

Stereotaxis, Inc.
Form 10-K/A
December 29, 2008
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K/A

Amendment No. 1

(MARK ONE)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE
ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2007**

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 000-50884

STEREOTAXIS, INC.

(Exact name of Registrant as Specified in its Charter)

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DELAWARE
(State or Other Jurisdiction of
Incorporation or Organization)

94-3120386
(I.R.S. Employer
Identification Number)

4320 Forest Park Avenue
St. Louis, MO 63108

(Address of Principal Executive Offices including Zip Code)

(314) 678-6100

(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act: Common Stock, \$.001 Par Value

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K, or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller
reporting company)

Smaller reporting company

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

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant on the last business day of the registrant's most recently completed second fiscal quarter (based on the closing sales prices on the NASDAQ Global Market on June 30, 2007) was approximately \$368 million.

The number of outstanding shares of the registrant's common stock on October 31, 2008 was 37,416,111.

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DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Registrant's next Annual Meeting of Stockholders to be held on May 29, 2008 are incorporated by reference into Part III of this Form 10-K.

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EXPLANATORY NOTE

This Amendment No. 1 amends Stereotaxis, Inc.'s (the "Company") Annual Report on Form 10-K for the year ended December 31, 2007, which was filed with the Securities and Exchange Commission on March 17, 2008 (the "Original Filing"). The Company is filing this Amendment No. 1 for the sole purpose of updating: (i) Note 19 to our Financial Statements to provide plans to address its liquidity and cash flow issues, (ii) the Report of Independent Registered Public Accounting Firm and (iii) Exhibits 23.1, 31.1, 31.2, 32.1 and 32.2.

Except as described above, this Amendment No. 1 does not amend any other information set forth in the Original Filing and the Company has not updated disclosures included therein to reflect any events that occurred subsequent to March 17, 2008.

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PART II

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA
Financial Statements

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| All other schedules have been omitted because they are not applicable or the required information is shown in the Financial Statements or the Notes thereto. | |

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders

Stereotaxis, Inc.

We have audited the accompanying balance sheets of Stereotaxis, Inc. (the Company) as of December 31, 2007 and 2006, and the related statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2007. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Since the date of completion of our audit of the accompanying financial statements and initial issuance of our report thereon dated March 13, 2008, the Company, as discussed in Note 19, has experienced net losses and negative operating cash flows adversely affecting the Company's current results of operations and liquidity. Note 19 describes management's plans to address these issues.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Stereotaxis, Inc. at December 31, 2007 and 2006, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 2 to the financial statements, on January 1, 2006, the Company changed its method of accounting for share-based payments.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Stereotaxis, Inc.'s internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 13, 2008, expressed an unqualified opinion thereon.

/s/ Ernst & Young, LLP

St. Louis, Missouri

March 13, 2008, except Note 19 as to which the date is December 26, 2008

Table of Contents**STEREOTAXIS, INC.****BALANCE SHEETS**

| | December 31, | |
|--|----------------------|----------------------|
| | 2007 | 2006 |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 17,022,200 | \$ 15,210,493 |
| Short-term investments | 6,634,178 | 21,773,288 |
| Accounts receivable, net of allowance of \$189,040 and \$90,716 in 2007 and 2006, respectively | 13,757,270 | 15,280,628 |
| Current portion of long-term receivables | 136,430 | 163,362 |
| Inventories | 9,964,460 | 8,285,825 |
| Prepaid expenses and other current assets | 3,421,202 | 2,580,773 |
| Total current assets | 50,935,740 | 63,294,369 |
| Property and equipment, net | 7,011,763 | 4,130,295 |
| Intangible assets, net | 1,411,111 | 1,544,444 |
| Long-term receivables | 272,859 | |
| Other assets | 844,321 | 321,552 |
| Total assets | \$ 60,475,794 | \$ 69,290,660 |
| Liabilities and stockholders equity | | |
| Current liabilities: | | |
| Current maturities of long-term debt | \$ 972,222 | \$ 1,666,666 |
| Accounts payable | 7,349,426 | 5,555,121 |
| Accrued liabilities | 11,913,418 | 10,025,231 |
| Deferred contract revenue | 8,774,958 | 5,663,553 |
| Total current liabilities | 29,010,024 | 22,910,571 |
| Long-term debt, less current maturities | 6,000,000 | 305,556 |
| Long-term deferred contract revenue | 942,573 | 1,220,174 |
| Other liabilities | 328,790 | 65,367 |
| Stockholders equity: | | |
| Preferred stock, par value \$0.001; 10,000,000 shares authorized at 2007 and 2006, none outstanding at 2007 and 2006 | | |
| Common stock, par value of \$0.001; 100,000,000 shares authorized at 2007 and 2006, 37,132,529 and 34,755,397 shares issued at 2007 and 2006, respectively | 37,133 | 34,755 |
| Additional paid in capital | 276,433,662 | 248,908,918 |
| Treasury stock, 40,151 shares at 2007 and 2006 | (205,999) | (205,999) |
| Accumulated deficit | (252,072,353) | (203,950,839) |
| Accumulated other comprehensive income | 1,964 | 2,157 |
| Total stockholders equity | 24,194,407 | 44,788,992 |
| Total liabilities and stockholders equity | \$ 60,475,794 | \$ 69,290,660 |

See accompanying notes.

Table of Contents**STEREOTAXIS, INC.****STATEMENTS OF OPERATIONS**

| | Year Ended December 31, | | |
|---|-------------------------|------------------------|------------------------|
| | 2007 | 2006 | 2005 |
| Revenue: | | | |
| Systems | \$ 30,118,627 | \$ 22,656,092 | \$ 12,760,593 |
| Disposables, service and accessories | 9,180,182 | 4,535,614 | 2,265,797 |
| Total revenue | 39,298,809 | 27,191,706 | 15,026,390 |
| Cost of revenue: | | | |
| Systems | 10,978,108 | 10,448,772 | 5,965,252 |
| Disposables, service and accessories | 2,497,459 | 2,443,977 | 1,755,454 |
| Inventory impairment | 1,870,653 | | |
| Total cost of revenue | 15,346,220 | 12,892,749 | 7,720,706 |
| Gross margin | 23,952,589 | 14,298,957 | 7,305,684 |
| Operating expenses: | | | |
| Research and development | 25,471,809 | 21,794,177 | 17,829,282 |
| Sales and marketing | 29,021,117 | 22,533,882 | 16,106,621 |
| General and administrative | 18,701,726 | 16,642,359 | 14,449,326 |
| Royalty settlement | | | 2,923,111 |
| Total operating expenses | 73,194,652 | 60,970,418 | 51,308,340 |
| Operating loss | (49,242,063) | (46,671,461) | (44,002,656) |
| Interest income | 1,471,503 | 2,126,987 | 949,918 |
| Interest expense | (350,954) | (1,175,296) | (505,097) |
| Net loss | \$ (48,121,514) | \$ (45,719,770) | \$ (43,557,835) |
| Net loss per common share: | | | |
| Basic and diluted | \$ (1.34) | \$ (1.39) | \$ (1.60) |
| Weighted average shares used in computing net loss per common share: | | | |
| Basic and diluted | 35,793,973 | 32,979,403 | 27,301,822 |

See accompanying notes.

