAL CORPORATION
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
FOR THE YEAR ENDED DECEMBER 31, 2011 AND THE PERIOD ENDED SEPTEMBER 30, 2012
(in thousands)

| | Common Stock Shares | Par Value | Additional Paid-in Capital | Deficit | Total |
|---|------------------------|-----------|----------------------------------|------------|-----------|
| January 1, 2011 | 17,564 | \$ 18 | \$ 25,113 | \$ (3,366) | \$ 21,765 |
| Options exercised | 69 | — | 39 | — | 39 |
| Stock based compensation | — | — | 132 | — | 132 |
| Stock swap to acquire options | (16) | — | (39) | — | (39) |
| Non-cash elimination of Lican restricted stock liability | — | — | 111 | — | 111 |
| Net income | — | — | — | 109 | 109 |
| December 31, 2011 | 17,617 | 18 | 25,356 | (3,257) | 22,117 |
| Options exercised | 26 | — | 17 | — | 17 |
| Stock based compensation | — | — | 109 | — | 109 |
| Stock swap to acquire options | (7) | — | (17) | — | (17) |
| Net income | — | — | — | 331 | 331 |
| September 30, 2012 (unaudited) | 17,636 | \$ 18 | \$ 25,465 | \$ (2,926) | \$ 22,557 |

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

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BOVIE MEDICAL CORPORATION
CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011
(UNAUDITED) (in thousands)

| | 2012 | 2011 |
|---|---------|---------|
| Cash flows from operating activities | | |
| Net income | \$331 | \$984 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 640 | 677 |
| Provision for (recovery of) inventory obsolescence | (19) | 34 |
| (Gain) loss on disposal of property and equipment, net | (41) | 1 |
| Stock based compensation | 109 | 105 |
| Change in fair value of liabilities | 108 | (181) |
| Provision for deferred taxes | 298 | 439 |
| Changes in current assets and liabilities: | | |
| Trade receivables | (422) | (70) |
| Prepaid expenses | (324) | 346 |
| Inventories | 414 | (87) |
| Deposits and other assets | (289) | (68) |
| Accounts payable | (468) | (240) |
| Accrued and other liabilities | (183) | 205 |
| Net cash provided by operating activities | 154 | 2,145 |
| Cash flows from investing activities | | |
| Purchases of property and equipment | (449) | (459) |
| Net cash used in investing activities | (449) | (459) |
| Cash flows from financing activities | | |
| Repayments of long-term bond debt | (97) | (105) |
| Net cash used in financing activities | (97) | (105) |
| Net change in cash and cash equivalents | (392) | 1,581 |
| Cash and cash equivalents, beginning of period | 4,880 | 3,827 |
| Cash and cash equivalents, end of period | \$4,488 | \$5,408 |
| Cash paid during the nine months ended September 30, 2012 and 2011 for: | | |
| Interest | \$175 | \$141 |
| Income taxes | \$-- | \$-- |

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

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BOVIE MEDICAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENT
UNAUDITED

NOTE 1. BASIS OF PRESENTATION

Unless the context otherwise indicates, the terms “we,” “our,” “us,” “Bovie,” and similar terms refer to Bovie Medical 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, 2011. 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, 2011 and December 31, 2011 financial statements have been reclassified to conform to the presentation in the September 30, 2012 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, 2012 and December 31, 2011 were as follows (in thousands):

| | September 30, 2012 | December 31, 2011 |
|--------------------------------|--------------------------|-------------------------|
| Raw materials | \$ 4,750 | \$ 5,127 |
| Work in process | 1,529 | 1,778 |
| Finished goods | 2,028 | 1,825 |
| Gross inventories | 8,307 | 8,730 |
| Less: reserve for obsolescence | (524) | (552) |
| Net inventories | \$ 7,783 | \$ 8,178 |

NOTE 3. INTANGIBLE ASSETS

At September 30, 2012 and December 31, 2011 intangible assets consisted of the following (in thousands):

| | September 30, 2012 | December 31, 2011 |
|-------------------------------------|--------------------------|-------------------------|
| Trade name (life indefinite) | \$ 1,510 | \$ 1,510 |
| Purchased technology (9-17 yr life) | \$ 1,441 | \$ 1,441 |
| Less: accumulated amortization | (755) | (689) |

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| | | | | |
|-------------------------------|----|-------|----|-------|
| Net carrying amount | \$ | 686 | \$ | 752 |
| License rights (5 yr life) | \$ | 316 | \$ | 316 |
| Less accumulated amortization | | (316) | | (290) |
| Net carrying amount | \$ | -- | \$ | 26 |

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NOTE 3. INTANGIBLE ASSETS (continued)

Amortization of intangibles, which is included in depreciation and amortization in the accompanying statements of cash flows, was approximately \$92,600 and \$129,000 during the respective nine month periods ended September 30, 2012 and 2011.

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. On January 1, 2012, ASU 2011-05 became effective. At this time, we do not have comprehensive income, therefore, the change did not affect our presentation nor 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. On January 1, 2012, ASU 2011-04 became effective. This amendment did not 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. On January 1, 2012, ASU No. 2011-08 became effective. This update did not have a material impact on our consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-11 which amended the disclosure requirements regarding offsetting assets and liabilities of derivatives, sale and repurchase agreements, reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. The enhanced disclosures will require entities to provide both net and gross information for these assets and liabilities. The amendment is effective for fiscal years beginning on or after January 1, 2013. The Company does not anticipate that this amendment will have a material impact on its financial statements.

In July 2012, the FASB issued ASU No. 2012-02, Intangibles—Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment. This update simplifies the guidance for testing the impairment of indefinite-lived intangible assets other than goodwill. The amendments in ASU 2012-02 allow an organization the option to first assess qualitative factors to determine whether it is necessary to perform the quantitative impairment test. An organization electing to perform a qualitative assessment is no longer required to calculate the fair value of an indefinite-lived intangible asset unless the organization determines, based on a qualitative assessment, that it is “more

likely than not” that the asset is impaired. The amendment is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. We will adopt the revised accounting guidance effective October 1, 2012, and we do not anticipate that its adoption will have a material impact on our 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, 2012 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

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NOTE 5.

FAIR VALUE MEASUREMENTS (continued)

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).

