NEOPROBE CORP
Form 10-Q
August 10, 2010

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2010

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

For the transition period from to to

Commission File Number: 0-26520

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

Delaware	31-1080091
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
425 Metro Place North, Suite 300, Dublin, Ohio	43017-1367
(Address of principal executive offices)	(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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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: 82,280,216 shares of common stock, par value $.001 per share (as of the close of business on August 6, 2010).

NEOPROBE CORPORATION and SUBSIDIARIES

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

Neoprobe Corporation and Subsidiaries
Consolidated Balance Sheets

	June 30, 2010 (unaudited)	December 31, 2009
ASSETS		
Current assets:		
Cash	$ 3,944,782	$ 5,639,842
Accounts receivable, net	1,896,956	1,331,908
Inventory	1,326,780	1,143,697
Prepaid expenses and other	138,243	474,243
Assets associated with discontinued operations	5,531	27,475
Total current assets	7,312,292	8,617,165
Property and equipment	2,265,914	1,990,603
Less accumulated depreciation and amortization	1,779,731	1,693,290
	486,183	297,313
Patents and trademarks	532,561	524,224
Less accumulated amortization	446,769	445,650
	85,792	78,574
Other assets	7,421	24,707
Total assets	$ 7,891,688	$ 9,017,759

Continued

Neoprobe Corporation and Subsidiaries,
Consolidated Balance Sheets, continued

	June 30, 2010 (unaudited)	December 31, 2009
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable	$ 1,372,286	$ 763,966
Accrued liabilities and other	1,041,438	1,048,304
Capital lease obligations, current portion	11,958	11,265
Deferred revenue, current portion	587,786	560,369
Liabilities associated with discontinued operations	15,894	18,743
Total current liabilities	3,029,362	2,402,647
Capital lease obligations	13,404	19,912
Deferred revenue	545,245	534,119
Note payable to Bupp Investors, net of discount of $54,093	—	945,907
Notes payable to investor	—	10,000,000
Derivative liabilities	1,569,271	1,951,664
Other liabilities	30,057	33,362
Total liabilities	5,187,339	15,887,611
Commitments and contingencies		
Preferred stock; $.001 par value; 5,000,000 shares authorized; 3,000 Series A shares, $1,000 face value, issued and outstanding at December 31, 2009	—	3,000,000
Stockholders' equity (deficit):		
Preferred stock; $.001 par value; 5,000,000 shares authorized; 10,000 Series B shares and 1,000 Series C shares issued and outstanding at June 30, 2010	11	—
Common stock; $.001 par value; 150,000,000 shares authorized; 82,151,043 and 80,936,711 shares outstanding at June 30, 2010 and December 31, 2009, respectively	82,151	80,937
Additional paid-in capital	249,007,591	182,747,897
Accumulated deficit	(246,385,404)	(192,698,686)
Total stockholders' equity (deficit)	2,704,349	(9,869,852)
Total liabilities and stockholders' equity (deficit)	$ 7,891,688	$ 9,017,759