Table of Contents**STEREOTAXIS, INC.****STATEMENTS OF STOCKHOLDERS EQUITY**

| | Common Stock | | | | Treasury Stock | Notes Receivable from Sale of Stock | Accumulated Deficit | Accumulated Other Comprehensive Income (Loss) | Total Stockholders Equity |
|---|--------------|-----------|----------------------------|-----------------------|----------------|-------------------------------------|---------------------|---|---------------------------|
| | Shares | Amount | Additional Paid-In Capital | Deferred Compensation | | | | | |
| Balance at December 31, 2004 | 27,187,042 | \$ 27,187 | \$ 174,143,587 | \$ (671,950) | \$ (162,546) | \$ (173,432) | \$ (114,673,234) | \$ (95,144) | \$ 58,394,468 |
| Issuance of warrants to purchase common stock | | | 938,850 | | | | | | 938,850 |
| Amortization of stock-based compensation | | | | 747,412 | | | | | 747,412 |
| Payments of notes receivable from sale of stock | | | | | | 3,750 | | | 3,750 |
| Interests receivable from sale of stock | | | | | | (10,937) | | | (10,937) |
| Issuance of stock under stock purchase plan | 29,554 | 30 | 201,097 | | | | | | 201,127 |
| Exercise of stock warrants | 14,888 | 15 | (15) | | | | | | |
| Exercise of stock options | 282,527 | 282 | 1,358,193 | | | | | | 1,358,475 |
| Grant of restricted shares, net of forfeitures | 359,100 | 359 | 2,644,863 | (2,645,222) | | | | | |
| Components of comprehensive income (loss): | | | | | | | | | |
| Net Loss | | | | | | | (43,557,835) | | (43,557,835) |
| Unrealized gain on short term investments | | | | | | | | 50,532 | 50,532 |
| Comprehensive Loss | | | | | | | | | (43,507,303) |
| Balance at December 31, 2005 | 27,873,111 | \$ 27,873 | \$ 179,286,575 | \$ (2,569,760) | \$ (162,546) | \$ (180,619) | \$ (158,231,069) | \$ (44,612) | \$ 18,125,842 |
| Balance at December 31, 2005 | 27,873,111 | 27,873 | 179,286,575 | (2,569,760) | (162,546) | (180,619) | (158,231,069) | (44,612) | 18,125,842 |
| Adoption of SFAS 123(R) | | | (2,569,760) | 2,569,760 | | | | | |
| Issuance common stock | 5,500,000 | 5,500 | 61,746,903 | | | | | | 61,752,403 |
| Amortization of stock-based compensation | | | 4,301,807 | | | | | | 4,301,807 |
| Payments of notes receivable from sale of stock | | | | | | 134,700 | | | 134,700 |
| Interests receivable from the sale of stock | | | | | | 45,919 | | | 45,919 |
| Issuance of stock under stock purchase plan | 74,917 | 75 | 574,507 | | | | | | 574,582 |
| Purchase of treasury stock, at cost | | | | | (43,453) | | | | (43,453) |
| Exercise of stock warrants | 638,472 | 638 | 4,264,909 | | | | | | 4,265,547 |
| Exercise of stock options and stock appreciation rights | 325,893 | 326 | 1,304,320 | | | | | | 1,304,646 |
| Grant of restricted shares, net of forfeitures | 343,004 | 343 | (343) | | | | | | |
| Components of comprehensive income (loss): | | | | | | | | | |
| Net Loss | | | | | | | (45,719,770) | | (45,719,770) |
| Unrealized gain on short term investments | | | | | | | | 46,769 | 46,769 |

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| | | | | | | | | | |
|--------------------|--|--|--|--|--|--|--|--|--------------|
| Comprehensive Loss | | | | | | | | | (45,673,001) |
|--------------------|--|--|--|--|--|--|--|--|--------------|

| | | | | | | | | | | |
|------------------------------|------------|-----------|----------------|----|--------------|----|------------------|----|-------|---------------|
| Balance at December 31, 2006 | 34,755,397 | \$ 34,755 | \$ 248,908,918 | \$ | \$ (205,999) | \$ | \$ (203,950,839) | \$ | 2,157 | \$ 44,788,992 |
|------------------------------|------------|-----------|----------------|----|--------------|----|------------------|----|-------|---------------|

See accompanying notes.

Table of Contents**STEREOTAXIS, INC.****STATEMENTS OF STOCKHOLDERS EQUITY (CONTINUED)**

| | Common Stock | | Additional Paid-In Capital | Deferred Compensation | Treasury Stock | Notes Receivable from Sale of Stock | Accumulated Deficit | Accumulated Other Comprehensive Income (Loss) | Total Stockholders Equity |
|--|--------------|-----------|----------------------------------|--------------------------|-------------------|--|------------------------|---|---------------------------------|
| | Shares | Amount | | | | | | | |
| Balance at December 31, 2006 | 34,755,397 | \$ 34,755 | \$ 248,908,918 | \$ | \$ (205,999) | \$ | \$ (203,950,839) | \$ 2,157 | \$ 44,788,992 |
| Issuance common stock | 1,919,000 | 1,919 | 20,105,317 | | | | | | 20,107,236 |
| Amortization of stock-based compensation | | | 5,597,800 | | | | | | 5,597,800 |
| Issuance of stock under stock purchase plan | 62,254 | 63 | 502,308 | | | | | | 502,371 |
| Exercise of stock warrants | 93,050 | 93 | 373,381 | | | | | | 373,474 |
| Exercise of stock options and stock appreciation rights | 210,745 | 211 | 946,030 | | | | | | 946,241 |
| Grant of restricted shares, net of forfeitures | 92,083 | 92 | (92) | | | | | | |
| Components of comprehensive income (loss): | | | | | | | | | |
| Net Loss | | | | | | | (48,121,514) | | (48,121,514) |
| Unrealized (loss) on short term investments | | | | | | | | (193) | (193) |
| Comprehensive Loss | | | | | | | | | (48,121,707) |
| Balance at December 31, 2007 | 37,132,529 | \$ 37,133 | \$ 276,433,662 | \$ | \$ (205,999) | \$ | \$ (252,072,353) | \$ 1,964 | \$ 24,194,407 |

See accompanying notes.

Table of Contents**STEREOTAXIS, INC.****STATEMENTS OF CASH FLOWS**

| | Year Ended December 31, | | |
|---|-------------------------|-----------------|-----------------|
| | 2007 | 2006 | 2005 |
| Cash flows from operating activities | | | |
| Net loss | \$ (48,121,514) | \$ (45,719,770) | \$ (43,557,835) |
| Adjustments to reconcile net loss to cash used in operating activities: | | | |
| Depreciation | 1,752,471 | 1,214,280 | 769,617 |
| Amortization (accretion) | (131,820) | 387,480 | 397,070 |
| Non-cash compensation | 5,597,800 | 4,301,807 | 747,412 |
| Interest receivable from sale of stock | | 48,992 | |
| Loss on asset disposal | 9,797 | 29,658 | 48,783 |
| Inventory impairment charge | 1,870,653 | | |
| Changes in operating assets and liabilities: | | | |
| Accounts receivable | 1,523,358 | (9,383,556) | 2,542,002 |
| Interest receivable on investments | 164,455 | (74,708) | 150,359 |
| Other receivables | (245,927) | 444,678 | (101,655) |
| Inventories | (3,549,288) | 1,118,967 | (4,730,798) |
| Prepaid expenses and other current assets | (840,429) | 1,873,767 | (2,064,410) |
| Other assets | (522,769) | (193,797) | (7,058) |
| Accounts payable | 1,794,305 | 688,965 | 2,736,683 |
| Accrued liabilities | 1,888,187 | 4,376,538 | 81,536 |
| Deferred revenue | 2,833,804 | 1,866,467 | 1,975,502 |
| Other | 263,423 | 37,351 | 26,609 |
| Net cash used in operating activities | (35,713,494) | (38,982,881) | (40,986,183) |
| Cash flows from investing activities | | | |
| Sale of equipment | 100,640 | 10,072 | |
| Purchase of equipment | (4,744,376) | (2,305,992) | (2,338,866) |
| Proceeds from the maturity/sale of available-for-sale investments | 29,050,000 | 18,604,217 | 37,154,608 |
| Purchase of available-for-sale investments | (13,810,385) | (32,701,841) | (9,763,722) |
| Net cash provided by (used in) investing activities | 10,595,879 | (16,393,544) | 25,052,020 |
| Cash flows from financing activities | | | |
| Proceeds from long-term debt | 7,000,000 | | 2,000,000 |
| Payments under long-term debt | (2,000,000) | (1,000,000) | (938,212) |
| Proceeds from issuance of stock, net of issuance costs | 21,929,322 | 67,897,178 | 1,559,602 |
| Purchase of treasury stock | | (43,453) | |
| Payments received on notes receivable from sale of common stock | | 134,700 | 3,750 |
| Net cash provided by financing activities | 26,929,322 | 66,988,425 | 2,625,140 |
| Net increase (decrease) in cash and cash equivalents | 1,811,707 | 11,612,000 | (13,309,023) |
| Cash and cash equivalents at beginning of period | 15,210,493 | 3,598,493 | 16,907,516 |
| Cash and cash equivalents at end of period | \$ 17,022,200 | \$ 15,210,493 | \$ 3,598,493 |
| Supplemental disclosures of cash flow information: | | | |
| Interest paid | \$ 166,868 | \$ 207,775 | \$ 216,763 |

See accompanying notes.