The following table summarizes our financial instruments measured at fair value as of September 30, 2012 (in thousands):

| | | September 30, 2012 | | | |
|--------------------------------------|----------|-------------------------|---------|---------|--|
| | | Fair Value Measurements | | | |
| | Total | Level 1 | Level 2 | Level 3 | |
| Assets: | | | | | |
| Cash and equivalents – United States | \$ 4,488 | \$ 4,488 | \$ – | \$ – | |
| Total assets | \$ 4,488 | \$ 4,488 | \$ – | \$ – | |
| Liabilities: | | | | | |
| Warrant liability (1) | \$ 213 | \$ – | \$ – | \$ 213 | |
| Total liabilities | \$ 213 | \$ – | \$ – | \$ 213 | |

The following table summarizes our financial instruments measured at fair value as of December 31, 2011 (in thousands):

| | | December 31, 2011 | | | |
|---|----------|-------------------------|---------|---------|--|
| | | Fair Value Measurements | | | |
| | Total | Level 1 | Level 2 | Level 3 | |
| Assets: | | | | | |
| Cash and equivalents – United States | \$ 4,870 | \$ 4,870 | \$ – | \$ – | |
| Cash and equivalents - Foreign currency | 10 | 10 | – | – | |
| | | | | | |
| Total assets | \$ 4,880 | \$ 4,880 | \$ – | \$ – | |
| | | | | | |
| Liabilities: | | | | | |
| Warrant liability (1) | \$ 105 | \$ – | \$ – | 105 | |
| | | | | | |
| Total liabilities | \$ 105 | \$ – | \$ – | 105 | |

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

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NOTE 5. FAIR VALUE MEASUREMENTS (continued)

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

| Description | September 30, 2012 | December 31, 2011 |
|--|--------------------------|-------------------------|
| Beginning balance | \$ 105 | \$ 504 |
| Purchases, issuances, and settlements (Note 6) | -- | -- |
| Reduced Lican liability from settlement | -- | (111) |
| Total loss (gain) included in earnings (2) | 108 | (288) |
| Ending Balance | \$ 213 | \$ 105 |

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

NOTE 6. WARRANTS AND STOCKHOLDERS' EQUITY

On April 18, 2010, we entered into a securities purchase agreement with purchasers named therein to raise in the aggregate approximately \$3 million 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, 2012 included an expected remaining life of 3 years, an expected dividend

yield of zero, estimated volatility range between 41% - 43%, and risk-free rates of return range between 0.31% - 0.40%. 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, 2012, we issued 19,238 common shares in exchange for 26,000 non-employee stock options (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, 2012.

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NOTE 7. EARNINGS PER SHARE (in thousands, except EPS)

We compute basic earnings per share ("basic EPS") by dividing net income by the weighted average number of common shares outstanding for the reporting period. Diluted earnings 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 per share for the three month and nine month periods ending September 30, 2012 and 2011.

| (in thousands, except EPS) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|--------|------------------------------------|---------|
| | 2012 | 2011 | 2012 | 2011 |
| Net income (loss) | \$ (7) | \$ 63 | \$ 331 | \$ 984 |
| Basic weighted average shares outstanding | 17,634 | 17,601 | 17,628 | 17,592 |
| Effect of potential dilutive securities | -- | 173 | 103 | 215 |
| Diluted weighted average shares outstanding | 17,634 | 17,774 | 17,731 | 17,807 |
| Basic EPS | \$ -- | \$ -- | \$ 0.02 | \$ 0.06 |
| Diluted EPS | \$ -- | \$ -- | \$ 0.02 | \$ 0.06 |

For the nine months ended September 30, 2012 and 2011, options and warrants to purchase approximately 778,000 and 1,000,000 shares of common stock respectively, were excluded from the computation of diluted earnings per share because their effects were anti-dilutive.

NOTE 8. 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, 2012, we expensed approximately \$109,000 in stock-based compensation.

Activity in our stock options during the period ended September 30, 2012 was as follows:

| | Number Of Options (in thousands) | Weighted Average Exercise Price |
|-----------------------------------|---|--|
| Outstanding at December 31, 2011 | 1,533 | \$ 3.99 |
| Granted | 279 | \$ 2.58 |
| Exercised | (26) | \$ 0.70 |
| Cancelled | (5) | \$ 7.33 |
| Outstanding at September 30, 2012 | 1,781 | \$ 3.80 |

The grant date fair value of options granted during the first nine months of 2012 were estimated on the grant date using a binomial lattice option-pricing model and the following assumptions: expected volatility of 43%, expected term of between 3-5 years, risk-free interest rate of 0.4%, and expected dividend yield of 0%.

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NOTE 8.

STOCK-BASED COMPENSATION (continued)

Expected volatility is based on a weighted average of the historical volatility of the Company's stock and peer company volatility. The weighting percentages relative to our stock and the peer group is a 50%/50% weighting. Our peer group has remained relatively the same throughout our calculations year over year, and a peer is only replaced with a similar peer company if it is removed from the public stock exchanges or no longer has significantly traded volume on the open stock options market. 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. The Company uses historical data to estimate pre-vesting forfeiture rates.

NOTE 9.

INCOME TAXES

While we are subject to U.S. federal income tax as well as income tax of certain state jurisdictions, during the nine months ended September 30, 2012, our current provision was zero because the net effect of our permanent and temporary differences resulted in us recognizing a loss for tax purposes. However, for the three month period ended September 30, 2012, permanent differences related to fair value adjustments resulted in us recognizing a gain for tax purposes and our current provision was approximately \$96,000. At September 30, 2012, we have remaining net operating loss carryforwards and other net deferred income tax assets of approximately \$2.9 million to reduce future taxable income. Our effective tax rate of 47.7% for the nine months ended September 30, 2012 was greater than the statutory tax rates primarily because we recognized certain losses from the fair value adjustments for financial statement purposes that are not expected to reverse (i.e. permanent differences).

NOTE 10.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 as of September 30, 2012 for the calendar years ended December 31, 2012, 2013, 2014, and 2015 (in thousands):

| | | |
|-------|----|-----|
| 2012 | \$ | 64 |
| 2013 | | 228 |
| 2014 | | 12 |
| 2015 | | -- |
| Total | \$ | 304 |

Rent expense approximated \$139,000 and \$148,000 for the nine month periods ending September 30, 2012 and 2011, respectively.

