NEOPROBE CORP
Form 10-Q
May 15, 2009

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 March 31, 2009

¨ 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 ¨

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 12b-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: 72,229,237 shares of common stock, par value $.001 per share (as of the close of business on May 8, 2009).

NEOPROBE CORPORATION and SUBSIDIARIES

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

Neoprobe Corporation and Subsidiaries
Consolidated Balance Sheets

ASSETS	March 31, 2009 (unaudited)	December 31, 2008
Current assets:		
Cash	$ 3,549,057	$ 3,565,837
Available-for-sale securities	-	495,383
Accounts receivable, net	1,685,209	1,644,070
Inventory	976,138	961,861
Prepaid expenses and other	546,162	573,573
Total current assets	6,756,566	7,240,724
Property and equipment	2,082,459	2,060,588
Less accumulated depreciation and amortization	1,696,304	1,669,796
	386,155	390,792
Patents and trademarks	3,032,667	3,020,001
Acquired technology	237,271	237,271
	3,269,938	3,257,272
Less accumulated amortization	1,909,871	1,863,787
	1,360,067	1,393,485
Other assets	568,019	594,449
Total assets	$ 9,070,807	$ 9,619,450

Continued

Neoprobe Corporation and Subsidiaries
Consolidated Balance Sheets, continued

LIABILITIES AND STOCKHOLDERS' DEFICIT	March 31, 2009 (unaudited)	December 31, 2008
Current liabilities:		
Accounts payable	$ 692,302	$ 731,220
Accrued liabilities and other	942,210	917,676
Capital lease obligations, current portion	7,417	9,084
Deferred revenue, current portion	511,776	526,619
Notes payable to finance companies	86,865	137,857
Total current liabilities	2,240,570	2,322,456
Capital lease obligations, net of current portion	9,341	11,095
Deferred revenue, net of current portion	474,193	490,165
Notes payable to CEO, net of discounts of $71,012 and $76,294, respectively	928,988	923,706
Notes payable to investors, net of discounts of $4,909,630 and $5,001,149, respectively	5,090,370	4,998,851
Derivative liabilities	12,345,006	853,831
Other liabilities	42,320	45,071
Total liabilities	21,130,788	9,645,175
Commitments and contingencies		
Preferred stock; $.001 par value; 5,000,000 shares authorized; 3,000 Series A shares, par value $1,000, issued and outstanding at March 31, 2009 and December 31, 2008	3,000,000	3,000,000
Stockholders' deficit:		
Common stock; $.001 par value; 150,000,000 shares authorized; 71,555,707 and 70,862,641 shares issued and outstanding at March 31, 2009 and December 31, 2008, respectively	71,556	70,863
Additional paid-in capital	136,967,308	145,742,044
Accumulated deficit	(152,098,845)	(148,840,015)
Unrealized gain on available-for-sale securities	-	1,383
Total stockholders' deficit	(15,059,981)	(3,025,725)
Total liabilities and stockholders' deficit	$ 9,070,807	$ 9,619,450

See accompanying notes to consolidated financial statements

Neoprobe Corporation and Subsidiaries
Consolidated Statements of Operations
(unaudited)

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
Revenues:		
Net sales	$ 2,700,036	$ 1,782,792
License and other revenue	25,000	-
Total revenues	2,725,036	1,782,792
Cost of goods sold	848,534	660,007
Gross profit	1,876,502	1,122,785
Operating expenses:		
Research and development	1,238,058	563,703
Selling, general and administrative	902,048	875,408
Total operating expenses	2,140,106	1,439,111
Loss from operations	(263,604)	(316,326)
Other income (expense):		
Interest income	9,949	10,608
Interest expense	(457,134)	(331,779)
Change in derivative liabilities	1,525,365	(386,746)
Other	(455)	(1,748)
Total other income (expense), net	1,077,725	(709,665)
Net income (loss)	814,121	(1,025,991)
Preferred stock dividends	(60,000)	-
Income (loss) attributable to common stockholders	$ 754,121	$ (1,025,991)
Income (loss) per common share:		
Basic	$ 0.01	$ (0.02)
Diluted	$ 0.01	$ (0.02)
Weighted average shares outstanding:		
Basic	71,387,438	67,284,589
Diluted	96,346,846	67,284,589

See accompanying notes to consolidated financial statements.

