Stereotaxis, Inc.
Form 10-Q
November 08, 2011
Table of Contents

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 September 30, 2011.

¨ **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 November 1, 2011 was 55,431,723.

Table of Contents

STEREOTAXIS, INC.

INDEX TO FORM 10-Q

Table of Contents

ITEM 1. FINANCIAL STATEMENTS

STEREOTAXIS, INC.

BALANCE SHEETS

	September 30, 2011 (Unaudited)	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 16,979,863	$ 35,248,819
Accounts receivable, net of allowance of $386,153 and $367,536 in 2011 and 2010, respectively	4,533,990	13,915,569
Current portion of long-term receivables	64,271	30,800
Inventories	5,866,506	5,441,475
Prepaid expenses and other current assets	3,314,810	4,557,718
Total current assets	30,759,440	59,194,381
Property and equipment, net	3,634,185	3,840,622
Intangible assets, net	2,354,111	2,578,986
Long-term receivables	81,514	109,266
Other assets	41,821	38,537
Total assets	$ 36,871,071	$ 65,761,792
Liabilities and stockholders equity (deficit)		
Current liabilities:		
Short-term debt and current maturities of long-term debt	$ 28,992,163	$ 20,894,091
Accounts payable	7,006,495	8,796,182
Accrued liabilities	6,153,088	6,966,571
Deferred revenue	8,180,801	6,600,313
Warrants	289,976	3,541,798
Total current liabilities	50,622,523	46,798,955
Long-term debt, less current maturities		8,000,000
Long-term deferred revenue	335,296	478,850
Other liabilities	3,094	8,741
Stockholders equity (deficit):		
Preferred stock, par value $0.001; 10,000,000 shares authorized at 2011 and 2010, none outstanding at 2011 and 2010		
Common stock, par value $0.001; 100,000,000 shares authorized at 2011 and 2010, 55,408,312 and 54,746,240 shares issued at 2011 and 2010, respectively	55,408	54,746
Additional paid in capital	355,954,708	354,002,770
Treasury stock, 40,151 shares at 2011 and 2010	(205,999)	(205,999)
Accumulated deficit	(369,893,959)	(343,376,271)
Total stockholders equity (deficit)	(14,089,842)	10,475,246
Total liabilities and stockholders equity (deficit)	$ 36,871,071	$ 65,761,792

See accompanying notes.

Table of Contents

STEREOTAXIS, INC.

STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Revenue:				
Systems	$ 2,037,742	$ 8,153,088	$ 11,350,461	$ 22,826,700
Disposables, service and accessories	6,506,272	5,719,166	19,020,396	16,680,241
Total revenue	8,544,014	13,872,254	30,370,857	39,506,941
Cost of revenue:				
Systems	1,723,874	3,091,734	6,428,783	9,482,225
Disposables, service and accessories	933,380	763,348	2,749,796	2,219,680
Total cost of revenue	2,657,254	3,855,082	9,178,579	11,701,905
Gross margin	5,886,760	10,017,172	21,192,278	27,805,036
Operating expenses:				
Research and development	3,529,321	2,868,426	10,234,757	9,595,972
Sales and marketing	6,885,786	7,269,005	24,936,641	22,410,734
General and administrative	4,527,489	3,471,244	13,384,313	11,337,637
Total operating expenses	14,942,596	13,608,675	48,555,711	43,344,343
Operating loss	(9,055,836)	(3,591,503)	(27,363,433)	(15,539,307)
Other income (expense)	2,611,067	(920,222)	3,251,822	49,830
Interest income	1,817	3,004	7,137	7,934
Interest expense	(830,118)	(635,176)	(2,413,214)	(1,951,098)
Net loss	$ (7,273,070)	$ (5,143,897)	$ (26,517,688)	$ (17,432,641)
Net loss per common share:				
Basic and diluted	$ (0.13)	$ (0.10)	$ (0.48)	$ (0.35)
Weighted average shares used in computing net loss per common share:				
Basic and diluted	54,878,235	50,137,857	54,793,509	49,847,321

See accompanying notes.

Table of Contents

STEREOTAXIS, INC.

STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended September 30, 2011	2010
Cash flows from operating activities		
Net loss	$ (26,517,688)	$ (17,432,641)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation	1,095,613	1,320,082
Amortization	224,875	155,500
Amortization of warrants	995,926	906,525
Share-based compensation	1,741,184	1,361,352
Loss on asset disposal	83,705	5,039
Non-cash royalty (income), net	(2,353,718)	(2,490,119)
Warrant adjustment	(3,251,822)	(49,830)
Changes in operating assets and liabilities:		
Accounts receivable	9,381,579	242,804
Other receivables	(5,719)	4,596
Inventories	(425,031)	(891,938)
Prepaid expenses and other current assets	246,982	797,438
Other assets	(3,284)	
Accounts payable	(1,789,687)	2,873,467
Accrued liabilities	(813,483)	(346,707)
Deferred revenue	1,436,934	(531,576)
Other liabilities	(5,647)	(8,552)
Net cash used in operating activities	(19,959,281)	(14,084,560)
Cash flows from investing activities		
Purchase of equipment	(972,881)	(605,673)
Net cash used in investing activities	(972,881)	(605,673)
Cash flows from financing activities		
Proceeds from revolving line of credit	52,309,376	42,469,200
Payments of revolving line of credit	(46,409,376)	(35,833,334)
Payments of short-term debt	(3,448,210)	
Payments of long-term debt		(1,300,782)
Proceeds from issuance of stock and warrants, net of issuance costs	211,416	601,327
Net cash provided by financing activities	2,663,206	5,936,411
Net decrease in cash and cash equivalents	(18,268,956)	(8,753,822)
Cash and cash equivalents at beginning of period	35,248,819	30,546,550
Cash and cash equivalents at end of period	$ 16,979,863	$ 21,792,728

See accompanying notes.

Table of Contents

STEREOTAXIS, INC.

NOTES TO FINANCIAL STATEMENTS

(Unaudited)

Notes to Financial Statements

1. Description of Business

Stereotaxis designs, manufactures and markets an advanced cardiology instrument control system for use in a hospital s interventional surgical suite to enhance the treatment of arrhythmias and coronary artery disease. 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 Enterprise 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.

The core components of the NIOBE and the ODYSSEY systems have received regulatory clearance in the U.S., Canada, Europe, China and various other countries.

From inception to September 30, 2011, the Company has incurred losses totaling approximately $369.9 million. The Company expects such losses to continue through at least the year ended December 31, 2011. In May 2011, the Company introduced the NIOBE EPOCH Solution. Although the NIOBE EPOCH Solution is not available to customers until December 2011, the product change created a rapid shift away from sales of the current NIOBE II, resulting in lower System Revenue through September 30, 2011 compared to the same period in 2010. During the quarter ended September 30, 2011, the Company implemented a detailed plan to rebalance and reduce operating expenses by 15% to 20% on an annual run rate basis. As of September 30, 2011, the Company has completed the majority of the operating expense declines through headcount reductions and discretionary spending cuts and continues to implement processes and changes to further reduce operating expenses.

As a result of the losses incurred, cash used in operations was significantly higher than expected. In September 2011, the Company amended its agreement with its primary lender. Under the amendment, the lender waived the minimum tangible net worth covenant contained in the original agreement for the compliance period ended September 30, 2011. The amendment also reduced the availability of all credit extensions, other than the term loan, from $30 million to $20 million and increased 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%. Finally, the amendment established a new financial covenant which requires the Company to receive net proceeds equal to or greater than $10 million on or before November 30, 2011 from (i) the issuance by the Company of additional subordinated debt; (ii) with the prior written consent of the Bank, the sale and/or exclusive licensing of certain assets of the Company; and/or (iii) the issuance of additional equity of the Company.

The Company entered into a non-binding term sheet on October 11, 2011 with an institutional investor to raise non-equity capital. The Company expects the capital raise to be completed by November 30, 2011, satisfying the Company s obligation under its agreement with its primary lender. The term sheet is subject to customary closing conditions, including the execution of definitive agreements. See Note 9 for additional discussion of the Company s outstanding debt facilities.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited financial statements of Stereotaxis, Inc. (the Company) 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 nine month period ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ended December 31, 2011 or for future operating periods.

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, 2010 as filed with the Securities and Exchange Commission (SEC) on March 11, 2011.

