Stereotaxis, Inc.
Form 10-Q
August 09, 2012
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 10-Q

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

**For the quarterly period ended June 30, 2012.**

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

**For the transition period from to .**

**Commission File Number: 000-50884**

# STEREOTAXIS, INC.

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

| | |
|---|---|
| **Delaware** | **94-3120386** |
| **(State of Incorporation)** | **(I.R.S. employer identification no.)** |

**4320 Forest Park Avenue Suite 100**

| | |
|---|---|
| **St. Louis, Missouri** | **63108** |
| **(Address of principal executive offices)** | **(Zip Code)** |

**Registrant s telephone number, including area code: (314) 678-6100**

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 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. x 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 Registration 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). x Yes ¨ No

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

| | | | |
|---|---|---|---|
| Large accelerated filer | ¨ | Accelerated filer | x |
| Non-accelerated filer | ¨ (Do not check if a smaller reporting company) | 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 x No

The number of outstanding shares of the registrant s common stock on July 31, 2012 was 7,803,921.

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**STEREOTAXIS, INC.**

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**ITEM 1. FINANCIAL STATEMENTS**

**STEREOTAXIS, INC.**

**BALANCE SHEETS**

| | June 30, 2012 (Unaudited) | December 31, 2011 |
|---|---|---|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $ 12,119,450 | $ 13,954,919 |
| Accounts receivable, net of allowance of $713,142 and 667,529 in 2012 and 2011, respectively | 8,235,138 | 11,104,038 |
| Current portion of long-term receivables | 60,692 | 59,679 |
| Inventories | 7,378,595 | 6,036,051 |
| Prepaid expenses and other current assets | 3,858,824 | 3,081,484 |
| Total current assets | 31,652,699 | 34,236,171 |
| Property and equipment, net | 2,763,723 | 3,323,856 |
| Intangible assets | 2,129,236 | 2,279,153 |
| Long-term receivables | 31,581 | 51,892 |
| Other assets | 38,616 | 40,760 |
| Total assets | $ 36,615,855 | $ 39,931,832 |
| Liabilities and stockholders deficit | | |
| Current liabilities: | | |
| Current maturities of long-term debt | $ 13,891,182 | $ 21,173,321 |
| Accounts payable | 4,635,569 | 5,610,181 |
| Accrued liabilities | 5,947,702 | 5,703,166 |
| Deferred contract revenue | 7,535,373 | 8,220,306 |
| Warrants and derivative liability | 2,079,104 | 125,415 |
| Total current liabilities | 34,088,930 | 40,832,389 |
| Long-term debt, less current maturities | 15,237,558 | 17,290,531 |
| Long-term deferred contract revenue | 766,860 | 634,713 |
| Other liabilities | 787 | 3,094 |
| Stockholders deficit: | | |
| Preferred stock, par value $0.001; 10,000,000 shares authorized at 2012 and 2011; none outstanding at 2012 and 2011 | | |
| Common stock, par value $0.001; 100,000,000 shares authorized at 2012 and 2011; 7,812,206 and 5,543,157 issued at 2012 and 2011, respectively | 7,812 | 5,543 |
| Additional paid-in capital | 365,133,838 | 356,779,007 |
| Treasury stock, 4,015 shares at 2012 and 2011 | (205,999) | (205,999) |
| Accumulated deficit | (378,413,931) | (375,407,446) |
| Total stockholders deficit | (13,478,280) | (18,828,895) |
| Total liabilities and stockholders deficit | $ 36,615,855 | $ 39,931,832 |