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

	Common Stock		Additional Paid-in	Accumulated	Accumulated Other Comprehensive Income	
	Shares	Amount	Capital	Deficit	(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	50,000	50	25,950	-	-	26,000
Issued stock as payment of interest on convertible debt	152,066	152	83,181	-	-	83,333
Stock compensation expense	-	-	70,536	-	-	70,536
Paid preferred stock issuance costs	-	-	(6,323)	-	-	(6,323)
Preferred stock dividends	-	-	-	(60,000)	-	(60,000)
Comprehensive income (loss):						
Net income	-	-	-	814,121	-	814,121
Unrealized loss on available-for-sale securities	-	-	-	-	(1,383)	(1,383)
Total comprehensive income						812,738
Balance, March 31, 2009	71,555,707	$ 71,556	$ 136,967,308	$ (152,098,845)	$ -	$ (15,059,981)

See accompanying notes to consolidated financial statements.

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

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
Cash flows from operating activities:		
Net income (loss)	$ 814,121	$ (1,025,991)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	100,896	95,815
Amortization of debt discount and debt offering costs	179,730	129,373
Provision for bad debts	-	4,558
Issuance of common stock in payment of interest	83,333	-
Stock compensation expense	70,536	48,211
Change in derivative liabilities	(1,525,365)	386,746
Other	4,581	32,795
Changes in operating assets and liabilities:		
Accounts receivable	(41,139)	404,655
Inventory	(28,794)	123,057
Prepaid expenses and other assets	33,955	64,041
Accounts payable	(38,918)	36,996
Accrued liabilities and other liabilities	(38,217)	(312,631)
Deferred revenue	(30,815)	(29,976)
Net cash used in operating activities	(416,096)	(42,351)
Cash flows from investing activities:		
Maturities of available-for-sale securities	494,000	-
Purchases of property and equipment	(40,491)	(15,572)
Proceeds from sales of property and equipment	251	120
Patent and trademark costs	(12,665)	(487)
Net cash provided by (used in) investing activities	441,095	(15,939)
Cash flows from financing activities:		
Proceeds from issuance of common stock	25,500	114,200
Payment of common stock offering costs	(6,544)	-
Payment of preferred stock offering costs	(6,322)	-
Payment of debt issuance costs	-	(11,406)
Payment of notes payable	(50,992)	(52,887)
Payments under capital leases	(3,421)	(3,656)
Net cash (used in) provided by financing activities	(41,779)	46,251
Net decrease in cash	(16,780)	(12,039)
Cash, beginning of period	3,565,837	1,540,220

Cash, end of period	$ 3,549,057	$ 1,528,181

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 March 31, 2009 and for the three-month periods ended March 31, 2009 and March 31, 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 U.S. generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the U.S. Securities and Exchange Commission. 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.

b. Financial Instruments and Fair Value: We adopted Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements, for financial assets and liabilities as of January 1, 2008. SFAS No. 157 establishes 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 or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under SFAS No. 157 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 that are subject to SFAS No. 157. 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 2.

We adopted the remaining provisions of SFAS No. 157 for non-financial assets and liabilities beginning January 1, 2009. Financial Accounting Standards Board (FASB) Staff Position (FSP) FAS 157-2 deferred the effective date of SFAS No. 157 for one year relative to nonfinancial assets and liabilities that are measured at fair value, but are recognized or disclosed at fair value on a nonrecurring basis. This deferral applied to such items as indefinite-lived intangible assets and nonfinancial long-lived asset groups measured at fair value for impairment assessments. The adoption of the remaining provisions of SFAS No. 157 did not have a material impact on our consolidated results of operations or financial condition.

2. Fair Value Hierarchy

The following tables set forth by level liabilities measured at fair value on a recurring basis.