Additionally, we amended the manufacturing agreement with our Bulgarian foreign supplier which, as of March 1, 2012, provides for certain contingent liabilities on our part if we terminate our arrangement prior to July 1, 2014. The table below reflects our approximate contingent liability for the calendar years ended December 31, 2012, 2013, and 2014 (in thousands):

| | | |
|------|----|-----|
| 2012 | \$ | 29 |
| 2013 | | 128 |
| 2014 | | 73 |

| | | |
|-------|----|-----|
| Total | \$ | 230 |
|-------|----|-----|

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NOTE 10.

COMMITMENTS AND CONTINGENCIES (continued)

Livneh/Lican Development Settlement

As previously reported, in December 2011, a settlement related to a litigation we were involved in with Steve Livneh ("Livneh") a former director and certain entities owned by him, was structured and subsequently entered into on February 22, 2012. Under the terms of the Settlement Agreement (the "Settlement Agreement"), the Company will, among other things, perform the following: (i) make a \$250,000 lump sum payment to Livneh (\$50,000 of which was previously recorded and expensed), (ii) make 18 installment payments to Livneh in the amount of \$23,222.22 per month, (iii) reimburse Livneh for all unpaid expenses that Livneh incurred on behalf of the Company during the period of his employment and/or consultancy (from October 1, 2006 through August 11, 2010), (iv) pay Livneh \$14,700, which represents the balance of the amounts due to Henvil Corp. Ltd. under a certain bill of sale, dated April 12, 2010, (v) transfer to Livneh the title of a certain automobile, (vi) transfer to Livneh all of the Company's right and interest in certain Intellectual Property (as defined in the Settlement Agreement) pertaining to the Modular Ergonomic Grip ("MEG"), Modullion, RF Skin Resurfacing, Scannula, Double Jaw Forceps and Tip-On-Tube designs and trade name (collectively, the "Assigned Patents"), (vi) transfer to Livneh certain parts for the MEG device, (vii) grant Livneh an exclusive license to produce, market and sell the Seal-N-Cut device in the People's Republic of China, (viii) pay to Livneh royalty payments of 3% on the Company's Net Sales (as defined in the Settlement Agreement) of the Seal-N-Cut device outside the People's Republic of China, and (ix) pay to Livneh a one-time royalty payment of 5% upon the closing of any sale by the Company of its right or interest in any Intellectual Property pertaining to the Seal-N-Cut device. To secure the Company's obligations, the Company granted Livneh a security interest in all of its rights and interest of the Company in the Seal-N-Cut device, including all Intellectual Property pertaining thereto. Since the loss was quantifiable and known in December 2011, we recognized this settlement loss in 2011 and all payments hereunder were accrued during the fourth quarter.

In exchange, Livneh agreed, among other things, to perform the following: (i) pay to the Company royalty payments of 3% on Livneh's Net Sales of the Assigned Patents, excluding any Net Sales of the RF Skin Resurfacing or Tip-On-Tube, (ii) pay to the Company a one-time royalty payment of 5% upon the closing of any sale by Livneh, Henvil or Lican Development Ltd. of their right or interest in any Intellectual Property pertaining to the Assigned Patents, and (iii) pay to the Company royalty payments of 3% on Livneh's Net Sales of the Seal-N-Cut device in the People's Republic of China.

The Settlement Agreement contains no admission of liability or wrongdoing by any party to the litigation. Pursuant to the Settlement Agreement, the Company, Mr. Makrides, Mr. Citronowicz, Livneh, Henvil and Lican agreed to dismiss the litigation with prejudice and they fully and finally released all claims known and unknown, foreseen and unforeseen, which they had against each other through the date of the Settlement Agreement.

Our future installment payment obligations related to this settlement as of September 30, 2012 for the calendar years ended December 31, 2012 and 2013 (in thousands):

| | | |
|-----------|----|-----|
| Current | \$ | 279 |
| Long Term | | 23 |
| Total | \$ | 302 |

As previously reported, the Company's position is that we have complied with the Settlement Agreement by having paid the initial \$250,000 lump sum and the \$14,700 due to Henvil, transferred the related inventory, initiated the transfer of other assets and patents as outlined in the Settlement Agreement, and by making installment payments commencing on May 1, 2012.

In July 2012, Steven Livneh and two of his related entities, Henvil Corp. Ltd. and Lican Development Ltd., commenced a new action against the Company, Andrew Makrides, the Company's Chief Executive Officer, and Moshe Citronowicz, the Company's Senior Vice President of Operations, in the United States District Court for the Middle District of Florida (Tampa division). The complaint asserts, among other things, that (i) the defendants breached their obligations to the plaintiffs under the Settlement Agreement by allegedly failing to take certain actions that facilitated the plaintiffs' marketing and sale of the Seal-N-Cut products in the People's Republic of China, (ii) that defendants tortiously interfered with plaintiffs' Chinese business relationships and expectations allegedly by, among other things, refusing to provide plaintiffs with an ICON VS generator and (iii) plaintiffs allegedly suffered damages, as a result of defendants' misrepresentations. The complaint seeks, among other things, the following: (i) unspecified compensatory damages in excess of \$4 million, (ii) providing plaintiffs with all ICON VS generators, (iii) an assignment to plaintiffs of all patents identified in the Settlement Agreement and (iv) a rescission of the Settlement Agreement. 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, no range of potential loss can be estimated 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.

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NOTE 10.

COMMITMENTS AND CONTINGENCIES (continued)

On July 24, 2012, the Company filed a motion to dismiss the complaint and to compel arbitration. The plaintiff opposed the motion, and the motion was subsequently withdrawn as moot due to the non-availability of the stipulated arbitrator.

Stockholder Derivative Action

As previously reported, in September 2011, we were served in a purported stockholder derivative action that was filed in the United States District Court for the Middle District of Florida against the Company, as a nominal defendant, and certain of its present and former officers and directors. The complaint asserts, among other things against the individual defendants, breach of fiduciary duties and bad faith in relation to the management of the Company. The complaint seeks, among other things against the individual defendants, 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 Livneh counterclaim described above.

