POSITRON CORP
Form 10-Q
November 14, 2011

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 September 30, 2011

Commission file number 000-29449

---

POSITRON CORPORATION

(Exact Name of Registrant as specified in its charter)

| | |
|---|---|
| Texas | 76-0083622 |
| (State or Other Jurisdiction of Incorporation or Organization) | (IRS Employer Identification No.) |
| 9715 Kincaid Boulevard, Suite 1000, Fishers, Indiana | 46038 |
| (Address of Principal Executive Offices) | (Zip Code) |

Registrant’s Telephone Number, Including Area Code: (317) 576-0183

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 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes x No ¨

Indicate by check mark whether the registrant is a larger accelerated filer, an accelerated filer, a non-accelerated or a smaller reporting company filer. See the definition of “large accelerated filer, accelerated filer and smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one)

| | |
|---|---|
| Large accelerated filer ¨ | Accelerated filer ¨ |
| 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 Exchange Act).
Yes ¨ No x

The numbers of shares outstanding of each of the issuer's classes of common equity, as of November 11, 2011, are as follows:

| Class of Securities | Shares Outstanding |
|---|---|
| Common Stock, $0.01 par value | 797,827,497 |

POSITRON CORPORATION

TABLE OF CONTENTS

PART 1 – FINANCIAL INFORMATION

ITEM 1. Financial Statements

POSITRON CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)
(Unaudited)

| | September 30, 2011 (Unaudited) | December 31, 2010 |
|---|---|---|
| ASSETS | | |
| | | |
| Current assets: | | |
| Cash and cash equivalents | $ 194 | $ 1,141 |
| Accounts receivable | 1,215 | 514 |
| Inventories | 798 | 622 |
| Prepaid expenses | 71 | 28 |
| Deposits – Attrius® PET systems | 560 | 2,484 |
| Total current assets | 2,838 | 4,789 |
| | | |
| Property and equipment, net | 202 | 251 |
| Deferred rent | 85 | 111 |
| Other assets | 30 | 22 |
| Total assets | $ 3,155 | $ 5,173 |
| | | |
| LIABILITIES AND STOCKHOLDERS' DEFICIT | | |
| | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | $ 1,434 | $ 803 |
| Customer deposits | 1,952 | 4,203 |
| Unearned revenue | 297 | 253 |
| Total current liabilities | 3,683 | 5,259 |
| | | |
| Convertible debenture, net | 173 | — |
| Embedded conversion derivative liabilities | 1,267 | — |
| Total liabilities | 5,123 | 5,259 |
| | | |
| Stockholders' deficit: | | |
| Series A Preferred Stock: $1.00 par value; 8% cumulative, convertible, redeemable; 5,450,000 shares authorized; 457,599 shares issued and outstanding. | 457 | 457 |
| Series B Preferred Stock: $1.00 par value; convertible, redeemable; 9,000,000 shares authorized; 7,615,186 and 6,668,444 shares issued and outstanding | 7,307 | 6,361 |
| Series G Preferred Stock: $1.00 par value; convertible, redeemable; 3,000,000 shares authorized; 19,200 and 19,200 shares issued and outstanding | 19 | 19 |
| Series S Preferred Stock: $1.00 par value; convertible, redeemable; 100,000 shares authorized; 100,000 shares issued and outstanding | 100 | 100 |
| | 7,662 | 7,511 |

| | | |
|---|---|---|
| Common stock: $0.01 par value; 800,000,000 shares authorized; 797,827,497 and 782,727,497 shares outstanding. | | |
| Additional paid-in capital | 89,970 | 88,126 |
| Other comprehensive income | (143) | (143) |
| Receivable for exercise of warrants | (50) | (250) |
| Accumulated deficit | (107,275) | (102,252) |
| Treasury Stock: 60,156 shares at cost | (15) | (15) |
| Total stockholders' deficit | (1,968) | (86) |
| Total liabilities and stockholders' deficit | $ 3,155 | $ 5,173 |

