

NEOPROBE CORP  
Form 10-Q  
November 16, 2009

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

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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, 2009

☐ 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: 0-26520

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

Delaware  
(State or other jurisdiction of incorporation or organization)

31-1080091  
(IRS Employer Identification No.)

425 Metro Place North, Suite 300, Dublin, Ohio  
(Address of principal executive offices)

43017-1367  
(Zip Code)

(614) 793-7500  
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). 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.

Large accelerated filer “ Accelerated filer “

Non-accelerated filer “ Smaller reporting company x

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date: 79,650,270 shares of common stock, par value \$.001 per share (as of the close of business on November 6, 2009).

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## NEOPROBE CORPORATION and SUBSIDIARIES

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## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements

Neoprobe Corporation and Subsidiaries  
Consolidated Balance Sheets

	September 30, 2009 (unaudited)	December 31, 2008
<b>ASSETS</b>		
<b>Current assets:</b>		
Cash	\$ 6,031,298	\$ 3,565,837
Available-for-sale securities	—	495,383
Accounts receivable, net	1,393,420	1,626,065
Inventory	1,038,407	544,126
Prepaid expenses and other	319,647	573,573
Assets associated with discontinued operations	31,389	435,740
<b>Total current assets</b>	<b>8,814,161</b>	<b>7,240,724</b>
<b>Property and equipment</b>	<b>1,949,461</b>	<b>1,940,748</b>
Less accumulated depreciation and amortization	1,654,969	1,593,501
	294,492	347,247
<b>Patents and trademarks</b>	<b>519,896</b>	<b>459,431</b>
Less accumulated amortization	440,018	433,358
	79,878	26,073
<b>Other assets</b>	<b>26,266</b>	<b>594,449</b>
<b>Other assets associated with discontinued operations</b>	<b>—</b>	<b>1,410,957</b>
<b>Total assets</b>	<b>\$ 9,214,797</b>	<b>\$ 9,619,450</b>

Continued

Neoprobe Corporation and Subsidiaries  
Consolidated Balance Sheets, continued

	September 30, 2009 (unaudited)	December 31, 2008
<b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>		
<b>Current liabilities:</b>		
Accounts payable	\$ 772,483	\$ 725,820
Accrued liabilities and other	1,155,398	900,796
Capital lease obligations, current portion	7,092	9,084
Deferred revenue, current portion	526,898	526,619
Notes payable to finance companies	—	137,857
Liabilities associated with discontinued operations	20,686	22,280
<b>Total current liabilities</b>	<b>2,482,557</b>	<b>2,322,456</b>
Capital lease obligations, net of current portion	5,721	11,095
Deferred revenue, net of current portion	440,873	490,165
Notes payable to CEO, net of discounts of \$59,917 and \$76,294, respectively	940,083	923,706
Notes payable to investors, net of discounts of \$0 and \$5,001,149, respectively	10,000,000	4,998,851
Derivative liabilities	2,697,487	853,831
Other liabilities	36,348	45,071
<b>Total liabilities</b>	<b>16,603,069</b>	<b>9,645,175</b>
<b>Commitments and contingencies</b>		
Preferred stock; \$.001 par value; 5,000,000 shares authorized; 3,000 Series A shares, par value \$1,000, issued and outstanding at September 30, 2009 and December 31, 2008	3,000,000	3,000,000
<b>Stockholders' deficit:</b>		
Common stock; \$.001 par value; 150,000,000 shares authorized; 79,363,787 and 70,862,641 shares outstanding at September 30, 2009 and December 31, 2008, respectively	79,364	70,863
Additional paid-in capital	181,877,412	145,742,044
Accumulated deficit	(192,345,048)	(148,840,015)
Unrealized gain on available-for-sale securities	—	1,383
<b>Total stockholders' deficit</b>	<b>(10,388,272)</b>	<b>(3,025,725)</b>
<b>Total liabilities and stockholders' deficit</b>	<b>\$ 9,214,797</b>	<b>\$ 9,619,450</b>

