

Patient Safety Technologies, Inc
Form 10-Q
May 14, 2013

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

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2013

OR

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

FOR THE TRANSITION PERIOD FROM ____ TO ____

COMMISSION FILE NUMBER: 001-09727

PATIENT SAFETY TECHNOLOGIES, INC.
(Exact name of registrant as specified in its charter)

Delaware 13-3419202
(State or other jurisdiction of incorporation (I.R.S. Employer Identification No.)
or organization)

2 Venture Plaza, Suite 350, Irvine, CA 92618
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (949) 387-2277

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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 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:

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Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer (Do not check if smaller reporting company)	<input type="checkbox"/>	Smaller Reporting Company	<input checked="" type="checkbox"/>

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

The number of outstanding shares of the registrant's common stock, par value \$0.0001 per share, as of April 15, 2013 was 37,543,448.

PATIENT SAFETY TECHNOLOGIES, INC.

FORM 10-Q FOR THE QUARTER
ENDED MARCH 31, 2013

TABLE OF CONTENTS

	Page
CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS	1
HELPFUL INFORMATION	1
PART I – FINANCIAL INFORMATION	2
ITEM 1. FINANCIAL STATEMENTS	2
Condensed Consolidated Balance Sheets	2
Condensed Consolidated Statements of Operations	3
Condensed Consolidated Statements of Cash Flows	4
Notes to Condensed Consolidated Financial statements	5
ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	12
ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	20
ITEM 4. CONTROLS AND PROCEDURES	20
PART II – OTHER INFORMATION	21
ITEM 1. LEGAL PROCEEDINGS	21
ITEM 1A. RISK FACTORS	21
ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS	21
ITEM 3. DEFAULTS UPON SENIOR SECURITIES	21
ITEM 4. MINE SAFETY DISCLOSURES	21
ITEM 5. OTHER INFORMATION	21
ITEM 6. EXHIBITS	21

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q (this “Report”) contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We claim the protection of the safe harbor contained in the Private Securities Litigation Reform Act of 1995. Our forward-looking statements relate to future events or our future performance and include, but are not limited to, statements concerning our business strategy, future commercial revenues, market growth, capital requirements, new product introductions, expansion plans and the adequacy of our funding. Other statements contained in this Report that are not historical facts are also forward-looking statements. You can sometimes identify forward-looking statements by our use of forward-looking words like “may,” “will,” “could,” “should,” “expects,” “intends,” “plans,” “anticipates,” “believes,” “estimates,” “seeks,” “predicts,” “potential,” or “continue” or the negative of these terms and other similar expressions and terminology.

We caution investors that any forward-looking statements presented in this Report, or that we may make orally or in writing from time to time, are based on the beliefs of, assumptions made by, and information currently available to us. Although we believe that the plans, objectives, expectations and intentions reflected in or suggested by our forward-looking statements are reasonable, those statements are based only on the current beliefs and assumptions of our management and on information currently available to us and, therefore, they involve uncertainties and risks as to what may happen in the future. Accordingly, we cannot guarantee that our plans, objectives, expectations or intentions will be achieved. Our actual results, performance (financial or operating) or achievements could differ from those expressed in or implied by any forward-looking statement in this Report as a result of many known and unknown factors, many of which are beyond our ability to predict or control, and those differences may be material. These factors include, but are not limited to, those described under the caption “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2012 filed on March 18, 2013 and amended on April 30, 2013, including without limitation the following:

our ability to successfully implement hospitals under contract but not yet implemented;

the early stage of adoption of our Safety-Sponge® System and the need to expand adoption of our Safety-Sponge® System;

the impact on our future revenue and cash flow from the Forward Order (described herein) and ordering patterns of our exclusive distributor, Cardinal Health, Inc;

our need for additional financing to support our business;

our reliance on third-party manufacturers, some of whom are sole-source suppliers, and on our exclusive distributor;

any inability to successfully protect our intellectual property portfolio; and

the impact on our revenues and financial position from managing our growth, including the initial costs typically associated with hospital implementations.

This Report and all other written and oral forward-looking statements attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained in or referred to in this section.