See accompanying notes to consolidated financial statements

POSITRON CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)

| | Three Months Ended September 30, 2011 | Three Months Ended September 30, 2010 | Nine Months Ended September 30, 2011 | Nine Months Ended September 30, 2010 |
|---|---|---|---|---|
| Revenues: | $ 482 | $ 1,013 | $ 6,374 | $ 2,414 |
| Costs of revenues: | 501 | 1,126 | 6,033 | 2,141 |
| Gross profit (loss) | (19) | (113) | 341 | 273 |
| Operating expenses: | | | | |
| Research and development | 401 | 417 | 1,062 | 881 |
| Selling and marketing | 221 | 343 | 888 | 779 |
| General and administrative | 459 | 1,761 | 1,791 | 11,493 |
| Total operating expenses | 1,081 | 2,521 | 3,741 | 13,153 |
| Loss from operations | (1,100) | (2,634) | (3,400) | (12,880) |
| Other income (expense) | | | | |
| Interest expense | (123) | — | (900) | (43) |
| Derivative losses | (230) | 2,104 | (723) | 2,104 |
| Other income | — | 824 | — | 1,455 |
| Total other income (expense) | (353) | 2,928 | (1,623) | 3,516 |
| Income (loss) before income taxes | (1,453) | 294 | (5,023) | (9,364) |
| Income taxes | — | — | — | — |
| Net income (loss) | $ (1,453) | $ 294 | $ (5,023) | $ (9,364) |
| Other comprehensive income | | | | |
| Foreign currency translation loss | — | (29) | — | (17) |
| Comprehensive income (loss) | $ (1,453) | $ 265 | $ (5,023) | $ (9,381) |
| Basic and diluted income (loss) per common share | $ (0.00) | $ 0.00 | $ (0.01) | $ (0.02) |
| Weighted average number of basic and diluted common shares outstanding | 797,751 | 755,595 | 790,653 | 582,766 |

See accompanying notes to financial statements

POSITRON CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

| | Nine Months Ended September 30, 2011 | Nine Months Ended September 30, 2010 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net loss | $(5,023) | $(9,364) |
| Adjustment to reconcile net loss to net cash used in operating activities | | |
| Depreciation and amortization | 57 | 24 |
| Derivative losses (gains) | 723 | (2,104) |
| Common stock issued for services | 386 | 6,284 |
| Preferred stock issued for services | 54 | 441 |
| Deferred rent | 26 | (119) |
| Accretion of interest | 873 | — |
| Stock based compensation | — | 2,500 |
| Preferred stock issued for post-acquisition contingent payment | — | 400 |
| Forgiveness of interest | — | (367) |
| Settlement of accounts payable | — | (986) |
| Forgiveness of accrued compensation | — | (103) |
| Bad debt expense | — | 34 |
| Inventory reserve | — | 239 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (701) | (230) |
| Inventories | (176) | (221) |
| Prepaid expenses | (43) | (65) |
| Other assets | 1,916 | (13) |
| Accounts payable and accrued liabilities | 631 | (748) |
| Customer deposits | (2,251) | 1,592 |
| Deposits | — | (1,957) |
| Unearned revenue | 44 | 88 |
| Net cash used in operating activities | (3,484) | (4,675) |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (8) | (196) |
| Net cash used in investing activities | (8) | (196) |
| Cash flows from financing activities: | | |
| Advance from related party | — | (575) |
| Proceeds from convertible debt | 1,700 | — |
| Payment of convertible note | — | (1,000) |
| Proceeds from common stock | — | 5,131 |
| Deposits for unissued securities | — | 2,016 |
| Repayments of advances to affiliated entities | — | 39 |

| | | |
|---|---|---|
| Proceeds from exercise of warrants | 845 | — |
| Net cash provided by financing activities | 2,545 | 5,611 |
| Effect of exchange rate changes on cash and cash equivalents | — | (17) |
| Net increase (decrease) in cash and cash equivalents | (947) | 723 |
| Cash and cash equivalents, beginning of period | 1,141 | 165 |
| Cash and cash equivalents, end of period | $194 | $888 |
| Supplemental cash flow information: | | |
| Interest paid | $— | $— |
| Income taxes paid | — | — |
| Non-cash disclosures | | |
| Conversion of Series B Preferred Stock to common stock | $20 | $1,324 |
| Conversion of Series G Preferred Stock to common stock | $— | $33 |
| Payment of convertible notes payable and accrued interest with common stock | $— | $680 |
| Allocation of Convertible Debentures to warrants and embedded conversion derivative liability | $1,700 | $— |
| Conversion of Convertible Debentures to Series B Preferred stock | $700 | $— |
| Conversion of embedded conversion derivative liability to paid in capital | $883 | $— |

See accompanying notes to consolidated financial statements

POSITRON CORPORATION AND SUBSIDIARIES
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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-K for Positron Corporation (the "Registrant" or the "Company") for the year ended December 31, 2010. In the opinion of management, all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of financial position, results of operations and cash flows 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, 2010, as reported in the Form 10-K, have been omitted.

In preparing the interim unaudited consolidated financial statements, management was required to make certain estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures at the financial reporting date and throughout the periods being reported upon. Certain of the estimates result from judgments that can be subjective and complex and consequently actual results may differ from these estimates.

