RETRACTABLE TECHNOLOGIES INC
Form 10-K/A
April 07, 2010
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-K/A

**Amendment No. 1**

**(Mark One)**

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

**For the fiscal year ended December 31, 2009**

**or**

**o 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 000-30885**

# Retractable Technologies, Inc.

(Exact name of registrant as specified in its charter)

| **Texas** | **75-2599762** |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| **511 Lobo Lane**<br>**Little Elm, Texas**<br>(Address of principal executive offices) | **75068-0009**<br>(Zip Code) |

**972-294-1010**

Registrant s telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act:

| **Title of each class** | **Name of each exchange on which registered** |
|---|---|
| Common | NYSE Amex LLC |

Securities registered pursuant to Section 12(g) of the Act:

**Preferred Stock**

(Title of class)

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

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 o No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) 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 the Form 10-K or any amendment to the Form 10-K. x

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

| | |
|---|---|
| Large accelerated filer o | Accelerated filer o |
| Non-accelerated filer o (Do not check if a smaller reporting company) | Smaller reporting company x |

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant s most recently completed second fiscal quarter. The aggregate market value of the common equity held by non-affiliates as of June 30, 2009 was $11,059,334.10, assuming a closing price of $0.90 and outstanding shares held by non-affiliates of 12,288,149.

APPLICABLE ONLY TO REGISTRANTS INVOLVED IN BANKRUPTCY

PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13, or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes o No o

(APPLICABLE ONLY TO CORPORATE REGISTRANTS)

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date. As of March 1, 2010, there were 23,825,149 shares of our Common Stock issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

List hereunder the following documents if incorporated by reference and the Part of the Form 10-K (e.g., Part I, Part II, etc.) into which the document is incorporated: (1) Any annual report to security holders; (2) Any proxy or information statement; and (3) Any prospectus filed pursuant to Rule 424(b) or (c) under the Securities Act of 1933. The listed documents should be clearly described for identification purposes (e.g., annual report to security holders for fiscal year ended December 24, 1980).

None except exhibits.

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**Explanatory Note**

We are filing this Amendment No. 1 to our Annual Report on Form 10-K for the year ended December 31, 2009 which was filed with the U.S. Securities and Exchange Commission on March 31, 2010 (the Original Filing ). The primary purposes of this Amendment No. 1 are to insert the following: (i) information with regard to the impact of certain nonrecurring charges on our Net earnings (see Item 7 of Part II of this Form 10-K/A); and (ii) additional information with regard to an impairment charge of $2,594,602 recognized in the fourth quarter of 2009 (see Items 7 and 8 of Part II of this Form 10-K/A). No other material changes have been made. The complete text of Items 7 and 8 of Part II are set forth herein. Certain exhibits and signatures are also provided.

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**RETRACTABLE TECHNOLOGIES, INC.**

**FORM 10-K/A**

**Amendment No. 1**

**For the Fiscal Year Ended December 31, 2009**

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**Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operation.**

FORWARD-LOOKING STATEMENT WARNING

Certain statements included by reference in this filing containing the words could, may, believes, anticipates, intends, expects, and simila words constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act. Any forward-looking statements involve known and unknown risks, uncertainties, and other factors that may cause our actual results, performance, or achievements to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements. Such factors include, among others, our ability to maintain liquidity, our maintenance of patent protection, the impact of current litigation (as it affects our costs as well as market access), our ability to maintain favorable supplier arrangements and relationships, our ability to receive royalties from BTMD, our ability to quickly increase capacity in response to an increase in demand, our ability to access the market, our ability to maintain or lower production costs, our ability to continue to finance research and development as well as operations and expansion of production, the increased interest of larger market players, specifically BD, in providing devices to the safety market, and other factors referenced in **Item 1A. Risk Factors** of the Form 10-K. Given these uncertainties, undue reliance should not be placed on forward-looking statements.

OVERVIEW

We have been manufacturing and marketing our products into the marketplace since 1997. We currently provide other safety medical products in addition to safety syringe products. One such product is the Patient Safe® syringe, which is uniquely designed to reduce the risk of bloodstream infections resulting from catheter hub contamination. Patient Safe® s unique luer guard reduces the risk of luer tip contact contamination and the risk of contamination of intravenous fluid. Safety syringes comprised 98.9% of our sales in 2009.

Historically, unit sales have increased in the latter part of the year due, in part, to the demand for syringes during the flu season. We expect the Swine Flu to have a longer worldwide immunization duration than the seasonal flu. In the third quarter of 2009, we were awarded a contract by the DHHS to supply a portion of the safety engineered syringes to be used in the U.S. efforts to vaccinate the U.S. population against the Swine Flu. The impact on us was material. Sales to the DHHS comprised 52.0% and 24.4% of our revenues for the three months and twelve months ended December 31, 2009, respectively. This program, which was estimated to run from August 2009 through March 2010, ended in December 2009. Our revenue increased 142.1% in the fourth quarter principally due to the DHHS contract. We do not know if there will be a similar program in 2010.

Our products have been and continue to be distributed nationally through numerous distributors. However, we have been blocked from access to the market by exclusive marketing practices engaged in by BD, which dominates the market. We believe that its monopolistic business practices continue despite: (i) its paying $100 million in 2004 to settle a prior lawsuit with us for anticompetitive practices, business disparagement, and tortious interference and (ii) the fact that a jury returned a verdict in November 2009 finding that all three patents asserted by us against BD are valid and infringed by BD (with regard to its IntegraTM product). Although we have made limited progress in some areas, such as the alternate care and international markets, our volumes are not as high as they should be given the nature and quality of our products and the federal and state legislation requiring the use of safe needle devices.

We continue to pursue various strategies to have better access to the hospital market, as well as other markets, including attempting to gain access to the market through our sales efforts, our innovative technology, introduction of new products, and, when necessary, litigation. We are also marketing more products internationally.

We sued OMI in April 2008 and separately sued BD in June 2007 for claims of patent infringement (see **Item 3. Legal Proceedings** of the Form 10-K), and in December 2009 and November 2009, respectively, such companies were found to infringe our patents. These judgments could increase demand for our product. However, there is no assurance when or if such increase will occur.

Beginning in 2004, we were given an award (from PATH) to supply syringes to various African countries under the President s Emergency Plan for AIDS relief (PEPFAR). Awards increased significantly from 2004 to 2007. The continuation of PEPFAR has been reauthorized by Congress through 2013. However, funding for the procurement of safety syringes in this program has not occurred to date.

As a result of the introduction of VanishPoint® syringes through the PEPFAR initiative, African countries have begun to procure products outside of the U.S.-funded program. In 2007, the Director General of Nigeria s National Agency for Food and Drug Administration and Control (NAFDAC), endorsed automated retraction syringes for use throughout Nigeria. We are currently selling syringes to a Nigerian distributor for use in that country. At the end of 2008, the Deputy Prime Minister of Namibia also publically endorsed automated retraction syringes as a public intervention that would protect health workers and save their patient s lives .

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The number of international distributors continues to increase.

In the event we continue to have only limited market access, the cash provided by the litigation settlements and generated from operations becomes insufficient, and royalties from BTMD are not forthcoming, we would take additional cost cutting measures to reduce cash requirements. Such measures could result in the reduction of units being produced, the reduction of workforce, the reduction of salaries of officers and other nonhourly employees, and the deferral of royalty payments. We took such actions at the end of the second quarter of 2009.