Table of Contents

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 NIOBE, ODYSSEY VISION, and ODYSSEY CINEMA 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 is recognized for other types of ODYSSEY systems upon completion of installation, since there are no qualified third party installers. We may deliver systems to a non-hospital site at the customer s request. We evaluate whether delivery has occurred considering general accounting principles for revenue recognition with respect to bill and hold transactions. 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 Loss per Common Share

Basic and diluted net loss per common share is computed by dividing the net loss for the period by the weighted average number of common shares outstanding during the period. The largest adjustment between the shares outstanding at September 30, 2011 and the weighted average shares used for calculating basic earnings per share for the quarter ended September 30, 2011 is the deduction of unvested restricted shares, which amounted to 531,202 at September 30, 2011.

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 all periods presented. The application of the two-class method of computing earnings per share under general accounting principles for participating securities is not applicable because the Company s unearned restricted shares do not contractually participate in its losses.

As of September 30, 2011, the Company had 5,711,316 shares of common stock issuable upon the exercise of outstanding options and stock appreciation rights at a weighted average exercise price of $5.00 per share and 10,381,613 shares of common stock issuable upon the exercise of outstanding warrants at a weighted average exercise price of $4.20 per share. The Company had a weighted average of 517,537 and 455,001 unearned restricted shares outstanding for the three and nine months ended September 30, 2011, respectively.

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).

The Company s financial assets consist of cash equivalents invested in money market funds in the amount of $43,471 and $12,238,932 at September 30, 2011 and December 31, 2010, respectively. These assets are classified as Level 1 as described above and total interest income recorded for these investments was approximately $30 and $1,400 during the three and nine months ended September 30, 2011. There were no transfers in or out of Level 1 during the nine months ended September 30, 2011.

The Company s financial liabilities consist of warrants in the amount of $289,976 at September 30, 2011. These liabilities are classified as Level 3 as described above and are measured using the Black-Scholes valuation model. The mark-to-market adjustment recorded in other income (expense) for these warrants was $2,611,067 and $3,251,822 during the three and nine months ended September 30, 2011. There were no purchases, sales, issuances, transfers, or settlements of Level 3 financial instruments during the nine months ended September 30, 2011. These warrants were transferred into Level 3 on January 1, 2009 based on the adoption of general accounting principles for determining whether an instrument (or embedded feature) is indexed to an entity s own stock. See Note 11 for additional details.

Fair Value Other Financial Instruments

The following methods and assumptions were used by the Company in estimating its fair value disclosures for other financial instruments as of September 30, 2011 and December 31, 2010.

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 and restricted shares 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.

Table of Contents

STEREOTAXIS, INC.

NOTES TO FINANCIAL STATEMENTS (Continued)

(Unaudited)

Recently Issued Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (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 US GAAP and International Financial Reporting Standards (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 is effective during interim and annual periods beginning after December 15, 2011.

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 Standard. 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 is 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.

3. Inventory

Inventory consists of the following:

	September 30, 2011	December 31, 2010
Raw materials	$ 2,160,000	$ 1,547,020
Work in process		592,221
Finished goods	3,865,450	3,841,752
Reserve for obsolescence	(158,944)	(539,518)
Total inventory	$ 5,866,506	$ 5,441,475

4. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist of the following:

	September 30, 2011	December 31, 2010
Prepaid expenses	$ 470,865	$ 401,789
Deferred cost of revenue	480,324	759,271
Other assets	2,363,621	3,396,658
Total prepaid expenses and other current assets	$ 3,314,810	$ 4,557,718

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.

Table of Contents

STEREOTAXIS, INC.

NOTES TO FINANCIAL STATEMENTS (Continued)

(Unaudited)

5. Property and Equipment

Property and equipment consist of the following:

	September 30, 2011	December 31, 2010
Equipment	$ 9,966,128	$ 8,950,043
Equipment held for lease	547,416	547,416
Leasehold improvements	2,328,381	2,473,880
	12,841,925	11,971,339
Less: Accumulated depreciation	(9,207,740)	(8,130,717)
Net property and equipment	$ 3,634,185	$ 3,840,622

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 September 30, 2011, the Company had total intangible assets, including those described above, of $3.7 million. Accumulated amortization at September 30, 2011 is $1.3 million.

7. Accrued Liabilities

Accrued liabilities consist of the following:

	September 30, 2011	December 31, 2010
Accrued salaries, bonus, and benefits	$ 3,378,210	$ 4,203,551
Accrued research and development	73,992	246,119
Accrued legal and other professional fees	279,470	170,498
Other	2,421,416	2,346,403
Total accrued liabilities	$ 6,153,088	$ 6,966,571

Table of Contents

STEREOTAXIS, INC.

