

POSITRON CORP
Form 10QSB
November 14, 2005

FORM 10-QSB

SEPTEMBER 30, 2005

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

FORM 10-QSB

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2005.
- TRANSITION REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO _____.

Commission file number: 0-24092

Positron Corporation
(Exact name of small business issuer as specified in its charter)

Texas 76-0083622
(State of incorporation) (IRS Employer Identification No.)

1304 Langham Creek Drive, Suite 300, Houston, Texas 77084
(Address of principal executive offices)

(281) 492-7100
(Issuer's telephone number)
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

As of September 30, 2005, there were 76,325,046 shares of the Registrant's Common Stock, \$.01 par value outstanding.

Transitional Small Business Disclosure Format (check one). Yes No

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FORM 10-QSB

SEPTEMBER 30, 2005

PART 1 -**FINANCIAL INFORMATION****ITEM 1.****Financial Statements****POSITRON CORPORATION****BALANCE SHEET****September 30, 2005**

(In thousands, except share data)

(Unaudited)

ASSETS

Current assets:

| | | |
|---------------------------|----|-----|
| Cash and cash equivalents | \$ | 154 |
| Inventories | | 715 |
| Prepaid expenses | | 35 |
| Other current assets | | 40 |

| | | |
|----------------------|--|-----|
| Total current assets | | 944 |
|----------------------|--|-----|

| | | |
|-----------------------------|--|-----|
| Property and equipment, net | | 117 |
|-----------------------------|--|-----|

| | | |
|--------------|--|-----|
| Other assets | | 253 |
|--------------|--|-----|

| | | |
|--------------|----|-------|
| Total assets | \$ | 1,314 |
|--------------|----|-------|

LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)

Current liabilities:

| | | |
|---|----|-------|
| Accounts payable, trade and accrued liabilities | \$ | 1,599 |
| Customer deposits | | 15 |
| Unearned revenue | | 125 |
| Convertible notes payable to affiliated entities, less discount of \$21 | | 1,312 |

| | | |
|---------------------------|--|-------|
| Total current liabilities | | 3,051 |
|---------------------------|--|-------|

| | | |
|--|--|-----|
| Convertible notes payable to affiliated entities, less discount of \$1,069 | | 731 |
|--|--|-----|

Stockholders' equity (deficit):

| | | |
|--|--|-----|
| Series A Preferred Stock: \$1.00 par value; 8% cumulative, convertible, redeemable; 5,450,000 shares authorized; 464,319 shares issued and outstanding | | 464 |
|--|--|-----|

| | | |
|---|--|-----|
| Common Stock: \$0.01 par value; 100,000,000 shares authorized; 76,385,202 shares issued and 76,325,046 shares outstanding | | 764 |
|---|--|-----|

| | | |
|----------------------------|--|--------|
| Additional paid-in capital | | 57,224 |
|----------------------------|--|--------|

| | | |
|-------------------------|--|------|
| Subscription receivable | | (30) |
|-------------------------|--|------|

| | | |
|---------------------|--|----------|
| Accumulated deficit | | (60,875) |
|---------------------|--|----------|

| | | |
|---------------------------------------|--|------|
| Treasury Stock: 60,156 shares at cost | | (15) |
|---------------------------------------|--|------|

| | | |
|--------------------------------------|--|---------|
| Total stockholders' equity (deficit) | | (2,468) |
|--------------------------------------|--|---------|

| | | |
|--|----|-------|
| Total liabilities and stockholders' equity (deficit) | \$ | 1,314 |
|--|----|-------|

See accompanying notes

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POSITRON CORPORATION
STATEMENTS OF OPERATIONS

(In thousands, except per share data)
(Unaudited)

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|------------------|---------------------|-------------------|
| | Sept. 30, 2005 | Sept. 30, 2004 | Sept. 30, 2005 | Sept. 30, 2004 |
| Revenues: | | | | |
| System sales | \$ -- | \$ 1,150 | \$ -- | \$ 1,150 |
| Upgrades | 3 | 382 | 37 | 382 |
| Service and component | 175 | 226 | 525 | 705 |
| Total revenues | 178 | 1,758 | 562 | 2,237 |
| Costs of sales and service: | | | | |
| System sales | 84 | 1,032 | 260 | 1,118 |
| Upgrades | -- | 177 | 8 | 177 |
| Service, warranty and component | 50 | 99 | 176 | 248 |
| Total costs of sales and services | 134 | 1,308 | 444 | 1,543 |
| Gross profit | 44 | 450 | 118 | 694 |
| Operating expenses: | | | | |
| Research and development | 92 | 141 | 352 | 242 |
| Selling and marketing | 127 | 160 | 570 | 245 |
| General and administrative | 457 | 290 | 1,165 | 865 |
| Stock based compensation | (61) | -- | (163) | 350 |
| Total operating expenses | 615 | 591 | 1,924 | 1,702 |
| Loss from operations | (571) | (141) | (1,806) | (1,008) |
| Other income (expense) | | | | |
| Interest income | -- | -- | 1 | -- |
| Interest expense | (284) | (62) | (637) | (84) |
| Total other income (expense) | (284) | (62) | (636) | (84) |
| Net loss | \$ (855) | \$ (203) | \$ (\$2,442) | \$ (1,092) |
| Basic and diluted loss per common share | \$ (0.01) | \$ (0.00) | \$ (0.04) | \$ (0.02) |
| Weighted average number of basic and diluted shares outstanding | 76,325 | 53,186 | 61,050 | 53,186 |