**See accompanying notes.**

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**STEREOTAXIS, INC.**

**STATEMENTS OF OPERATIONS**

**(Unaudited)**

| | Three Months Ended June 30, 2012 | Three Months Ended June 30, 2011 | Six Months Ended June 30, 2012 | Six Months Ended June 30, 2011 |
|---|---|---|---|---|
| Revenue: | | | | |
| Systems | $ 3,863,107 | $ 5,024,543 | $ 9,042,612 | $ 9,312,719 |
| Disposables, service and accessories | 6,649,791 | 6,577,596 | 13,753,514 | 12,514,124 |
| Total revenue | 10,512,898 | 11,602,139 | 22,796,126 | 21,826,843 |
| Cost of revenue: | | | | |
| Systems | 2,175,971 | 2,520,431 | 4,518,381 | 4,704,909 |
| Disposables, service and accessories | 1,084,107 | 995,915 | 2,503,528 | 1,816,416 |
| Total cost of revenue | 3,260,078 | 3,516,346 | 7,021,909 | 6,521,325 |
| Gross margin | 7,252,820 | 8,085,793 | 15,774,217 | 15,305,518 |
| Operating expenses: | | | | |
| Research and development | 2,196,073 | 3,311,177 | 5,021,280 | 6,705,436 |
| Sales and marketing | 6,223,330 | 9,712,519 | 12,222,069 | 18,050,855 |
| General and administrative | 3,469,346 | 4,606,555 | 7,342,219 | 8,856,824 |
| Total operating expenses | 11,888,749 | 17,630,251 | 24,585,568 | 33,613,115 |
| Operating loss | (4,635,929) | (9,544,458) | (8,811,351) | (18,307,597) |
| Other income | 9,269,424 | 620,409 | 9,081,354 | 640,755 |
| Interest income | 2,008 | 2,133 | 3,371 | 5,320 |
| Interest expense | (1,829,076) | (772,769) | (3,279,859) | (1,583,096) |
| Net income (loss) | $ 2,806,427 | $ (9,694,685) | $ (3,006,485) | $ (19,244,618) |
| Net earnings (loss) per common share: | | | | |
| Basic | $ 0.42 | $ (1.77) | $ (0.49) | $ (3.51) |
| Diluted | $ 0.32 | $ (1.77) | $ (0.49) | $ (3.51) |
| Weighted average shares used in computing net earnings (loss) per common share: | | | | |
| Basic | 6,741,578 | 5,478,087 | 6,120,447 | 5,475,044 |
| Diluted | 9,263,149 | 5,478,087 | 6,120,447 | 5,475,044 |

**See accompanying notes.**

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**STEREOTAXIS, INC.**

**STATEMENTS OF CASH FLOWS**

**(Unaudited)**

| | Six Months Ended June 30, 2012 | 2011 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Net loss | $ (3,006,485) | $ (19,244,618) |
| Adjustments to reconcile net loss to cash used in operating activities: | | |
| Depreciation | 669,040 | 731,101 |
| Amortization | 149,917 | 149,916 |
| Amortization of deferred financing costs and debt discount | 1,366,471 | 660,302 |
| Share-based compensation | 1,794,729 | 1,582,866 |
| Loss on asset disposal | 4,122 | |
| Non-cash royalty (income), net | | (1,597,685) |
| Adjustment of warrants and debt conversion features | (9,081,354) | (640,755) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 2,868,900 | 3,737,168 |
| Other receivables | 19,298 | (3,935) |
| Inventories | (1,342,544) | (473,568) |
| Prepaid expenses and other current assets | (398,952) | 311,230 |
| Other assets | 2,144 | (6,071) |
| Accounts payable | (974,612) | (866,138) |
| Accrued liabilities | 71,203 | 884,923 |
| Deferred revenue | (552,786) | 18,939 |
| Other liabilities | (2,307) | (4,894) |
| Net cash used in operating activities | (8,413,216) | (14,761,219) |
| **Cash flows from investing activities** | | |
| Purchase of equipment | (113,030) | (615,523) |
| Net cash used in investing activities | (113,030) | (615,523) |
| **Cash flows from financing activities** | | |
| Payments under term note | (2,000,000) | |
| Proceeds from revolving line of credit | 33,073,407 | 32,909,375 |
| Payments of revolving line of credit | (40,363,204) | (28,100,000) |
| Proceeds from subordinated convertible debt, net of issuance costs | 7,738,351 | |
| Payments of Cowen debt | (925,533) | |
| Payments under Biosense debt | | (1,572,587) |
| Proceeds from issuance of stock and warrants, net of issuance costs | 9,167,756 | 151,600 |
| Net cash provided by financing activities | 6,690,777 | 3,388,388 |
| Net decrease in cash and cash equivalents | (1,835,469) | (11,988,354) |
| Cash and cash equivalents at beginning of period | 13,954,919 | 35,248,819 |
| Cash and cash equivalents at end of period | $ 12,119,450 | $ 23,260,465 |

**See accompanying notes.**

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**STEREOTAXIS, INC.**

**NOTES TO FINANCIAL STATEMENTS**

**(Unaudited)**

**Notes to Financial Statements**

In this report, Stereotaxis, the Company, Registrant, we, us, and our refer to Stereotaxis, Inc. and its wholly-owned subsidiaries. *Niobe*®, *Epoch* , *Odyssey* , and *Odyssey Cinema* are trademarks of Stereotaxis, Inc.