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Notes to Financial Statements

1. Description of Business

Stereotaxis, Inc. (the Company) designs, manufactures, and markets an advanced cardiology instrument control system for the interventional treatment of arrhythmias and coronary artery disease. The Company also markets and sells various disposable interventional devices, including catheters, guidewires and other delivery devices, for use in conjunction with its system. The Company has received regulatory approval for the core components of its system in the U.S., Europe, Canada and various other countries.

2. Summary of Significant Accounting Policies

Cash and Cash Equivalents

The Company considers all short-term investments purchased with original maturities of three months or less to be cash equivalents. The Company places its cash with high-credit-quality financial institutions and invests primarily in money market accounts. As of December 31, 2006, \$713,865 of cash is restricted subject to satisfaction of certain conditions related to a delivered system. No cash was restricted at December 31, 2007.

Investments

In accordance with Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, the Company's investment securities are classified as available-for-sale and are carried at market value, which approximates cost. Realized gains or losses, calculated based on the specific identification method, were not material for the years ended December 31, 2007, 2006 and 2005. Interest and dividends on securities classified as available-for-sale are included in interest income.

Accounts Receivable and Allowance for Uncollectible Accounts

Accounts receivable primarily include amounts due from hospitals and distributors for acquisition of magnetic systems and associated disposable device sales. Credit is granted on a limited basis, with balances due generally within 30 days of billing. The provision for bad debts is based upon management's assessment of historical and expected net collections considering business and economic conditions and other collection indicators.

Financial Instruments

Financial instruments consist of cash and cash equivalents, short-term investments, accounts receivable, accounts payable and long-term debt. The carrying value of such amounts reported at the applicable balance sheet dates approximates fair value.

Inventory

The Company values its inventory at the lower of cost, as determined using the first-in, first-out (FIFO) method, or market. The Company periodically reviews its physical inventory for obsolete items and provides a reserve upon identification of potential obsolete items.

Property and Equipment

Property and equipment consist primarily of computer, office and research and demonstration equipment held for lease and leasehold improvements and are stated at cost. Depreciation is calculated using the straight-line method over the estimated useful lives or life of the base lease term, ranging from three to ten years.

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Long-Lived Assets

If facts and circumstances suggest that a long-lived asset may be impaired, the carrying value is reviewed. If this review indicates that the carrying value of the asset will not be recovered, as determined based on projected undiscounted cash flows related to the asset over its remaining life, the carrying value of the asset is reduced to its estimated fair value.

Intangible Assets

Intangible assets consist of purchased technology arising out of collaboration with a strategic partner valued at the cost of acquisition on the acquisition date and amortized over its estimated useful life of 15 years. Accumulated amortization at December 31, 2007 and 2006 is \$588,889 and \$455,555, respectively. Amortization expense in 2007, 2006 and 2005 is \$133,333 during each year, as determined under the straight-line method. The estimated future amortization of intangible assets is \$133,333 annually through July 2018.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles 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 and the reported amounts of income and loss during the reporting period. Actual results could differ from those estimates.

Revenue and Costs of Revenue

For arrangements with multiple deliverables, the Company allocates the total revenue to each deliverable based on the provisions of Staff Accounting Bulletin (SAB) 104 and Emerging Issues Task Force (EITF) Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*, and recognizes revenue for each separate element as the criteria are met. In the second quarter of 2007, the Company determined that installation met the criteria under SAB 104 and EITF Issue No. 00-21 for recognition as a separate element or unit of accounting. Under this policy, as of December 31, 2007 there were seven Niobe systems for which the Company had recognized systems revenue upon delivery but for which installation revenue had not yet been recognized. Revenue for system sales is recognized for the portion of sales price due upon delivery, provided delivery has occurred, title has passed, there are no uncertainties regarding acceptance, persuasive evidence of an arrangement exists, the sales price is fixed and determinable, and collection of the related receivable is reasonably assured. The sales price due upon installation is recognized as revenue when the standard installation process is complete. When installation is the responsibility of the customer, revenue from system sales is recognized upon shipment since these arrangements do not include an installation element or right of return privileges. If uncertainties exist regarding collectability, the Company recognizes revenue when those uncertainties are resolved. Amounts collected prior to satisfying the above revenue recognition criteria are reflected as deferred revenue. Revenue from services and license fees, whether sold individually or as a separate unit of accounting in a multi-element arrangement, is deferred and amortized over the service or license fee period, which is typically one year. Revenue from services is derived primarily from the sale of annual product maintenance plans. The Company recognizes revenue from disposable device sales or accessories upon shipment and an appropriate reserve for returns is established. The Company recognizes fees earned on the shipment of product to customers as revenue and recognize costs incurred on the shipment of product to customers as cost of revenue.

Costs of systems revenue include direct product costs, installation labor and other costs, estimated warranty costs, and training and product maintenance costs and are recorded at the time of sale. Costs of disposable revenue include direct product costs and are recorded at the time of sale. Cost of revenue from services and license fees are recorded when incurred. During the 2007 year, the Company recorded approximately \$1.9 million of charges for inventory impairment related to the first generation Niobe system. The Company also includes in cost of revenue any expected loss related to executed contracts in the period in which the loss becomes known. During the year ended December 31, 2005 the Company incurred \$135,560 for costs in excess of contractual revenue, primarily on certain system sales.

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Research and Development Costs

Internal research and development costs are expensed in the period incurred. Amounts receivable from strategic partners under research reimbursement agreements are recorded as a contra-research and development expense in the period reimbursable costs are incurred. Advance receipts or other unearned reimbursements are included in accrued liabilities on the accompanying balance sheet until earned.

Stock-Based Compensation

Effective January 1, 2006, the Company adopted the fair value recognition provisions of Financial Accounting Standards Board Statement No. 123(R), *Share-Based Payment* (SFAS 123(R)), using the modified prospective transition method to account for its grants of stock options, stock appreciation rights, restricted shares and its employee stock purchase plan. SFAS 123(R) supersedes the provisions of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* (APB Opinion No. 25) and requires recognition of an expense when goods or services are provided. SFAS 123(R) requires the determination of the fair value of the share-based compensation at the grant date and the recognition of the related expense over the period in which the share-based compensation vests. Prior to January 1, 2006, the Company accounted for those plans under the provisions of APB Opinion No. 25, and related interpretations in accounting for stock-based employee compensation as permitted by SFAS 123, *Accounting for Stock-Based Compensation*. Prior to the adoption of SFAS 123(R), stock-based compensation for grants of stock options was included as a pro forma disclosure in the Notes to the Consolidated Financial Statements as permitted by SFAS 123. Results for prior periods have not been restated.

Under the modified prospective transition method of SFAS 123(R), the Company recognized stock-based compensation expense related to 1) the remaining unvested portion of all stock option, stock appreciation rights and restricted share awards granted prior to January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123; and 2) expense related to all stock option, stock appreciation rights and restricted share awards modified or granted on or subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). The Company utilizes the Black-Scholes valuation model to determine the fair value of share-based payments at the date of grant with the following inputs: 1) expected dividend rate of 0%; 2) expected volatility of 50% based on the Company's historical volatility and a review of the volatilities of comparable companies; 3) risk-free interest rate based on the Treasury yield on the date of grant and; 4) expected term for grants made subsequent to the adoption of SFAS 123(R) determined in accordance with Staff Accounting Bulletin No. 107 using the simplified method ranging from 3.75 to 5.5 years. The resulting compensation expense is recognized over the requisite service period, generally one to four years. Compensation expense is recognized only for those awards expected to vest, with forfeitures estimated based on the Company's historical experience and future expectations. Prior to the adoption of SFAS 123(R), the effect of forfeitures on the pro forma expense amounts was recognized as the forfeitures occurred.

Stock options or stock appreciation rights issued to non-employees, including individuals for scientific advisory services, are recorded at their fair value as determined in accordance with SFAS 123 and Emerging Issues Task Force (EITF) No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction With Selling, Goods or Services*, and recognized over the service period for those options with graded vesting. Deferred compensation for options granted to non-employees is periodically remeasured through the vesting or forfeiture date.