See accompanying notes

POSITRON CORPORATION
STATEMENTS OF CASH FLOWS

(In thousands)
(Unaudited)

| | Nine Months Ended | |
|---|-------------------|----------------|
| | Sept. 30, 2005 | Sept. 30, 2004 |
| Cash flows from operating activities: | | |
| Net loss | \$ (2,442) | \$ (1,092) |
| Adjustment to reconcile net loss to net cash used in operating activities | | |
| Depreciation | 58 | 65 |
| Amortization of loan costs, debt discount and beneficial conversion | 441 | 55 |
| Compensation related to re-pricing of warrants | (164) | 350 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | -- | (253) |
| Inventory | (94) | 326 |
| Prepaid expenses | 27 | 144 |
| Other current assets | (12) | (41) |
| Field service parts and supplies | (1) | 13 |
| Accounts payable and accrued liabilities | 206 | (520) |
| Customer deposits | (1) | (75) |
| Unearned revenue | (28) | 76 |
| Net cash used in operating activities | (2,010) | (952) |
| Cash flows from investing activities: | | |
| Capital expenditures | (19) | (3) |
| Net cash used in investing activities | (19) | (3) |
| Cash flows from financing activities: | | |
| Proceeds from notes payable to affiliated entities | 2,050 | 1,250 |
| Deferred loan costs | -- | (100) |
| Repayment of capital lease obligation | -- | (9) |
| Net cash provided by financing activities | 2,050 | 1,141 |
| Net increase in cash and cash equivalents | 21 | 186 |
| Cash and cash equivalents, beginning of period | 133 | 5 |
| Cash and cash equivalents, end of period | \$ 154 | \$ 191 |

See accompanying notes

POSITRON CORPORATION
SELECTED NOTES TO FINANCIAL STATEMENTS

1. **Basis of Presentation**

The accompanying unaudited interim financial statements have been prepared in accordance with generally accepted accounting principles and the rules of the U.S. Securities and Exchange Commission, and should be read in conjunction with the audited financial statements and notes thereto contained in the Annual Report on Form 10-KSB for Positron Corporation (the "Company") for the year ended December 31, 2004. In the opinion of management, all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of financial position and the results of operations for the interim periods presented have been reflected herein. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year. Notes to the financial statements which would substantially duplicate the disclosures contained in the audited financial statements for the most recent fiscal year ended December 31, 2004, as reported in the Form 10-KSB, have been omitted.

2. **Accounting Policies**

Revenue Recognition

Revenues from POSICAM™ system contracts are recognized when all significant costs have been incurred and the system has been shipped to the customer. The Company also recognizes revenue on bill and hold transactions when the product is completed and is ready to be shipped and the risk of loss is transferred to the customer. In certain cases, at the customers' request, the Company is storing the product for a brief period of time. Revenues from maintenance contracts are recognized over the term of the contract. Service revenues are recognized upon performance of the services.

Reclassifications

Certain prior year amounts have been reclassified to conform with the presentation for the current year. Such reclassifications had no impact on net income or stockholders' equity as previously reported.

3. **Going Concern Consideration**

Since its inception, the Company has been unable to sell POSICAM™ systems in quantities sufficient to be operationally profitable. Consequently, the Company has sustained substantial losses. At September 30, 2005, the Company had an accumulated deficit of \$60,875,000 and a stockholders' deficit of \$2,468,000. Due to the sizable prices of the Company's systems and the limited number of systems sold or placed in service each year, the Company's revenues have fluctuated significantly from year to year.

The Company utilized proceeds of \$2,050,000 from notes payable to affiliated entities to fund its operating activities for the nine month period ended September 30, 2005. As a result, the Company had cash and cash equivalents of \$154,000 at September 30, 2005. At the same date, the Company had accounts payable and accrued liabilities of \$1,599,000.

There can be no assurance that the Company will be successful in implementing its business plan and ultimately achieving operational profitability. The Company's long-term viability as a going concern is dependent on its ability to 1) achieve adequate profitability and cash flows from operations to sustain its operations, 2) control costs and expand revenues from existing or new business and 3) meet current commitments and fund the continuation of its business operation in the near future.