***1. Description of Business***

Stereotaxis designs, manufactures and markets the *Epoch* Solution, which is an advanced remote robotic navigation system for use in a hospital s interventional surgical suite, or interventional lab , that we believe revolutionizes the treatment of arrhythmias and coronary artery disease by enabling enhanced safety, efficiency and efficacy for catheter-based, or interventional, procedures. The *Epoch* Solution is comprised of the *Niobe* ES Robotic Magnetic Navigation System ( *Niobe* ES system ), *Odyssey* Information Management Solution ( *Odyssey* Solution ), and the *Vdrive* Robotic Navigation System.

The *Niobe* system is designed to enable physicians to complete more complex interventional procedures by providing image guided delivery of catheters and guidewires through the blood vessels and chambers of the heart to treatment sites. This is achieved using externally applied magnetic fields that govern the motion of the working tip of the catheter or guidewire, resulting in improved navigation, efficient procedures and reduced x-ray exposure.

In addition to the *Niobe* system and its components, Stereotaxis also has developed the *Odyssey* Solution, which consolidates all lab information enabling doctors to focus on the patient for optimal procedure efficiency. The system also features a remote viewing and recording capability called *Odyssey Cinema*, which is an innovative solution delivering synchronized content for optimized workflow, advanced care and improved productivity. This tool includes an archiving capability that allows clinicians to store and replay entire procedures or segments of procedures. This information can be accessed from locations throughout the hospital local area network and over the global *Odyssey* Network providing physicians with a tool for clinical collaboration, remote consultation and training.

Our *Vdrive* Robotic Navigation System provides navigation and stability for diagnostic and therapeutic devices designed to improve interventional procedures. The *Vdrive* Robotic Navigation System complements the *Niobe* ES system control of therapeutic catheters for fully remote procedures and enables single-operator workflow and is sold as two options, the *Vdrive* System and the *Vdrive Duo* System. In addition to the *Vdrive* System and the *Vdrive Duo* System, we also manufacture and market various disposable components which can be manipulated by these systems.

We promote the full *Epoch* Solution in a typical hospital implementation, subject to regulatory approvals or clearances. The full *Epoch* Solution implementation requires a hospital to agree to an upfront capital payment and recurring payments. The upfront capital payment typically includes equipment and installation charges. The recurring payments typically include disposable costs for each procedure, equipment service costs beyond warranty period, and software licenses and *Odyssey* Network fees. In hospitals where the full *Epoch* Solution has not been implemented, equipment upgrade or expansion can be implemented upon purchasing of the necessary upgrade or expansion.

The core components of Stereotaxis systems have received regulatory clearance in the U.S., Europe, Canada and elsewhere; the V-Loop circular catheter manipulator is currently under regulatory review by the U.S. Food and Drug Administration.

Since our inception, we have generated significant losses. As of June 30, 2012, we had incurred cumulative net losses of approximately $378 million. The Company expects such losses to continue through at least the year ended December 31, 2012. In May 2011, the Company introduced the *Niobe* ES, which is the latest generation of the *Niobe* Robotic Magnetic Navigation System and will replace the *Niobe* II system going forward. Due to the fact that the *Niobe* ES system and upgrades from *Niobe* II to *Niobe* ES systems were not available to customers until December 2011, the product change created a rapid shift away from sales of the current *Niobe* II system, resulting in lower System Revenue in 2011. As of June 30, 2012, the Company had performed 47 installations to upgrade *Niobe* II systems to *Niobe* ES systems and has received positive feedback from the physicians at these sites. On May 8, 2012, the Company announced that it expects to reduce operating expenses by 15-20% from first quarter levels by the fourth quarter of 2012.