At the end of the second quarter of 2009, we announced that in the interest of the long-term survival of the Company we would reorganize some of the Company s functions and implement staff reductions, all in order to minimize our cash expenditures and conserve our resources. Our workforce was reduced by 16% on July 1, 2009. However, due to the expected increase in production from sales to DHHS, we increased the workforce at the Little Elm facility beginning in the latter part of the third quarter of 2009. The rehiring only slightly affected our prior estimate that annual compensation costs and related expenses would be reduced by $2.1 million annually due to the layoffs. An anticipated reduction of inventory was estimated (at the time of the announcement) to result in a minimum of $1.0 million reduction in cash outlays over the subsequent twelve months. However, due to the orders from the DHHS, that particular initiative is on hold. Our President and CEO, Thomas J. Shaw, waived future royalty payments beginning July 1, 2009, for an aggregate savings of $1.0 million which affected royalty payments (not expenses) in the third and fourth quarter of 2009. Salaries for all personnel above a certain salary level were cut by 10% in 2009 (subject to contract rights). Such reduction, along with discontinuing the 401(k) matching, was estimated to save $600,000. We expect to save an additional $1.6 million by the following actions: moving most, if not all, of the molding of piece parts back to Little Elm; reducing professional fees; and various other cost cutting measures. Professional fees have been reduced and we have begun additional molding in Little Elm. These measures will remain in place as long as Management deems them necessary.

We recorded a $200,000 charge in the second quarter of 2009 for severance pay offered to the terminated employees. All severance payments were paid in the third quarter of 2009. We incurred a noncash expense of $2.1 million related to the issuance of stock options. The remaining stock option expense will be fully amortized by the end of the second quarter of 2010. We wrote off approximately $2.6 million of catheter production equipment.

We are focusing on methods of upgrading our manufacturing capability and efficiency in order to reduce costs. We believe our current capitalization provides the resources necessary to implement some of these changes and improve our manufacturing capacity and efficiency, thereby reducing our unit cost.

Product purchases from Double Dove, a Chinese manufacturer, have enabled us to increase manufacturing capacity with little capital outlay and have provided a competitive manufacturing cost. In 2009, Double Dove manufactured approximately 67.5% of the units we produced. The cost of production per unit has generally declined as volumes increased. We believe we could make up any long-term disruption in these supplies by utilizing more of the capacity at the Little Elm facility, except for the 0.5mL insulin syringe, the 5mL and 10mL syringes, and the autodisable syringe which altogether comprised about 3.8% of our 2009 revenues.

We previously entered into a License Agreement with BTMD as of May 13, 2005. That license expired on May 13, 2008 (prior to the manufacture and delivery of any products). Nevertheless, BTMD continued to work toward completing the facility and gaining the necessary approvals in order to manufacture and sell products. The facility has been completed and BTMD has met Chinese Government requirements. BTMD received a Registration Certificate for Medical Device on August 24, 2009. Production efforts are currently underway and are being tested. We entered into a new agreement (effective as of July 1, 2009) with BTMD along similar terms as the prior agreement. This agreement expires on July 1, 2010 which may automatically extend under certain conditions. Such terms include granting to BTMD a limited exclusive

license to manufacture and a limited exclusive right to sell syringes in the PRC having retractable needles that incorporate our technology. This License Agreement is subject to the Technology License Agreement dated June 23, 1995 between Mr. Thomas J. Shaw, our founder and CEO, as licensor, and the Company, as licensee (as amended). Accordingly, Mr. Shaw will receive 5% of the licensing proceeds we receive. BTMD has agreed to manufacture and sell these products in the PRC and to pay us a quarterly royalty of two and one-half cents per unit on 3mL and 5mL syringes and a royalty of three and one-half cents per unit on 0.5mL, 1mL, and 10mL syringes. The obligation to pay the royalties continues even if

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any and all of our patent rights in the PRC are found to be invalid or unenforceable for any reason. We still continue to expect royalty payments although we are unable to predict the date we will begin to receive such royalties.

With increased volumes, our manufacturing unit costs have generally tended to decline. Factors that could affect our unit costs include increases in costs by third party manufacturers, changing production volumes, costs of petroleum products, and transportation costs. Increases in such costs may not be recoverable through price increases of our products.

We completed the expansion of an existing warehouse in the first quarter of 2009. This expansion increased our warehouse area, provided for additional office space, and added a second Controlled Environment. The additional Controlled Environment will enable us to do more molding in-house.

**LIQUIDITY**

At the present time, Management does not intend to raise equity capital. Due to the funds received from prior litigation settlements, we have sufficient cash reserves and intend to rely on operations, cash reserves, and debt financing as the primary ongoing sources of cash.

Historical Sources of Liquidity

We have historically funded operations primarily from the proceeds from revenues, private placements, loans, and litigation settlements.

Internal Sources of Liquidity

*Margins and Market Access*

To achieve break even quarters, we need minimal access to hospital markets which has been difficult to obtain due to the monopolistic marketplace which was the subject of our initial lawsuit and now also included in our second antitrust lawsuit against BD. We will continue to attempt to gain access to the market through our sales efforts, innovative technology, the introduction of new products, and, when necessary, litigation.

We are focusing on methods of upgrading our manufacturing capability and efficiency in order to reduce costs. We believe our current capitalization provides the resources necessary to implement some of these changes and improve our manufacturing capacity and efficiency, thereby reducing our unit cost.

In the third quarter of 2009, we were awarded a contract by the DHHS to supply a portion of the safety engineered syringes to be used in the U.S. efforts to vaccinate the U.S. population against the Swine Flu. The impact on us was material. Sales to the DHHS comprised 52.0% and 24.4% of our revenues for the three months and twelve months ended December 31, 2009, respectively. This program, which was estimated to run from August 2009 through March 2010, ended in December 2009. Our revenue increased 142.1% in the fourth quarter principally due to the DHHS contract. We do not know if there will be a similar program in 2010.

Beginning in early 2004, we began to receive shipment of product from Double Dove which enabled us to lower our unit costs. Fluctuations in the cost and availability of raw materials and inventory and our ability to maintain favorable supplier arrangements and relationships could result in the need to manufacture all (as opposed to 32.0%) of our products in the U.S. This could temporarily increase unit costs as we ramp up domestic production.

The mix of domestic and international sales affects the average sales price of our products. Generally, the higher the ratio of domestic sales to international sales, the higher the average sales price will be. Typically international sales are shipped directly from China to the customer. Purchases of product manufactured in China, if available, usually decrease the average cost of manufacture for all units as domestic costs, such as indirect labor and overhead, remain relatively constant. The number of units produced by the Company versus manufactured in China can have a significant effect on the carrying costs of inventory as well as Cost of sales. We will continue to evaluate the appropriate mix of products manufactured domestically and those manufactured in China to achieve economic

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benefits as well as to maintain our domestic manufacturing capability. Currently, approximately 32.0% of our products are produced domestically.

Fluctuations in the cost of oil (since our products are petroleum based) and transportation and the volume of units purchased from Double Dove may have an impact on the unit costs of our product. Increases in such costs may not be recoverable through price increases of our products. Reductions in oil prices may not quickly affect petroleum product prices.

*Seasonality*

Historically, unit sales have increased in the latter part of the year due, in part, to the demand for syringes during the flu season. We expect the Swine Flu to have a longer worldwide immunization duration than the seasonal flu.