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4. **Inventories**

Inventories at September 30, 2005 consisted of the following (in thousands):

| | |
|-------------------------------|--------|
| Raw materials | \$ 748 |
| Work in progress | 17 |
| Subtotal | 765 |
| Less reserve for obsolescence | (50) |
| Total | \$ 715 |

5. **Other Assets**

Other assets at September 30, 2005 consisted of the following (in thousands):

| | |
|----------------------------------|--------|
| Field service parts and supplies | \$ 216 |
| Deferred loan costs | 37 |
| Total | \$ 253 |

6. **Accounts Payable and Accrued Liabilities**

Accounts payable and accrued liabilities at September 30, 2005 consisted of the following (in thousands):

| | |
|----------------------------|----------|
| Trade accounts payable | \$ 347 |
| Accrued royalties | 320 |
| Accrued interest | 262 |
| Sales taxes payable | 236 |
| Accrued compensation | 204 |
| Accrued property taxes | 107 |
| Accrued professional fees | 80 |
| Accrued warranty costs | 30 |
| Insurance premiums payable | 13 |
| Total | \$ 1,599 |

Accrued compensation includes severance payments payable to the Company's former Chief Executive Officer, Gary H. Brooks. Mr. Brooks resigned effective September 29, 2005. In connection with his resignation, the Company agreed to make severance payments to Mr. Brooks of \$18,583.33 per month for a period of six months, and to extend the expiration date of options held by Mr. Brooks through September 30, 2006, and warrants held by Mr. Brooks until the later of (i) October 31, 2007 for 7,000,000 warrants and June 2009 for 500,000 warrants, and (ii) the date on which a registration statement filed with the Securities Exchange Commission permitting a sale of the shares underlying such warrants shall have become effective and shall have remained effective for a period of six months.

7. **Convertible Notes Payable to Affiliated Entities**

Notes payable to affiliated entities at September 30, 2005 consisted to the following (in thousands):

| | |
|--|----------|
| IMAGIN Diagnostic Centres, Inc., less discount of \$21 | \$ 1,712 |
| Solaris Opportunity Fund, L.P., less discount of \$1,069 | 331 |
| Total | \$ 2,043 |

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IMAGIN Diagnostic Centres, Inc.*Financing Agreements dated May 21, 2004*

On May 26, 2004 and June 17, 2004, the Company sold two separate secured convertible promissory notes under a Note Purchase Agreement dated May 21, 2004, to IMAGIN Diagnostic Centres, Inc. ("IMAGIN") in the principal amounts of \$400,000 and \$300,000, respectively. Interest is charged on the outstanding principal at the rate of ten percent (10%) per annum and is payable annually to the extent of positive cash flow on the anniversary dates of these notes. The principal and any unpaid interest must be paid on the earlier to occur of May 21, 2006 or when declared due and payable by IMAGIN upon occurrence of an event of default. The notes are initially convertible into new shares of Series C Preferred Stock that, in turn are convertible into an aggregate of 35,000,000 shares of the Company's common stock. These notes are collateralized by all of the assets of the Company. As of September 30, 2005, principal of \$700,000 has been advanced and remains outstanding related to these notes. Full convertibility of the shares of Series C Preferred Stock into common stock will require an amendment to the Company's Articles of Incorporation which must be approved by the shareholders. The Company has obtained consent to amend its Articles of Incorporation and is preparing to file the amendment.

In a second stage of the financing IMAGIN agreed to purchase additional secured convertible promissory notes in the aggregate principal amount of \$1,300,000. These notes were to be purchased over a six and a half month period, commencing July 15, 2004. These notes are due and payable on May 21, 2006. These notes are initially convertible into new shares of Series D Preferred Stock that, in turn is convertible into an aggregate of 52,000,000 shares of the Company's common stock. As of June 30, 2005, principal of \$1,208,500 had been advanced related to these notes. On June 30, 2005, IMAGIN converted \$575,000 of these promissory notes into shares of Series D Preferred Stock that, in turn were converted into 23,000,000 shares of the Company's common stock. This conversion reduced the principal owed under these promissory notes from \$1,208,500 to \$633,500. Full convertibility of the shares of Series D Preferred Stock into common stock will require an amendment to the Company's Articles of Incorporation which must be approved by the shareholders. The Company has obtained consent to amend its Articles of Incorporation and is preparing to file the amendment.

The agreements with IMAGIN provided for a \$200,000 transaction fee payable to IMAGIN upon completion of the financing. Under terms of these agreements, this fee obligation was to be reduced by an amount equal to \$0.02 multiplied by the number of warrants issued to IMAGIN. The agreements with IMAGIN also provided for the issuance of new warrants for the purchase of 4,575,000 shares of common stock, which resulted in a \$91,500 decrease in this fee obligation to \$108,500. This fee obligation is included in the principal of the notes payable to IMAGIN at September 30, 2005. The Company allocated the proceeds received from this convertible debt with detachable warrants using the relative fair value of the individual elements at the time of issuance. The notes payable to IMAGIN contain an unamortized discount balance of approximately \$21,000 at September 30, 2005. The discount of the debt is to be amortized over the term of the notes payable.