Restricted shares granted to employees are valued at the fair market value at the date of grant. The Company amortizes the amount to expense over the service period on a straight-line basis for those shares with graded vesting. If the shares are subject to performance objectives, the resulting compensation expense is amortized over the anticipated vesting period and is subject to adjustment based on the actual achievement of objectives. Under APB 25, if the shares granted were subject to variable performance criteria, the compensation expense was periodically remeasured through the vesting or forfeiture date.

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Shares purchased by employees under the 2004 Employee Stock Purchase Plan are considered to be compensatory and are accounted for in accordance with SFAS 123(R). Under APB Opinion 25, these shares were not considered to be compensatory and were not included in expense but were included in the pro forma expense calculation.

In accordance with SFAS 123(R), the Company recorded approximately \$4.3 million of share based compensation expense during the year ended December 31, 2006. As a result, the Company's net loss for the year ended December 31, 2006 was approximately \$2.0 million lower than if it had continued to account for share-based compensation under APB Opinion No. 25. Net loss per share for the year ended December 31, 2006 was \$0.06 lower than if the Company had continued to account for share-based compensation under APB Opinion No. 25.

Net Loss per Share

Basic loss per common share is computed by dividing the net loss for the period by the weighted average number of common shares outstanding during the period. Diluted loss per share is computed by dividing the loss for the period by the weighted average number of common and common equivalent shares outstanding during the period.

The Company has deducted shares subject to repurchase from the calculation of shares used in computing net loss per share, basic and diluted. The Company has excluded all outstanding convertible preferred stock, options, stock appreciation rights, warrants, shares subject to repurchase and unearned restricted shares from the calculation of diluted loss per common share because all such securities are anti-dilutive for all periods presented. As of December 31, 2007, the Company had 3,324,509 shares of common stock issuable upon the exercise of outstanding options and stock appreciation rights at a weighted average exercise price of \$8.72 per share and 357,350 shares of common stock issuable upon the exercise of outstanding warrants at a weighted average exercise price of \$8.83 per share.

Income Taxes

In accordance with SFAS No. 109, *Accounting for Income Taxes*, a deferred income tax asset or liability is determined based on the difference between the financial statement and tax basis of assets and liabilities as measured by the enacted tax rates that will be in effect when these differences reverse. The Company provides a valuation allowance against net deferred income tax assets unless, based upon available evidence, it is more likely than not the deferred income tax assets will be realized.

Product Warranty Provisions

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

The warranty activity for the year ended December 31, 2007 is as follows:

| | December 31, 2007 |
|---------------------------------------|------------------------------|
| Warranty accrual at December 31, 2006 | \$ 188,198 |
| Warranty expense incurred | 254,858 |
| Payments made | (208,105) |
| Warranty accrual at December 31, 2007 | \$ 234,951 |

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During the year ended December 31, 2006, the Company expensed approximately \$237,000 related to a warranty obligation for a system installed at a hospital whose President and Chief Executive Officer is a member of our board of directors.

Patent Costs

Costs related to filing and pursuing patent applications are expensed as incurred, as recoverability of such expenditures is uncertain.

Concentrations of Risk

The majority of the company's cash, cash equivalents and investments are deposited with one major financial institution in the United States of America. Deposits in this institution exceed the amount of insurance provided on such deposits.

One customer, Siemens AG, Medical Solutions and its affiliated entities, as our distributor, accounted for \$5,611,496, \$5,941,884 and \$4,392,349, or 14%, 22% and 29%, of total net sales for the years ended December 31, 2007, 2006 and 2005, respectively. At December 31, 2007 and 2006 this customer had balances due to us of \$2,265,000 and \$1,708,000, respectively.

Comprehensive Income (Loss)

Comprehensive income (loss) generally represents all changes in stockholders' equity except those resulting from investments by stockholders, and includes the Company's unrealized income (loss) on marketable securities. Comprehensive income (loss) for the years ended December 31, 2007 and 2006 included unrealized gain (loss) on available-for-sale investments of \$(193) and \$46,769, respectively. Accumulated other comprehensive income at December 31, 2007 and 2006 was \$1,964 and \$2,157, respectively.

Reclassifications

Costs of revenue in the prior years financial statements have been reclassified to disclose components related to systems and disposables, service and accessories to conform to current year presentation with no impact to reported net income.

Recently Adopted Accounting Pronouncements

Effective January 1, 2007 the Company adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109 (FIN 48)*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements and provides guidance on the recognition, de-recognition and measurement of benefits related to an entity's uncertain tax positions. The adoption of FIN 48 did not have an impact on the Company's financial position or results of operations.

Pending Accounting Pronouncements

In June 2007, the FASB ratified EITF 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities* (EITF 07-3). EITF 07-3 requires that nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities be deferred and capitalized and recognized as an expense as the goods are delivered or the related services are performed. EITF 07-3 is effective, on a prospective basis, for fiscal years beginning after December 15, 2007 and will be adopted by us in the first quarter of fiscal 2008. The adoption of EITF 07-06 is not expected to have a material impact to the Company's financial statements.

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In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS 159 will be effective for the Company on January 1, 2008. The adoption of SFAS 159 is not expected to have a material impact to the Company's financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 provides a single definition of fair value, establishes a framework and gives guidance regarding the methods used for measuring fair value, and expands disclosures about fair value measurements. Statement 157 applies to those previously issued pronouncements that prescribe fair value as the relevant measure of value, except SFAS No. 123R and related interpretations and pronouncements that require or permit measurement similar to fair value but are not intended to measure fair value. SFAS No. 157 is effective for financial statements issued for fiscal years beginning January 1, 2008. The adoption of SFAS 157 is not expected to have a material impact to the Company's financial statements.

3. Investments

The following table summarizes available-for-sale securities included in short-term investments as of the respective dates:

| | December 31, 2007 | | | | December 31, 2006 | | | |
|-------------------------|---------------------|---------------------|-----------|---------------------|----------------------|---------------------|-----------------|----------------------|
| | Cost | Unrealized Gains | Losses | Fair Value | Cost | Unrealized Gains | Losses | Fair Value |
| Short-term investments: | | | | | | | | |
| Corporate debt | \$ | \$ | \$ | \$ | \$ 1,844,463 | \$ | \$ (475) | \$ 1,843,988 |
| U.S. government agency | | | | | 9,274,072 | 2,559 | | 9,276,631 |
| Commercial paper | 6,131,899 | 1,964 | | 6,133,863 | 7,558,765 | 494 | | 7,559,259 |
| Certificates of deposit | | | | | 2,092,674 | | (421) | 2,092,253 |
| Auction rate securities | 500,315 | | | 500,315 | 1,001,157 | | | 1,001,157 |
| Total | \$ 6,632,214 | \$ 1,964 | \$ | \$ 6,634,178 | \$ 21,771,131 | \$ 3,053 | \$ (896) | \$ 21,773,288 |

The Company views its available-for-sale portfolio as available for use in its current operations.

4. Inventory

Inventory consists of the following:

| | December 31, | |
|--------------------------|---------------------|---------------------|
| | 2007 | 2006 |
| Raw Materials | \$ 2,394,846 | \$ 2,501,312 |
| Work in Process | 214,996 | 29,443 |
| Finished Goods | 7,949,723 | 5,966,525 |
| Reserve for obsolescence | (595,105) | (211,455) |
| | \$ 9,964,460 | \$ 8,285,825 |

Table of Contents**5. Prepaid Expenses and Other Assets**

Prepaid and other assets consists of the following:

| | December 31, | |
|---|--------------|--------------|
| | 2007 | 2006 |
| Prepaid expenses | \$ 1,519,211 | \$ 1,424,224 |
| Deferred cost of revenue | 1,176,109 | 347,933 |
| Other assets | 1,570,203 | 1,130,168 |
| | 4,265,523 | 2,902,325 |
| Less: Long-term other assets | (844,321) | (321,552) |
| Total prepaid expenses and other assets | \$ 3,421,202 | \$ 2,580,773 |

Deferred cost of revenue represents the cost of systems for which title has transferred from the Company but for which revenue has not been recognized.