*Licensing Agreement*

We previously entered into a License Agreement with BTMD as of May 13, 2005. That license expired on May 13, 2008 (prior to the manufacture and delivery of any products). Nevertheless, BTMD continued to work toward completing the facility and gaining the necessary approvals in order to manufacture and sell products. The facility has been completed and BTMD has met Chinese government requirements. BTMD received a Registration Certificate for Medical Device on August 24, 2009. Production efforts are currently underway and are being tested. We entered into a new agreement (effective as of July 1, 2009) with BTMD along similar terms as the prior agreement. This agreement expires on July 1, 2010 which may automatically extend under certain conditions. Such terms include granting to BTMD a limited exclusive license to manufacture and a limited exclusive right to sell syringes in the PRC having retractable needles that incorporate our technology. This License Agreement is subject to the Technology License Agreement dated June 23, 1995 between Mr. Thomas J. Shaw, our founder and CEO, as licensor, and the Company, as licensee (as amended). Accordingly, Mr. Shaw will receive 5% of the licensing proceeds we receive. BTMD has agreed to manufacture and sell these products in the PRC and to pay us a quarterly royalty of two and one-half cents per unit on 3mL and 5mL syringes and a royalty of three and one-half cents per unit on 0.5mL, 1mL, and 10mL syringes. The obligation to pay the royalties continues even if any and all of our patent rights in the PRC are found to be invalid or unenforceable for any reason. We still continue to expect royalty payments although we are unable to predict the date we will begin to receive such royalties.

*Cash Requirements*

Due to funds received from prior litigation settlements, we have sufficient cash reserves and intend to rely on operations, cash reserves, and debt financing as the primary ongoing sources of cash. In the event we continue to have only limited market access and cash generated from operations becomes insufficient to support operations, we would take additional cost cutting measures to reduce cash requirements. Such measures could result in the reduction of units being produced, the reduction of workforce, the reduction of salaries of officers and other nonhourly employees, and the deferral of royalty payments.

External Sources of Liquidity

We have obtained several loans from our inception, which have, together with the proceeds from the sales of equities and litigation efforts, enabled us to pursue development and production of our products. Given the current economic conditions, our ability to obtain additional funds through loans is uncertain. Furthermore, the shareholders previously authorized an additional 5,000,000 shares of a Class C Preferred Stock that could, if necessary, be designated and used to raise funds through the sale of equity. Due to the current market price of our Common Stock, it is unlikely we would choose to raise funds by the sale of equity. We obtained a loan from 1st International for $2,500,000, secured by the land and existing buildings, which provided funding for the construction of the 47,250 square foot warehouse placed in service in 2005. This loan had a maturity date in late March 2010. We anticipate refinancing this loan.

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**CAPITAL RESOURCES**

Material Commitments for Expenditures

On August 29, 2008, we obtained a $4,210,000 interim construction loan from Lewisville State Bank, a division of 1st International Bank. The purpose of the loan was to expand the warehouse, including additional office space, and construct a new Controlled Environment. The interest rate was WSJPR plus 0.25%. The loan was renewed on December 10, 2009 with a 20 year amortization and 10 year maturity. The interest rate is 5.968%. The construction project has been completed.

Trends in Capital Resources

Interest expense will increase due to the recent loan of approximately $4.2 million, but will be somewhat mitigated by lower borrowing rates if current conditions in the credit markets continue. Interest income may be negatively affected by lower interest rates and our prior movement of cash to U.S. Treasury bills and other U.S. government backed securities. Although we believe that we have granted credit to credit-worthy firms, current economic conditions may affect the timing and/or collectability of some accounts.

**RESULTS OF OPERATIONS**

The following discussion contains trend information and other forward-looking statements that involve a number of risks and uncertainties. Our actual future results could differ materially from our historical results of operations and those discussed in the forward-looking statements. All period references are to our fiscal years ended December 2009, 2008, or 2007. Dollar amounts have been rounded for ease of reading.

*Comparison of Year Ended*

*December 31, 2009, and Year Ended December 31, 2008*

Revenues increased 39.7%, due principally to sales under the DHHS contract. Domestic sales were 88.4% of revenues with international sales comprising the remainder. Without the DHHS contract, our revenues would have increased 5.6%, with domestic revenues increasing 7.3% and international revenues declining 3.0%. Unit sales of the 1mL syringe increased 17.1% and 3mL unit sales increased 54.3%. Unit sales of all products increased 27.3%. Domestic unit sales as well as average sales prices increased. International unit sales decreased slightly and average selling prices increased. Sales to two customers accounted for 38.4% of our revenues in 2009. Only one of these two customers was a customer in 2008, and such customer accounted for 17.1% of our revenues in 2008.

Cost of sales increased due to greater volumes. Royalty expenses were higher due to higher gross sales.

As a result, gross profit margins increased from 29.5% in 2008 to 34.7% in 2009.

Operating expenses increased from the prior year due to litigation costs and stock option expense mitigated by the cost cutting measures beginning in the third quarter of 2009.

Sales and marketing expenses decreased due primarily to lower compensation due to staff reduction and reduction in pay, lower advertising expenses and reduced travel costs. Stock option expense and consulting costs increased.

Research and development costs were lower. We had decreases in engineering costs due principally to reduction in staff and pay as well as lower consulting cost. Stock option expense increased.

General and administrative costs increased due principally to litigation costs and stock option expense. Compensation costs decreased due to staff reductions and reductions in pay.

In the fourth quarter of 2009, we recognized an impairment charge of $2,594,602 associated with catheter production equipment. See Note 2, **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Long-lived assets** for a further discussion.

Preferred Stock dividend requirements decreased slightly due to conversion of preferred stock in the first quarter of 2008. The dividend arrearage at December 31, 2009, on all classes of Preferred Stock was approximately $15.3 million.

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Interest income decreased due to lower interest rates and lower cash balances. Interest expense decreased due to capitalized interest. Interest expense is expected to increase in 2010 due to completion of significant capital projects in 2009 for which interest was being capitalized.

There are several charges to our Statement of Operations in 2009 that are nonrecurring or are not typical of a manufacturing company. These charges include litigation costs, stock option expense (a noncash charge which will be fully amortized at the end of the second quarter of 2010), and an impairment of assets. Additionally we recognized an income tax benefit attributable to recent tax legislation which allows us to carry back our net operating losses to a prior period. Were it not for the charges and the tax benefit described above, our Net earnings applicable to common shareholders for the year would have been slightly above breakeven. The removal of the same items, applicable to the fourth quarter of 2009, would have provided a Net earnings applicable to common shareholders exceeding $4.0 million. There would be no federal income tax impact since we have net operating loss carryforwards which would eliminate our tax obligation. Based on the current status of legal matters, our litigation costs should decline sometime prior to the end of the second quarter of 2010.

Cash flow from operations was a negative $12.3 million for 2009 due principally to operating losses and increases in receivables. Most of the increase in receivables was related to billings in December 2009 to DHHS and collected in January 2010. The increase in income taxes receivable is related to a refund for carryback of our 2009 net operating loss. We will file for this refund early in the second quarter of 2010. The effect of non-cash expenses and the change in working capital was a negative $2.9 million. Investing activities utilized $2.4 million in cash.

*Comparison of Year Ended*

*December 31, 2008, and Year Ended December 31, 2007*

Revenues increased 6.1%, due principally to higher average sales prices and greater volumes. Domestic sales were 83.3% of revenues with international sales comprising the remainder. Unit sales of the 1mL syringe increased 22.7% and 3mL unit sales decreased 4.0%. Unit sales of all products increased 3.1%. Domestic unit sales as well as average sales prices increased. International unit sales and average selling prices declined. Sales to one distributor accounted for 17.1% and 13.7% of our revenues in 2008 and 2007, respectively.