In May 2012, the Company entered into financing agreements and received gross proceeds of approximately $18.5 million. Upon closing the financing transactions, the Company amended its agreement with its primary lender. See Notes 9 and 10 for additional details.

***2. Summary of Significant Accounting Policies***

*Basis of Presentation*

The accompanying unaudited financial statements of Stereotaxis, Inc. have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all the disclosures required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, they include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results for the interim periods presented. Operating results for the six month period ended June 30, 2012 are not necessarily indicative of the results that may be expected for the year ended December 31, 2012 or for future operating periods.

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**STEREOTAXIS, INC.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

These interim financial statements and the related notes should be read in conjunction with the annual financial statements and notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2011 as filed with the Securities and Exchange Commission (SEC) on March 15, 2012.

As described in Note 10, on July 10, 2012, the Company effected a one-for-ten reverse stock split of the Company s common stock. All information set forth in the financial statements and related notes gives effect to such reverse stock split.

**STEREOTAXIS, INC.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

*Revenue and Costs of Revenue*

For arrangements with multiple deliverables, the Company allocates the total revenue to each deliverable based on the provisions of general accounting principles for revenue recognition and multiple-deliverable revenue arrangements and recognizes revenue for each separate element as the criteria for revenue recognition are met. Each element is assigned an estimated selling price using vendor-specific objective evidence, third party evidence, or management s estimate.

Under our revenue recognition policy, a portion of revenue for the *Niobe*, *Odyssey* Vision, *Odyssey Cinema*, and *Vdrive* systems is recognized upon delivery, provided that title has passed, there are no uncertainties regarding acceptance, persuasive evidence of an arrangement exists, the sales price is fixed and determinable, and collection of the related receivable is reasonably assured. Revenue for *Niobe, Odyssey* Vision Standard HD, *Odyssey* Vision Quad, *Odyssey* Enterprise Cinema, and *Vdrive* systems is recognized upon delivery due to the fact that third parties became qualified to perform installations. Revenue is recognized for other types of *Odyssey* systems upon completion of installation, since there are no qualified third party installers. When installation is the responsibility of the customer, revenue from system sales is recognized upon shipment since these arrangements do not include an installation element or right of return privileges. The Company does not recognize revenue in situations in which inventory remains at a Stereotaxis warehouse or in situations in which title and risk of loss have not transferred to the customer. However, the Company may deliver systems to a non-hospital site at the customer s request as outlined in the terms and conditions of the sales agreement, in which case the Company evaluates whether the substance of the transaction meets the delivery and performance requirements for revenue recognition under bill and hold guidance. Amounts collected prior to satisfying the above revenue recognition criteria are reflected as deferred revenue.

Revenue from services and license fees, whether sold individually or as a separate unit of accounting in a multiple-deliverable arrangement, is deferred and amortized over the service or license fee period, which is typically one year. Revenue from services is derived primarily from the sale of annual product maintenance plans. We recognize revenue from disposable device sales or accessories upon shipment and establish an appropriate reserve for returns. The return reserve, which is applicable only to disposable devices, is estimated based on historical experience which is periodically reviewed and updated as necessary. In the past, changes in estimate have had only a de minimus effect on revenue recognized in the period. We believe that the estimate is not likely to change significantly in the future.

Costs of systems revenue include direct product costs, installation labor and other costs, estimated warranty costs, and initial training and product maintenance costs. These costs are recorded at the time of sale. Costs of disposable revenue include direct product costs and estimated warranty costs and are recorded at the time of sale. Cost of revenue from services and license fees are recorded when incurred.

*Net Earnings (Loss) per Common Share*

Basic and diluted net earnings (loss) per common share are computed by dividing the net income (loss) for the period by the weighted average number of common shares outstanding during the period. On July 10, 2012, the Company effected a one-for-ten reverse stock split of the Company s common stock. The net earnings (loss) per common share, shares outstanding, and weighted average shares outstanding reported in the financial statements and notes to the financial statements for the three and six month periods ending June 30, 2012 and 2011 are presented on a post-split basis. See Note 10 for additional discussion of the reverse stock split.