See accompanying notes to consolidated financial statements

Neoprobe Corporation and Subsidiaries
Consolidated Statements of Operations
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Revenues:				
Net sales	2,513,876	$ 1,778,999	$ 5,171,748	$ 4,436,220
License revenue	25,000	25,000	50,000	50,000
Total revenues	2,538,876	1,803,999	5,221,748	4,486,220
Cost of goods sold	811,754	576,082	1,700,621	1,402,445
Gross profit	1,727,122	1,227,917	3,521,127	3,083,775
Operating expenses:				
Research and development	1,737,501	1,303,581	4,139,173	2,525,550
Selling, general and administrative	918,342	801,641	2,046,544	1,638,964
Total operating expenses	2,655,843	2,105,222	6,185,717	4,164,514
Loss from operations	(928,721)	(877,305)	(2,664,590)	(1,080,739)
Other income (expense):				
Interest income	1,947	3,761	3,761	13,708
Interest expense	(268,551)	(461,585)	(552,989)	(918,719)
Change in derivative liabilities	(154,315)	(13,730,204)	(583,607)	(12,204,839)
Loss on extinguishment of debt	(41,717,380)	—	(41,717,380)	—
Other	(2,122)	(1,357)	(2,578)	(1,631)
Total other expense, net	(42,140,421)	(14,189,385)	(42,852,793)	(13,111,481)
Loss from continuing operations	(43,069,142)	(15,066,690)	(45,517,383)	(14,192,220)
Discontinued operations – loss from operations	(717)	(50,244)	(12,590)	(110,593)
Net loss	(43,069,859)	(15,116,934)	(45,529,973)	(14,302,813)
Preferred stock dividends	(8,096,745)	(60,000)	(8,156,745)	(120,000)
Loss attributable to common stockholders	$ (51,166,604)	$ (15,176,934)	$ (53,686,718)	$ (14,422,813)
Loss per common share (basic and diluted):				
Continuing operations	$ (0.64)	$ (0.21)	$ (0.67)	$ (0.20)
Discontinued operations	$ —	$ —	$ —	$ —
Attributable to common stockholders	$ (0.64)	$ (0.21)	$ (0.67)	$ (0.20)
Weighted average shares outstanding:				
Basic and diluted	80,260,077	71,316,657	79,917,641	70,908,835

See accompanying notes to consolidated financial statements.

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

	Preferred Stock Shares	Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Deficit	Total
Balance, December 31, 2009	—	$ —	80,936,711	$ 80,937	$ 182,747,897	$ (192,698,686)	$ (9,869,852)
Issued stock in payment of interest on convertible debt and dividends on convertible preferred stock	—	—	347,832	348	476,319	—	476,667
Issued stock upon exercise of options, net of issuance costs	—	—	152,460	152	1,036	—	1,188
Issued stock in connection with stock purchase agreement, net of costs	—	—	660,541	661	776,797	—	777,458
Issued stock to 401(k) plan at $0.76	—	—	53,499	53	40,570	—	40,623
Issued Series B and Series C convertible preferred stock, net of issuance costs	11,000	11	—	—	64,661,789	—	64,661,800
Stock compensation expense	—	—	—	—	303,183	—	303,183
Preferred stock dividends, including deemed dividends	—	—	—	—	—	(8,156,745)	(8,156,745)
Comprehensive loss:							
Net loss	—	—	—	—	—	(45,529,973)	(45,529,973)
Balance, June 30, 2010	11,000	$ 11	82,151,043	$ 82,151	$ 249,007,591	$ (246,385,404)	$ 2,704,349

See accompanying notes to consolidated financial statements.

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

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Cash flows from operating activities:		
Net loss	$ (45,529,973)	$ (14,302,813)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	112,217	204,014
Amortization of debt discount and debt offering costs	16,109	364,838
Issuance of common stock in payment of interest and dividends	476,667	411,333
Stock compensation expense	303,183	145,314
Non-cash inventory adjustment	324,000	—
Change in derivative liabilities	583,607	12,204,839
Loss on extinguishment of debt	41,717,380	—
Other	42,487	38,902
Changes in operating assets and liabilities:		
Accounts receivable	(552,843)	497,529
Inventory	(541,511)	(172,788)
Prepaid expenses and other assets	113,456	101,700
Accounts payable	608,320	(195,413)
Accrued liabilities and other liabilities	(131,075)	(66,763)
Deferred revenue	38,543	(11,993)
Net cash used in operating activities	(2,419,433)	(781,301)
Cash flows from investing activities:		
Maturities of available-for-sale securities	—	494,000
Purchases of equipment	(253,797)	(58,652)
Proceeds from sales of equipment	—	251
Patent and trademark costs	(12,202)	(60,967)
Net cash (used in) provided by investing activities	(265,999)	374,632
Cash flows from financing activities:		
Proceeds from issuance of common stock	1,044,400	95,250
Payment of stock offering costs	(48,212)	(12,867)
Payment of notes payable	—	(102,826)
Payments under capital leases	(5,816)	(5,684)
Net cash provided by (used in) financing activities	990,372	(26,127)
Net decrease in cash	(1,695,060)	(432,796)
Cash, beginning of period	5,639,842	3,565,837
Cash, end of period	$ 3,944,782	$ 3,133,041

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements
(unaudited)

1. Summary of Significant Accounting Policies

a. Basis of Presentation: The information presented as of June 30, 2010 and for the three-month and six-month periods ended June 30, 2010 and June 30, 2009 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. The balances as of June 30, 2010 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, 2009, 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 the 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 development initiatives. Our consolidated statements of operations have been reclassified, as required, 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.