Patrick G. Rooney, Chairman of the Board of the Company is the son of Patrick Rooney, Director of Corporate Development of IMAGIN Diagnostic Centres, Inc. Patrick G. Rooney was appointed to the Board of Directors of the Company in connection with the financing with IMAGIN.

Financing Agreements dated August 8, 2005

On August 8, 2005, the Company sold to IMAGIN 10% secured convertible promissory notes under a Note Purchase Agreement, dated the same date, in the aggregate principal amount of \$400,000. As of September 30, 2005, IMAGIN has purchased \$400,000 of these notes. These notes are due and payable on August 7, 2008. These notes are convertible into an aggregate of 20,000,000 shares of the Company's common stock. Full convertibility of the notes

into shares of common stock will require an amendment to the Company's Articles of Incorporation which must be approved by the shareholders. The Company has obtained consent for amending its Articles of Incorporation and is preparing to file the amendment.

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In accordance with generally accepted accounting principals in the event the conversion price is less than the Company's stock price at the date of the agreement, the difference is considered to be a beneficial conversion feature and is amortized over the period from the date of issuance to the stated maturity date. The fair value of the common stock at the commitment date of \$1,200,000 less the \$400,000 in loan proceeds, results in intrinsic value of \$800,000 for the beneficial conversion feature. However, the beneficial conversion feature is limited to the \$400,000 proceeds of the debt. Due to the fact that there were not enough common shares available to facilitate the conversion of the debt into common stock on August 8, 2005, no beneficial conversion feature was recorded for this transaction.

Pursuant to the terms of the agreements, the Company granted to IMAGIN a security interest in all of its assets to secure payment of the convertible promissory notes. The security interest is subordinate to the security interest previously granted in the same collateral to IMAGIN and Solaris Opportunity Fund, L.P. ("Solaris").

Solaris Opportunity Fund, L.P.

Financing Agreements dated February 28, 2005

On February 28, 2005, the Company entered into a series of agreements with Solaris pursuant to which Solaris agreed to purchase an aggregate of \$1,000,000 face amount of the Company's 10% secured convertible promissory notes. As of September 30, 2005, Solaris has purchased \$1,000,000 of these notes. These notes are due and payable on March 6, 2007. The notes are initially convertible into new shares of Series E Preferred Stock that, in turn are convertible into an aggregate of 22,000,000 shares of the Company's common stock. As of September 30, 2005, full convertibility of the shares of Series E Preferred Stock into common stock will require an amendment to the Company's Articles of Incorporation which must be approved by the shareholders. The Company has obtained consent for amending its Articles of Incorporation and is preparing to file the amendment.

In accordance with generally accepted accounting principles in the event the conversion price is less than the Company's stock price at the date of the agreement, the difference is considered to be a beneficial conversion feature and is amortized over the period from the date of issuance to the stated maturity date. On February 28, 2005, enough common shares were available to facilitate the conversion of substantially all of the debt into common stock. The fair value of the related Series E Preferred Stock at the commitment date of \$2,200,000 less the \$1,000,000 in loan proceeds, results in an intrinsic value of \$1,200,000 for the beneficial conversion feature. However, the beneficial conversion feature is limited to the \$1,000,000 proceeds of the debt.

Pursuant to the terms of the agreements, the Company granted to Solaris a security interest in all of its assets to secure payment of the convertible promissory notes. The security interest is subordinate to the security interest previously granted in the same collateral to IMAGIN.

We have been advised by Solaris that it has since sold the \$1,000,000 principal amount of these notes to IMAGIN.

Financing Agreements dated June 27, 2005

On June 27, 2005, the Company entered into a series of agreements with Solaris pursuant to which Solaris agreed to purchase an aggregate of \$400,000 face amount of the Company's 10% secured convertible promissory notes. As of September 30, 2005, Solaris has purchased \$400,000 of these notes. These notes are due and payable on March 6, 2007. The notes are initially convertible into new shares of Series F Preferred Stock that, in turn are convertible into an aggregate of 20,000,000 shares of the Company's common stock. As of September 30, 2005, full convertibility of the shares of Series F Preferred Stock into common stock will require an amendment to the Company's Articles of Incorporation, which must be approved by the shareholders. The Company has obtained consent for amending its Articles of Incorporation and is preparing to file the amendment.

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In accordance with generally accepted accounting principles in the event the conversion price is less than the Company's stock price at the date of the agreement, the difference is considered to be a beneficial conversion feature and is amortized over the period from the date of issuance to the stated maturity date. On June 27, 2005, enough common shares were available to facilitate the conversion of all of the debt into common stock. The fair value of the related Series F Preferred Stock at the commitment date of \$1,600,000 less the \$400,000 in loan proceeds, results in an intrinsic value of \$1,200,000 for the beneficial conversion feature. However, the beneficial conversion feature is limited to the \$400,000 proceeds of the debt.