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**STEREOTAXIS, INC.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

The following table sets forth the computation of basic and diluted EPS:

| | Three months ended June 30, 2012 | Three months ended June 30, 2011 | Six months ended June 30, 2012 | Six months ended June 30, 2011 |
|---|---|---|---|---|
| **Numerator:** | | | | |
| Numerator for basic EPS | $ 2,806,427 | $ (9,694,685) | $ (3,006,485) | $ (19,244,618) |
| Effect of dilutive securities: | | | | |
| Subordinated convertible debentures | 203,830 | | | |
| Numerator for diluted EPS | $ 3,010,257 | $ (9,694,685) | $ (3,006,485) | $ (19,244,618) |
| **Denominator:** | | | | |
| Denominator for basic EPS weighted average shares | 6,741,578 | 5,478,087 | 6,120,447 | 5,475,044 |
| Effect of dilutive securities: | | | | |
| Subordinated convertible debentures | 2,521,571 | | | |
| Denominator for diluted EPS | 9,263,149 | 5,478,087 | 6,120,447 | 5,475,044 |
| Basic EPS | $ 0.42 | $ (1.77) | $ (0.49) | $ (3.51) |
| Diluted EPS | $ 0.32 | $ (1.77) | $ (0.49) | $ (3.51) |

In the second quarter of 2012, the Company entered into a securities purchase agreement with certain institutional investors whereby the Company agreed to sell an aggregate of approximately $8.5 million in aggregate principal amount of unsecured, subordinated, convertible debentures, which became convertible into shares of the Company s common stock at a conversion price of $3.361 per share (or approximately 2.5 million shares in the aggregate), on July 10, 2012, the date that the Company received shareholder approval for the transaction. Interest expense of $203,830 related to the subordinated convertible debentures was recorded for the period ended June 30, 2012. The interest expense includes interest paid as well as amortization of the debt discount. Refer to Note 9 for additional discussion of this transaction.

The following potential common shares were excluded from diluted EPS for the three months ended June 30, 2012 as they were antidilutive: 423,669 stock options and stock appreciation rights, 112,775 restricted share awards, 82,106 restricted stock units, and 6,099,476 warrants.

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**STEREOTAXIS, INC.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

In addition, the Company did not include any portion of unearned restricted shares, outstanding options, stock appreciation rights or warrants in the calculation of diluted loss per common share because all such securities are anti-dilutive for the three and six months ended June 30, 2011 and the six months ended June 30, 2012. The application of the two-class method of computing earnings per share under general accounting principles for participating securities is not applicable during these periods because the Company s unearned restricted shares do not contractually participate in its losses.

As of June 30, 2012, the Company had 423,669 shares of common stock issuable upon the exercise of outstanding options and stock appreciation rights at a weighted average exercise price of $44.95 per share and 6,099,476 shares of common stock issuable upon the exercise of outstanding warrants at a weighted average exercise price of $9.98 per share. The Company had a weighted average of 111,226 and 98,098 unearned restricted shares outstanding for the three and six months ended June 30, 2012.

*Fair Value Measurements*

The Company measures certain financial assets and liabilities at fair value on a recurring basis, including cash equivalents and warrants. General accounting principles for fair value measurement established a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets and liabilities ( Level 1 ) and the lowest priority to unobservable inputs ( Level 3 ). See Note 11 for additional details.

The following methods and assumptions were used by the Company in estimating its fair value disclosures for other financial instruments as of June 30, 2012 and December 31, 2011.

Cash and cash equivalents, accounts receivable, accounts payable and accrued expenses have carrying values which approximate fair value due to the short maturity or the financial nature of these instruments.

Long and short-term debt fair value estimates are based on estimated borrowing rates to discount the cash flows to their present value. See Note 9 for disclosure of the fair value of debt.

*Share-Based Compensation*

The Company accounts for its grants of stock options, stock appreciation rights, restricted shares, and restricted stock units and for its employee stock purchase plan in accordance with the provisions of general accounting principles for share-based payments. These accounting principles require the determination of the fair value of the share-based compensation at the grant date and the recognition of the related expense over the period in which the share-based compensation vests.