6. Property and Equipment

Property and equipment consist of the following:

| | December 31, | |
|-------------------------------|--------------|--------------|
| | 2007 | 2006 |
| Equipment | \$ 9,637,232 | \$ 5,307,519 |
| Equipment held for lease | 303,412 | 303,412 |
| Leasehold improvements | 1,506,576 | 1,309,715 |
| | 11,447,220 | 6,920,646 |
| Less accumulated depreciation | (4,435,457) | (2,790,351) |
| | \$ 7,011,763 | \$ 4,130,295 |

7. Related Party Transactions

In November 2005, the Company entered into a six-month commitment with certain affiliated investors providing for the availability of \$20 million in unsecured borrowings. The lenders received five-year warrants to purchase shares of the Company's common stock upon commitment of the funds. The Company recorded the fair value of \$938,850 to paid in capital and has amortized the expense over the 6-month term of the commitment. During 2006 and 2005, the Company expensed \$674,312 and \$264,538, respectively, related to these warrants. The facility expired in May 2006.

In February 2008, the Company received a \$20 million commitment for unsecured borrowings from certain affiliated investors as described in Note 18.

8. Accrued Liabilities

Accrued liabilities consist of the following:

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| | December 31, | |
|---|---------------|---------------|
| | 2007 | 2006 |
| Accrued salaries, bonus, and benefits | \$ 3,531,582 | \$ 3,495,023 |
| Accrued research and development | 4,456,049 | 3,471,094 |
| Accrued legal and other professional fees | 824,448 | 323,224 |
| Other | 3,101,339 | 2,735,890 |
| | \$ 11,913,418 | \$ 10,025,231 |

Table of Contents**9. Long-Term Debt**

Long-term debt consists of the following:

| | December 31, | |
|--|--------------|--------------|
| | 2007 | 2006 |
| Revolving credit agreement, due March 2009 | \$ 5,000,000 | \$ 1,000,000 |
| April 2004 term note, due June 2007 | | 333,333 |
| November 2005 term note, due November 2008 | 305,555 | 638,889 |
| June 2007 term note, due June 2010 | 1,666,667 | |
| | 6,972,222 | 1,972,222 |
| Less current maturities | (972,222) | (1,666,666) |
| | \$ 6,000,000 | \$ 305,556 |

In March 2007, the Company amended its Revolving Credit Agreement with its primary lending bank. The amended agreement retained substantially all of the same terms and conditions as the agreement in place at December 31, 2006, but increased the maximum borrowing capacity to \$25 million, an increase of \$15 million, and provided for an additional \$2 million in equipment advances. The maturity date of the revolving line of credit was extended to March 2009 and the interest rate was adjusted to the lender's prime rate plus either 0.25% or 0.75%, depending on a defined liquidity measure. The Company is required to maintain a ratio of quick assets (cash, cash equivalents, accounts receivable and short term investments) to current liabilities (less deferred revenue) of at least 1.25 to 1.0. In the event the Company's quick asset ratio (as defined in the agreement) falls below 1.75 to 1, the Company would also be required to maintain certain operating performance measures. The \$2 million equipment loan was drawn in June 2007.

In December 2007, the Company amended its Revolving Credit Agreement with its primary lending bank to modify the terms of the arrangement to increase the availability under the existing line and deferred required compliance with both quick ratio measures.

As of December 31, 2007, the Company had \$5.0 million outstanding under the working capital line of credit and had an unused line of approximately \$20.0 million with current borrowing capacity of approximately \$13.9 million, secured by qualifying receivables and inventory balances. As of December 31, 2007, the Company is in compliance with all required covenants. The Revolving Credit Agreement was further amended in March 2008 as described in Note 18 herein.

In April 2004, the Company entered into a term note due in June 2007 with its primary lender for \$2,000,000, (April 2004 term note). The Company was required to make equal payments of principal and interest, at 7%, through June 2007. The note was paid in full in June 2007.

In November 2005, the Company entered into a term note due in November 2008 with its primary lender for \$1,000,000 (November 2005 term note). The Company is required to make equal payments of principal plus interest at prime plus 1.5% through November 2008.

In June 2007, the Company entered into a term note due in June 2010 with its primary lender for \$2,000,000, (June 2007 term note). The Company is required to make equal payments of principal and interest, at prime plus 1%, through June 2010.

The Revolving Credit Agreement, April 2004 term note and November 2005 term note (collectively, the Credit Agreements) are secured by substantially all of the Company's assets. The Company is also required under the Credit Agreements to maintain its primary operating account and the majority of its cash and investment balances in accounts with the primary lender.

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In November 2005, the Company entered into a six-month commitment with certain affiliates providing for the availability of up to \$20 million of unsecured borrowings. This commitment was available to be drawn against at any time through May 10, 2006, the initial six-month commitment period. The commitment period, as well as the maturity date on any funds drawn under the commitment, was subject to one six-month extension, through November 2006, at the Company's sole election. The lenders received five-year warrants to purchase shares of the Company's common stock upon commitment of the funds. The Company did not draw funds under this agreement nor did it extend the commitment period beyond its May 2006 expiration.

In February 2008, the Company entered into a one year commitment with certain stockholders providing for the availability of \$20 million of unsecured borrowings as described in Note 18 herein.

Contractual principal maturities of long-term debt at December 31, 2007 are as follows:

| | |
|------|--------------|
| 2008 | \$ 972,222 |
| 2009 | 5,666,667 |
| 2010 | 333,333 |
| | \$ 6,972,222 |

10. Lease Obligations

The Company leases its facilities under operating leases. For the years ended December 31, 2007, 2006, and 2005 rent expense was \$1,195,617, \$1,182,107, and \$942,937 respectively.

In January 2006, the Company moved its primary operations into new facilities. The new facility is subject to a 10 year lease, expiring in 2015. Under the terms of the lease, the Company has options to expand its space and to renew for up to six additional years. The lease contains an escalating rent provision which the Company has straight-lined over the term of the lease.

The future minimum lease payments under noncancelable leases as of December 31, 2007 are as follows:

| Year | Operating Lease |
|-------------------------------------|----------------------|
| 2008 | \$ 1,439,103 |
| 2009 | 1,528,790 |
| 2010 | 1,519,112 |
| 2011 | 1,482,388 |
| 2012 | 1,524,133 |
| Beyond 2012 | 4,655,886 |
| Total minimum lease payments | \$ 12,149,412 |

11. Stockholders' Equity

Public Offerings of Common Stock

In February 2006, the Company completed an offering of its common stock of 5,500,000 shares of its common stock at \$12.00 per share, including the underwriters' exercise of an option to purchase an additional 500,000 shares. In conjunction with these transactions, the Company received approximately \$61.7 million in net proceeds after deduction of underwriting discounts and commissions and payment of estimated offering expenses.

In August 2006, the Company filed a universal shelf registration statement for the issuance and sale from time to time to the public of up to \$75 million in securities, including debt, preferred stock, common stock and warrants. The shelf registration was declared effective by the SEC in September 2006. In March 2007, the

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Company completed an offering of 1,919,000 shares of its common stock at \$10.50 per share pursuant to the shelf registration. In conjunction with this transaction, the Company received approximately \$20.1 million in net proceeds after deducting offering expenses

Common Stock

The holders of common stock are entitled one vote for each share held and to receive dividends whenever funds are legally available and when declared by the Board of Directors subject to the prior rights of holders of all classes of stock having priority rights as dividends and the conditions of the our Revolving Credit Agreement. No dividends have been declared or paid as of December 31, 2007.

The Company has reserved shares of common stock for the exercise of warrants, the issuance of options granted under the Company's stock option plan and its stock purchase plan as follows:

| | December 31, | |
|------------------------------|--------------|-----------|
| | 2007 | 2006 |
| Warrants | 357,350 | 510,626 |
| Stock award plans | 4,326,412 | 2,795,907 |
| Employee Stock Purchase Plan | 111,065 | 173,319 |
| | 4,794,827 | 3,479,852 |

Stock Award Plans

The Company has various stock plans that permit the Company to provide incentives to employees and directors of the Company in the form of equity compensation. In 2002, the Board of Directors adopted a stock incentive plan (the 2002 Stock Incentive Plan) and a non-employee directors' stock plan (2002 Director Plan). In 1994, the Board of Directors adopted the 1994 Stock Option Plan. Each of these plans was subsequently approved by the Company's stockholders. At December 31, 2007 and 2006, the Board of Directors has reserved a total of 4,326,412 and 2,795,907, shares respectively, of the Company's common stock to provide for current and future grants under the 2002 Stock Incentive Plan and the 2002 Director Plan and for all current grants under the 1994 Stock Option Plan.