Our forward-looking statements speak only as of the date they are made and should not be relied upon as representing our plans, objectives, expectations and intentions as of any subsequent date. Although we may elect to update or

revise forward-looking statements at some time in the future, we specifically disclaim any obligation to do so, even if our plans, objectives, expectations or intentions change.

HELPFUL INFORMATION

As used throughout this Quarterly Report on Form 10-Q, the terms “the Company,” “the registrant,” “we,” “us,” and “our” mean Patient Safety Technologies, Inc., a Delaware corporation, together with its consolidated subsidiary, SurgiCount Medical Inc., a California corporation, unless the context otherwise requires.

Unless otherwise indicated, all statements presented in this Quarterly Report on Form 10-Q regarding the medical patient safety market, the market for surgical sponges, our market share, the cumulative number of surgical sponges used and number of procedures are internal estimates only.

Safety-Sponge®, SurgiCounter™ and SurgiCount360™, among others, are registered or unregistered trademarks of Patient Safety Technologies, Inc. (including its subsidiary).

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PATIENT SAFETY TECHNOLOGIES, INC.

Condensed Consolidated Balance Sheets

	March 31, 2013 (Unaudited)	December 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	\$ 4,346,266	\$ 5,177,082
Accounts receivable	1,991,385	1,415,634
Inventories, net	3,580,689	3,968,436
Prepaid expenses	116,051	308,285
Total current assets	10,034,391	10,869,437
Property and equipment, net	4,590,847	4,833,754
Goodwill	1,832,027	1,832,027
Patents, net	2,057,967	2,139,202
Other assets	37,462	37,462
Total assets	\$ 18,552,694	\$ 19,711,882
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 4,423,343	\$ 4,499,002
Accrued liabilities	343,480	960,062
Deferred revenue – current portion	822,849	846,395
Total current liabilities	5,589,672	6,305,459
Deferred revenue	793,327	969,395
Total liabilities	6,382,999	7,274,854
Commitments and contingencies (Note 11)		
Stockholders' equity :		
Preferred stock, \$1.00 par value, 1,000,000 shares authorized:		
Series A preferred stock, \$1.00 par value, cumulative 7% dividend: 500,000 shares designated; 10,950 issued and outstanding at March 31, 2013 and December 31, 2012; (Liquidation preference of \$1.1 million at March 31, 2013 and December 31, 2012)		
	10,950	10,950
Series B convertible preferred stock, \$1.00 par value, cumulative 7% dividend: 150,000 shares designated; 70,425 issued and outstanding at March 31, 2013 and December 31, 2012; (Liquidation preference of \$7.1 million at March 31, 2013 and December 31, 2012)		
	70,425	70,425
Common stock, \$0.0001 par value: 100,000,000 shares authorized; 37,543,448 shares issued and outstanding at March 31, 2013 and 37,041,170 shares issued and		
	3,754	3,705

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outstanding at December 31, 2012		
Additional paid-in capital	74,649,552	74,094,855
Accumulated deficit	(62,564,986)	(61,742,907)
Total stockholders' equity	12,169,695	12,437,028
Total liabilities and stockholders' equity	\$ 18,552,694	\$ 19,711,882

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

PATIENT SAFETY TECHNOLOGIES, INC.
Condensed Consolidated Statements of Operations
(Unaudited)

	For the Three Months Ended March 31,	
	2013	2012
Revenues	\$ 4,757,734	\$ 3,102,258
Cost of revenue	2,918,915	1,865,631
Gross profit	1,838,819	1,236,627
Operating expenses:		
Research and development	133,411	147,643
Sales and marketing	1,067,929	1,299,096
General and administrative	1,250,557	1,091,865
Total operating expenses	2,451,897	2,538,604
Operating loss	(613,078)	(1,301,977)
Other income (expense):		
Interest income, net	2,122	3,878
Interest expense – related party	(68,717)	—
Total other (expense) income	(66,595)	3,878
Loss before income taxes	(679,673)	(1,298,099)
Income tax expense	—	(3,712)
Net loss	(679,673)	(1,301,811)
Preferred dividends	(142,406)	(130,523)
Net loss applicable to common stockholders	\$ (822,079)	\$ (1,432,334)
Loss per common share		
Basic and Diluted	\$ (0.02)	\$ (0.04)
Weighted average common shares outstanding:		
Basic and Diluted	37,283,879	34,021,788