NOTES TO FINANCIAL STATEMENTS (Continued)

(Unaudited)

8. Deferred Revenue

Deferred revenue consists of the following:

	September 30, 2011	December 31, 2010
Product shipped, revenue deferred	$ 876,320	$ 552,692
Customer deposits	1,465,647	312,154
Deferred service and license fees	6,174,130	6,214,317
	8,516,097	7,079,163
Less: Long-term deferred revenue	(335,296)	(478,850)
Total current deferred revenue	$ 8,180,801	$ 6,600,313

9. Long-Term Debt and Credit Facilities

Debt outstanding consists of the following:

	September 30, 2011		December 31, 2010	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Revolving credit agreement, due March 2012	$ 16,900,000	$ 17,074,473	$ 11,000,000	$ 11,284,412
Term note, due December 2013	9,000,000	9,000,000	10,000,000	10,000,000
Biosense Webster Advance	3,092,163	3,115,645	7,894,091	8,005,365
Total debt	28,992,163	29,190,118	28,894,091	29,289,777
Less current maturities	(28,992,163)	(29,190,118)	(20,894,091)	(21,289,777)
Total long term debt	$	$	$ 8,000,000	$ 8,000,000

Table of Contents

STEREOTAXIS, INC.

NOTES TO FINANCIAL STATEMENTS (Continued)

(Unaudited)

Revolving line of credit

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 accrues 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. Pursuant to the agreement, the lender waived the minimum tangible net worth financial covenant contained in the original amendment for the compliance period ended September 30, 2011. The Company was in compliance with the liquidity ratio covenant for this period. The amendment also reduces the availability amount of all credit extensions, other than the term loan, from $30 million to $20 million, and modifies 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%. Additionally, the amendment provides for a new financial covenant that, on or before November 30, 2011, the Company must receive net proceeds in an amount equal to or greater than $10 million from (i) the issuance by the Company of additional subordinated debt; (ii) with the prior written consent of the primary lender, the sale and/or exclusive licensing of certain assets of the Company; and/or (iii) the issuance of additional equity of the Company.

As of September 30, 2011, the Company had $16.9 million outstanding under the revolving line of credit. Draws on the line of credit are made based on the borrowing capacity one month in arrears. As of August 31, 2011, the Company had a borrowing capacity of $17.0 million based on the Company s collateralized assets, including amounts already drawn. As such, the Company had the ability to borrow an additional $0.1 million under the revolving line of credit at September 30, 2011. As of September 30, 2011, the Company had no remaining availability on its Lender loan and guarantee. In the event that the Company does not renew or modify the terms of its existing debt facility, it is probable that the Company will not meet all covenants of its bank loan agreement as of November 30, 2011. In the event that the covenants are not met, it is possible that the primary lender could call the Company s outstanding debt, including the revolving line of credit and term note (defined below).

The Revolving Credit Agreement 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.

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 accrues 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%. As described above, in the event that the covenants of the loan agreement are not met, the primary lender could call the Company s outstanding debt. Under ASC 470 Debt, callable obligations are classified as current unless the creditor waives the right to call the debt for a period of more than one year or it is probable that the violation will be cured within the grace period provided by the lender. Because the lender waived the covenant only for the quarter ended September 30, 2011 and without a future capital transaction, the Company does not expect to cure the violation prior to December 31, 2011, the entire term note is classified as short-term debt as of September 30, 2011.

Biosense Webster Advance

In July 2008, the Company and Biosense Webster entered into an amendment to their existing agreements relating to the development and sale of catheters. Pursuant to the amendment, Biosense Webster agreed to pay to the Company $10.0 million as an advance on royalty amounts that were owed at the time the amendment was executed or would be owed in the future by Biosense Webster to the Company pursuant to the royalty provisions of one of the existing agreements. The Company and Biosense Webster also agreed that an aggregate of up to $8.0 million of certain agreed upon research and development expenses that were owed at the time the amendment was executed or may be owed in the future by the