On March 29, 2012, plaintiffs amended their complaint to remove one of the plaintiffs and replace it with another. The amended complaint asserts essentially the same allegations as the original filing. We believe the allegations to be frivolous and without merit and we intend to defend the action vigorously. We are investigating whether there is a collusive connection between the derivative action and the previously settled lawsuit with Livneh. While no claims are asserted directly against the Company, the Company may have certain indemnification obligations to the individual defendants with respect to amounts paid by the individual defendants in connection with the litigation. The outcome of this matter is uncertain, no range of potential loss can be estimated 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 May 2012, the Company and the individual defendants filed a motion to dismiss the plaintiff's complaint based, in part, upon the plaintiff's failure to make demand upon the board as required by applicable law. The motion was denied and the parties are proceeding with discovery.

Keen Action

In February 2012, we received notice that an action had been commenced against us in United States District Court for the Middle District of Florida, by Leonard Keen, our former Vice President and General Counsel, related to his termination on December 9, 2011 and associated employment contract. Mr. Keen is demanding amounts outlined

under his employment contract which provided for the payment of a base annual salary of not less than \$187,500 as well as certain other payments and benefits. The employment agreement also provided for the payment, under certain circumstances, of a lump sum severance payment equal to three times base compensation plus certain other payments and benefits as set forth in the employment agreement under severance payment. Mr. Keen also asserts a claim concerning an alleged violation of the Florida "Whistle Blower's Act" and seeks specific performance of certain indemnification rights under his employment agreement. On April 27, 2012, we filed our answers with counterclaim in this action.

On July 3, 2012, plaintiff amended the complaint to add Andrew Makrides, the Company's Chief Executive Officer, as a defendant. The amended complaint asserts essentially the same allegations as the original filing but asserts additional claims concerning (i) an alleged violation of ERISA and (ii) an alleged tortious interference with the plaintiff's employment contract by Andrew Makrides. We believe we have meritorious defenses against Mr. Keen's claims and are vigorously defending this action. 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, however the range of potential loss is zero to approximately \$600,000 plus possible attorney fees which are not determinable at this time.

On July 16, 2012, the Company filed a motion to dismiss the amended complaint. In August 2012, the court issued a decision, dismissing the claim against Mr. Makrides as well as the claim alleging breach by the Company of the implied covenant of good faith. Discovery in the action is proceeding on the remaining claims.

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NOTE 10.

COMMITMENTS AND CONTINGENCIES (CONTINUED)

In addition to the above, in the normal course of business, we are subject, from time to time, to legal proceedings. 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, 2012. These matters could affect the operating results of any one or more quarters when resolved in future periods.

We expense costs of litigation related to contingencies in the periods in which the costs are incurred.

NOTE 11.

RELATED PARTY TRANSACTION

Two of our former board of directors were considered related parties to whom we paid consulting fees during the nine months ended September 30, 2012. Both of these directors resigned in March 2012. We paid consulting fees of approximately \$20,000 to an entity owned by one of the former directors and \$7,500 directly to the other former director during the time period that they were acting as a director.

End of financial statements

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 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, 2011, 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;

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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 the 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, Medical Illumination (MII) Lighting, laparoscopic instruments, 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 approximately 18.8% of total revenues for the first nine months of 2012, as compared with approximately 22.7% for the first nine months of 2011. 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 / J-Plasma 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, 2012 Compared to Three and Nine Months Ended September 30, 2011

Sales

| Sales by Product Line (in thousands) | Three months ended | | | Percent change | Nine months ended | | | Percent change | | |
|---|-----------------------|-----------------------|----|-------------------|-----------------------|-----------------------|--------|-------------------|--------|------|
| | September 30, 2012 | September 30, 2011 | | | September 30, 2012 | September 30, 2011 | | | | |
| Electrosurgical | \$ | 4,149 | \$ | 3,989 | 4.0% | \$ | 13,417 | \$ | 12,905 | 4.0% |

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| | | | | | | |
|-----------|----------|----------|--------|-----------|-----------|-------|
| Cauteries | 1,878 | 1,577 | 19.1% | 5,181 | 4,720 | 9.8% |
| Other | 644 | 690 | (6.7)% | 2,245 | 1,627 | 38.0% |
| Total | \$ 6,671 | \$ 6,256 | 6.6% | \$ 20,843 | \$ 19,252 | 8.3% |

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| Sales by Domestic and International (in thousands) | Three months ended | | | Percent change | Nine months ended | | | Percent change |
|---|--------------------|----------|---------------|-------------------|-------------------|-----------|---------------|-------------------|
| | September 30, | | September 30, | | September 30, | | September 30, | |
| | 2012 | 2011 | | | 2012 | 2011 | | |
| Domestic | \$ 5,308 | \$ 5,024 | | 5.7% | \$ 16,865 | \$ 14,835 | | 13.7% |
| International | 1,363 | 1,232 | | 10.6% | 3,978 | 4,417 | | (9.9)% |
| Total | \$ 6,671 | \$ 6,256 | | 6.6% | \$ 20,843 | \$ 19,252 | | 8.3% |

During the three months ended September 30, 2012, we experienced increases in demand in both of our primary product line categories. The largest dollar sales increases occurred in our cauteries category amounting to approximately \$301,000, or a 19.1% increase for the three months ended September 30, 2012 compared to the same period in 2011. The 4.0% sales increase experienced in our electrosurgical category during the three months ended September 30, 2012 compared to the same period in 2011, was mainly attributable to increased demand for our electrosurgical generators both internationally and with our domestic OEM customer amounting to approximately \$160,000. We experienced a 6.7% decrease, or approximately \$46,000, in our “other products” category sales for the three months ended September 30, 2012 when compared to the same period in 2011.

Sales during the nine months ended September 30, 2012 increased approximately \$1.6 million or 8.3% compared to the same period in 2011. Our largest dollar sales increase which approximated \$618,000 or 38% was in our “other products” category. This increase was also related to the sales trend of our new medical lighting systems and laproscopic instruments, amounting to increases of approximately \$523,000 and \$48,000 respectively. Some additional contributing factors to these increases were in various other products as well as engineering consulting services for which the combined net increase approximated \$47,000 for the nine months ended September 30, 2012 as compared to the same period in 2011. The stronger demand for our OEM domestic electrosurgical generators we saw at the beginning of the year continued through the nine months ended September 30, 2012 and resulted in a 4.0% sales increase in our electrosurgical category, or approximately \$513,000 when compared to the same period in 2011. Our trend of increased demand from our domestic customers for cauteries continued through the nine months ended September 30, 2012 amounting to approximately \$461,000 or 9.8% when compared to the same period in 2011.