Liabilities Measured at Fair Value on a Recurring Basis as of March 31, 2009

Description	Quoted Prices in Active Markets for Identical Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of March 31, 2009
Liabilities:				
Derivative liabilities related to warrants	$ -	$ 6,743,325	$ -	$ 6,743,325
Derivative liabilities related to conversion and put options	-	-	5,601,681	5,601,681
Total derivative liabilities	$ -	$ 6,743,325	$ 5,601,681	$ 12,345,006

Assets and Liabilities Measured at Fair Value on a Recurring Basis as of December 31, 2008

Description	Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of December 31, 2008
Assets:				
Available-for-sale securities	$ 495,383	$ -	$ -	$ 495,383
Liabilities:				
Derivative liabilities related to conversion and put options	$ -	$ -	$ 853,831	$ 853,831

The following table sets forth a summary of changes in the fair value of our Level 3 liabilities for the three months ended March 31, 2009:

Description	Balance at December 31, 2008	Unrealized Gains	Transfers In and/or (Out) (See Note 10)	Balance at March 31, 2009
Liabilities:				
Derivative liabilities related to conversion and put options	$ 853,831	$ (556,637)	$ 5,304,487	$ 5,601,681

The unrealized gains and losses on the derivatives are classified in other expenses as a change in derivative liabilities in the statement of operations. Fair value of available-for-sale securities is determined based on a discounted cash flow analysis using current market rates. 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.

3. Stock-Based Compensation

We account for stock-based compensation in accordance with SFAS No. 123(R), Share-Based Payment. At March 31, 2009, we have three stock-based compensation plans. Under the Amended and Restated Stock Option and Restricted Stock Purchase Plan (the Amended Plan), the 1996 Stock Incentive Plan (the 1996 Plan), and the Second Amended and Restated 2002 Stock Incentive Plan (the 2002 Plan), we may grant incentive stock options, nonqualified stock options, and restricted stock awards to full-time employees, and nonqualified stock options and restricted awards may be granted to our consultants and agents. Total shares authorized under each plan are 2 million shares, 1.5 million shares and 7 million shares, respectively. Although options are still outstanding under the Amended Plan and the 1996 Plan, these plans are considered expired and no new grants may be made from them. Under all three plans, the exercise price of each option is greater than or equal to the closing market price of our common stock on the day prior to the date of the grant.

Options granted under the Amended Plan, the 1996 Plan and the 2002 Plan generally vest on an annual basis over one to three years. Outstanding options under the plans, if not exercised, generally expire ten years from their date of grant or 90 days from the date of an optionee's separation from employment with the Company. We issue new shares of our common stock upon exercise of stock options.

Compensation cost arising from stock-based awards is recognized as expense using the straight-line method over the vesting period. As of March 31, 2009, there was approximately $356,000 of total unrecognized compensation cost related to unvested stock-based awards, which we expect to recognize over remaining weighted average vesting terms of 0.8 years. For the three-month periods ended March 31, 2009 and 2008, our total stock-based compensation expense was approximately $71,000 and $48,000, respectively. We have not recorded any income tax benefit related to stock-based compensation in either of the three-month periods ended March 31, 2009 and 2008.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option pricing model to value share-based payments. Expected volatilities are based on the Company's historical volatility, which management believes represents the most accurate basis for estimating expected volatility under the current circumstances. Neoprobe uses historical data to estimate forfeiture rates. The expected term of options granted is based on the vesting period and the contractual life of the options. The risk-free rate is based on the U.S. Treasury yield in effect at the time of the grant.

A summary of stock option activity under our stock option plans as of March 31, 2009, and changes during the three-month period then ended is presented below:

	Three Months Ended March 31, 2009			
	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Outstanding at beginning of period	5,619,500	$ 0.40		
Granted	283,000	0.59		
Exercised	(80,000)	0.30		
Forfeited	-	-		
Expired	(79,000)	1.25		
Outstanding at end of period	5,743,500	$ 0.40	5.4 years	$ 938,200
Exercisable at end of period	4,914,500	$ 0.39	4.8 years	$ 847,700

A summary of the status of our unvested restricted stock as of March 31, 2009, and changes during the three-month period then ended is presented below:

	Three Months Ended March 31, 2009	
	Number of Shares	Weighted Average Grant-Date Fair Value
Unvested at beginning of period	473,000	$ 0.37
Granted	500,000	0.60
Vested	-	-
Forfeited	(9,000)	0.68
Unvested at end of period	964,000	$ 0.49

Restricted shares generally vest upon occurrence of a specific event or achievement of goals as defined in the grant agreements. As a result, we have recorded compensation expense related to grants of restricted stock based on management's estimates of the probable dates of the vesting events.

4. Comprehensive Income (Loss)

Due to our net operating loss carryforwards, there are no income tax effects on comprehensive income (loss) components for the three-month period ended March 31, 2009.