Company to Biosense Webster pursuant to the existing agreement would be deferred and will be due, together with any unrecouped portion of the $10.0 million royalty advance, on the Final Payment Date (as defined below). Interest on the outstanding and unrecouped amounts of the royalty advance and deferred research and development expenses will accrue at an interest rate of the prime rate plus 0.75%. Outstanding royalty advances and deferred research and development expenses and accrued interest thereon will be recouped by Biosense Webster by deductions from royalty amounts otherwise owed to the Company from Biosense Webster pursuant to the existing agreement. The Company has the right to prepay any amounts due pursuant to the Amendment at any time without penalty. Approximately $18.0 million had been advanced by Biosense Webster to the Company pursuant to the amendment. As of September 30, 2011, $12.4 million of royalty payments owed by Biosense and $4.5 million in supplemental payments had been used to reduce the advances together with the accrued interest thereon and the remaining approximately $3.1 million of amounts owed to Biosense Webster has been classified as short-term debt in the accompanying balance sheet. The Company recorded interest expense of $0.1 million and $0.2 million and disposables, service and accessories revenue of $0.8 million and $2.6 million for the three and nine months ended September 30, 2011, related to this agreement.

Table of Contents

STEREOTAXIS, INC.

NOTES TO FINANCIAL STATEMENTS (Continued)

(Unaudited)

All funds owed by the Company to Biosense Webster must be repaid on the sooner of December 31, 2011 or the date of an Accelerating Recoupment Event as defined below (the Final Payment Date). Commencing on May 15, 2010 the Company is required to make quarterly payments (the Supplemental Payments) to Biosense Webster equal to the difference between the aggregate royalty payments recouped by Biosense Webster from the Company (other than royalty amounts attributable to Biosense Webster s sales of irrigated catheters) in such quarter and $1 million, until the earlier of (1) the date all funds owed by the Company to Biosense Webster pursuant to the Amendment are fully repaid or (2) the Final Payment Date. An Accelerating Recoupment Event means any of the following: (i) the closing of any equity-based registered public financing transaction or in the event of convertible debt, the conversion of such debt into equity which raises at least $50 million for the Company; (ii) the failure of the Company to make any Supplemental Payment; or (iii) a change of control of the Company (as defined in the amendment).

Table of Contents

STEREOTAXIS, INC.

NOTES TO FINANCIAL STATEMENTS (Continued)

(Unaudited)

10. Stockholders Equity

Stock Award Plans

The Company has various stock plans that permit the Company to provide incentives to employees and directors of the Company in the form of equity compensation that are described in both the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2010 and the Company s definitive Proxy Statement on Schedule 14A filed with the SEC on April 15, 2011. At September 30, 2011, the Board of Directors had reserved a total of 6,976,670 shares of the Company s common stock to provide for current and future grants under its various equity plans.

At September 30, 2011, the total compensation cost related to options, stock appreciation rights and non-vested stock granted to employees under the Company s stock award plans but not yet recognized was approximately $5.9 million, net of estimated forfeitures of approximately $1.7 million. This cost will be amortized over a period of up to four years on a straight-line basis over the underlying estimated service periods and will be adjusted for subsequent changes in estimated forfeitures and anticipated vesting periods.

A summary of the option and stock appreciation rights activity for the nine months ended September 30, 2011 is as follows:

	Number of Options/SARs	Range of Exercise Price	Weighted Average Exercise Price per Share
Outstanding, December 31, 2010	4,711,082	$ 1.37 - $12.55	$ 5.80
Granted	1,918,250	$ 1.00 - $4.03	$ 3.44
Exercised	(4,682)	$ 1.62 - $1.62	$ 1.54
Forfeited	(913,334)	$ 1.37 - $12.03	$ 5.84
Outstanding, September 30, 2011	5,711,316	$ 1.00 - $12.55	$ 5.00

A summary of the restricted share grant activity for the nine months ended September 30, 2011 is as follows:

	Number of Shares	Weighted Average Grant Date Fair Value per Share
Outstanding, December 31, 2010	33,514	$ 8.19
Granted	614,550	$ 3.45
Vested	(18,022)	$ 8.60
Forfeited	(98,840)	$ 3.73
Outstanding, September 30, 2011	531,202	$ 3.52

A summary of the restricted stock outstanding as of September 30, 2011 is as follows:

	Number of Shares
Time based restricted shares	209,002
Performance based restricted shares	322,200
Outstanding, September 30, 2011	531,202

11. Warrants Liability

The Company currently does not have derivative instruments to manage its exposure to currency fluctuations or other business risks. The Company evaluates all of its financial instruments to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. All derivative financial instruments are recognized in the balance sheet at fair value.