Our ten largest customers accounted for approximately 66% of net revenues for the nine months ended September 30, 2012 and 67% for the same period in 2011. At September 30, 2012 and 2011, our ten largest trade receivables accounted for approximately 62% and 67% of our net receivables, respectively. During the first nine months of 2012, two of our customers each accounted for 11% of total sales. No customer accounted for greater than 10% of our sales for the same period ending September 30, 2011.

Gross Profit

| (in thousands) | Three months ended | | | Percent of sales | Percent change | Nine months ended | | | Percent of sales | Percent change |
|----------------|--------------------|---------|---------------|------------------|----------------|-------------------|----------|---------------|------------------|----------------|
| | September 30, | | September 30, | | | September 30, | | September 30, | | |
| | 2012 | 2011 | | 2012 | 2011 | 2012 | 2011 | | 2012 | 2011 |
| Cost of sales | \$3,777 | \$3,650 | 56.6 % | 58.3 % | 3.5 % | \$12,297 | \$11,167 | 59.0 % | 58.0 % | 10.1 % |
| Gross profit | \$2,894 | \$2,606 | 43.4 % | 41.7 % | 11.1 % | \$8,546 | \$8,085 | 41.0 % | 42.0 % | 5.7 % |

In addition to our increased overall sales, our gross profit also increased as a percentage of sales by approximately 1.7% or \$288,000 for the three months ended September 30, 2012 as compared to the same period in 2011. This increase is mainly attributable to higher sales of higher profit margin products which are offset by increased costs of goods sold expenses in areas of direct labor, health insurance, and direct and indirect J-Plasma product line costs, all

totaling approximately \$127,000 during the three months ended September 30, 2012 as compared to the same period in 2011.

Our gross profit for the nine months ended September 30, 2012 increased by approximately \$461,000, or 5.7%, as compared to the same period in 2011. Although our gross profit was an increase in actual dollars it amounted to a 1% decrease as a percentage of sales, which was primarily attributable to higher sales of lower profit margin OEM generators during the period, lower sales of our higher profit margin generators sold through distribution during the period, a 70% cost of sales attributable to the additional medical lighting systems sales which we only began selling in the third quarter of 2011, and increases related to direct and indirect costs in the initial manufacture and roll out of our J-Plasma product line.

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Other Gain

Salient/Medtronic Settlement

During the nine months ended September 30, 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 TM) worldwide through February 2015. In exchange, Salient made a one-time payment to us of \$750,000.

Research and Development Expense

| (in thousands) | Three months ended | | Percent of sales | | | Nine months ended | | Percent of sales | | |
|----------------|--------------------|--------|------------------|------|----------------|-------------------|--------|------------------|------|----------------|
| | September 30, | | | | | September 30, | | | | |
| | 2012 | 2011 | 2012 | 2011 | Percent change | 2012 | 2011 | 2012 | 2011 | Percent change |
| R & D Expense | \$ 322 | \$ 288 | 4.8% | 4.6% | 11.8% | \$ 969 | \$ 924 | 4.6% | 4.8% | 4.9% |

We experienced an increase in research and development costs approximating \$34,000 or 11.8% in the three months ended September 30, 2012 as compared to the same period in 2011, which were directly related to increased engineering labor, consulting, and testing costs related to advancing the J-Plasma product line as well as other new products.

During the nine months ended September 30, 2012, we experienced a 4.9% increase in research and development costs, or approximately \$45,000, when compared to the same period in 2011. This increase, similar to our experience in the recent quarter, was mainly related to increased engineering labor, consulting, and testing costs with our other new products as well as advancing the J-Plasma product line.

Professional Services

| (in thousands) | Three months ended | | | | | Nine months ended | | | | |
|-----------------------|--------------------|--------|------------------|------|----------------|-------------------|--------|------------------|------|----------------|
| | September 30, | | Percent of sales | | Percent change | September 30, | | Percent of sales | | Percent change |
| | 2012 | 2011 | 2012 | 2011 | | 2012 | 2011 | 2012 | 2011 | |
| Professional services | \$ 408 | \$ 289 | 6.1% | 4.6% | 41.2% | \$ 1,061 | \$ 906 | 5.1% | 4.7% | 17.1 % |

We experienced an increase of approximately \$119,000, or 41.2% in our professional services costs during the three months ended September 30, 2012 when compared to the same period in 2011. The main area of increase was in legal fees where we experienced an approximate increase of \$133,000 primarily attributable to litigation expenses. This increase was offset by a reduction in accounting and auditing costs of approximately \$14,000.

Our professional services costs for the nine months ended September 30, 2012 increased by approximately \$155,000, or 17.1%, mainly due to increased legal fees related to existing lawsuits when compared to the same nine month period in 2011.

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Salaries

| (in thousands) | Three months ended | | Percent of sales | | Percent change | Nine months ended | | Percent of sales | | Percent change |
|-------------------------|--------------------|--------|------------------|-------|----------------|--------------------|----------|------------------|-------|----------------|
| | September 30, 2012 | 2011 | 2012 | 2011 | | September 30, 2012 | 2011 | 2012 | 2011 | |
| Salaries & related cost | \$ 781 | \$ 785 | 11.7% | 12.5% | (0.5)% | \$ 2,352 | \$ 2,391 | 11.3% | 12.4% | (1.6)% |

During the three months ended September 30, 2012, we had two additional sales positions which were offset by a reduction in in-house legal salaries, as compared to the same period in 2011, which resulted in our salaries expense in dollars remaining relatively the same.

We experienced a net 1.6% decrease in salaries and related costs, or approximately \$39,000, during the nine months ending September 30, 2012 as compared to the same period in 2011 for similar reasons previously mentioned and experienced during the quarter.