Cost of sales increased due to higher manufacturing costs and higher volumes. Royalty expenses were higher due to an increase in gross revenues.

As a result, gross profit margins declined from 30.4% in 2007 to 29.5% in 2008.

Operating expenses increased from the prior year due to higher general and administrative expenses mitigated by lower Sales and marketing and Research and development costs.

Sales and marketing expenses decreased due primarily to reduced travel and entertainment, trade shows and market expense, compensation and office supplies. Consulting expense also decreased.

Research and development costs were flat. We had decreases in engineering costs due principally to higher costs of validation and engineering samples offset by higher compensation costs.

General and administrative costs increased due principally to increased legal costs (including a settlement of litigation whereby we obtained a patent license/assignment), office expenses, compensation, property taxes and freight costs. Travel and entertainment costs and fees to distributors decreased.

Preferred Stock dividend requirements decreased due to conversion of Preferred Stock to Common Stock. The dividend arrearage at December 31, 2008, on all classes of Preferred Stock was approximately $13.9 million.

Interest income decreased due to lower interest rates and cash balances. Interest expense decreased due to lower interest rates mitigated by higher debt balances and capitalized interest, principally due to the construction of the warehouse.

Other accrued liabilities increased due to prepayments from international customers.

Cash flow from operations was a negative $5.7 million for 2008 due principally to our losses. The effect of non-cash expenses and the change in working capital was a positive $4.0 million. Investing activities utilized $2.2 million in cash.

OFF-BALANCE SHEET ARRANGEMENTS

None.

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CONTRACTUAL OBLIGATIONS

Contractual Obligations and Commercial Commitments

The following chart summarizes our material obligations and commitments to make future payments under contracts for long-term debt as of December 31, 2009:

| | Payments Due by Period | | | | |
|---|---|---|---|---|---|
| **Contractual Obligations** | **Total** | **Less Than 1 Year** | **1-3 Years** | **3-5 Years** | **More Than 5 Years** |
| Long-term debt, including current maturities | $ 7,505,789 | $ 2,659,573 | $ 988,749 | $ 273,366 | $ 3,584,101 |

These amounts do not reflect the effect of the beneficial conversion feature and therefore will be greater than the amounts in the financial statements.

SIGNIFICANT ACCOUNTING POLICIES

We consider the following to be our most significant accounting policies. Careful consideration and review is given to these and all accounting policies on a routine basis to ensure that they are accurately and consistently applied.

**Accounts Receivable**

We record trade receivables when revenue is recognized. No product has been consigned to customers. Our allowance for doubtful accounts is primarily determined by review of specific trade receivables. Those accounts that are doubtful of collection are included in the allowance. An additional allowance has been established based on a percentage of receivables outstanding. These provisions are reviewed to determine the adequacy of the allowance for doubtful accounts. Trade receivables are charged off when there is certainty as to their being uncollectible. Trade receivables are considered delinquent when payment has not been made within contract terms.

**Revenue Recognition**

Revenue is recognized for sales to distributors when title and risk of ownership passes to the distributor, generally upon shipment. Revenue is recorded on the basis of sales price to distributors, less contractual pricing allowances. Contractual pricing allowances consist of (i) rebates granted to distributors who provide tracking reports which show, among other things, the facility that purchased the products, and (ii) a provision for estimated contractual pricing allowances for products that we have not received tracking reports. Rebates are recorded when issued and are applied against the customer s receivable balance. The provision for contractual pricing allowances is reviewed at the end of each quarter and adjusted for changes in levels of products for which there is no tracking report. Additionally, if it becomes clear that tracking reports will not be provided by individual distributors, the provision is further adjusted. The estimated contractual allowance is netted against individual distributors accounts receivable balances for financial reporting purposes. The resulting net balance is reflected in accounts receivable or accounts payable, as appropriate. The terms and conditions of contractual pricing allowances are governed by contracts between us and our distributors. Revenue for shipments directly to end-users is recognized when title and risk of ownership passes from us. Any product shipped or distributed for evaluation purposes is expensed.

Our domestic return policy is set forth in our standard Distribution Agreement. This policy provides that a customer may return incorrect shipments within 10 days following arrival at the distributor s facility. In all such cases the distributor must obtain an authorization code from us and affix the code to the returned product. We will not accept returned goods without a returned goods authorization number. We may refund the customer s money or replace the product minus a 10% restocking fee and all applicable freight charges.

Our return policy also provides that a customer may return product that is overstocked. Overstocking returns are limited to two times in each 12 month period up to 1% of distributor s total purchase of products for the prior 12 month period. All product overstocks and returns are subject to inspection and acceptance by manufacturer.

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Our international Distribution Agreements do not provide for any returns.

We record an allowance for estimated returns as a reduction to accounts receivable and gross sales. Historically, returns have been less than 0.5% of net sales.

**Inventories**

Inventories are valued at the lower of cost or market, with cost being determined using actual average cost. A reserve is established for any excess or obsolete inventories.

**Marketing Fees**

Under a sales and marketing agreement with Abbott, we paid marketing fees until we terminated the contract for breach. The contracted services were to include participation in promotional activities, development of educational and promotional materials, representation at trade shows, clinical demonstrations, inservicing and training, and tracking reports detailing the placement of our products to end-users. Marketing fees were accrued at the time of the sale of product to Abbott. These fees were paid after Abbott provided us a tracking report of product sales to end-users. These costs were included in Sales and marketing expense in the Statements of Operations. No marketing fees have been accrued since October 15, 2003, the date the National Marketing and Distribution Agreement with Abbott was terminated. We filed suit against Abbott in August 2005 for breach of contract and trial is scheduled for May 2010. We do not expect the eventual liability for marketing fees, if any, to exceed the amount accrued.

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**Item 8. Financial Statements and Supplementary Data.**

**RETRACTABLE TECHNOLOGIES, INC.**

**FINANCIAL STATEMENTS AND**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**DECEMBER 31, 2009 AND 2008**

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**RETRACTABLE TECHNOLOGIES, INC.**

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders

of Retractable Technologies, Inc.

We have audited the accompanying balance sheets of Retractable Technologies, Inc. as of December 31, 2009 and 2008, and the related statements of operations, changes in stockholders equity, and cash flows for each of the three years in the period ended December 31, 2009. Our audits also included the financial statement schedule of Retractable Technologies, Inc., listed in Item 15(a). These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements 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 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Retractable Technologies, Inc. as of December 31, 2009 and 2008, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2009 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.

We were not engaged to examine management s assertion about the effectiveness of the Company s internal control over financial reporting as of December 31, 2009 included in Item 9A of the Company s December 31, 2009 Form 10-K and, accordingly, we do not express an opinion thereon.

/s/ CF & Co., L.L.P.
CF & Co., L.L.P.