All significant intercompany balances and transactions have been eliminated.

2. Accounting Policies

For a summary of significant accounting policies (which have not changed from December 31, 2010), see the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported amount of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Debt discount

Costs incurred with parties who are providing long-term financing, which generally include the value of warrants or the fair value of an embedded derivative conversion feature are reflected as a debt discount and are amortized over the life of the related debt. The debt discount attributable to the warrants issued with convertible debentures during the nine months ended September 30, 2011 was $273,000. The debt discount attributable to the embedded conversion derivative liability was $1,427,000 during the nine months ended September 30, 2011.

Fair value of financial instruments

The carrying value of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and unearned revenue, approximate their fair values because of the short-term nature of these instruments. Management believes the Company is not exposed to significant interest or credit risks arising from these financial instruments.

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value maximize the use of observable inputs and minimize the use of unobservable inputs. The Company utilizes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable.

- Level 1 — Quoted prices in active markets for identical assets or liabilities. These are typically obtained from real-time quotes for transactions in active exchange markets involving identical assets.

- Level 2 — Quoted prices for similar assets and liabilities in active markets; quoted prices included for identical or similar assets and liabilities that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets. These are typically obtained from readily-available pricing sources for comparable instruments.

• Level 3 — Unobservable inputs, where there is little or no market activity for the asset or liability. These inputs reflect the reporting entity's own beliefs about the assumptions that market participants would use in pricing the asset or liability, based on the best information available in the circumstances.

The following table presents the embedded conversion derivative liabilities, the Company's only financial liabilities measured and recorded at fair value on the Company's consolidated balance sheets on a recurring basis and their level within the fair value hierarchy as of September 30, 2011(in thousands):

| | September 30, 2011 | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Embedded conversion derivative liability | $ 1,267 | $ - | $ - | $ 1,267 |

The following table reconciles, for the nine months ended September 30, 2011, the beginning and ending balances for financial instruments that are recognized at fair value in the consolidated financial statements (in thousands):

| | |
|---|---|
| Balance of embedded conversion derivative liability as of December 31, 2010 | $- |
| Fair value of embedded conversion derivative liabilities at issuance | 1,427 |
| Reductions in fair value due to conversion of Convertible Debentures to Series B Preferred Stock | (883 ) |
| Loss on fair value adjustments to embedded conversion derivative liabilities | 723 |
| Balance of embedded conversion derivative liabilities at September 30, 2011 | $1,267 |

The fair value of the conversion features are calculated at the time of issuance and the Company records a derivative liability for the calculated value using a Black-Scholes option-pricing model. Changes in the fair value of the derivative liability are recorded in other income (expense) in the consolidated statements of operations. Upon conversion of the convertible debt to stock, the Company reclassifies the related embedded conversion derivative liability to paid in capital. Since the fair value of the embedded conversion derivative liability exceeded the carrying value of the convertible debentures on the issuance date, the convertible debentures were recorded at a full discount. The Company recognizes expense for accretion of the convertible debentures discount over the term of the notes. The Company has considered the provisions of ASC 480, Distinguishing Liabilities from Equity , as the conversion feature embedded in each debenture could result in the note principal being converted to a variable number of the Company's common shares.

Revenue Recognition

Prior to July 1, 2010, revenues from system contracts and other nuclear imaging devices were recognized when all significant costs have been incurred and the system has been shipped to the customer and in cases, when the Company is responsible for installation, after installation is complete. Revenues from maintenance contracts were recognized over the term of the contract. Service revenues were recognized upon performance of the services.

The delivered items, specifically: a) the medical machine, delivery and installation, and b) the one year warranty/service agreement, are considered separate units of accounting. Both have value to the customer on a standalone basis, each have objective and reliable evidence of their fair values and the performance of each item is considered probable and in control of the Company to perform. Additionally, performance and delivery of the delivered items are the responsibility of the Company and would be liable for any type of return.

Selling prices of the deliverable items are established based on list prices of similar items, including delivery, installation and maintenance contracts (for years subsequent to the one year warranty/service period). We utilize competitive information to align price points for each specific unit. There is a detailed proposal for each customer, breaking down each deliverable as well as the price for future annual service agreements. The general timing of delivery and performance of each specific unit differs depending on the customer, but generally delivery, installation and acceptance occur within 120-150 days of the signed contract and the warranty/service covers one year after acceptance and final payment. Cancellation of the agreements are allowed with full or partial refund within specified time periods prior to shipment. Product returns based on improper shipment or apparent damage may be claimed in writing within 14 days of receipt of the machine and must be accepted by the Company. Revenue is not recognized until unit is properly tested and written acceptance is provided by the buyer.