Pursuant to the terms of the agreements, the Company granted to Solaris a security interest in all of its assets to secure payment of the convertible promissory notes. The security interest is subordinate to the security interest previously granted in the same collateral to IMAGIN and Solaris.

Patrick G. Rooney, Chairman of the Board of the Company, is the managing director of the manager of Solaris.

8. **Stockholders' Equity**

Stockholders converted 45,900 shares of Series A Preferred Stock into 199,243 shares of common stock during the nine month period ended September 30, 2005.

9. **Earnings Per Share**

Basic earnings per common share are based on the weighted average number of common shares outstanding in each period and earnings adjusted for preferred stock dividend requirements. Diluted earnings per common share assume that any dilutive convertible preferred shares outstanding at the beginning of each period were converted at those dates, with related interest, preferred stock dividend requirements and outstanding common shares adjusted accordingly. It also assumes that outstanding common shares were increased by shares issuable upon exercise of those stock options and warrants for which market price exceeds exercise price, less shares which could have been purchased by the Company with related proceeds. The convertible preferred stock and outstanding stock options and warrants were not included in the computation of diluted earnings per common share for the three and nine month periods ended September 30, 2004 and 2005 since it would have resulted in an antidilutive effect.

The following table sets forth the computation of basic and diluted earnings per share.

| | Three Months Ended | | Nine Months Ended | |
|--|---------------------------------------|-------------------|-------------------|-------------------|
| | Sept. 30, 2005 | Sept. 30, 2004 | Sept. 30, 2005 | Sept. 30, 2004 |
| | (In Thousands, except per share data) | | | |
| Numerator | | | | |
| Basic and diluted loss | \$ (855) | \$ (203) | \$ (2,442) | \$ (1,092) |
| Denominator | | | | |
| Basic and diluted earnings per share - weighted average shares outstanding | 76,325 | 53,186 | 61,050 | 53,186 |
| Basic and diluted loss per common share | \$ (0.01) | \$ (0.00) | \$ (0.04) | \$ (0.02) |

10. **Litigation**

Please refer to our Quarterly Report on Form 10-QSB for the fiscal quarter ended March 31, 2005, filed on May 16, 2005, which discloses claims that have been filed against the Company. There have been no material developments with respect to these claims since the previously filed Quarterly Report.

11. **Stock Based Compensation**

In connection with the May 2004 transaction with IMAGIN, the Company re-priced various options and warrants to employees that are subject to the variable accounting rules. The market price of the Company's common stock decreased \$0.04 from \$0.12 at December 31, 2004 to \$0.08 at September 30, 2005. Due to the decline in price, application of the variable accounting rules resulted in the reversal of stock based compensation by approximately \$163,000 during the nine months ended September 30, 2005.

12. **Joint Venture with Neusoft Medical Systems Co., Ltd.**

On July 30, 2005, the Company entered into a Joint Venture Contract (the "JV Contract") with Neusoft Medical Systems Co., Ltd. ("Neusoft") to form a jointly-owned company to be organized in the People's Republic of China to develop and manufacture PET and PET/CT systems. Governmental approval of the formation of the joint venture company has been obtained and Neusoft Positron Medical Systems Co., Ltd. (the "JV Company") was organized on September 6, 2005. The JV Company will receive its final authorization upon completion of its capitalization by the parties.

Pursuant to the JV Contract, Neusoft's capital contribution consists of \$1,350,000 in cash and it will have a 67.5% interest in the JV Company. The Company's capital contribution consists of the transfer of an undivided interest in its PET technology valued at \$400,000 and \$250,000 in cash and it will have a 32.5% interest in the JV Company. As of October 31, 2005, substantially all of the technology had been transferred and the Company is in the process of funding its cash contribution. In addition, the Company has agreed to sublicense certain of its cardiac technology in consideration of a \$250,000 royalty payment.

13. **Subsequent Events****Amendment of Rights of Series C Preferred Stock**

On October 3, 2005, the Company entered into an agreement with IMAGIN, under which the Company agreed to amend the Statement of Designation of Series C Preferred Stock to provide each share of Series C Preferred Stock with 130 votes on all matters submitted to or requiring the vote of its shareholders. In consideration for the amendment of the Statement of Designation of Series C Preferred Stock, IMAGIN agreed to convert outstanding 10% secured convertible notes in the principal amount of \$770,000 held by IMAGIN into shares of Series C Preferred Stock.

The Company entered into the agreement with IMAGIN to ensure approval of the amendment and restatement of our Articles of Incorporation which provides for a 100-to-1 reverse stock split and maintenance of the number of authorized shares of common stock at 100,000,000. IMAGIN has agreed to convert its shares of Series C Preferred Stock into 385,000 shares of Common Stock following the reverse split. The Company attempted to receive shareholder approval of the amendment at a shareholders meeting held on August 24, 2005, but was unable to obtain enough votes to approve the proposal because of the large number of shares held by offshore investors and the difficulties encountered in communicating with and obtaining proxies from these investors in a timely and cost effective manner. The Company has no reason to believe that they oppose the proposal.