	Three Months Ended March 31, 2009
Net income	$ 814,121
Unrealized losses on available-for-sale securities	(1,383)
Other comprehensive income	$ 812,738

We had no accumulated other comprehensive income (loss) activity during the three-month period ended March 31, 2008; therefore, our total comprehensive loss was equal to our net loss for that period.

5. Earnings Per Share

Basic earnings (loss) per share is calculated by dividing net income (loss) by the weighted-average number of common shares and participating securities outstanding during the period. Diluted earnings (loss) per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by the Company include unvested restricted stock, convertible securities, options and warrants, if dilutive.

The following table sets forth the reconciliation of the weighted average number of common shares outstanding to those used to compute basic and diluted earnings (loss) per share for the three-month periods ended March 31, 2009 and 2008:

	Three Months Ended March 31, 2009		Three Months Ended March 31, 2008	
	Basic Earnings Per Share	Diluted Earnings Per Share	Basic Earnings Per Share	Diluted Earnings Per Share
Outstanding shares	71,555,707	71,555,707	68,950,821	68,950,821
Effect of weighting changes in outstanding shares	(168,269)	(168,269)	(1,216,232)	(1,216,232)
Unvested restricted stock	-	-	(450,000)	(450,000)
Stock options	-	1,803,941	-	-
Warrants	-	5,596,328	-	-
Convertible debt	-	11,559,139	-	-
Convertible preferred stock	-	6,000,000	-	-
Adjusted shares	71,387,438	96,346,846	67,284,589	67,284,589

Earnings (loss) per common share for the periods ended March 31, 2009 and 2008 excludes the effects of 14,163,538 and 33,959,645 common share equivalents, respectively, since such inclusion would be anti-dilutive. The excluded shares consist of common shares issuable upon exercise of outstanding stock options and warrants, or upon the conversion of convertible debt and convertible preferred stock.

Effective January 1, 2009, we were required to adopt FASB FSP Emerging Issues Task Force (EITF) 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities. FSP EITF 03-6-1 requires that unvested stock awards which contain nonforfeitable rights to dividends or dividend equivalents, whether paid or unpaid (referred to as “participating securities”), be included in the number of shares outstanding for both basic and diluted earnings per share calculations. Under FSP EITF 03-6-1, the Company’s unvested restricted stock is considered a participating security. All prior period earnings per share data presented is required to be adjusted retrospectively to conform to the provisions of the FSP. In the event of a net loss, the participating securities are excluded from the calculation of both basic and diluted earnings per share. Due to our net loss, 450,000 shares of unvested restricted stock were excluded in determining basic and diluted loss per share for the three-month period ended March 31, 2008.

The following table presents the key factors considered in the calculation of basic and diluted net earnings per common share for the three-month period ended March 31, 2009. There was no difference in basic and diluted loss per share for the three-month period ended March 31, 2008.

	Three Months Ended March 31, 2009		
	Earnings (Numerator)	Weighted Average Shares (Denominator)	Per Share Amount
Net income	$ 814,121		
Preferred stock dividends	(60,000)		
Basic EPS:			
Income available to common stockholders	754,121	71,387,438	$ 0.01
Effect of Dilutive Securities:			
Stock options	-	1,803,941	
Warrants	-	5,596,328	
Convertible debt	105,315	11,559,139	
Convertible preferred stock	60,000	6,000,000	
Diluted EPS:			
Income available to common stockholders, including assumed conversions	$ 919,436	96,346,846	$ 0.01

6. Inventory

From time to time, we capitalize certain inventory costs associated with our Lymphoseek® product prior to regulatory approval and product launch based on management's judgment of probable future commercial use and net realizable value of the inventory. We could be required to permanently write down previously capitalized costs related to pre-approval or pre-launch inventory upon a change in such judgment, due to a denial or delay of approval by regulatory bodies, a delay in commercialization, or other potential factors. Conversely, our gross margins may be favorably impacted if some or all of the inventory previously written down becomes available and is used for commercial sale. During the three-month periods ended March 31, 2009 and 2008, we did not capitalize any inventory costs associated with our Lymphoseek product.