Dallas, Texas
March 31, 2010, except for Note 2, (SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Long-lived assets) as to which the date is April 7, 2010

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**RETRACTABLE TECHNOLOGIES, INC.**

**BALANCE SHEETS**

| | December 31, 2009 | December 31, 2008 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 18,126,084 | $ 33,283,740 |
| Accounts receivable, net of allowance for doubtful accounts of $681,966 and $499,966, respectively | 9,948,210 | 3,288,942 |
| Inventories, net | 6,907,369 | 6,641,532 |
| Income taxes receivable | 3,655,637 | |
| Other current assets | 624,393 | 400,113 |
| Total current assets | 39,261,693 | 43,614,327 |
| Property, plant, and equipment, net | 14,234,181 | 14,435,667 |
| Intangible assets, net | 426,675 | 470,115 |
| Other assets | 18,750 | 18,750 |
| Total assets | $ 53,941,299 | $ 58,538,859 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 6,997,310 | $ 6,144,435 |
| Current portion of long-term debt | 2,628,652 | 451,865 |
| Accrued compensation | 561,484 | 650,704 |
| Marketing fees payable | 1,419,760 | 1,419,760 |
| Accrued royalties to shareholders | 843,327 | 620,987 |
| Other accrued liabilities | 745,460 | 949,770 |
| Total current liabilities | 13,195,993 | 10,237,521 |
| Long-term debt, net of current maturities | 4,824,833 | 6,095,535 |
| Total liabilities | 18,020,826 | 16,333,056 |
| Stockholders equity: | | |
| Preferred Stock $1 par value: | | |
| Class B; authorized: 5,000,000 shares | | |
| Series I, Class B; issued: 1,000,000 shares; outstanding: 144,000 and 144,000 shares, respectively (liquidation preference of $900,000 and $900,000 respectively) | 144,000 | 144,000 |
| Series II, Class B; issued: 1,000,000 shares; outstanding: 219,700 and 219,700, respectively (liquidation preference of $2,746,250 and $2,746,250, respectively) | 219,700 | 219,700 |
| Series III, Class B; issued: 1,160,445 shares; outstanding: 130,245 and 130,245 shares, respectively (liquidation preference of $1,628,063 and $1,628,063, respectively) | 130,245 | 130,245 |
| Series IV, Class B; issued: 1,133,800 shares; outstanding: 552,500 and 552,500 shares (liquidation preference of $6,077,500 and $6,077,500, respectively) | 552,500 | 552,500 |
| Series V, Class B; issued: 2,416,221 shares; outstanding: 1,238,821 and 1,238,821 shares, respectively (liquidation preference of $5,450,812 and $5,450,812, respectively) | 1,238,821 | 1,238,821 |
| Common Stock, no par value; authorized: 100,000,000 shares; issued and outstanding: 23,825,149 and 23,800,064 shares, respectively | | |
| Additional paid-in capital | 57,089,153 | 53,952,183 |
| Retained deficit | (23,453,946 ) | (14,031,646 ) |
| Total stockholders equity | 35,920,473 | 42,205,803 |
| Total liabilities and stockholders equity | $ 53,941,299 | $ 58,538,859 |

See accompanying notes to financial statements

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**RETRACTABLE TECHNOLOGIES, INC.**

**STATEMENTS OF OPERATIONS**

| | Years Ended December 31, | | |
|---|---|---|---|
| | **2009** | **2008** | **2007** |
| Sales, net | $ 38,981,837 | $ 27,899,318 | $ 26,289,720 |
| Cost of Sales | | | |
| Costs of manufactured product | 22,659,437 | 17,504,842 | 16,212,609 |
| Royalty expense to shareholders | 2,806,223 | 2,168,268 | 2,087,596 |
| Total cost of sales | 25,465,660 | 19,673,110 | 18,300,205 |
| Gross profit | 13,516,177 | 8,226,208 | 7,989,515 |
| | | | |
| Operating expenses: | | | |
| Sales and marketing | 4,372,163 | 4,835,272 | 5,299,157 |
| Research and development | 1,030,622 | 1,066,068 | 1,071,143 |
| General and administrative | 18,814,392 | 12,769,774 | 11,565,144 |
| Impairment of assets | 2,594,602 | | |
| Total operating expenses | 26,811,779 | 18,671,114 | 17,935,444 |
| Loss from operations | (13,295,602 ) | (10,444,906 ) | (9,945,929 ) |
| | | | |
| Interest and other income | 57,604 | 855,685 | 1,870,512 |
| Interest expense, net | (21,892 ) | (54,359 ) | (326,304 ) |
| Loss before income taxes | (13,259,890 ) | (9,643,580 ) | (8,401,721 ) |
| Benefit for income taxes | (3,837,590 ) | | (1,453,617 ) |
| Net loss | (9,422,300 ) | (9,643,580 ) | (6,948,104 ) |
| Preferred Stock dividend requirements | (1,370,868 ) | (1,373,019 ) | (1,399,062 ) |
| Net loss applicable to common shareholders | $ (10,793,168 ) | $ (11,016,599 ) | $ (8,347,166 ) |
| | | | |
| Loss per share | $ (0.45 ) | $ (0.46 ) | $ (0.35 ) |
| | | | |
| Weighted average common shares outstanding | 23,806,533 | 23,794,566 | 23,727,029 |

See accompanying notes to financial statements

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**RETRACTABLE TECHNOLOGIES, INC.**

**STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY**

| | Series I Class B | | Series II Class B | | Series III Class B | | Series IV Class B | | Series V Class B | | Common | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | Shares | Amount | Shares | Amount | Shares | Amount | Shares | Amount |
| Balance as of December 31, 2006 | 164,000 | $164,000 | 224,700 | $224,700 | 135,245 | $135,245 | 553,500 | $553,500 | 1,363,721 | $ 1,363,721 | 23,644,164 | $ |
| Conversion of Preferred Stock into Common Stock | (20,000) | (20,000) | (5,000) | (5,000) | (5,000) | (5,000) | | | (81,250) | (81,250) | 111,250 | |
| Recognition of stock option compensation | | | | | | | | | | | | |
| Dividends declared and paid on Series I Class B Preferred Stock | | | | | | | | | | | | |
| Dividends declared and paid on Series II Class B Preferred Stock | | | | | | | | | | | | |
| Net loss | | | | | | | | | | | | |
| Balance as of December 31, 2007 | 144,000 | 144,000 | 219,700 | 219,700 | 130,245 | 130,245 | 553,500 | 553,500 | 1,282,471 | 1,282,471 | 23,755,414 | |
| Conversion of Preferred Stock into Common Stock | | | | | | | (1,000) | (1,000) | (43,650) | (43,650) | 44,650 | |
| Recognition of stock option compensation | | | | | | | | | | | | |
| Net loss | | | | | | | | | | | | |
| Balance as of December 31, 2008 | 144,000 | 144,000 | 219,700 | 219,700 | 130,245 | 130,245 | 552,500 | 552,500 | 1,238,821 | 1,238,821 | 23,800,064 | |

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Recognition of stock option exercise | | | | | | | | | | | 25,085 | |
| Royalty waiver | | | | | | | | | | | | |
| Recognition of stock option compensation | | | | | | | | | | | | |
| Net loss | | | | | | | | | | | | |
| Balance as of December 31, 2009 | 144,000 | $144,000 | 219,700 | $219,700 | 130,245 | $130,245 | 552,500 | $552,500 | 1,238,821 | $ 1,238,821 | 23,825,149 | $ |

See accompanying notes to financial statements

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**RETRACTABLE TECHNOLOGIES, INC.**

**STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY**

| | Additional Paid-in Capital | Retained Earnings (Deficit) | Total |
|---|---|---|---|
| Balance as of December 31, 2006 | $ 54,709,108 | $ 2,560,038 | $ 59,710,312 |
| Conversion of Preferred Stock into Common Stock | 111,250 | | |
| Recognition of stock option compensation | 52,173 | | 52,173 |
| Dividends declared and paid on Series I Class B Preferred Stock | (262,819 ) | | (262,819) |
| Dividends declared and paid on Series II Class B Preferred Stock | (790,725 ) | | (790,725 ) |
| Net loss | | (6,948,104 ) | (6,948,104 ) |
| Balance as of December 31, 2007 | 53,818,987 | (4,388,066) | 51,760,837 |
| Conversion of Preferred Stock into Common Stock | 44,650 | | |
| Recognition of stock option compensation | 88,546 | | 88,546 |
| Net loss | | (9,643,580 ) | (9,643,580 ) |
| Balance as of December 31, 2008 | 53,952,183 | (14,031,646 ) | 42,205,803 |
| Recognition of stock option exercise | 25,610 | | 25,610 |
| Royalty waiver | 1,000,000 | | 1,000,000 |
| Recognition of stock option compensation | 2,111,360 | | 2,111,360 |
| Net loss | | (9,422,300 ) | (9,422,300 ) |
| Balance as of December 31, 2009 | $ 57,089,153 | $ (23,453,946 ) | $ 35,920,473 |

See accompanying notes to financial statements

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**RETRACTABLE TECHNOLOGIES, INC.**

**STATEMENTS OF CASH FLOWS**

| | Years Ended December 31, | | |
|---|---|---|---|
| | **2009** | **2008** | **2007** |
| **Cash flows from operating activities:** | | | |
| Net loss | $ (9,422,300 ) | $ (9,643,580 ) | $ (6,948,104 ) |
| Adjustments to reconcile net loss to net cash used by operating activities: | | | |
| Depreciation and amortization | 1,396,793 | 1,397,333 | 1,430,072 |
| Stock option compensation | 2,111,360 | 32,629 | 6,478 |
| Provision for inventory valuation | | | 155,600 |
| Provision for doubtful accounts | 182,000 | 224,633 | 169,223 |
| Impairment of assets | 2,594,602 | | |
| Accreted interest | 43,151 | 54,387 | 120,486 |
| (Increase) decrease in assets: | | | |
| Inventories | (265,837 ) | 395,597 | (806,949 ) |
| Accounts receivable | (6,841,268 ) | (1,845,939 ) | 119,897 |
| Income taxes receivable | (3,655,637 ) | 2,345,041 | 10,691 |
| Other current assets | (224,280 ) | (41,306 ) | (91,100 ) |
| Other assets | | (12,725 ) | |
| Increase (decrease) in liabilities: | | | |
| Accounts payable | 852,875 | 609,070 | 1,287,735 |
| Other accrued liabilities | 1,015,505 | 798,578 | 506,386 |
| Increase (decrease) in income taxes payable | (86,695 ) | | |
| Net cash used by operating activities | (12,299,731 ) | (5,686,282 ) | (4,039,585 ) |
| **Cash flows from investing activities:** | | | |
| Purchase of property, plant, and equipment | (2,383,867 ) | (2,580,516 ) | (641,501 ) |
| Investment in LLC | | 497,690 | |
| Acquisitions of patents, trademarks, licenses, and intangibles | | (89,152 ) | (188,168 ) |
| Net cash used by investing activities | (2,383,867 ) | (2,171,978 ) | (829,669 ) |
| **Cash flows from financing activities:** | | | |
| Repayments of long-term debt and notes payable | (499,668 ) | (489,160 ) | (384,460 ) |
| Proceeds from long-term debt | | 1,123,729 | |
| Proceeds from the exercise of stock options | 25,610 | | |
| Payment of Preferred Stock dividends | | | (1,053,544 ) |
| Net cash provided (used) by financing activities | (474,058) | 634,569 | (1,438,004 ) |
| Net decrease in cash and cash equivalents | (15,157,656 ) | (7,223,691 ) | (6,307,258 ) |
| Cash and cash equivalents at: | | | |
| Beginning of period | 33,283,740 | 40,507,431 | 46,814,689 |
| End of period | $ 18,126,084 | $ 33,283,740 | $ 40,507,431 |
| Supplemental schedule of cash flow information: | | | |
| Interest paid | $ 184,018 | $ 236,932 | $ 382,901 |
| Income taxes paid | $ | $ | $ |
| Supplemental schedule of noncash investing and financing activities: | | | |

| | | | | |
|---|---|---|---|---|
| Debt assumed to construct a warehouse | $ | 1,362,602 | $ 1,723,277 | $ |
| Forgiveness of royalties by shareholder | $ | 1,000,000 | $ | $ |

See accompanying notes to financial statements

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**NOTES TO FINANCIAL STATEMENTS**

**1. BUSINESS OF THE COMPANY AND BASIS OF PRESENTATION**

**Business of the Company**

Retractable Technologies, Inc. (the Company ) was incorporated in Texas on May 9, 1994, and designs, develops, manufactures, and markets safety syringes and other safety medical products for the healthcare profession. The Company began to develop its manufacturing operations in 1995. The Company s manufacturing and administrative facilities are located in Little Elm, Texas. The Company s primary products with Notice of Substantial Equivalence to the FDA are the VanishPoint® 0.5mL insulin syringe; 1mL tuberculin, insulin, and allergy antigen syringes; the 0.5mL, 3mL, 5mL, and 10mL syringes; the small diameter tube adapter; the blood collection tube holder; the allergy tray; the IV safety catheter; and the Patient Safe® syringe.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Accounting estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles ( GAAP ) 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 revenues and expenses during the reporting period. Actual results could differ significantly from those estimates.

**Cash and cash equivalents**

For purposes of reporting cash flows, cash and cash equivalents include unrestricted cash, money market accounts, and investments with original maturities of three months or less.

**Accounts receivable**

The Company records trade receivables when revenue is recognized. No product has been consigned to customers. The Company s allowance for doubtful accounts is primarily determined by review of specific trade receivables. Those accounts that are doubtful of collection are included in the allowance. An additional allowance has been established based on a percentage of receivables outstanding. These provisions are

reviewed to determine the adequacy of the allowance for doubtful accounts. Trade receivables are charged off when there is certainty as to their being uncollectible. Trade receivables are considered delinquent when payment has not been made within contract terms.

**Inventories**

Inventories are valued at the lower of cost or market, with cost being determined using actual average cost. A reserve is established for any excess or obsolete inventories.

**Property, plant, and equipment**

Property, plant, and equipment are stated at cost. Expenditures for maintenance and repairs are charged to operations as incurred. Cost includes major expenditures for improvements and replacements which extend useful lives or increase capacity and interest cost associated with significant capital additions. For the years ended December 31, 2009, 2008, and 2007, the Company capitalized interest of approximately $205,000; $237,000; and $177,000. Gains or losses from property disposals are included in income.

Depreciation and amortization are calculated using the straight-line method over the following useful lives:

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| | |
|---|---|
| Production equipment | 3 to 13 years |
| Office furniture and equipment | 3 to 10 years |
| Buildings | 39 years |
| Building improvements | 15 years |
| Automobiles | 7 years |

**Long-lived assets**

The Company assesses the recoverability of long-lived assets using an assessment of the estimated undiscounted future cash flows related to such assets. In the event that assets are found to be carried at amounts which are in excess of estimated gross future cash flows, the assets will be adjusted for impairment to a level commensurate with a discounted cash flow analysis of the underlying assets.

During the fourth quarter of 2009, the Company recognized an impairment charge of $2,594,602 associated with its catheter production equipment. The Company has determined it is more cost effective to outsource the majority of this production through overseas manufacturers, and thus the Company s catheter production equipment will be utilized less. Minimal cash flows are expected to be generated by this equipment. Accordingly, the Company has reduced the carrying value of the catheter production equipment to an estimated fair value of zero. The Company s management estimated the fair value of the equipment based on guidance established by the *Fair Value Measurements and Disclosures* Topic of the FASB Accounting Standards Codification. In this instance, the Company s management determined the impairment charge by utilizing observable market data, a Level 2 input under the FASB Accounting Standards Codification. A Level 1 input would require quoted prices, which were not available in this matter.