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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) Note payable to Bupp Investors: 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 December 31, 2009, the note payable to the Bupp Investors had an estimated fair value of $3.9 million, based on the closing market price of our common stock. During June 2010, the Bupp Investors exchanged their note for preferred stock, resulting in extinguishment of the debt. See Note 10.

(3) Notes payable to investor: The carrying value of our debt is presented as the face amount of the notes. At December 31, 2009, the notes payable to investors had an estimated fair value of $31.0 million, based on the closing market price of our common stock. During June 2010, the investor exchanged their notes for preferred stock, resulting in extinguishment of the debt. See Note 10.

(4) 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 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. During June 2010, certain investors exchanged their notes for preferred stock, resulting in extinguishment of our remaining put option liabilities. See Note 10.

c. Recent Accounting Developments: In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-6, Improving Disclosures about Fair Value Measurements. ASU 2010-6 amends FASB ASC Topic 820, Fair Value Measurements and Disclosures. ASU 2010-6 requires new disclosures as follows: (1) Transfers in and out of Levels 1 and 2 and (2) Activity in Level 3 fair value measurements. An entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. In the reconciliation of fair value measurements using significant unobservable inputs (Level 3), an entity should present separately information about purchases, sales, issuances, and settlements (that is, on a gross basis rather than as one net number). ASU 2010-6 also clarifies existing disclosures as follows: (1) Level of disaggregation and (2) Disclosures about inputs and valuation techniques. An entity should provide fair value measurement disclosures for each class of assets and liabilities. A class is often a subset of assets or liabilities within a line item in the statement of financial position. An entity needs to use judgment in determining the appropriate classes of assets and liabilities. An entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. Those disclosures are required for fair value measurements that fall in either Level 2 or Level 3. ASU 2010-6 is effective for interim and annual reporting periods beginning after December 15, 2009, except for the separate disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. We adopted the initial provisions of ASU 2010-6 beginning January 1, 2010. As the new provisions of ASU 2010-6 provide only disclosure requirements, the adoption of this standard did not impact our consolidated financial position, results of operations or cash flows, but did result in increased disclosures.

2. Discontinued Operations

In August 2009, the Company's Board of Directors decided to discontinue the operations of Cardiosonix and to attempt to sell 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 device product and drug development initiatives. We are in the process of identifying potential buyers, but our efforts thus far have not resulted in any definitive offers.

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 and reduced them to their estimated fair value at that time. 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:

	June 30, 2010	December 31, 2009
Accounts receivable, net	$ 3,144	$ 15,349
Inventory	2,387	12,126
Current assets associated with discontinued operations	$ 5,531	$ 27,475
Accounts payable	$ 5,400	$ 5,400
Accrued expenses	10,494	13,343
Current liabilities associated with discontinued operations	$ 15,894	$ 18,743

We recorded an impairment loss of $1.7 million related to the assets of Cardiosonix during the third quarter of 2009 and have reclassified all related revenues and expenses to discontinued operations for all periods presented. Until a sale is completed, we expect to continue to generate minimal revenues and incur minimal expenses related to our blood flow measurement device business. The following amounts have been segregated from continuing operations and included in discontinued operations in the consolidated statements of operations:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net sales	$ 21,790	$ 29,744	$ 36,235	$ 72,559
Cost of goods sold	5,227	11,553	11,616	33,724
Gross profit	16,563	18,191	24,619	38,835
Operating expenses:				
Research and development	10,557	4,397	10,808	20,486
Selling, general and administrative	6,660	64,122	26,522	128,847