Financing Agreements dated October 31, 2005

On October 31, 2005, the Company entered into a series of agreements with IMAGIN pursuant to which IMAGIN agreed to purchase from the Company 10% convertible secured notes in the aggregate principal amount of \$400,000. In addition, the Board approved the sale of an additional 10% convertible secured note in the principal amount of

\$25,000 to a private investor on the same terms. As of October 31, 2005, IMAGIN has purchased \$200,000 of these notes. These notes are due and payable on October 31, 2008 and are convertible into an aggregate of 21,250,000 shares of the Company's common stock. Full convertibility of the notes into shares of common stock will require an amendment to the Company's Articles of Incorporation, which must be approved by the shareholders. The Company has obtained consent for amending its Articles of Incorporation and is preparing to file the amendment.

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

We are including the following cautionary statement in this Quarterly Report on Form 10-QSB to make applicable and utilize the safe harbor provision of the Private Securities Litigation Reform Act of 1995 regarding any forward-looking statements made by, or on behalf of, the Company. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements, which are other than statements of historical facts. Certain statements contained herein are forward-looking statements and, accordingly, involve risks and uncertainties, which could cause actual results or outcomes to differ materially from those expressed in the forward-looking statements.

Our expectations, beliefs and projections are expressed in good faith and are believed by us to have a reasonable basis, including without limitations, our examination of historical operating trends, data contained in our records and other data available from third parties, but there can be no assurance that our expectations, beliefs or projections will result, or be achieved, or be accomplished.

Comparison of the Results of Operations for the Three Months ended September 30, 2005 and 2004

We experienced a loss of \$855,000 for the three months ended September 30, 2005 compared to a loss of \$203,000 for the same quarter in 2004. The larger loss in 2005 resulted from increases in costs related to personnel, legal fees and interest, offset by the reversal of expense related to stock based compensation. The loss in the third quarter of 2004 included profits from the sale of a system and system upgrades.

We generated no revenues from sales of systems in the three months ended September 30, 2005 compared to \$1,150,000 on the sale of one system in the third quarter of 2004. We earned revenues of \$382,000 from upgrades of systems in the third quarter of 2004. Our service revenues decreased \$51,000 to \$175,000 in the three months ended September 30, 2005 from \$226,000 in the same period in 2004. Service revenues in the three month period ended September 30, 2004 included the recognition of \$50,000 in revenue relating to support provided to GE Medical Systems in conjunction with the sale of our Cardiac PET Software.

We generated gross profits of \$44,000 during the three months ended September 30, 2005 compared to profits of \$450,000 for the same three months in 2004. We earned profits from the sale of a system and system upgrades in the third quarter of 2004. Revenues of \$50,000 relating to services provided to GE Medical Systems were also included in gross profits in the quarter ended September 30, 2004.

Our operating expenses increased \$24,000 to \$615,000 for the three months ended September 30, 2005 from \$591,000 for the same period in 2004. Research and development expenses decreased \$49,000 to \$92,000 from \$141,000 as a result of a decrease in the use of consultants. Sales and marketing expenses also decreased \$33,000 to \$127,000 from \$160,000 primarily as a result of decreased personnel costs. General and administrative expenses increased \$167,000 to \$457,000 in the quarter ended September 30, 2005 from \$290,000 in the same period in 2004. This increase in general and administrative expenses primarily resulted from increased legal fees and the recording of an obligation of 111,500 for severance pay in 2005. We reversed expense related to stock based compensation by \$61,000 in the quarter ended September 30, 2005 relating to the application of the variable accounting rules to the re-pricing of warrants and options.

We recognized interest expense of \$284,000 in the third quarter of 2005 compared to \$62,000 of interest expense in the same period in 2004. Interest expense in the third quarter of 2005 relates to the notes payable to IMAGIN Diagnostic Centres, Inc. and Solaris Opportunity Fund, L.P. and includes \$207,000 in amortization of loan costs, debt discounts and beneficial conversion features.

Comparison of the Results of Operations for the Nine Months ended September 30, 2005 and 2004

We experienced a loss of \$2,442,000 for the nine months ended September 30, 2005 compared to a loss of \$1,092,000 for the same period in 2004. The larger loss in 2005 resulted primarily from increases in costs related to personnel, legal fees and interest, offset by the reversal of expense related to stock based compensation. The loss in 2004 included profits from the sale of a system and system upgrades.

We generated no revenues from sales of systems in the nine months ended September 30, 2005 compared to \$1,150,000 on the sale of one system in the same period of the prior year. We earned revenues of \$37,000 from upgrades of systems in the first nine months of 2005 compared to \$382,000 in revenues from system upgrades in the same period in 2004. Our service revenues decreased \$180,000 to \$525,000 in the nine months ended September 30, 2005 from \$705,000 in the same period in 2004. Service revenues in the nine month period ended September 30, 2004 included the recognition of \$150,000 in revenue relating to support provided to GE Medical Systems in conjunction with the sale of our Cardiac PET Software.