See accompanying notes to consolidated financial statements



Neoprobe Corporation and Subsidiaries  
Consolidated Statements of Operations  
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
<b>Revenues:</b>				
Net sales	\$ 2,562,079	\$ 1,715,324	\$ 6,998,299	\$ 5,629,573
License and other revenue	25,000	—	75,000	—
Total revenues	2,587,079	1,715,324	7,073,299	5,629,573
Cost of goods sold	927,587	641,106	2,330,032	2,123,728
Gross profit	1,659,492	1,074,218	4,743,267	3,505,845
<b>Operating expenses:</b>				
Research and development	1,204,811	1,741,484	3,730,361	3,084,432
Selling, general and administrative	778,658	707,794	2,417,622	2,248,466
Total operating expenses	1,983,469	2,449,278	6,147,983	5,332,898
Loss from operations	(323,977)	(1,375,060)	(1,404,716)	(1,827,053)
<b>Other income (expense):</b>				
Interest income	2,360	18,824	16,068	47,891
Interest expense	(330,806)	(456,941)	(1,249,525)	(1,258,500)
Change in derivative liabilities	(6,334,479)	59,415	(18,539,318)	(440,773)
Loss on extinguishment of debt	(16,240,592)	—	(16,240,592)	—
Other	(585)	4,242	(2,216)	2,501
Total other expense, net	(22,904,102)	(374,460)	(36,015,583)	(1,648,881)
Loss from continuing operations	(23,228,079)	(1,749,520)	(37,420,299)	(3,475,934)
<b>Discontinued operations:</b>				
Impairment loss	(1,728,887)	—	(1,728,887)	—
Loss from operations	(52,303)	(141,070)	(162,896)	(459,506)
Net loss	(25,009,269)	(1,890,590)	(39,312,082)	(3,935,440)
Preferred stock dividends	(60,000)	—	(180,000)	—
Loss attributable to common stockholders	\$ (25,069,269)	\$ (1,890,590)	\$ (39,492,082)	\$ (3,935,440)
<b>Loss per common share (basic):</b>				
Continuing operations	\$ (0.31)	\$ (0.03)	\$ (0.53)	\$ (0.05)
Discontinued operations	\$ (0.03)	\$ (0.00)	\$ (0.03)	\$ (0.01)
Loss to common stockholders	\$ (0.34)	\$ (0.03)	\$ (0.56)	\$ (0.06)
<b>Loss per common share (diluted):</b>				
Continuing operations	\$ (0.31)	\$ (0.03)	\$ (0.53)	\$ (0.05)
Discontinued operations	\$ (0.03)	\$ (0.00)	\$ (0.03)	\$ (0.01)
Loss to common stockholders	\$ (0.34)	\$ (0.03)	\$ (0.56)	\$ (0.06)



Weighted average shares outstanding:				
Basic	74,380,714	68,758,281	70,915,204	68,191,889
Diluted	74,380,714	68,758,281	70,915,204	68,191,889

See accompanying notes to consolidated financial statements.

Neoprobe Corporation and Subsidiaries  
Consolidated Statement of Stockholders' Deficit  
(unaudited)

	Common Stock Shares	Amount	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total
Balance, December 31, 2008	70,862,641	\$ 70,863	\$ 145,742,044	\$ (148,840,015)	\$ 1,383	\$ (3,025,725)
Effect of adopting EITF 07-5	—	—	(8,948,089)	(4,012,951)	—	(12,961,040)
Issued restricted stock	500,000	500	—	—	—	500
Cancelled restricted stock	(9,000)	(9)	9	—	—	—
Issued stock upon exercise of warrants and other	6,641,555	6,641	6,196,513	—	—	6,203,154
Issued stock upon exercise of options	330,000	330	133,420	—	—	133,750
Issued stock as payment of interest on convertible debt and dividends on preferred stock	957,708	958	553,709	—	—	554,667
Effect of change in terms of notes payable, warrants and preferred stock	—	—	37,999,312	—	—	37,999,312
Issued stock to 401(k) plan at \$0.41	80,883	81	33,392	—	—	33,473
Stock compensation expense	—	—	271,554	—	—	271,554
Paid common stock issuance costs	—	—	(98,129)	—	—	(98,129)
Paid preferred stock issuance costs	—	—	(6,323)	—	—	(6,323)
Preferred stock dividends	—	—	—	(180,000)	—	(180,000)
Comprehensive loss:						
Net loss	—	—	—	(39,312,082)	—	(39,312,082)
Unrealized loss on available-for-sale securities	—	—	—	—	(1,383)	(1,383)
Total comprehensive loss						(39,313,465)
Balance, September 30, 2009	79,363,787	\$ 79,364	\$ 181,877,412	\$ (192,345,048)	\$ —	\$ (10,388,272)

See accompanying notes to consolidated financial statements.