**Reclassifications**

Certain prior year amounts have been reclassified to conform with the current year s presentation.

**Intangible assets**

Intangible assets are stated at cost and consist primarily of patents, a license agreement granting exclusive rights to use patented technology, and trademarks which are amortized using the straight-line method over 17 years.

**Financial instruments**

The Company estimates the fair market value of financial instruments through the use of public market prices, quotes from financial institutions, and other available information. Judgment is required in interpreting data to develop estimates of market value and, accordingly, amounts are not necessarily indicative of the amounts that could be realized in a current market exchange. Short-term financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and other liabilities, consist primarily of instruments without extended maturities,

the fair value of which, based on Management s estimates, equals their recorded values.

**Concentration risks**

The Company s financial instruments exposed to concentrations of credit risk consist primarily of cash, cash equivalents, and accounts receivable. Cash balances, some of which exceed federally insured limits, are maintained in financial institutions; however, Management believes the institutions are of high credit quality. The majority of accounts receivable are due from companies which are well-established entities. As a consequence, Management considers any exposure from concentrations of credit risks to be limited. Two customers, DHHS and Cardinal Health, comprised 68.4% of the Company s accounts receivable at December 31, 2009. The Company had a high concentration of sales with two significant customers. For the year ended December 31, 2009, the aforementioned customers accounted for $15.0 million, or 38.4% of net sales. Sales to the DHHS comprised 52.0% and 24.4% of the Company s revenues for the three months and twelve months ended December 31, 2009, respectively. This program, which was estimated to run from August 2009 through March 2010, ended in December 2009. The Company does not know if there will be a similar program in 2010.

Considering the current economic climate, the Company increased its Provision for doubtful accounts by approximately $182,000 this year.

The Company manufactures syringes in Little Elm, Texas as well as utilizing manufacturers in China. The Company purchases most of its product components from single suppliers, including needle adhesives and packaging materials. There are multiple sources of these materials. The Company obtained roughly 67.5% of its finished products in 2009 through Double Dove, a Chinese manufacturer. In the event that the Company becomes unable to purchase such product from Double Dove, the Company would need to find an alternate

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supplier for its 0.5mL insulin syringe, its 5mL and 10mL syringes, and its autodisable syringe and increase domestic production for 1mL and 3mL syringes to avoid a disruption in supply.

**Revenue recognition**

Revenue is recognized for sales to distributors when title and risk of ownership passes to the distributor, generally upon shipment. Revenue is recorded on the basis of sales price to distributors, less contractual pricing allowances. Contractual pricing allowances consist of: (i) rebates granted to distributors who provide tracking reports which show, among other things, the facility that purchased the products, and (ii) a provision for estimated contractual pricing allowances for products that the Company has not received tracking reports. Rebates are recorded when issued and are applied against the customer s receivable balance. The provision for contractual pricing allowances is reviewed at the end of each quarter and adjusted for changes in levels of products for which there is no tracking report. Additionally, if it becomes clear that tracking reports will not be provided by individual distributors, the provision is further adjusted. The estimated contractual allowance is netted against individual distributor s accounts receivable balances for financial reporting purposes. The resulting net balance is reflected in accounts receivable or accounts payable, as appropriate. The terms and conditions of contractual pricing allowances are governed by contracts between the Company and its distributors. Revenue for shipments directly to end-users is recognized when title and risk of ownership pass from the Company. Any product shipped or distributed for evaluation purposes is expensed.

The Company s domestic return policy is set forth in its standard Distribution Agreement. This policy provides that a customer may return incorrect shipments within 10 days following arrival at the distributor s facility. In all such cases the distributor must obtain an authorization code from the Company and affix the code to the returned product. The Company will not accept returned goods without a returned goods authorization number. The Company may refund the customer s money or replace the product.

The Company s return policy also provides that a customer may return product that is overstocked. Overstocking returns are limited to two times in each 12-month period up to 1% of distributor s total purchase of products for the prior 12-month period. All product overstocks and returns are subject to inspection and acceptance by manufacturer.

The Company s international distribution agreements do not provide for any returns.

The Company records an allowance for estimated returns as a reduction to Accounts receivable and Gross sales. Historically, returns have been less than 0.5% of net sales.

**Marketing fees**

Under a sales and marketing agreement with Abbott Laboratories ( Abbott ), the Company paid marketing fees until the Company terminated the contract for breach. The contracted services were to include participation in promotional activities, development of educational and promotional materials, representation at trade shows, clinical demonstrations, inservicing and training, and tracking reports detailing the placement of the Company s products to end-users. Marketing fees were accrued at the time of the sale of product to Abbott. These fees were paid after Abbott

provided the Company a tracking report of product sales to end-users. These costs were included in Sales and marketing expense in the Statements of Operations. No marketing fees have been accrued since October 15, 2003, the date the National Marketing and Distribution Agreement with Abbott was terminated. The Company filed suit against Abbott in August 2005 for breach of contract. The District Court has issued a scheduling order calling for trial in May 2010. See Note 8 **COMMITMENTS AND CONTINGENCIES** for further discussion.

**Litigation Proceeds**

Proceeds from litigation, if any, are recognized when realizable. Generally, realization is not reasonably assured and expected until proceeds are collected.

**Income taxes**

The Company evaluates tax positions taken or expected to be taken in a tax return for recognition in the financial statements based on whether it is more-likely-than-not that a tax position will be sustained based upon the technical merits of the position. Measurement of the tax position is based upon the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement.

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The Company provides for deferred income taxes through utilizing an asset and liability approach for financial accounting and reporting based on the tax effects of differences between the financial statement and tax bases of assets and liabilities, based on enacted rates expected to be in effect when such differences reverse in future periods. Deferred tax assets are periodically reviewed for realizability. The Company had sufficient taxable income from prior carryback years to realize all of its taxable losses through December 31, 2006. Taxable losses for 2007 and thereafter are subject to loss carryforwards. The Company has established a valuation allowance for its net deferred tax asset as future taxable income cannot be reasonably assured. Penalties and interest on uncertain tax positions are classified as income taxes in the Statements of Operations. Under recent tax law changes, companies are allowed to carry back taxable losses from either 2008 or 2009. The Company will file for a tax refund utilizing its 2009 taxable losses which will result in a minimum of a $3.7 million refund.

**Earnings per share**

The Company computes basic earnings per share by dividing net earnings for the period (adjusted for any cumulative dividends for the period) by the weighted average number of common shares outstanding during the period. The Company s potentially dilutive Common Stock equivalents, consisting of options, convertible debt, and convertible Preferred Stock, are all antidilutive for all periods presented. Accordingly, basic loss per share is equal to diluted earnings per share. Annual cumulative preferred dividends have been added to net losses for the years ended December 31, 2009, 2008 and 2007 to arrive at net loss per share.

**Shipping and handling costs**

The Company classifies shipping and handling costs as part of Cost of sales in the Statements of Operations.

**Research and development costs**

Research and development costs are expensed as incurred.