We generated gross profits of \$118,000 during the nine months ended September 30, 2005 compared to \$694,000 for the same period in 2004. We earned profits from the sale of a system and system upgrades in 2004. Revenues of \$150,000 relating to services provided to GE Medical Systems were also included in gross profits in the nine months ended September 30, 2004.

Our operating expenses increased \$222,000 to \$1,924,000 for the nine months ended September 30, 2005 from \$1,702,000 for the same period in 2004. Research and development expenses increased \$110,000 to \$352,000 from \$242,000 as a result of increased personnel costs. Sales and marketing expenses also increased \$325,000 to \$570,000 from \$245,000 primarily as a result of increased personnel costs. General and administrative expenses increased \$300,000 to \$1,165,000 in the nine month period ended September 30, 2005 from \$865,000 in the same period in 2004. This increase in general and administrative expenses primarily resulted from increased legal fees and the recording of an obligation of \$111,500 for severance pay in 2005. We reversed expense related to stock based compensation by \$163,000 in the nine months ended September 30, 2005 related to the application of the variable accounting rules to the re-pricing of warrants and options. We recorded expense of \$350,000 related to stock based compensation in the first nine months of 2004.

We recognized interest expense of \$637,000 in the first nine months of 2005 compared to \$84,000 of interest expense in the same period in 2004. Interest expense in the first nine months of 2005 relates to the notes payable to IMAGIN Diagnostic Centres, Inc. and Solaris Opportunity Fund, L.P. and includes \$440,000 in amortization of loan costs, debt discounts and beneficial conversion features.

Financial Condition

We had cash and cash equivalents of \$154,000 on September 30, 2005. On the same date, we had accounts payable and accrued liabilities outstanding of \$1,599,000. We did not sell any imaging systems in the nine-month period ended September 30, 2005. In order to resolve our liquidity problems, we must sell imaging systems or seek alternative sources of debt or equity funding. However, there is no assurance that we will be successful in selling new systems or securing additional debt or equity funds.

Since inception, we have been unable to sell our POSICAM™ systems in quantities sufficient to be operationally profitable. Consequently, we have sustained substantial losses. Due to the sizable selling prices of our systems and the limited number of systems sold or placed into service each year, revenues have fluctuated significantly from year to year. We have an accumulated deficit of \$60,875,000 at September 30, 2005. The Company will need to increase system sales to achieve profitability in the future.

These events raise doubt as to our ability to continue as a going concern. The report of our independent public accountants, which accompanied our financial statements for the year ended December 31, 2004, was qualified with respect to that risk. If we are unable to obtain debt or equity financing to meet our cash needs we may have to severely limit or cease our business activities or may seek protection from our creditors under the bankruptcy laws.

FORM 10-QSB

SEPTEMBER 30, 2005

New Accounting Pronouncements

Please refer to the Annual Report Form 10-KSB for the year ended December 31, 2004 for disclosures regarding the Company's treatment of new accounting pronouncements.

Critical Accounting Policies**Revenue Recognition**

Revenues from POSICAM™ system contracts are recognized when all significant costs have been incurred and the system has been shipped to the customer. The Company also recognizes revenue on bill and hold transactions when the product is completed and is ready to be shipped and the risk of loss is transferred to the customer. In certain cases, at the customers' request, the Company is storing the product for a brief period of time. Revenues from maintenance contracts are recognized over the term of the contract. Service revenues are recognized upon performance of the services.

ITEM 3 - CONTROLS AND PROCEDURES

As of September 30, 2005, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chairman of the Board, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e) and Rule 15d-15(e)). Based upon that evaluation, the Company's Chairman of the Board concluded that the Company's disclosure controls and procedures are effective at a reasonable level. There has been no change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that has materially affected or is reasonably likely to materially affect, the Company's internal control over financial reporting.

The Company's management, including the Chairman of the Board, do not expect that the Company's disclosure controls or internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met due to numerous factors, ranging from errors to conscious acts of an individual, or individuals acting together. In addition, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in a cost-effective control system, misstatements due to error and/or fraud may occur and not be detected.

PART II OTHER INFORMATION**ITEM 1 -****LEGAL PROCEEDINGS**

Please refer to our Quarterly Report on Form 10-QSB for the fiscal quarter ended March 31, 2005, filed on May 16, 2005, which discloses claims which have been filed against the Company. There have been no material developments with respect to these claims since the previously filed Quarterly Report.

ITEM 2 -**UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS****Recent Sales of Unregistered Securities**

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On August 8, 2005, the Company sold to IMAGIN Diagnostic Centres, Inc. a 10% secured convertible promissory notes under a Note Purchase Agreement dated August 8, 2005, in the aggregate principal amount of \$400,000. These notes are convertible at the option of the holder into an aggregate 20,000,000 shares of the Company's common stock.