Table of Contents

STEREOTAXIS, INC.

NOTES TO FINANCIAL STATEMENTS (Continued)

(Unaudited)

In conjunction with its December 29, 2008 registered direct offering, the Company issued warrants to purchase 1,792,408 shares of the Company s common stock that contained a provision that required a reduction of the exercise price if certain equity events occurred. Under the provisions of general accounting principles for derivatives and hedging activities and determining whether an instrument (or embedded feature) is indexed to an entity s own stock, such a reset provision does not meet the exemptions for equity classification and as such, the Company accounts for these warrants as derivative instruments. The calculated fair value of the warrants is classified as a liability and is periodically remeasured with any changes in value recognized in Other income (expense) in the Statement of Operations. General accounting principles for determining whether an instrument (or embedded feature) is indexed to an entity s own stock became effective for the Company as of January 1, 2009. Accordingly, the fair value of the warrants as of that date was reclassified from stockholders equity into current liabilities.

In accordance with general accounting principles for fair value measurement, the Company s warrants in the amount of $289,976 were measured at fair value on a recurring basis as of September 30, 2011 and were valued using Level 3 valuation inputs. A Black-Scholes model was used to value the Company s warrants at September 30, 2011 using the following assumptions: 1) dividend yield of 0%; 2) volatility of 65%; 3) risk-free interest rate of 0.42%; and 4) expected life of 2.75 years. The fair value of the outstanding derivative instrument and the effect on the Statement of Operations is as follows:

	Fair Value of Warrants
Balance, December 31, 2010	$ 3,541,798
Change in fair value	(3,251,822)
Balance, September 30, 2011	$ 289,976

12. Product Warranty Provisions

The Company s standard policy is to warrant all NIOBE and ODYSSEY systems against defects in material or workmanship for one year following installation. The Company s estimate of costs to service the warranty obligations is based on historical experience and current product performance trends. A regular review of warranty obligations is performed to determine the adequacy of the reserve and adjustments are made to the estimated warranty liability as appropriate.

Accrued warranty, which is included in other accrued liabilities, consists of the following:

	September 30, 2011
Warranty accrual, December 31, 2010	$ 469,837
Warranty expense incurred	551,721
Payments made	(394,209)
Warranty accrual, September 30, 2011	$ 627,349

13. Commitments and Contingencies

The Company at times becomes a party to claims in the ordinary course of business. Management believes that the ultimate resolution of pending or threatened proceedings will not have a material effect on the financial position, results of operations or liquidity of the Company.

14. Subsequent Events

The Company entered into a non-binding term sheet on October 11, 2011 with an institutional investor to raise non-equity capital. The Company expects the capital raise to be completed by November 30, 2011, satisfying the Company s obligation under the Fourth Loan Modification Agreement with Silicon Valley Bank. The term sheet is subject to customary closing conditions, including the execution of definitive agreements.

On October 31, 2011, the Company and its primary lender entered into a waiver agreement in which the lender waived testing the liquidity ratio financial covenant for the compliance period ending October 31, 2011.

Table of Contents

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

The following discussion and analysis should be read in conjunction with our financial statements and notes thereto included in this report on Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2010. Operating results are not necessarily indicative of results that may occur in future periods.

This report includes various forward-looking statements that are subject to risks and uncertainties, many of which are beyond our control. Our actual results could differ materially from those anticipated in these forward looking statements as a result of various factors, including those set forth in Item 1A Risk Factors and in our Annual Report on Form 10-K for the year ended December 31, 2010. Forward-looking statements discuss matters that are not historical facts and include, but are not limited to, discussions regarding our operating strategy, sales and marketing strategy, regulatory strategy, industry, economic conditions, financial condition, liquidity and capital resources and results of operations. Such statements include, but are not limited to, statements preceded by, followed by or that otherwise include the words believes, expects, anticipates, intends, estimates, projects, can, could, may, will, would, or similar expressions. For those statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. You should not unduly rely on these forward-looking statements, which speak only as of the date on which they were made. They give our expectations regarding the future, but are not guarantees. We undertake no obligation to update publicly or revise any forward-looking statements, whether as a result of new information, future events or otherwise, unless required by law.

Overview

Stereotaxis designs, manufactures and markets an advanced cardiology instrument control system for use in a hospital s interventional surgical suite to enhance the treatment of arrhythmias and coronary artery disease. 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 Enterprise 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 hosp