The components of net inventory are as follows:

	March 31, 2009 (unaudited)	December 31, 2008
Materials and component parts	$ 301,667	$ 380,912
Finished goods	674,471	580,949
Total	$ 976,138	$ 961,861

7. Intangible Assets

The major classes of intangible assets are as follows:

	March 31, 2009			December 31, 2008	
Wtd	Gross	Accumulated		Gross	Accumulated

	Avg Life	Carrying Amount	Amortization	Carrying Amount	Amortization
Patents and trademarks	7.5 yrs	$ 3,032,667	$ 1,672,600	$ 3,020,001	$ 1,626,516
Acquired technology	0 yrs	237,271	237,271	237,271	237,271
Total		$ 3,269,938	$ 1,909,871	$ 3,257,272	$ 1,863,787

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The estimated amortization expenses for the next five fiscal years are as follows:

	Estimated Amortization Expense
For the year ended 12/31/2009	$ 170,957
For the year ended 12/31/2010	170,341
For the year ended 12/31/2011	169,224
For the year ended 12/31/2012	168,885
For the year ended 12/31/2013	168,675

8. Product Warranty

We warrant our products against defects in design, materials, and workmanship generally for a period of one year from the date of sale to the end customer, except in cases where the product has a limited use as designed. Our accrual for warranty expenses is adjusted periodically to reflect actual experience and is included in accrued liabilities on the consolidated balance sheets. Our primary marketing partner, Ethicon Endo-Surgery, Inc. (EES), a Johnson & Johnson company, also reimburses us for a portion of warranty expense incurred based on end customer sales they make during a given fiscal year. Payments charged against the reserve are disclosed net of EES' estimated reimbursement.

The activity in the warranty reserve account, included in accrued liabilities and other, for the three-month periods ended March 31, 2009 and 2008 is as follows:

	Three Months Ended March 31,	
	2009	2008
Warranty reserve at beginning of period	$ 72,643	$ 115,395
Provision for warranty claims and changes in reserve for warranties	37,109	(14,036)
Payments charged against the reserve	(30,380)	(19,846)
Warranty reserve at end of period	$ 79,372	$ 81,513

9. Convertible Securities

In July 2007, David C. Bupp, our President and CEO, and certain members of his family (the Bupp Investors) purchased a $1.0 million convertible note (the Bupp Note) and warrants. The note bears interest at 10% per annum, had an original term of one year and is repayable in whole or in part with no penalty. The note is convertible, at the option of the Bupp Investors, into shares of our common stock at a price of $0.31 per share, a 25% premium to the average closing market price of our common stock for the 5 days preceding the closing of the transaction. As part of this transaction, we issued the Bupp Investors Series V Warrants to purchase 500,000 shares of our common stock at an exercise price of $0.31 per share, expiring in July 2012. The value of the beneficial conversion feature of the note was estimated at $86,000 based on the effective conversion price at the date of issuance. The fair value of the warrants issued to the investors was approximately $80,000 on the date of issuance and was determined using the Black-Scholes option pricing model with the following assumptions: an average risk-free interest rate of 4.95%, volatility of 105% and no expected dividend rate. The value of the beneficial conversion feature and the fair value of the warrants issued to the investors were recorded as discounts on the note. We incurred $43,000 of costs related to completing the Bupp financing, which were recorded in other assets. The discounts and the deferred debt issuance costs were being amortized over the term of the note using the effective interest method.

In December 2007, we executed a Securities Purchase Agreement (SPA) with Platinum Montaur Life Sciences, LLC (Montaur), pursuant to which we issued Montaur: (1) a 10% Series A Convertible Senior Secured Promissory Note in the principal amount of $7,000,000, due December 26, 2011 (the Series A Note); and (2) a Series W Warrant to purchase 6,000,000 shares of our common stock at an exercise price of $0.32 per share, expiring in December 2012 (the Series W Warrant). Additionally, pursuant to the terms of the SPA: (1) upon commencement of the Phase 3 clinical studies of Lymphoseek, in April 2008, we issued Montaur a 10% Series B Convertible Senior Secured Promissory Note, due December 26, 2011 (the Series B Note, and hereinafter referred to collectively with the Series A Note as the Montaur Notes), and a five-year warrant to purchase an amount of common stock equal to the number of shares into which Montaur may convert the Series B Note, at an exercise price of 115% of the conversion price of the Series B Note (the Series X Warrant), for an aggregate purchase price of $3,000,000; and (2) upon obtaining 135 vital blue dye lymph nodes from patients with breast cancer or melanoma who completed surgery with the injection of the drug in a Phase 3 clinical trial of Lymphoseek in December 2008, we issued Montaur 3,000 shares of our 8% Series A Cumulative Convertible Preferred Stock (the Preferred Stock) and a five-year warrant to purchase an amount of common stock equal to the number of shares into which Montaur may convert the Preferred Stock, at an exercise price of 115% of the conversion price of the Preferred Stock (the Series Y Warrant, and hereinafter referred to collectively with the Series W Warrant and Series X Warrant as the Montaur Warrants), also for an aggregate purchase price of $3,000,000.

In accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, the conversion option and two put options associated with the Series A Note were considered derivative instruments and were required to be bifurcated from the Series A Note and accounted for separately. In addition, in accordance with SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, the Series W Warrant was accounted for as a liability due to the existence of certain provisions in the instrument. As a result, we recorded a total aggregate derivative liability of $2.6 million on the date of issuance of the Series A Note and Series W Warrant. The fair value of the bifurcated conversion option and put options was approximately $1.45 million on the date of issuance. The fair value of the Series W Warrant was approximately $1.15 million on the date of issuance and was determined using the Black-Scholes option pricing model with the following assumptions: an average risk-free interest rate of 3.7%, volatility of 94% and no expected dividend rate.

On March 14, 2008, Neoprobe and Montaur executed amendments to the Series A Note and the Series W Warrant. The amendments eliminated certain minor cash-based penalty provisions in the Series A Note and Series W Warrant which entitled the holders to different compensation than our common shareholders under certain circumstances and qualifying Triggering Events. The provisions that were eliminated and/or modified were the provisions that led to the derivative accounting treatment for the embedded conversion option in the Series A Note and the Series W Warrant. The effect of marking the conversion option and warrant liabilities to “market” at March 14, 2008 resulted in an increase in the estimated fair value of the conversion option and warrant liabilities of $381,000 which was recorded as non-cash expense during the first quarter of 2008. The estimated fair value of the conversion option and warrant liabilities of $2.9 million was reclassified to additional paid-in capital during the first quarter of 2008 as a result of the amendments. The estimated fair value of the put option liabilities related to the Series A Note of $360,000 remained classified as derivative liabilities. The initial aggregate fair value of the conversion option and the put options related to the Series A Note and the fair value of the Series W Warrant of $2.6 million were recorded as a discount on the note and are being amortized over the term of the note using the effective interest method.

In April 2008, we completed the second closing under the December 2007 Montaur SPA, as amended, pursuant to which we issued Montaur a 10% Series B Convertible Senior Secured Promissory Note in the principal amount of $3,000,000, due December 26, 2011; and a Series X Warrant to purchase 8,333,333 shares of our common stock at an exercise price of $0.46 per share, expiring in April 2013. The two put options related to the Series B Note were considered derivative instruments and were required to be bifurcated from the Series B Note and accounted for separately. The fair value of the bifurcated put options was approximately $258,000 on the date of issuance. The value of the beneficial conversion feature of the Series B Note was estimated at $1.44 million based on the effective conversion price at the date of issuance. The fair value of the Series X Warrant was approximately $1.28 million on the date of issuance and was determined using the Black-Scholes option pricing model with the following assumptions: an average risk-free interest rate of 2.6%, volatility of 95% and no expected dividend rate. The initial aggregate fair value of the beneficial conversion feature and put options related to the Series B Note, and the fair value of the Series X Warrant of $2.98 million were recorded as discounts on the note and are being amortized over the term of the note using the effective interest method. We incurred $188,000 of costs related to completing the second Montaur financing, which were recorded in other assets on the consolidated balance sheet. The deferred financing costs are being amortized using the effective interest method over the term of the note.