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

PATIENT SAFETY TECHNOLOGIES, INC.
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Three Months Ended March 31,	
	2013	2012
Operating activities:		
Net loss	\$ (679,673)	\$ (1,301,811)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	555,528	285,875
Amortization of patents	81,235	81,235
Stock-based compensation	189,747	199,690
Changes in operating assets and liabilities:		
Accounts receivable	(575,751)	(635,949)
Inventories	387,747	(489,173)
Prepaid expenses	192,232	136,700
Other assets	—	3,001
Accounts payable	(75,659)	663,754
Accrued liabilities	(616,583)	(59,087)
Deferred revenue	(199,613)	558,146
Net cash used in operating activities	(740,790)	(557,619)
Investing activities:		
Purchase of property and equipment	(312,620)	(1,599,236)
Net cash used in investing activities	(312,620)	(1,599,236)
Financing activities:		
Payments of preferred stock series A dividends	(19,163)	(19,163)
Payments of convertible preferred stock series B dividends	(123,243)	(60)
Proceeds from exercise of stock options	365,000	—
Net cash provided by (used in) financing activities	222,594	(19,223)
Net decrease in cash and cash equivalents	(830,816)	(2,176,078)
Cash and cash equivalents at beginning of period	5,177,082	3,668,524
Cash and cash equivalents at end of period	\$ 4,346,266	\$ 1,492,446
Supplemental disclosures of cash flow information:		
Cash paid during the period for taxes	\$ —	\$ 3,712
Non cash investing and financing activities:		
Payment of Series B preferred dividends in preferred B shares	\$ —	\$ 111,300
Issuance of common shares previously earned	\$ —	\$ 990

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

Patient Safety Technologies, Inc.

Notes to Condensed Consolidated Interim Financial Statements (Unaudited)

1. DESCRIPTION OF BUSINESS

Patient Safety Technologies, Inc. (the "Company", "us", "we") is a Delaware corporation. The Company's operations are conducted through its wholly-owned operating subsidiary, SurgiCount Medical, Inc. ("SurgiCount"), a California corporation.

The Company's operating focus is the development, marketing and sales of products and services focused in the medical patient safety markets. The SurgiCount Safety-Sponge® System is a patented system of bar-coded surgical sponges, SurgiCounter™ scanners, and software applications integrated to form a comprehensive counting and documentation system. This system is designed to reduce the number of retained surgical sponges unintentionally left inside of patients during surgical procedures by allowing faster and more accurate counting of surgical sponges.

2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited condensed consolidated interim financial statements have been prepared in accordance with the instructions to Form 10-Q and applicable sections of Regulation S-X and do not include all the information and disclosures required by accounting principles generally accepted in the United States of America ("GAAP"). The condensed consolidated interim financial information is unaudited but reflects all normal adjustments that are, in the opinion of management, necessary to make the financial statements not misleading. The condensed consolidated balance sheet as of December 31, 2012 was derived from the Company's audited financial statements. The condensed consolidated interim financial statements should be read in conjunction with the consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 (as amended). Results of the three months ended March 31, 2013 are not necessarily indicative of the results to be expected for the twelve months ended December 31, 2013.

Principles of Consolidation

The accompanying condensed consolidated interim financial statements include the accounts of the Company and its subsidiary. All significant intercompany balances and transactions have been eliminated in consolidation.

Reclassifications

Certain prior year amounts have been reclassified to conform to the 2013 presentation. These reclassifications had no effect on previously reported results of operations or accumulated deficit.

Use of Estimates

The condensed consolidated interim financial statements have been prepared in accordance with GAAP. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These estimates and assumptions include, but are not limited to, assessing the following: the valuation of accounts receivable and inventory, impairment of goodwill and intangible assets, the fair value of stock-based compensation, valuation allowance related to deferred tax assets, warranty obligations,

provisions for returns and allowances and the determination of the collection of revenue arrangements.