Selling, General & Administrative Expenses

| (in thousands) | Three months ended | | Percent of sales | | Percent change | Nine months ended | | Percent of sales | | Percent change |
|----------------|--------------------|--------|------------------|-------|----------------|--------------------|----------|------------------|-------|----------------|
| | September 30, 2012 | 2011 | 2012 | 2011 | | September 30, 2012 | 2011 | 2012 | 2011 | |
| SG & A costs | \$ 1,101 | \$ 996 | 16.5% | 15.9% | 10.5% | \$ 3,246 | \$ 3,231 | 15.6% | 16.8% | 0.5% |

Our selling, general and administrative costs increased by approximately \$105,000, or 10.5% for the three months ended September 30, 2012 as compared to the same period in 2011. This overall increase was the net result of the following approximate offsetting amounts:

- a \$61,000 decrease in bank fees and other various overhead related costs along with a gain on disposition of assets;
- increases in rental fees, shareholder and stock exchange related costs, obsolete inventory provisions, general insurance, and various other overhead related costs amounting to approximately \$144,000;
 - a \$14,000 decrease in regulatory costs related to the support of our distribution and new product sales;
 - a \$21,000 decrease in amortization costs related to the Meg product line which was written-off last year;
- a \$15,000 net increase in selling and marketing costs which includes trade shows, sales travel both international and domestic, and advertising; and
 - a \$42,000 increase in commission expense due to increased distribution sales;

For the nine months ending September 30, 2012, we experienced an increase of approximately \$15,000, or 0.5% in selling, general and administrative costs as compared to the same period in 2011. This slight overall increase was the net result of the following approximate offsetting amounts:

- a \$152,000 decrease in bank fees, general insurance from a premium reduction, royalty expense, obsolete inventory provisions, building maintenance utilities, and other various overhead related costs along with a gain on disposition of assets;
 - a \$65,000 decrease in regulatory costs related to the support of our distribution and new product sales;
 - a \$37,000 decrease in amortization costs related to the Meg product line which was written-off last year;
- a \$56,000 decrease in miscellaneous cost related to the 2011 one time legal settlement which was absent for the same period 2012;

- increases in computers and software, rental fees, general insurance, shareholder and stock exchange related costs, and various other overhead related costs amounting to approximately \$101,000;
- a \$159,000 increase in selling and marketing costs related to our existing products along with our new J-Plasma line of products, which includes trade shows, sales travel both international and domestic, and advertising; and
 - a \$66,000 increase in commission expense due to increased distribution sales;

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Other Income

| (in thousands) | Three months ended | | Percent of | | Percent change | Nine months ended | | Percent of | | Percent change |
|-------------------------------------|--------------------|----------|------------|---------|----------------|--------------------|----------|------------|--------|----------------|
| | September 30, 2012 | 2011 | 2012 | 2011 | | September 30, 2012 | 2011 | 2012 | 2011 | |
| Net interest expense | \$ (58) | \$ (42) | (0.9)% | (0.7)% | 38.1% | \$ (175) | \$ (141) | (0.8)% | (0.7)% | 24.1% |
| Change in fair value of liabilities | \$ (135) | \$ (67) | (2.0)% | (1.1) % | 101.5% | \$ (108) | \$ 181 | (0.5)% | 0.9% | 159.7% |

Net interest expense increased by approximately \$16,000 or 38.1% in the three months ended September 30, 2012 as compared to the same period in 2011. The increase was mainly due to slightly higher interest rates and amortization of charges due to refinancing of the industrial revenue bonds in late 2011.

For the nine-month period ended September 30, 2012 as compared to the same period in 2011, net interest expense increased by \$34,000. The increase was mainly due to slightly higher interest rates and amortization of charges due to refinancing of the industrial revenue bonds in late 2011.

The change in fair value of liabilities was related to the warrants associated with our equity issuance in April 2010. The derivative warrant liability was valued at approximately \$105,000 at December 31, 2011 and was valued at approximately \$213,000 on September 30, 2012 resulting in a year-to-date loss of approximately \$108,000.

Income Taxes

| (in thousands) | Three months ended | | Percent of | | Percent change | Nine months ended | | Percent of | | Percent change |
|---------------------------------|--------------------|---------|------------|---------|----------------|--------------------|----------|------------|---------|----------------|
| | September 30, 2012 | 2011 | 2012 | 2011 | | September 30, 2012 | 2011 | 2012 | 2011 | |
| Income before income taxes | \$89 | \$139 | 1.3 % | 2.2 % | (36.0)% | \$635 | \$1,423 | 3.0 % | 7.4 % | (55.4)% |
| Provision for income taxes, net | \$(96) | \$(76) | (1.4)% | (1.2)% | 26.3 % | \$(304) | \$(439) | (1.5)% | (2.3)% | 30.8 % |
| Effective tax rate | 107.9 % | 54.7 % | | | | 47.9 % | 30.9 % | | | |

While we are subject to U.S. federal income tax as well as income tax of certain state jurisdictions, during the nine months ended September 30, 2012, our current provision was zero because the net effect of our permanent and temporary differences resulted in us recognizing a loss for tax purposes. However, for the three month period ended September 30, 2012, permanent differences related to fair value adjustments resulted in us recognizing a gain for tax purposes and our current provision was approximately \$96,000. At September 30, 2012, we have remaining net operating loss carryforwards and other net deferred income tax assets of approximately \$2.9 million to reduce future taxable income. Our effective tax rate of 47.9% for the nine months ended September 30, 2012 was greater than the statutory tax rates primarily because we recognized certain losses from the fair value adjustments for financial

statement purposes that are not expected to reverse (i.e. permanent differences).

Net Income

| (in thousands) | Three months ended | | | Percent of sales | | | Percent change | | | Nine months ended | | | Percent of sales | | | Percent change | | |
|-------------------|--------------------|-----|----|------------------|--------|------|----------------|----|------|-------------------|-----|------|------------------|---------|------|----------------|--|------|
| | September 30, | | | 2012 | | 2011 | 2012 | | 2011 | September 30, | | | 2012 | | 2011 | 2012 | | 2011 |
| Net income (loss) | \$ | (7) | \$ | 63 | (0.1)% | 1.0% | (111.1)% | \$ | 331 | \$ | 984 | 1.6% | 5.1% | (66.4)% | | | | |

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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 and equity issuances. 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 2012, we continued to invest in expanding our J-Plasma product line and technology, ICON VS™ and the accompanying 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.

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 two collaborative arrangements with foreign suppliers, one informal and one contractual, 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. We recently amended the manufacturing agreement with our Bulgarian supplier, which as of March 1, 2012, may result in certain contingent liabilities on our part if we terminate our arrangement prior to July 1, 2014 (see Note 10).