FORM 10-QSB

SEPTEMBER 30, 2005

The sales of securities described above were exempt from the registration requirements of the Securities Act of 1933, as amended, pursuant to Section 4(2) of the Securities Act of 1933, since the issuance constituted a sale not involving a public offering.

ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

At the Registrant's Annual Meeting of Stockholders held on August 24, 2005 (which was adjourned several times) the following proposals were adopted by the margins indicated:

| | <u>For</u> | Number of Shares | <u>Withheld</u> |
|---|------------|------------------|-----------------|
| 1. To elect a five directors to hold office until the Annual Meeting of Shareholders to be held in 2006 or until their respective successors have been elected or appointed | | | |
| Gary H. Brooks (1) | 27,959,696 | | 203,517 |
| Sachio Okamura | 50,991,050 | | 172,163 |
| Patrick G. Rooney | 50,934,696 | | 228,517 |
| John E. McConnaughey (2) | 50,936,050 | | 227,163 |
| Dr. Anthony C. Nicholls | 50,941,050 | | 222,163 |

(1) Resigned on September 29, 2005.

(2) Resigned on October 3, 2005.

| | <u>For</u> | <u>Against</u> | <u>Abstain</u> | <u>Not Voted</u> |
|--|------------|----------------|----------------|------------------|
| 2. To approve a proposed amendment and restatement of the Company's Articles of Incorporation to effect a 100 to 1 reverse stock split and to maintain the number of shares of Common Stock authorized at 100,000,000. | 28,294,571 | 1,264,864 | 18,500 | 21,585,278 |
| 3. To ratify the appointment of Ham, Langston & Brezina, L.L.P. as the Company's independent auditors for the fiscal year ended December 31, 2005. | 50,804,673 | 207,727 | 21,000 | -- |

After several adjournments of the Annual Meeting, the Company was unable to obtain enough votes to approve the proposal related to amendment of the Company's Articles of Incorporation because of the large number of shares held by offshore investors and the difficulties encountered in communicating with and obtaining proxies from these investors in a timely and cost effective manner. As a result, subsequent to final adjournment of the meeting, the Company obtained the written consent of sufficient shares to approve the proposal and is in the process of its implementation. A description of the proposal and the consent is contained in the Definitive Information Statement filed with the Commission on October 24, 2005.

ITEM 5 - OTHER INFORMATION

On October 27, 2005, J. David Wilson was appointed as the Company's new Chief Executive Officer and Corey N. Conn as the Company's new Chief Financial Officer and Executive Vice President of Operations. Griffith L. Miller remains the Company's President.

ITEM 6 -**EXHIBITS**

Exhibit Description of the Exhibit

- 10.1 Joint Venture Contract dated July 30, 2005 between Positron Corporation and Neusoft Medical Systems Co., Ltd.
- 10.2 Technologies Contribution Agreement dated July 30, 2005 between Positron Corporation and Neusoft Positron Medical Systems Co., Ltd.
- 10.3 Software Sub-License Agreement dated September 6, 2005 between Positron Corporation and Neusoft Positron Medical Systems Co., Ltd.
- 10.4 Trademark License Agreement dated July 30, 2005 between Positron Corporation and Neusoft Positron Medical Systems Co., Ltd.
- 10.5 Corporate Name License Agreement dated July 30, 2005 between Positron Corporation and Neusoft Positron Medical Systems Co., Ltd.
- 10.6 Note Purchase Agreement dated August 8, 2005 between Positron Corporation and IMAGIN Diagnostic Centres, Inc. (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on August 12, 2005 (File No. 000-24092)).
- 10.7 Form Secured Convertible Promissory Note (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on August 12, 2005 (File No. 000-24092)).
- 10.8 Registration Rights Agreement dated August 8, 2005 between Positron Corporation and IMAGIN Diagnostic Centres, Inc. (incorporated herein by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on August 12, 2005 (File No. 000-24092)).
- 10.9 Agreement between Gary H. Brooks and Positron Corporation dated September 29, 2005 (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on October 3, 2005 (File No. 000-24092)).
- 31.1 Chairman of the Board Certification of Periodic Financial Report Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
- 32.1 Chairman of the Board Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the

Sarbanes-Oxley Act of 2002.#

* Filed herewith

Furnished herewith

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

P O S I T R O N
CORPORATION
(Registrant)

Date: November
14, 2005

/s/ Patrick G. Rooney

Patrick G. Rooney
Chairman of the Board

EXHIBIT INDEX

| Exhibit | Description of the Exhibit |
|---------|---|
| 31.1 | <u>Chairman of the Board Certification of Periodic Financial Report</u> Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.* |
| 32.1 | <u>Chairman of the Board Certification</u> Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.# |

* Filed herewith

Furnished herewith