Revenue from sales of Attrius® PET systems is recognized on a gross basis because the sale of the Attrius® product meets the various requirements identified in Topic 605-45-45, including:

1) The Company is the primary obligor in the arrangement. All sales agreements are between the Company and the buyer and the Company is responsible for delivery and performance of the machines.
2) The Company has full responsibility for any returned products from customers and has general inventory risk.
3) The Company has complete authority over establishing the price of the individual units of our sales agreements and has full credit risk with regards to collection.
4) All machines are installed and serviced by the Company.
5) All machines acquired from its joint venture partner are sold FOB shipping point.

Recent Accounting Pronouncements

Recently issued or adopted accounting pronouncements are not expected to, or did not have, a material impact on our financial position, results of operations or cash flows.

Reclassifications

Certain items in the financial statements for 2010 have been reclassified to conform with the current year presentation. Such reclassification had no effect on net income.

3. Going Concern

Since inception, the Company has expended substantial resources on research and development and sustained losses. Due to the limited number of systems sold or placed into service each year, revenues have fluctuated significantly from year to year and have not been sufficient to be operationally profitable. The Company had an accumulated deficit of $107,275,000 and a stockholders' deficit of $1,968,000 at September 30, 2011. The Company will need to increase sales and apply the research and development advancements to achieve profitability in the future. The Company expects to experience a significant increase in sales of the Attrius® Positron Emission Tomography ("PET") system and additional service agreements; it also expects recurring revenue from the sale of radiopharmaceuticals through PosiRx™, its automated radiopharmaceutical system and sales of radiopharmaceuticals manufactured at its Crown Point facility. The Company expects that these developments will have a positive impact on revenue and net margins.

The Company had cash and cash equivalents of $194,000 at September 30, 2011. At the same date, the Company had accounts payable and accrued liabilities of $1,434,000 at September 30, 2011. Working capital requirements for the upcoming year may reach beyond our current cash balances. As the Company executes its plans for expansion, it may increase sales and services to meet business operations however it may also continue to raise funds as required through equity and debt financing to sustain business operations if necessary. The Company expects to achieve sufficient revenues or raise sufficient funds to sustain business operations; however, no assurance can be given.

4. Deposits - Attrius® PET systems

At September 30, 2011, the Company had $560,000 in deposits paid to our joint venture partner, Neusoft Positron Medical Systems Co., Ltd., ("Neusoft") for Attrius® PET systems for which the Company has sales contracts on three Attrius® PET systems.

5. Inventories

Inventories consisted of the following (in thousands) as of:

| | September 30, 2011 | December 31, 2010 |
|---|---|---|
| Finished systems | $ 150 | $ 120 |
| Raw materials and service parts | 383 | 379 |
| Work in progress | 632 | 490 |
| | 1,165 | 989 |
| Less: Reserve for obsolete inventory | (367) | (367) |
| | $ 798 | $ 622 |

8

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out (FIFO) method of inventory valuation. The Company evaluated the reserve as of September 30, 2011 and December 31, 2010.

6. Property and equipment

Property and equipment consisted of the following (in thousands) as of:

| | September 30, 2011 | December 31, 2010 |
|---|---|---|
| Furniture and fixtures | $ 27 | $ 21 |
| Leasehold improvements | 19 | 19 |
| Computer equipment | 57 | 55 |
| Machinery and equipment | 214 | 214 |
| | 317 | 309 |
| Less: Accumulated depreciation | (115 ) | (58 ) |
| | $ 202 | $ 251 |

7. Customer Deposits

Customer deposits represent amounts paid to the Company by customers for devices in advance of manufacturing completion and/or shipment of the device to the customer. Deposit amounts may vary depending on the contract. Included in customer deposits at September 30, 2011 were deposits of approximately $669,000 from a customer that had placed an order in 2007 for five Nuclear Pharm-Assist™ systems. As of the date of this report, there can be no assurance that this customer will fulfill its order for these devices.

Also, included in customer deposits at September 30, 2011 are $1,283,000 deposits on three Attrius® PET systems sale orders and two used machines.

8. Income (Loss) Per Share

Basic loss per common share is 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 assumes 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 months ended September 30, 2011 and 2010, respectively since it would have resulted in an antidilutive effect.

The following table sets forth the computation of basic and diluted loss per share (In thousands, except per share data).

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 30, 2011 | September 30, 2010 | September 30, 2011 | September 30, 2010 |
| | (In thousands, except per share data) | | | |
| Numerator | | | | |

| | | | | |
|---|---|---|---|---|
| Basic and diluted income (loss) | $(1,453) | $ 294 | $(5,023) | $ (9,364) |