The 2002 Stock Incentive Plan allows for the grant of incentive stock options, non-qualified stock options, stock appreciation rights and restricted shares to employees, directors, and consultants. Options granted under the 2002 Stock Incentive Plan expire no later than ten years from the date of grant. The exercise price of each incentive stock option shall not be less than 100% of the fair value of the stock subject to the option on the date the option is granted. The exercise price of each non-qualified option shall not be less than 85% of the fair value of the stock subject to the option on the date the option is granted. The vesting provisions of individual options may vary, but incentive stock options generally vest 25% on the first anniversary of each grant and 1/48 per month over the next three years. Stock appreciation rights are rights to acquire a calculated number of shares of the Company's common stock upon exercise of the rights. The number of shares to be issued is calculated as the difference between the exercise price of the right and the aggregate market value of the underlying shares on the exercise date divided by the market value as of the exercise date. Stock appreciation rights granted under the 2002 Stock Incentive Plan generally vest 25% on the first anniversary of such grant and 1/48 per month over the next three years and expire no later than five years from the date of grant. The Company generally issues new shares upon the exercise of stock options and stock appreciation rights.

Restricted share grants under the 2002 Stock Incentive Plan are either time-based or performance-based. Time-based restricted shares generally vest 25% on each anniversary of such grant. Performance-based restricted shares vest upon the achievement of performance objectives which are determined by the Company's Board of Directors.

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The 2002 Director Plan allows for the grant of non-qualified stock options to the Company's non-employee directors. Options granted under the 2002 Director Plan expire no later than ten years from the date of grant. The exercise price of options under the 2002 Director Plan shall not be less than 100% of the fair value of the stock subject to the option on the date the option is granted. Initial grants of options to new directors generally vest over a two year period. Annual grants to directors generally vest upon the earlier of one year or the next shareholder meeting.

The 1994 Stock Option Plan allows for the grant of incentive stock options and non-qualified stock options to employees, directors, and consultants to the Company. Options granted under the 1994 Stock Option Plan expire no later than ten years from the date of grant and generally vest over a period of two to four years. Options granted may be exercised prior to vesting, in which case the related shares would be subject to repurchase by the Company at original purchase price until vested. The Company no longer grants options under the 1994 Stock Option Plan.

As of December 31, 2007 1,812,237 options and stock appreciation rights were vested and outstanding under all stock award plans.

A summary of the options and stock appreciation rights activity for the year ended December 31, 2007 is as follows:

| | Number of Options/SARs | Range of Exercise Price | Weighted Average Exercise Price per Share |
|--------------------------------|---------------------------|----------------------------|--|
| Outstanding, December 31, 2006 | 2,403,507 | \$ 0.25-\$12.35 | \$ 7.08 |
| Granted | 1,260,680 | \$ 10.24-\$14.84 | \$ 11.13 |
| Exercised | (219,247) | \$ 0.25-\$12.03 | \$ 4.82 |
| Forfeited | (120,431) | \$ 0.30-\$12.03 | \$ 8.18 |
| Outstanding, December 31, 2007 | 3,324,509 | \$ 0.25-\$14.84 | \$ 8.72 |

As of December 31, 2007 the weighted average remaining contractual life of the options and stock appreciation rights outstanding was 4.8 years. Of the 3,324,509 options and stock appreciation rights that were outstanding as of December 31, 2007, 1,812,237 were vested and exercisable with a weighted average exercise price of \$6.94 per share and a weighted average remaining term of 5.0 years.

A summary of the options and stock appreciation rights outstanding by range of exercise price is as follows:

| Range of Exercise Prices | Year Ended December 31, 2007 | | | | |
|--------------------------|---------------------------------|------------------------------------|------------------------------------|---|--|
| | Options/ SARs Outstanding | Weighted Average Remaining Life | Weighted Average Exercise Price | Number of Options/SARs Currently Exercisable | Weighted Average Exercise Price per Share |
| \$0.25 - \$5.94 | 764,695 | 4.7 years | \$ 4.92 | 763,248 | \$ 4.92 |
| \$6.77 - \$9.90 | 1,058,365 | 5.0 years | 7.83 | 880,319 | 7.82 |
| \$10.06 - \$14.84 | 1,501,449 | 4.6 years | 11.29 | 168,670 | 11.51 |
| | 3,324,509 | 4.8 years | \$ 8.72 | 1,812,237 | \$ 6.94 |

The intrinsic value of options and stock appreciation rights is calculated as the difference between the exercise price of the underlying awards and the quoted price of the Company's common stock for the 3,002,269 options and stock appreciation rights that were in-the-money at December 31, 2007. The intrinsic value of the options and stock appreciation rights outstanding at December 31, 2007 was approximately \$11.9 million based on a closing share price of \$12.22 on December 31, 2007. The intrinsic value of fully vested options and stock appreciation rights outstanding at December 31, 2007 was approximately \$9.6 million based on a closing price of

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\$12.22 on December 31, 2007. During the year ended December 31, 2007, the aggregate intrinsic value of options and stock appreciation rights exercised under the Company's stock option plans was approximately \$1.5 million. The weighted average grant date fair value of options and stock appreciation rights granted during the year ended December 31, 2007 was \$4.83 per share.

During the year ended December 31, 2007 and 2006, the Company realized approximately \$1.0 and \$1.3 million, respectively, from the exercise of stock options and stock appreciation rights.

The 2002 Stock Incentive Plan allows for the grant of restricted shares to employees. These grants expire no later than five years from the date of grant. Restricted share grants under the 2002 Stock Incentive Plan are either time-based or performance-based. Time-based restricted shares generally vest 25% on each anniversary of such grant. Performance-based restricted shares vest upon the achievement of performance objectives which are determined by the Company's Compensation Committee.

A summary of the restricted share grant activity for the year ended December 31, 2007 is as follows:

| | Number of Shares | Weighted Average Grant Date Fair Value per Share |
|--------------------------------|---------------------|--|
| Outstanding, December 31, 2006 | 679,544 | \$ 9.84 |
| Granted | 195,660 | \$ 12.08 |
| Vested | (50,212) | \$ 9.94 |
| Forfeited | (103,577) | \$ 8.76 |
| Outstanding, December 31, 2007 | 721,415 | \$ 10.60 |

A summary of the restricted stock outstanding as of December 31, 2007 is as follows:

| | Number of Shares |
|-------------------------------------|---------------------|
| Time based restricted shares | 235,341 |
| Performance based restricted shares | 486,074 |
| Outstanding, December 31, 2007 | 721,415 |

The intrinsic value of restricted shares outstanding at December 31, 2007 was approximately \$8.8 million based on a closing share price of \$12.22 as of December 31, 2007. During the year ended December 31, 2007, the aggregate intrinsic fair value of restricted shares vested was approximately \$635,000 determined at the date of vesting.

At December 31, 2007, the total compensation cost related to options, stock appreciation rights and non-vested stock granted to employees under the Company's stock award plans but not yet recognized was approximately \$9.8 million, net of estimated forfeitures of approximately \$1.1 million. This cost will be amortized over a period of up to four years on a straight-line basis over the underlying estimated service periods and will be adjusted for subsequent changes in estimated forfeitures.

2004 Employee Stock Purchase Plan

Upon the effectiveness of the initial public offering in August 2004, the Company adopted its 2004 Employee Stock Purchase Plan and reserved 277,777 shares of common stock for issuance pursuant to the plan. The Company offered employees the opportunity to participate in the plan beginning January 1, 2005 with an initial purchase date of June 30, 2005. Eligible employees have the opportunity to participate in a new purchase

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period every 6 months. Under the terms of the plan, employees can purchase up to \$12,500 of the Company's common stock at 85% of the fair market value of the stock at the beginning or the end of the purchase period, subject to certain plan limitations. As of December 31, 2007, 2006, and 2005 166,712, 104,458, and 29,541 shares, respectively, had been purchased under this plan.

Pro Forma Net Loss

The following table illustrates the effect on net loss if the Company had applied the fair value recognition provisions of SFAS 123 to stock-based compensation:

| | Year Ended December 31, 2005 |
|---|---|
| Net loss, as reported | \$ (43,557,835) |
| Add total stock-based compensation cost included in net loss | 747,412 |
| Deduct total stock-based compensation expense under fair value method | (3,374,460) |
| Pro forma net loss | \$ (46,184,883) |
| Net loss per share, basic and diluted, as reported | \$ (1.60) |
| Net loss per share, basic and diluted, pro forma | \$ (1.69) |

For purposes of the above proforma disclosure, the fair value of each option or stock appreciation right is estimated on the date of grant using the Black-Scholes option pricing model using the following assumptions for the year ended 2005: dividend yield of 0%, expected volatility ranging from 50% to 120%, risk free interest rates ranging from 1.09% to 5.28% an initial expected life ranging from five to ten years.