In December 2008, after we obtained 135 vital blue dye lymph nodes from patients who had completed surgery and the injection of Lymphoseek in a Phase 3 clinical trial in patients with breast cancer or melanoma, we issued Montaur 3,000 shares of our 8% Preferred Stock and a five-year Series Y warrant to purchase 6,000,000 shares of our common stock, at an exercise price of $0.575 per share, for an aggregate purchase price of $3,000,000. The "Liquidation Preference Amount" for the Preferred Stock is $1,000 and the "Conversion Price" of the Preferred Stock was set at $0.50 on the date of issuance, thereby making the shares of Preferred Stock convertible into an aggregate 6,000,000 shares of our common stock, subject to adjustment as described in the Certificate of Designations. The value of the beneficial conversion feature of the Preferred Stock was estimated at $1.55 million based on the effective conversion price at the date of issuance. The put option was considered a derivative instrument and was required to be bifurcated from the Preferred Stock and accounted for separately. The fair value of the bifurcated put option was approximately $216,000 on the date of issuance. The fair value of the Series Y warrant was approximately $2.07 million on the date of issuance and was determined using the Black-Scholes option pricing model with the following assumptions: an average risk-free interest rate of 1.7%, volatility of 74% and no expected dividend rate. The relative fair value of the warrant, the amount recorded to equity in accordance with Accounting Principles Board Opinion No. 14, Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants, was $1.13 million.

In accordance with EITF Topic D-98, Classification and Measurement of Redeemable Securities, the Preferred Stock was classified as temporary equity as the shares are subject to redemption under the contingent put option. The initial intrinsic value of the beneficial conversion feature and put option related to the Preferred Stock and the initial relative fair value of the Series Y warrant of $1.13 million were recorded as deemed distributions and added to the accumulated deficit. We incurred $180,000 of costs related to completing the third Montaur financing, which were recorded as a reduction of additional paid-in capital on the consolidated balance sheet.

In connection with the SPA, Montaur requested that the term of the $1.0 million Bupp Note be extended until at least one day following the maturity date of the Montaur Notes. In consideration for the Bupp Investors' agreement to extend the term of the Bupp Note pursuant to an Amendment to the Bupp Purchase Agreement, dated December 26, 2007, we agreed to provide security for the obligations evidenced by the Amended 10% Convertible Note in the principal amount of $1,000,000, due December 31, 2011, executed by Neoprobe in favor of the Bupp Investors (the Amended Bupp Note), under the terms of a Security Agreement, dated December 26, 2007, by and between Neoprobe and the Bupp Investors (the Bupp Security Agreement). As further consideration for extending the term of the Bupp Note, we issued the Bupp Investors Series V Warrants to purchase 500,000 shares of our common stock at an exercise price of $0.32 per share, expiring in December 2012. The fair value of the warrants issued to the Bupp Investors was approximately $96,000 on the date of issuance and was determined using the Black-Scholes option pricing model with the following assumptions: an average risk-free interest rate of 3.72%, volatility of 94% and no expected dividend rate. The fair value of the warrants was recorded as a discount on the note and is being amortized over the term of the note using the effective interest method. We treated the amendment to the Bupp Note as an extinguishment of debt for accounting purposes. As such, the remaining discount resulting from the value of the beneficial conversion feature and the fair value of the warrants and the remaining unamortized deferred financing costs associated with the original note were written off as a loss on extinguishment of debt in December 2007.

Effective January 1, 2009, we were required to adopt new accounting guidance that clarified the determination of whether equity-linked instruments (or embedded features), such as our convertible securities and warrants to purchase our common stock, are considered indexed to our own stock. As a result of adopting such guidance, certain embedded features of our convertible securities, as well as warrants to purchase our common stock, that were previously treated as equity are now considered derivative liabilities. See Note 10.

During the three-month periods ended March 31, 2009 and 2008, we recorded interest expense of $151,000 and $104,000, respectively, related to amortization of the debt discount related our convertible notes. During the three-month periods ended March 31, 2009 and 2008, we recorded interest expense of $29,000 and $26,000, respectively, related to amortization of the deferred financing costs related to our convertible notes.

10. Derivative Instruments

We account for derivative instruments in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, which provides accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts. We do not use derivative instruments for hedging of market risks or for trading or speculative purposes. Effective January 1, 2009, we were required to adopt EITF Issue No. 07-5, Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity's Own Stock. EITF Issue No. 07-5 clarified the determination of whether equity-linked instruments (or embedded features), such as our convertible securities and warrants to purchase our common stock, are considered indexed to our own stock, which would qualify as a scope exception under SFAS No. 133. As a result of adopting EITF Issue No. 07-5, certain embedded features of our convertible securities, as well as warrants to purchase our common stock, that were previously treated as equity are now considered derivative liabilities.