Neoprobe Corporation and Subsidiaries  
Consolidated Statements of Cash Flows  
(unaudited)

	Nine Months Ended September 30,	
	2009	2008
Cash flows from operating activities:		
Net loss	\$ (39,312,082)	\$ (3,935,440)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	284,219	302,904
Amortization of debt discount and debt offering costs	420,063	515,056
Provision for bad debts	458	699
Issuance of common stock in payment of interest and dividends	554,667	—
Stock compensation expense	271,554	156,897
Change in derivative liabilities	18,539,318	440,773
Loss on extinguishment of debt	16,240,592	—
Impairment loss on discontinued operations	1,728,887	—
Other	48,697	111,295
Changes in operating assets and liabilities:		
Accounts receivable	226,052	305,274
Inventory	(550,816)	323,957
Prepaid expenses and other assets	260,470	111,229
Accounts payable	47,063	(79,470)
Accrued liabilities and other liabilities	53,104	105,775
Deferred revenue	(49,013)	(81,638)
Net cash used in operating activities	(1,236,767)	(1,722,689)
Cash flows from investing activities:		
Purchases of available-for-sale securities	—	(196,000)
Maturities of available-for-sale securities	494,000	196,000
Purchases of property and equipment	(74,554)	(97,673)
Proceeds from sales of property and equipment	251	120
Patent and trademark costs	(66,317)	(13,616)
Net cash provided by (used in) investing activities	353,380	(111,169)
Cash flows from financing activities:		
Proceeds from issuance of common stock	3,625,250	232,156
Payment of common stock offering costs	(104,673)	(900)
Payment of preferred stock offering costs	(6,323)	—
Proceeds from notes payable	—	3,000,000
Payment of debt issuance costs	(20,183)	(200,154)
Payment of notes payable	(137,857)	(124,770)
Payments under capital leases	(7,366)	(12,878)
Net cash provided by financing activities	3,348,848	2,893,454
Net increase in cash	2,465,461	1,059,596
Cash, beginning of period	3,565,837	1,540,220

Cash, end of period	\$ 6,031,298	\$ 2,599,816
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See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements  
(unaudited)

1. Summary of Significant Accounting Policies

a. Basis of Presentation: The information presented as of September 30, 2009 and for the three-month and nine-month periods ended September 30, 2009 and September 30, 2008 is unaudited, but includes all adjustments (which consist only of normal recurring adjustments) that the management of Neoprobe Corporation (Neoprobe, the Company, or we) believes to be necessary for the fair presentation of results for the periods presented. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the U.S. Securities and Exchange Commission. We have evaluated subsequent events through November 16, 2009, the date our consolidated financial statements were issued. The balances as of September 30, 2009 and the results for the interim periods are not necessarily indicative of results to be expected for the year. The consolidated financial statements should be read in conjunction with Neoprobe's audited consolidated financial statements for the year ended December 31, 2008, which were included as part of our Annual Report on Form 10-K.

Our consolidated financial statements include the accounts of Neoprobe, our wholly-owned subsidiary, Cardiosonix Ltd. (Cardiosonix), and our 90%-owned subsidiary, Cira Biosciences, Inc. (Cira Bio). All significant inter-company accounts were eliminated in consolidation.

In August 2009, the Company's Board of Directors decided to discontinue operations of Cardiosonix and to attempt to divest our Cardiosonix subsidiary. This decision was based on the determination that the blood flow measurement device segment was no longer considered a strategic initiative to the Company, due in large part to positive events in our other development initiatives. Our consolidated balance sheets and statements of operations have been restated for all prior periods presented to reflect Cardiosonix as a discontinued operation. Cash flows associated with the operation of Cardiosonix have been combined within operating, investing and financing cash flows, as appropriate, in our consolidated statements of cash flows. See Note 2.

b. Financial Instruments and Fair Value: The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value, giving the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

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 financial instruments for which all significant inputs are observable, either directly or indirectly; and