Warrants

Prior to its public offering in 2004, the Company issued warrants to purchase 418,819 shares of common stock at \$7.81 per share exercisable through December 2006, warrants to purchase 446,063 shares of common stock at \$7.81 exercisable through December 2007, warrants to purchase 298,936 shares of common stock at \$10.55 per share exercisable through February 2009 in connection with a corresponding issuance of convertible preferred stock. During 2005, the Company issued warrants to purchase 306,418 shares of common stock at \$6.53 in conjunction with a commitment for unsecured borrowing capacity from two affiliated investors. Such warrants are exercisable through November 2010. The fair value of the warrants was credited to additional paid-in capital and was recognized as commitment fees over the term of the agreement. During 2008, the Company issued warrants to certain stockholders in conjunction with a \$20 million loan commitment as described in Note 18.

During 2007, 2006, and 2005, warrants for 147,619, 858,810 and 72,507 shares, respectively, were exercised. Certain of these shares were exercised under the cashless exercise provision of the warrant agreements for a net issuance of 93,050, 638,472, and 14,888 shares of common stock during 2007, 2006, and 2005, respectively.

Table of Contents**12. Income Taxes**

The provision for income taxes consists of the following:

| | Year Ended December 31, | | |
|---------------------|-------------------------|---------------|---------------|
| | 2007 | 2006 | 2005 |
| Deferred: | | | |
| Federal | \$ 11,396,216 | \$ 14,321,316 | \$ 14,654,439 |
| State and local | (\$ 2,378,549) | 2,384,413 | 2,361,140 |
| Total deferred | 9,017,667 | 16,705,729 | 17,015,579 |
| Valuation allowance | (9,017,667) | (16,705,729) | (17,015,579) |
| Net deferred | \$ | \$ | \$ |

The provision for income taxes varies from the amount determined by applying the U.S. federal statutory rate to income before income taxes as a result of the following:

| | Year Ended December 31, | | |
|--|-------------------------|---------|---------|
| | 2007 | 2006 | 2005 |
| U.S. statutory income tax rate | 34.0% | 34.0% | 34.0% |
| State and local taxes, net of federal tax benefit | (4.9)% | 3.4% | 3.6% |
| Permanent differences between book and tax and other | (10.4)% | (1.5)% | (0.2)% |
| Research credits | 0.0% | 0.6% | 1.7% |
| Valuation allowance | (18.7)% | (36.5)% | (39.1)% |
| Effective income tax rate | 0.0% | 0.0% | 0.0% |

In assessing the realizability of deferred tax assets, the Company considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. The Company considers projected future taxable income and tax planning strategies in making this assessment. Based upon the level of historical taxable losses, and projections for future losses over periods which the deferred tax assets are deductible, the Company determined that a 100% valuation allowance of deferred tax assets was appropriate. Accordingly, a 100% valuation allowance has been established. The valuation allowance for deferred tax assets includes approximately \$251,000 for which subsequently recognized tax benefits will be applied directly to contributed capital.

The components of the deferred tax asset are as follows:

| | December 31, | |
|--|--------------|--------------|
| | 2007 | 2006 |
| Current accruals | \$ 2,028,654 | \$ 567,126 |
| Depreciation and amortization | 1,672,233 | 1,525,704 |
| Deferred compensation | 2,677,348 | 1,626,847 |
| Net operating loss carryovers | 82,150,858 | 72,276,229 |
| Research and development credit carryovers | | 3,702,394 |
| Deferred tax assets | 88,529,093 | 79,698,300 |
| Valuation allowance | (88,529,093) | (79,698,300) |

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Net deferred tax assets \$ \$

As of December 31, 2007, the Company has federal net operating loss carryforwards of approximately \$229 million. The net operating loss carryforwards will expire at various dates beginning in 2008, approximately \$3,512,000 will expire between 2008 and 2011 and approximately \$225,001,000 will expire between 2012 and

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2027, if not utilized. The federal research and development credits were decreased to \$0 as of December 31, 2007 as the Company had determined it is more likely than not that it does not have sufficient documentation to support the recognition of these credits for financial statement purposes.

The Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes (FIN 48)* on January 1, 2007. The Company had no unrecognized tax benefits in the financial statements as of January 1, 2007. A portion of the previously reported gross deferred tax assets as of December 31, 2006, primarily the Research and Development credit are not more-likely-than-not assets under FIN 48. As such, the Company determined that it would be appropriate to present deferred tax assets net of this asset and the associated valuation allowance. As a result of the adoption, there were no unrecognized tax benefits in the financial statements as of January 1, 2007.

The Company files income tax returns in the U.S. federal jurisdiction and various state and local jurisdictions. As the Company has a federal Net Operating Loss carryforward from the year ended December 31, 1993 forward, all tax years from 1993 forward are subject to examination. As states have varying carryforward periods, and the Company has recently entered into additional states, the states are generally subject to examination for the previous 15 years or less.

The Company recognizes interest accrued, net of tax and penalties, related to unrecognized tax benefits as components of income tax provision as applicable. As of December 31, 2007, the Company did not have any accrued interest and penalties.

13. Net Loss per Share

The following is a reconciliation of the numerator (net loss) and the denominator (number of shares) used in the basic and diluted earnings per share calculations:

| | Year Ended December 31, | | |
|---|-------------------------|-------------------|-------------------|
| | 2007 | 2006 | 2005 |
| Basic and diluted: | | | |
| Net loss | \$ (48,121,514) | \$ (45,719,770) | \$ (43,557,835) |
| Weighted average common shares outstanding | 35,793,973 | 32,979,403 | 27,312,041 |
| Less weighted average shares subject to repurchase | | | (10,219) |
| Weighted average shares used in basic and diluted net loss per share | 35,793,973 | 32,979,403 | 27,301,822 |
| Net loss per share | \$ (1.34) | \$ (1.39) | \$ (1.60) |

The following table sets forth the number of common shares that were excluded from the computation of earnings per share because their inclusion would have been anti-dilutive as follows:

| | December 31, | | |
|-----------------------------------|--------------|-----------|-----------|
| | 2007 | 2006 | 2005 |
| Shares outstanding | | | |
| Restricted shares | 675,078 | 651,288 | 308,105 |
| Shares issuable upon exercise of: | | | |
| Options to purchase common stock | 3,324,509 | 2,403,507 | 2,456,488 |
| Warrants | 357,350 | 510,626 | 1,369,436 |
| | 4,356,937 | 3,565,421 | 4,134,029 |

Table of Contents**14. Employee Benefit Plan**

Beginning in 2002, the Company offered employees the opportunity to participate in a 401(k) plan. The Company matches employee contributions dollar for dollar up to 3% of the employee's salary during the employee's period of participation. For the years ended December 31, 2007, 2006 and 2005, the Company expensed \$605,063, \$492,142 and \$450,370, respectively, related to the plan.

15. Commitments and Contingencies

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

The Company has entered into two letters of credit to support certain purchase and other commitments in the amount of approximately \$2.7 million.

16. Quarterly Data (Unaudited)

The following tabulations reflect the unaudited quarterly results of operations for the years ended December 31, 2007 and 2006:

| | Net Sales | Gross Margin | Net Loss | Basic and Diluted Loss Per Share |
|----------------|--------------|--------------|-----------------|----------------------------------|
| 2007 | | | | |
| First quarter | \$ 9,160,955 | \$ 5,910,607 | \$ (10,504,105) | \$ (0.31) |
| Second quarter | 7,835,239 | 3,491,908 | (15,005,916) | (0.42) |
| Third quarter | 12,047,754 | 8,014,171 | (10,398,262) | (0.29) |
| Fourth quarter | 10,254,861 | 6,535,903 | (12,213,231) | (0.34) |
| 2006 | | | | |
| First quarter | \$ 1,731,793 | \$ 499,802 | \$ (14,595,306) | \$ (0.47) |
| Second quarter | 3,814,020 | 1,631,595 | (13,610,529) | (0.41) |
| Third quarter | 7,640,313 | 3,964,791 | (11,353,573) | (0.34) |
| Fourth quarter | 14,005,580 | 8,202,769 | (6,160,362) | (0.18) |

17. Segment Information

The Company considers reporting segments in accordance with SFAS 131, *Disclosures about Segments of an Enterprise and Related Information*. The Company's system and disposable devices are developed and marketed to a broad base of hospitals in the United States and internationally. The Company considers all such sales to be part of a single operating segment.