Liquidity and Capital Resources

Our working capital at September 30, 2012 increased by approximately \$0.3 million to \$14.4 million compared to approximately \$14.1 million at December 31, 2011. This increase was mainly the result of a decrease in inventory purchases and increased sales. Accounts receivable days of sales outstanding were 39.1 days and 34.8 days at September 30, 2012 and 2011, 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 13 days to 224 days equating to an inventory turn ratio of 1.5 at September 30, 2012 from 237 days and an inventory turn ratio of 1.3 at December 31, 2011. The lower number of days worth of sales is mainly due to the increased conversion of raw materials to accommodate the nine month period increased sales.

We generated cash from operations of approximately \$0.2 million for the nine months ended September 30, 2012, compared to cash generated from operations of approximately \$2.1 million for the same period in 2011, which included a one time gain of \$750,000 resulting from a legal settlement, a decrease of approximately \$1.9 million.

During the nine month period ended September 30, 2012, we used approximately \$450,000 for the purchase of property and equipment as compared to purchases amounting to approximately \$459,000 for the same period in 2011.

We used cash from financing activities of approximately \$97,000 during the first nine months of 2012, a decrease of approximately \$8,000 as compared with the same period in 2011. The decrease in cash from financing activities resulted primarily from lower net payments related to our long-term bonds.

We currently have approximately \$3.5 million outstanding under industrial revenue bonds which we previously used for the purchase and renovation of our Clearwater, Florida facility. These bonds were refinanced in October 2011 through PNC Bank, N.A. The bonds, which are being amortized over a 20-year term, balloon in November 2018 and bear interest at a fixed interest rate of 5.6%. Scheduled maturities of this indebtedness are \$33,300, \$137,300, \$145,000, \$153,100 and \$161,700 for 2012, 2013, 2014, 2015 and 2016, respectively and approximately \$2.8 million thereafter.

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We had approximately \$4.5 million in cash and cash equivalents at September 30, 2012. 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 twelve months. Should additional funds be required, we have secured additional borrowing capacity with PNC Bank (See below).

We have a \$6 million secured revolving line of credit facility with PNC Bank, which at September 30, 2012 had a zero balance. Advances under the \$6 million line of credit are due on demand and bear interest at a rate of daily LIBOR plus 1.75% and are secured by a perfected first security interest in our inventory and accounts receivable.

In addition we have a separate credit facility with PNC Bank for up to \$1 million for financing new equipment purchases. This credit facility provides for a 1 year draw up to the conversion date of October 31, 2013. Prior to the conversion dates amounts outstanding will bear an interest rate of daily LIBOR plus 2.25%. Once the note is converted the term will be 5 years and will bear an interest rate of daily LIBOR plus 2.50%. The note would be secured by a perfected first security interest in the new equipment purchased.

Subsequent available borrowings for both these credit facilities are subject to a borrowing base utilizing a percentage of eligible receivables, inventories, and any assigned cash along with certain financial ratios, specifically maintaining: (i) a ratio of tangible net worth of less than 0.75 to 1.0 and (ii) a ratio of minimum fixed charge of 1.25 to 1.0 measured on a rolling four quarter basis.

At September 30, 2012, we were in full compliance with the loan covenants and ratios of both the credit facilities. According to our most recent borrowing base calculation, we had approximately \$3.7 million total availability under the \$6 million credit line, of which we currently have a zero balance. We also have available approximately \$1.0 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, | | | | | |
|-----------------------|---------------------------|--------|-------|------|------|------|
| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
| Operating leases | \$ 64 | \$ 228 | \$ 12 | \$ - | - | - |
| Employment agreements | 160 | 642 | 48 | - | - | - |
| Purchase Commitments | 2,295 | 1,562 | - | - | - | - |

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, 2011, which we filed in March 2012.

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:

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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.

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

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 6).

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.

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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, 2012, 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 carry-forwards), we are subject to income tax audits in the jurisdictions in which we operate.

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. As such we do not believe we are exposed to significant interest rate risk. 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. If a 10% change in interest rates were to have occurred on September 30, 2012, this change would not have had a material effect on the fair value of our investment portfolio 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, 2012. 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 three months ended September 30, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II.

OTHER INFORMATION

ITEM 1.

LEGAL PROCEEDINGS

Livneh/Lican Development Settlement

As previously reported, in December 2011, a settlement related to a litigation we were involved in with Steve Livneh (“Livneh”) a former director and certain entities controlled by him, was structured and subsequently entered into on February 22, 2012. Under the terms of the Settlement Agreement (the “Settlement Agreement”), the Company will, among other things, perform the following: (i) make a \$250,000 lump sum payment to Livneh (\$50,000 of which was previously recorded and expensed), (ii) make 18 installment payments to Livneh in the amount of \$23,222.22 per month, (iii) reimburse Livneh for all unpaid expenses that Livneh incurred on behalf of the Company during the period of his employment and/or consultancy (from October 1, 2006 through August 11, 2010), (iv) pay Livneh \$14,700, which represents the balance of the amounts due to Henvil Corp. Ltd. under a certain bill of sale, dated April 12, 2010, (v) transfer to Livneh the title of a certain automobile, (vi) transfer to Livneh all of the Company’s right and interest in certain Intellectual Property (as defined in the Settlement Agreement) pertaining to the Modular Ergonomic Grip (“MEG”), Modullion, RF Skin Resurfacing, Scannula, Double Jaw Forceps and Tip-On-Tube designs and trade name (collectively, the “Assigned Patents”), (vi) transfer to Livneh certain parts for the MEG device, (vii) grant Livneh an exclusive license to produce, market and sell the Seal-N-Cut device in the People’s Republic of China, (viii) pay to Livneh royalty payments of 3% on the Company’s Net Sales (as defined in the Settlement Agreement) of the Seal-N-Cut device outside the People’s Republic of China, and (ix) pay to Livneh a one-time royalty payment of 5% upon the closing of any sale by the Company of its right or interest in any Intellectual Property pertaining to the Seal-N-Cut device. To secure the Company’s obligations, the Company granted Livneh a security interest in all of its rights and interest of the Company in the Seal-N-Cut device, including all Intellectual Property pertaining thereto. Since the loss was quantifiable and known in December 2011, we recognized this settlement loss in 2011 and all payments hereunder were accrued during the fourth quarter.

In exchange, Livneh agreed, among other things, to perform the following: (i) pay to the Company royalty payments of 3% on Livneh’s Net Sales of the Assigned Patents, excluding any Net Sales of the RF Skin Resurfacing or Tip-On-Tube, (ii) pay to the Company a one-time royalty payment of 5% upon the closing of any sale by Livneh, Henvil or Lican Development Ltd. of their right or interest in any Intellectual Property pertaining to the Assigned Patents, and (iii) pay to the Company royalty payments of 3% on Livneh’s Net Sales of the Seal-N-Cut device in the People’s Republic of China.