The Company utilizes the Black-Scholes valuation model to determine the fair value of stock options and stock appreciation rights at the date of grant. The resulting compensation expense is recognized over the requisite service period, which is generally four years. Compensation expense is recognized only for those awards expected to vest, with forfeitures estimated based on the Company s historical experience and future expectations. Restricted shares granted to employees are valued at the fair market value at the date of grant. The Company amortizes the amount to expense over the service period on a straight-line basis. If the shares are subject to performance objectives, the resulting compensation expense is amortized over the anticipated vesting period and is subject to adjustment based on the actual achievement of objectives.

*Reclassifications*

Common stock and additional paid-in capital in the prior year s financial statements have been reclassified to reflect the one-for-ten reverse stock split effected on July 10, 2012. Refer to Note 10 for additional discussion of the reverse stock split.

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**STEREOTAXIS, INC.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

*Recently Issued Accounting Pronouncements*

In December 2011, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update No. 2011-11, Disclosures about Offsetting Assets and Liabilities. The Update enhances the disclosure of offsetting assets and liabilities by requiring companies to disclose both the gross and net information about instruments and transactions eligible for offset as well as those subject to an agreement similar to master netting arrangements. This guidance is effective for the Company s interim and annual periods beginning January 1, 2013. The Company is currently evaluating the impact of adoption on the financial statements.

In June 2011, the FASB issued new accounting guidance related to the presentation of comprehensive income that increases comparability between U.S. GAAP and International Financial Reporting Standards ( IFRS ). This guidance eliminates the current option to report other comprehensive income (OCI) and its components in the statement of changes in stockholders equity. This guidance was effective for the Company s interim and annual periods beginning January 1, 2012. As the Company has no items of other comprehensive income, the Company is not required to report comprehensive income or other comprehensive income.

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS. The Update amends the guidance on fair value measurements to develop common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. GAAP and IFRS. The Update does not require additional fair value measurements and is not intended to establish valuation standards or affect valuation practices outside of financial reporting. This guidance was effective during interim and annual periods beginning after December 15, 2011. The adoption of this ASU did not have a material effect on our financial position or results of operations.

***3. Inventory***

Inventory consists of the following:

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| Raw materials | $ 3,532,122 | $ 2,264,603 |
| Work in process | 354,344 | 131,980 |
| Finished goods | 3,723,835 | 3,790,625 |
| Reserve for obsolescence | (231,706) | (151,157) |
| Total inventory | $ 7,378,595 | $ 6,036,051 |

***4. Prepaid Expenses and Other Current Assets***

Prepaid expenses and other current assets consist of the following:

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| Prepaid expenses | $ 390,292 | $ 460,297 |
| Deferred cost of revenue | 389,860 | 289,312 |
| Derivative asset | 3,951 | |

| | | |
|---|---|---|
| Other assets | 3,074,721 | 2,331,875 |
| Total prepaid expenses and other current assets | $ 3,858,824 | $ 3,081,484 |

Deferred cost of revenue represents the cost of systems for which title has transferred from the Company but for which revenue has not been recognized.

The derivative asset represents the fair value of a debt conversion feature that is part of the subordinated convertible debentures. Refer to Notes 9 and 11 for discussion of the debentures and fair value measurement, respectively.

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STEREOTAXIS, INC.

NOTES TO FINANCIAL STATEMENTS (Continued)

(Unaudited)

***5. Property and Equipment***

Property and equipment consist of the following:

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| Equipment | $ 8,946,967 | $ 8,977,623 |
| Equipment held for lease | 547,416 | 547,416 |
| Leasehold improvements | 2,473,880 | 2,473,880 |
| | 11,968,263 | 11,998,919 |
| Less: Accumulated depreciation | (9,204,540) | (8,675,063) |
| Net property and equipment | $ 2,763,723 | $ 3,323,856 |

***6. Intangible Assets***

On June 4, 2010, the Company entered into an agreement to issue 450,000 shares of its common stock to a consultant (the Purchaser ) in exchange for intellectual property rights related to the Company s products. The Company issued 200,000 shares upon execution of the agreement and will issue an aggregate of 250,000 shares in annual installments on the first three anniversaries of the agreement. The unissued shares meet the criteria for equity classification under Accounting Standards Codification (ASC) 480 Distinguishing Liabilities from Equity and therefore are recorded in additional paid-in capital. There was no cash consideration paid for the securities. The securities were issued in consideration of the assignment to the Company of the Purchaser s rights in certain intellectual property, including patent applications, in all inventions and discoveries in the Company s business field (as defined in the agreement) that had been developed under various other agreements, which were terminated. The securities were sold by the Company in a private placement exempt from registration under Section 4(2) of the Securities Act of 1933 and Regulation D promulgated thereunder. There were no underwriters or placement agents involved in the transaction.