Geographic revenue is as follows:

| | Year Ended December 31, | | |
|---------------|-------------------------|----------------------|----------------------|
| | 2007 | 2006 | 2005 |
| United States | \$ 25,930,305 | \$ 10,069,492 | \$ 10,998,617 |
| International | 13,368,504 | 17,122,214 | 4,027,773 |
| Total | \$ 39,298,809 | \$ 27,191,706 | \$ 15,026,390 |

All of the Company's long-lived assets are located in the United States.

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18. Subsequent Events

In February 2008 the Company entered into a Loan and Warrant Purchase Agreement with two of its shareholders providing for \$20 million in loan availability. These funds can be drawn at the Company's election, would be subordinated to any bank debt, would be unsecured, and would be due at the maturity date of February 2009. The commitment may also be used to provide guarantees to the Company's primary lending bank to support advances under the credit agreement with the bank. The financing commitment from the shareholders is subject to a 90 day extension, solely at the Company's option, providing for an extended maturity date of May 2009. In conjunction with this transaction, the Company and its primary lending bank amended the working capital line of credit by increasing the line to \$30 million subject to a borrowing base of qualifying accounts receivable and inventory, with up to \$10 million available under the line supported by these guarantees. Under the revised facility the Company is required to maintain a minimum tangible net worth as defined in the agreement of at least \$5 million at the end of any calendar quarter during the term of the agreement, with lesser amounts required at non-quarter month ends. Warrants to purchase approximately 572,000 shares of the Company's common stock at an exercise price of \$6.99 were issued to the shareholders in exchange for the financing commitment. The warrants are exercisable immediately upon grant and expire five years from the date of grant.

At December 31, 2007, the Company had invested \$500,000 in a taxable auction rate security (ARS) which we classified as a current asset. The Company considers these securities as available for sale. The ARS held by the Company is a private placement security with a long-term stated maturity for which the interest rate is reset through a Dutch auction every 28 days. The auctions have historically provided a liquid market for these securities as investors historically could readily sell their investments at auction. With the liquidity issues experienced in global credit and capital markets, the Company was unable to sell its ARS at auction on February 22, 2008, as the amount of securities submitted for sale exceeded the amount of purchase orders. The Company's ARS was issued by South Carolina Student Loan Corporation and currently carries a AAA/Aaa rating. It has not experienced any payment defaults and is insured by AMBAC. Nonetheless, if uncertainties in the credit and capital markets continue, these markets deteriorate further or there are any ratings downgrades on this ARS we hold, we may be required to recognize an impairment and/or reclassify these investments from short-term to long-term investment. In addition, these securities may not provide the liquidity to us as we need it, as it could take until the final maturity of the underlying note (June 2034) to realize our investments' recorded value. The Company intends to liquidate these securities at par at the earliest possibility opportunity.

19. Liquidity (Unaudited)

The Company has continued to experience net operating losses and negative cash flows during 2008, which has had an impact on the Company's financial position and liquidity. As of September 30, 2008 and for the nine months then ended, the Company had working capital of \$2.9 million, and used \$25.2 million of cash for operations. At September 30, 2008, the Company had approximately \$20 million of cash and equivalents, unused borrowing capacity of \$4.5 million under its revolving line of credit, and \$6 million of availability remaining on the shareholder loan agreement. The Company continues to address its liquidity needs and believes it can obtain sufficient liquidity for 2009 operations.

In July 2008 the Company entered into an amendment to its existing agreements with Biosense Webster, Inc. Pursuant to the amendment Biosense Webster agreed to pay the Company \$10 million as an advance on revenue share amounts that were owed at the time the amendment was executed or may be owed in the future by Biosense Webster to the Company pursuant to the revenue share provisions of the existing agreement. The Company also agreed that an aggregate of up to \$8 million of certain agreed upon research and development expenses that were owed at the time the amendment was executed or may be owed in the future by the Company to Biosense Webster pursuant to the existing agreement would be deferred and will be due, together with any unrecouped portion of the \$10 million revenue share advance on the Final Payment Date, which is defined in the agreement as December 31, 2011 or the date of an Accelerating Recoupment Event as defined in the agreement.

In November 2008 the Company, Sanderling Venture Partners and Alafi Capital executed a term sheet under which Sanderling Venture Partners and Alafi Capital committed to extend their February 2008 agreement to loan the Company an aggregate \$20 million on an unsecured basis. As amended, if extended by the Company the agreement will expire on the earlier of March 31, 2010 or the date the Company receives at least \$20 million of third party, non-bank financing. This facility may also be used by the Company to guarantee its loan commitments with Silicon Valley Bank, its primary bank lender, through the same extended term.

The Company also has approximately \$55 million of remaining availability under a shelf registration statement that was filed in August 2006 for the issuance and sale from time to time to the public of securities, including debt, preferred stock, common stock and warrants.

The Company is currently in negotiation with its primary lender to renew its bank line of credit, which expires on March 31, 2009, through March 31, 2010 on substantially the same terms as the current line.

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PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

Exhibit Listing

| Exhibits | Description |
|-----------------|---|
| 23.1 | Consent of Independent Registered Accounting Firm |
| 24.1 | Power of Attorney authorizing certain persons to sign this First Amendment to the Annual Report on Form 10-K on behalf of certain directors and officers of the Company |
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification (pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, executed by Chief Executive Officer) |
| 31.2 | Rule 13a-14(a)/15d-14(a) Certification (pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, executed by Chief Financial Officer) |
| 32.1 | Section 1350 Certification (pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, executed by Chief Executive Officer) |
| 32.2 | Section 1350 Certification (pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, executed by Chief Financial Officer) |

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SIGNATURES

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

STEREOTAXIS, INC.
(Registrant)

Date: December 29, 2008

By: /s/ BEVIL J. HOGG
Bevil J. Hogg,
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|----------------------------|--|-------------------|
| /s/ FRED A. MIDDLETON* | Chairman of the Board of Directors | December 29, 2008 |
| Fred A. Middleton | | |
| /s/ BEVIL J. HOGG | Chief Executive Officer (principal executive officer) | December 29, 2008 |
| Bevil J. Hogg | | |
| /s/ JAMES M. STOLZE | Vice President and Chief Financial Officer (principal financial officer and principal accounting officer) | December 29, 2008 |
| James M. Stolze | | |
| /s/ CHRISTOPHER ALAFI* | Director | December 29, 2008 |
| Christopher Alafi | | |
| /s/ DAVID W. BENFER* | Director | December 29, 2008 |
| David W. Benfer | | |
| /s/ RALPH G. DACEY, JR.* | Director | December 29, 2008 |
| Ralph G. Dacey, Jr. | | |

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| Signature | Title | Date |
|--|---|-------------------|
| /s/ MICHAEL P. KAMINSKI Michael P. Kaminski | President, Chief Operating Officer and Director | December 29, 2008 |
| /s/ WILLIAM M. KELLEY* William M. Kelley | Director | December 29, 2008 |
| /s/ ABHIJEET J. LELE* Abhijeet J. Lele | Director | December 29, 2008 |
| /s/ WILLIAM C. MILLS III* William C. Mills III | Director | December 29, 2008 |
| /s/ ROBERT J. MESSEY* Robert J. Messey | Director | December 29, 2008 |
| /s/ ERIC N. PRYSTOWSKY* Eric N. Prystowsky | Director | December 29, 2008 |

*By: /s/ JAMES M. STOLZE
James M. Stolze, attorney-in-fact, by authority of
the power of attorney filed as Exhibit 24.1 hereto.

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EXHIBIT INDEX

| Exhibits | Description |
|-----------------|--|
| 23.1 | Consent of Independent Registered Public Accounting Firm |
| 24.1 | Power of Attorney authorizing certain persons to sign this Amendment No. 1 Annual Report on Form 10-K on behalf of certain directors and officers of the Company |
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification (pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, executed by Chief Executive Officer) |
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