The impact of adopting EITF Issue No. 07-5 is summarized in the following table:

	December 31, 2008	Impact of Adopting EITF Issue No. 07-5	January 1, 2009
Other assets	$ 594,449	$ 2,104	$ 596,553
Total assets	$ 9,619,450		$ 9,621,554
Notes payable to investors, net of discounts	$ 4,998,851	(54,396)	$ 4,944,455
Derivative liabilities	853,831	13,017,540	13,871,371
Total liabilities	$ 9,645,175		$ 22,608,319
Additional paid-in capital	$ 145,742,044	(8,948,089)	$ 136,793,955
Accumulated deficit	(148,840,015)	(4,012,951)	(152,852,966)
Total stockholders' deficit	$ (3,025,725)		$ (15,986,765)

Convertible Notes – other assets increased $2,104, notes payable to investors, net of discount, increased $518,229, derivative liabilities increased $4,146,392, additional paid-in capital decreased $2,843,781, and accumulated deficit increased $1,818,736.
Convertible Preferred Stock – derivative liabilities increased $1,158,095, additional paid-in capital decreased $1,550,629, and accumulated deficit decreased $392,534.
Warrants – notes payable to investors, net of discount, decreased $572,625, derivative liabilities increased $7,713,053, additional paid-in capital decreased $4,553,679, and accumulated deficit increased $2,586,749.

The estimated fair values of the derivative liabilities are recorded as non-current liabilities on the consolidated balance sheet. Changes in the estimated fair values of the derivative liabilities are recorded in the consolidated statement of operations. The effect of marking the derivative liabilities to “market” at March 31, 2009 resulted in a net decrease in the estimated fair values of the derivative liabilities of $1.5 million which was recorded as non-cash income during the first quarter of 2009. The total estimated fair value of the derivative liabilities was $12.3 million as of March 31, 2009. See Note 9.

11. Stock Warrants

During the first quarter of 2009, David C. Bupp, our President and CEO, exercised 50,000 Series Q Warrants in exchange for issuance of 50,000 shares of our common stock, resulting in gross proceeds of $25,000. The remaining 325,000 Series Q Warrants expired during the quarter.

At March 31, 2009, there are 23.1 million warrants outstanding to purchase our common stock. The warrants are exercisable at prices ranging from $0.31 to $0.85 per share with a weighted average exercise price of $0.45 per share.

12. Income Taxes

We account for uncertainty in income taxes in accordance with Financial Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. FIN 48 also prescribes a recognition threshold and measurement model for the financial statement recognition of a tax position taken, or expected to be taken, and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. No adjustment was made to the beginning retained earnings balance as the ultimate deductibility of all tax positions is highly certain, although there is uncertainty about the timing of such deductibility. As a result, no liability for uncertain tax positions was recorded as of March 31, 2009. Should we need to accrue interest or penalties on uncertain tax positions, we would recognize the interest as interest expense and the penalties as a selling, general and administrative expense.

13. Segment and Subsidiary Information

We report information about our operating segments using the “management approach” in accordance with SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information. This information is based on the way management organizes and reports the segments within the enterprise for making operating decisions and assessing performance. Our reportable segments are identified based on differences in products, services and markets served. There were no inter-segment sales. We own or have rights to intellectual property involving two primary types of medical device products, including oncology instruments currently used primarily in the application of sentinel lymph node biopsy, and blood flow measurement devices. We also own or have rights to intellectual property related to several drug and therapy products.

The information in the following table is derived directly from each reportable segment's financial reporting.

($ amounts in thousands) Three Months Ended March 31, 2009	Oncology Devices	Blood Flow Devices	Drug and Therapy Products	Corporate	Total
Net sales:					
United States1	$ 2,553	$ 29	$ -	$ -	$ 2,582
International	104	14	-	-	118
Research and development expenses	294	16	928	-	1,238
Selling, general and administrative expenses, excluding depreciation and amortization2	34	15	-	752	801
Depreciation and amortization	37	48	1	15	101
Income (loss) from operations	1,491	(58)	(929)	(768)	(264)
Other income (expenses)4	-	-	-	1,078	1,078
Total assets, net of depreciation and amortization:					
United States operations	2,526	411	24	4,793	7,754
Israeli operations (Cardiosonix Ltd.)	-	1,317	-	-	1,317
Capital expenditures	-	-	-	40	40

($ amounts in thousands) Three Months Ended March 31, 2008	Oncology Devices	Blood Flow Devices	Drug and Therapy Products	Corporate	Total
Net sales:					