As of June 30, 2012, the Company had total intangible assets, including those described above, of $3.7 million. Accumulated amortization at June 30, 2012 was $1.6 million.

***7. Accrued Liabilities***

Accrued liabilities consist of the following:

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| Accrued salaries, bonus and benefits | $ 2,966,208 | $ 3,229,382 |
| Accrued research and development | 19,547 | 27,044 |
| Accrued legal and other professional fees | 58,762 | 25,000 |
| Other | 2,903,185 | 2,421,740 |
| Total accrued liabilities | $ 5,947,702 | $ 5,703,166 |

**STEREOTAXIS, INC.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

***8. Deferred Revenue***

Deferred revenue consists of the following:

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| Product shipped, revenue deferred | $ 1,595,106 | $ 2,001,160 |
| Customer deposits | 447,700 | 1,156,900 |
| Deferred service and license fees | 6,259,427 | 5,696,959 |
| | 8,302,233 | 8,855,019 |
| Less: Long-term deferred revenue | (766,860) | (634,713) |
| Total current deferred revenue | $ 7,535,373 | $ 8,220,306 |

***9. Long-Term Debt and Credit Facilities***

Debt outstanding consists of the following:

| | June 30, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Revolving line of credit, due March 2013 | $ 8,000,000 | $ 8,119,966 | $ 15,290,510 | $ 15,371,063 |
| Term note, due December 2013 | 6,000,000 | 6,000,000 | 8,000,000 | 8,000,000 |
| Cowen debt | 14,075,189 | 14,075,189 | 15,173,342 | 15,173,342 |
| Subordinated convertible debentures | 1,053,551 | 1,053,551 | | |
| Total debt | 29,128,740 | 29,248,706 | 38,463,852 | 38,544,405 |
| Less current maturities | (13,891,182) | (14,011,148) | (21,173,321) | (21,253,874) |
| Total long term debt | $ 15,237,558 | $ 15,237,558 | $ 17,290,531 | $ 17,290,531 |

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**STEREOTAXIS, INC.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

*Revolving line of credit*

The revolving line of credit and the Company s term notes (collectively, the Credit Agreements ) are secured by substantially all of the Company s assets. The Company is also required under the Credit Agreements to maintain its primary operating account and the majority of its cash and investment balances in accounts with the primary lender.

In December 2010, the Company amended its agreement with its primary lender to extend the maturity of the current working capital line of credit from March 31, 2011 to March 31, 2012, retaining the $30 million total availability under the line per the 2009 amendment. The revised agreement retained the $10 million sublimit for borrowings supported by guarantees from stockholders who are affiliates of two members of its board of directors ( Lenders ) and considered to be related parties. Under the revised facility the Company is required to maintain a minimum tangible net worth and liquidity ratio as defined in the agreement. Interest on the facility accrued at the rate of prime plus 0.5% subject to a floor of 6% for the amount under guarantee and prime plus 1.75% subject to a floor of 7% for the remaining amounts.

In September 2011, the Company amended its agreement with its primary lender. The amendment reduced the availability amount of all credit extensions, other than the term loan, from $30 million to $20 million, and modified the interest rate applicable to the term loan from the lender s prime rate plus 3.5% to the lender s prime rate plus 5.5%.

On November 30, 2011, the Company entered into a Second Amended and Restated Loan and Security Agreement with its primary lender ( Amended Loan Agreement ). Under the Amended Loan Agreement, the Company agreed to revised tangible net worth and liquidity ratio covenants. Further, certain intellectual property assets of the Company were added to the collateral which secures repayment of the loan. Finally, the Amended Loan Agreement permits the Company to repay Cowen Healthcare Royalty Partners II, L.P. ( Cowen ) under the Agreement with the royalties due to the Company under the Biosense Agreement (the Biosense Agreement ), as described below.