5

Patient Safety Technologies, Inc.
Notes to Condensed Consolidated Interim Financial Statements

Revenue Recognition

Revenue related to surgical products is recognized when persuasive evidence of an arrangement exists, the price to the buyer is fixed or determinable, collectability is reasonably assured and risk of loss transfers, usually when products are shipped. Reimbursements related to scanners and related equipment provided to hospitals are recognized on a straight-line basis over the expected term of the related customer contract, while the cost of the scanners and related equipment is carried as hardware equipment within property, plant and equipment and depreciated as a component of cost of revenue over its estimated useful life. Generally, the expected term of the customer contracts and the estimated useful life of the scanners are both 3 years. Provisions for estimated future product returns and allowances are recorded in the period of the sale based on the historical and anticipated future rate of returns. Revenue is recorded net of any rebates given to the buyer.

Inventories

Inventories are stated at the lower of cost or market on the first-in, first-out (FIFO) basis. Inventory consists of the Company's sponge and towel product as well as scanners and related hardware used in the Safety Sponge System®. The FIFO cost for all inventories approximates replacement cost.

The Company maintains reserves for excess and obsolete inventory resulting from the potential inability to sell its products at prices in excess of current carrying costs. The markets in which the Company operates are highly competitive, and new products and surgical procedures are introduced on an ongoing basis. Such marketplace changes may cause the Company's products to become obsolete. The Company makes estimates regarding the future recoverability of the costs of these products and records a provision for excess and obsolete inventories based on historical experience and expected future trends.

Property and Equipment

Property and equipment is stated at cost. The Company's property and equipment consists mainly of scanners and related hardware used in the Safety Sponge System® which are located at our customer facilities for their use at no additional cost. Depreciation expense associated with this hardware is recorded in cost of revenue. Depreciation is amortized straight-line over the estimated useful lives of three to seven years. Upon retirement or disposition of equipment, the related cost and accumulated depreciation or amortization is removed and a gain or loss is recorded, as applicable.

Impairment of Long-Lived Assets

Our management reviews our long-lived assets with finite useful lives for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. We recognize an impairment loss when the sum of the future undiscounted net cash flows expected to be realized from the asset is less than its carrying amount. If an asset is considered to be impaired, the impairment charge to be recognized is measured by the amount of difference between the recorded carrying value of the asset versus its fair value. Considerable judgment is necessary to estimate the fair value of the assets and accordingly, actual results can vary significantly from such estimates. Our most significant estimate and judgment used when measuring whether there is an impairment to our long-lived assets includes the timing and amount of projected future cash flows.

3. LOSS PER COMMON SHARE

Loss per common share is determined by dividing the loss applicable to common stockholders by the weighted average number of common shares outstanding. The Company complies with FASB (“Financial Accounting Standards Board”) Accounting Standards Codification (“ASC”) 260-10 Earnings Per Share, which requires dual presentation of basic and diluted loss per share on the face of the condensed consolidated statements of operations. Basic loss per common share excludes dilution and is computed by dividing loss attributable to common stockholders by the weighted-average common shares outstanding for the period. Diluted earnings per common share reflects the potential dilution that could occur if convertible preferred stock, options and warrants were to be exercised or converted or otherwise resulted in the issuance of common stock that then shared in the earnings of the entity.

For the three month period ended March 31, 2013 and 2012, potential shares associated with the convertible preferred stock plus warrants and options of 16,740,486 and 18,452,419, have a value in excess of the average stock price during the three month period ending March 31, 2013 and 2012, respectively. Because the effects of these securities are anti-dilutive, shares of common stock underlying these instruments have been excluded from the computation of loss per common share for the three months ended March 31, 2013.

Patient Safety Technologies, Inc.
Notes to Condensed Consolidated Interim Financial Statements

4. PROPERTY AND EQUIPMENT, NET

Property and equipment, net consists of the following:

	As of	
	March 31, 2013	December 31, 2012
Computer software and equipment	\$ 1,836,057	\$ 1,718,247
Furniture and equipment	158,339	