The Settlement Agreement contains no admission of liability or wrongdoing by any party to the litigation. Pursuant to the Settlement Agreement, the Company, Mr. Makrides, Mr. Citronowicz, Livneh, Henvil and Lican agreed to dismiss the litigation with prejudice and they fully and finally released all claims known and unknown, foreseen and unforeseen, which they had against each other through the date of the Settlement Agreement.

Our future installment payment obligations related to this settlement as of September 30, 2012 for the calendar years ended December 31, 2012 and 2013 (in thousands):

| | | |
|-----------|----|-----|
| Current | \$ | 279 |
| Long Term | | 23 |
| Total | \$ | 302 |

As previously reported, the Company’s position is that we have complied with the Settlement Agreement by having paid the initial \$250,000 lump sum and the \$14,700 due to Henvil, transferred the related inventory, initiated the

transfer of other assets and patents as outlined in the Settlement Agreement, and by making installment payments commencing on May 1, 2012.

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In July 2012, Steven Livneh and two of his related entities, Henvil Corp. Ltd. and Lican Development Ltd., commenced a new action against the Company, Andrew Makrides, the Company's Chief Executive Officer, and Moshe Citronowicz, the Company's Senior Vice President of Operations, in the United States District Court for the Middle District of Florida (Tampa division). The complaint asserts, among other things, that (i) the defendants breached their obligations to the plaintiffs under the Settlement Agreement by allegedly failing to take certain actions that facilitated the plaintiffs' marketing and sale of the Seal-N-Cut products in the People's Republic of China, (ii) that defendants tortiously interfered with plaintiffs' Chinese business relationships and expectations allegedly by, among other things, refusing to provide plaintiffs with an ICON VS generator and (iii) plaintiffs allegedly suffered damages as a result of defendants' misrepresentations. The complaint seeks, among other things, the following: (i) unspecified compensatory damages in excess of \$4 million, (ii) providing plaintiffs with all ICON VS generators, (iii) an assignment to plaintiffs of all patents identified in the Settlement Agreement and (iv) a rescission of the Settlement Agreement. 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, no range of potential loss can be estimated 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 July 24, 2012, the Company filed a motion to dismiss the complaint and to compel arbitration. The plaintiffs opposed the motion and the motion was subsequently withdrawn as moot due to the non-availability of the stipulated arbitrator.

Stockholder Derivative Action

As previously reported, in September 2011, we were served in a purported stockholder derivative action that was filed in the United States District Court for the Middle District of Florida against the Company, as a nominal defendant, and certain of its present and former officers and directors. The complaint asserts, among other things against the individual defendants, 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 Livneh counterclaim described above.

On March 29, 2012, plaintiffs amended their complaint to remove one of the plaintiffs and replace it with another. The amended complaint asserts essentially the same allegations as the original filing. We believe the allegations to be frivolous and without merit and we intend to defend the action vigorously. We are investigating whether there is a collusive connection between the derivative action and the previously settled lawsuit with Livneh. While no claims are asserted directly against the Company, the Company may have certain indemnification obligations to the individual defendants with respect to amounts paid by the individual defendants in connection with the litigation. The outcome of this matter is uncertain, no range of potential loss can be estimated 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 May 2012, the Company and the individual defendants filed a motion to dismiss the plaintiff's complaint based, in part, upon the plaintiff's failure to make demand upon the board as required by applicable law. The motion was denied and the parties are proceeding with discovery.

Keen Action

In February 2012, we received notice that an action had been commenced against us in United States District Court for the Middle District of Florida, by Leonard Keen, our former Vice President and General Counsel, related to his termination on December 9, 2011 and associated employment contract. Mr. Keen is demanding amounts outlined

under his employment contract which provided for the payment of a base annual salary of not less than \$187,500 as well as certain other payments and benefits. The employment agreement also provided for the payment, under certain circumstances, of a lump sum severance payment equal to three times base compensation plus certain other payments and benefits as set forth in the employment agreement under severance payment. Mr. Keen also asserts a claim concerning an alleged violation of the Florida “Whistle Blower’s Act” and seeks specific performance of certain indemnification rights under his employment agreement. On April 27, 2012, we filed our answers with counterclaim in this action.

On July 3, 2012, plaintiff amended the complaint to add Andrew Makrides, the Company’s Chief Executive Officer, as a defendant. The amended complaint asserts essentially the same allegations as the original filing but asserts additional claims concerning (i) an alleged violation of ERISA and (ii) an alleged tortious interference with the plaintiff’s employment contract by Andrew Makrides. We believe we have meritorious defenses against Mr. Keen’s claims and are vigorously defending this action. 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, however the range of potential loss is zero to approximately \$600,000 plus possible attorney fees which are not determinable at this time.

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On July 16, 2012, the Company filed a motion to dismiss the amended complaint. In August 2012, the court issued a decision, dismissing the claim against Mr. Makrides as well as the claim alleging breach by the Company of the implied covenant of good faith. Discovery in the action is proceeding on the remaining claims.

In addition to the above, in the normal course of business, we are subject, from time to time, to legal proceedings. 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, 2012. These matters could affect the operating results of any one or more quarters when resolved in future periods.

We expense costs of litigation related to contingencies in the periods in which the costs are incurred.

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors previously disclosed in our Form 10-K for the year ended December 31, 2011, in response to Item 1A to Part 1 of Form 10-K.

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

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.

Second Amendment to Credit Documents between Bovie Medical Corporation and PNC Bank National Association. *

10.2 Third Amendment to Loan Document between Bovie Medical Corporation and PNC Bank National Association.*

101.1 Financial Statements from the Quarterly Report on Form 10-Q of Bovie Medical Corporation for the three months ended September 30, 2012, filed on November 14, 2012, formatted in XBRL.

* Incorporated by reference from the Company's 8K filing with the Commission on October 24, 2012.

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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, 2012

By: /s/ Andrew Makrides
Andrew Makrides
Chief Executive Officer

Dated: November 14, 2012

By: /s/ Gary D. Pickett
Gary D. Pickett
Chief Financial Officer