On March 30, 2012, the Company amended its agreement with its primary lender. The amendment extended the maturity date of the working capital line of credit from March 31, 2012 to April 30, 2012 and reduced the Company s borrowing availability by $3,333,333. The Company also extended until April 30, 2012 the $10 million guarantee provided by the Lenders. As a result of this extension, the Company issued the Lenders warrants to purchase 75,735 shares of common stock at $6.60 per share.

On May 1, 2012, the Company and its primary lender entered into an agreement in which the lender extended the maturity of the revolving line of credit from April 30, 2012 to May 15, 2012. The Company also amended its agreement with the Lenders to extend the $10 million loan guarantee through May 15, 2012. The Company granted warrants to purchase an aggregate of 60,976 shares of Common Stock in exchange for the extension of the guarantee.

On May 10, 2012, upon closing of financing transactions for gross proceeds of $18.5 million, the Company entered into the Third Loan Modification Agreement with its primary lender. The amendment extended the revolving credit facility maturity to March 31, 2013 and revised the financial covenants. Additionally, the revolving line of credit was decreased from $20 million to $13 million. The reduction was as a result of the pay down of $7 million of the guarantees provided by the Lenders.

As of June 30, 2012, the Company had $8.0 million outstanding under the revolving line of credit. Draws on the line of credit are made based on the borrowing capacity one week in arrears. As of June 30, 2012, the Company had a borrowing capacity of $8.0 million based on the Company s collateralized assets, including amounts already drawn. As such, the Company had no remaining borrowing availability at June 30, 2012. As of June 30, 2012, the Company was in compliance with all covenants of the bank loan agreement and had no remaining availability on its Lender loan and guarantee.

*Term note*

Under the 2010 amendment to the loan agreement, the Company entered into a $10 million term loan maturing on December 31, 2013, with $2 million of principal due in 2011 and $4 million of principal due in each of 2012 and 2013. Interest on the term loan accrued at the rate of prime plus 3.5%. Under the September 2011 amendment of the loan agreement, the interest rate on the term loan was increased to prime plus 5.5%. Under this agreement, the Company provided its primary lender with warrants to purchase 11,111 shares of common stock. The warrants are exercisable at $36.00 per share, beginning on December 17, 2010 and expiring on December 17, 2015. The fair value of these warrants of $228,332, calculated using the Black Scholes method, will be deferred and amortized to interest expense ratably over the life of the term loan.

*Cowen Debt*

In November 2011, the Company entered into a loan agreement with Cowen. Under the agreement the Company borrowed from Cowen $15 million. The Company may borrow up to an additional $5 million in the aggregate based on the achievement by the Company of certain milestones related to *Niobe* system sales in 2012. The loan will be repaid through, and secured by, royalties payable to the Company under its Development, Alliance and Supply Agreement with Biosense Webster, Inc. The Biosense Agreement relates to the development and

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**STEREOTAXIS, INC.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

distribution of magnetically enabled catheters used with Stereotaxis *Niobe* system in cardiac ablation procedures. Under the terms of the Agreement, Cowen will be entitled to receive 100% of all royalties due to the Company under the Biosense Agreement until the loan is repaid. The loan is a full recourse loan, matures on December 31, 2018, and bears interest at an annual rate of 16% payable quarterly with royalties received under the Biosense Agreement. If the payments received by the Company under the Biosense Agreement are insufficient to pay all amounts of interest due on the loan, then such deficiency will increase the outstanding principal amount on the loan. After the loan obligation is repaid, the royalties under the Biosense Agreement will again be paid to the Company. The loan is also secured by certain assets and intellectual property of the Company. The Agreement also contains customary affirmative and negative covenants. The use of payments due to the Company under the Biosense Agreement was approved by our primary lender under the Amended Loans Agreement described above.

On July 30, 2012, the Company gave irrevocable notice to borrow an additional $2.5 million based upon achievement of the milestone related to *Niobe* system sales. Refer to Note 14 for additional discussion.

*Subordinated Convertible Debentures*

In May 2012, the Company entered into a securities purchase agreement with certain institutional investors whereby the Company agreed to sell an aggregate of approximately $8.5