Level 3 – Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. In determining the appropriate levels, we perform a detailed analysis of the assets and liabilities whose fair value is measured on a recurring basis. At each reporting period, all assets and liabilities for which the fair value measurement is based on significant unobservable inputs or instruments which trade infrequently and therefore have little or no price transparency are classified as Level 3. In estimating the fair value of our

derivative liabilities, we used the Black-Scholes option pricing model and, where necessary, other macroeconomic, industry and Company-specific conditions. See Note 3.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

- (1) Cash, accounts receivable, accounts payable, and accrued liabilities: The carrying amounts approximate fair value because of the short maturity of these instruments.
- (2) Available-for-sale securities: Available-for-sale securities are recorded at fair value. Fair value of available-for-sale securities is determined based on a discounted cash flow analysis using current market rates. Unrealized holding gains and losses on available-for-sale securities are excluded from earnings and are reported as a separate component of other comprehensive income (loss) until realized. Realized gains and losses from the sale of available-for-sale securities are determined on a specific identification basis.

A decline in the market value of any available-for-sale security below cost that is deemed to be other than temporary results in a reduction in carrying amount to fair value. The impairment is charged to earnings or other comprehensive income (loss) and a new cost basis for the security is established. Premiums and discounts are amortized or accreted over the life of the related available-for-sale security as an adjustment to yield using the effective interest method. Dividend and interest income are recognized when earned.

Available-for-sale securities are accounted for on a specific identification basis. As of December 31, 2008, we held available-for-sale securities with an aggregate fair value of \$495,383, including \$1,383 of net unrealized gains recorded in accumulated other comprehensive income. As of December 31, 2008, all of our available-for-sale securities were invested in short-term certificates of deposit with maturity dates within 1 year. Available-for-sale securities were classified as current based on their maturity dates as well as our intent to use them to fund short-term working capital needs. We held no available-for-sale securities at September 30, 2009.

- (3) Notes payable to finance companies: The fair value of our debt is estimated by discounting the future cash flows at rates currently offered to us for similar debt instruments of comparable maturities by banks or finance companies. At December 31, 2008, the carrying values of these instruments approximate fair value. We had no notes payable to finance companies at September 30, 2009.
- (4) Note payable to CEO: The carrying value of our debt is presented as the face amount of the note less the unamortized discount related to the initial estimated fair value of the warrants to purchase common stock issued in connection with the note. At September 30, 2009, the note payable to our CEO had an estimated fair value of \$4.5 million. At December 31, 2008, the note payable to our CEO had an estimated fair value of \$1.8 million.
- (5) Notes payable to outside investors: The carrying value of our debt is presented as the face amount of the notes less the unamortized discounts related to the fair value of the beneficial conversion features, the initial estimated fair value of the put options embedded in the notes and the initial estimated fair value of the warrants to purchase common stock issued in connection with the notes. At September 30, 2009, the notes payable to outside investors had an estimated fair value of \$35.6 million. At December 31, 2008, the notes payable to outside investors had an estimated fair value of \$15.9 million.
- (6) Derivative liabilities: Derivative liabilities are recorded at fair value. Fair value of warrant liabilities is determined based on a Black-Scholes option pricing model calculation. Fair value of conversion and put option liabilities is determined based on a probability-weighted Black-Scholes option pricing model calculation. Unrealized gains and losses on the derivatives are classified in other expenses as a change in derivative liabilities in the statements of operations.





2.

## Discontinued Operations

In August 2009, the Company's Board of Directors decided to discontinue operations of Cardiosonix and to attempt to divest our Cardiosonix subsidiary. This decision was based on the determination that the blood flow measurement device segment was no longer considered a strategic initiative of the Company, due in large part to positive events in our other product and drug development initiatives.

As a result of our decision to hold Cardiosonix for sale, we reclassified certain assets and liabilities as assets and liabilities associated with discontinued operations. The following assets and liabilities have been segregated and included in assets associated with discontinued operations or liabilities associated with discontinued operations, as appropriate, in the consolidated balance sheets:

	September 30, 2009	December 31, 2008
Accounts receivable, net	\$ 5,727	\$ 18,005
Inventory	25,662	417,735
Property and equipment, net of accumulated depreciation	—	43,545
Patents and trademarks, net of accumulated amortization	—	1,367,412
Assets associated with discontinued operations	\$ 31,389	