**Share-based compensation**

On September 26, 2008, the Company s shareholders approved the 2008 Stock Option Plan and also approved an Offer to Exchange Stock Options (the Exchange Offer ) whereby employees, including executive officers, and Directors exchanged certain outstanding underwater options for options issued under the 2008 Stock Option Plan. Pursuant to the Exchange Offer, eligible participants (totaling 103) tendered, and the Company accepted for cancellation, eligible options to purchase an aggregate of 1,925,365 shares of the Company s Common Stock representing 99.4% of the total shares of Common Stock underlying options eligible to exchange in the Exchange Offer. The Company issued new options under the 2008 Stock Option Plan to purchase an aggregate of 962,683 shares of Common Stock in exchange for the cancellation of the tendered options. Options issued to employees vested after one year. Options issued to non-employee Directors vested immediately.

Prior to 2008, the Company had issued options under three stock-based Director, independent contractor and employee compensation plans as well as several individual option agreements. Two of these plans and one individual option agreement have terminated and the unissued and unsold stock under these terminated plans has been deregistered pursuant to Post-Effective Amendment No. 1 to Form S-8 Registration Statement, filed December 2, 2008. As earlier mentioned, in 2008, the 2008 Stock Option Plan was approved and options have been issued under it pursuant to the Exchange Offer. In July 2009, the Company issued options for the purchase of a total of 1,886,425 shares to Directors, Executive Officers, employees, and consultants under the 2008 Stock Option Plan. Of this amount, incentive stock options for the purchase of 269,956 shares of Common Stock and Non Qualified Stock Options for the purchase of 229,494 shares of Common Stock were issued to Executive Officers and Directors. Additionally, in 2009, an option to purchase Three Million (3,000,000) shares issued to Thomas J. Shaw outside these plans was approved by shareholders.

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The Company s share-based payments are accounted for using the fair value method. The Company records share-based compensation expense on a straight-line basis over the requisite service period. The Company incurred the following share-based compensation costs:

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| Cost of sales | $ 317,644 | $ (1,797) | $ 6,648 |
| Sales and marketing | 242,509 | (2,156) | 3,086 |
| Research and Development | 47,168 | (281) | (7,863) |
| General and administrative | 1,504,039 | 36,863 | 4,607 |
| | $ 2,111,360 | $ 32,629 | $ 6,478 |

Options awarded to employees in 2009 and 2008 were amortized over twelve months. The Company amortized one month s expense for options granted in 2008 in the fourth quarter of 2008. The Company expensed five months of expense for options issued in 2009. Non-employee Directors option expense was all expensed in the third quarter of 2009.

**Recent Pronouncements**

In June 2009, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standard ( SFAS ) No. 168, *The FASB Accounting Standards CodificationTM and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162* ( SFAS 168 ) (FASB ASC 105-10). SFAS 168 replaces all previously issued accounting standards and establishes the *FASB Accounting Standards CodificationTM* ( FASB ASC or the Codification ) as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with U.S. GAAP. SFAS 168 is effective for all interim and annual periods ending after September 15, 2009. The FASB ASC is not intended to change existing U.S. GAAP. The adoption of this pronouncement only resulted in changes to the Company s financial statement disclosure references. As such, the adoption of this pronouncement had no effect on the Company s financial position, results of operations, or cash flows.

In order to facilitate the transition to the FASB ASC, the Company has elected to show all references to FASB ASC within this report on Form 10-K/A along with a parenthetical reference to the previous accounting standard.

In April 2008, the FASB issued FASB Staff Position ( FSP ) FAS 142-3, *Determination of the Useful Life of Intangible Assets* included in the Codification under FASB ASC 350. This FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, *Goodwill and Other Intangible Assets* ( SFAS 142 ). The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under the Business Combinations Topic of the Codification and other GAAP. FSP FAS 142-3 was effective for the Company beginning January 1, 2009. The adoption of FSP FAS 142-3 did not have a material impact on the Company s financial position, results of operations, or cash flows.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events*, included in the Codification under FASB ASC 855, which establishes general standards of accounting for and disclosure of events occurring after the

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balance sheet date, but before the financial statements are issued or available to be issued. In February 2010, FSAB ASC 855 was amended, removing certain disclosure requirements for public companies that conflicted with certain SEC disclosure requirements. Adoption of this standard and its amendment did not have a material impact on the Company s financial position, results of operations, or cash flows.

**3. INVENTORIES**

Inventories consist of the following:

| | Year Ended December 31, | |
|---|---|---|
| | **2009** | **2008** |
| Raw materials | $ 2,424,818 | $ 1,885,158 |
| Finished goods | 4,688,151 | 4,961,974 |
| | 7,112,969 | 6,847,132 |
| Inventory reserve | (205,600) | (205,600) |
| | $ 6,907,369 | $ 6,641,532 |

**4. PROPERTY, PLANT, AND EQUIPMENT**

Property, plant, and equipment consist of the following**:**

| | December 31, | |
|---|---|---|
| | **2009** | **2008** |
| Land | $ 261,893 | $ 261,893 |
| Buildings and building improvements | 11,079,905 | 5,319,732 |
| Production equipment | 14,428,077 | 14,270,577 |
| Office furniture and equipment | 2,148,622 | 1,825,781 |
| Construction in progress | 1,198,856 | 6,287,503 |
| Automobiles | 102,321 | 102,321 |
| | 29,219,674 | 28,067,807 |
| Accumulated depreciation | (14,985,493) | (13,632,140) |
| | $ 14,234,181 | $ 14,435,667 |

Depreciation expense for the years ended December 31, 2009, 2008, and 2007 was $1,353,353; $1,351,547; and $1,370,228, respectively.

**5. INTANGIBLE ASSETS**

Intangible assets consist of the following:

| | December 31, 2009 | December 31, 2008 |
|---|---|---|
| License agreement | $ 500,000 | $ 500,000 |
| Trademarks and patents | 508,743 | 508,743 |
| | 1,008,743 | 1,008,743 |
| Accumulated amortization | (582,068) | (538,628) |
| | $ 426,675 | $ 470,115 |

In 1995, the Company entered into a license agreement with the Chief Executive Officer of the Company for the exclusive right to manufacture, market, and distribute products utilizing automated retraction technology. This license agreement was amended July 3, 2008 to include certain additional patent applications owned by such officer in the definition of Patent Properties so that such additional patent applications would be covered by the license. This technology is the subject of various patents and patent applications owned by

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such officer of the Company. The initial licensing fee of $500,000 is being amortized over 17 years. The license agreement also provides for quarterly payments of a 5% royalty fee on gross sales. The royalty fee expense is recognized in the period in which it is earned. Royalty fees of $2,806,223; $2,168,268; and $2,087,596 are included in Cost of sales for the years ended December 31, 2009, 2008, and 2007, respectively. Royalties payable under this agreement aggregated $843,327 and $620,987 at December 31, 2009 and 2008, respectively. Gross sales upon which royalties are based were $56,124,453; $43,365,361; and $41,751,897 for 2009, 2008, and 2007, respectively.

In the third quarter of 2009, the Company announced several cost cutting and cash saving initiatives to conserve its cash. As a part of those initiatives, the Chief Executive Officer waived payment to him of $1,000,000 in royalty fees. Therefore, the royalty fees of $2,806,223 for 2009 resulted in a cash outlay of $1,806,223.

Amortization expense for the years ended December 31, 2009, 2008, and 2007, was $43,440; $43,597; and $43,454, respectively. Future amortization expense for the years 2010 through 2014 is estimated to be $43,000 per year.

**6. OTHER ASSETS**

In 2006, the Company invested $500,000 in a limited liability company. The Company exercised its option to have that investment returned. The investment was returned in April 2008.

**7. LONG-TERM DEBT**

Long-term debt consists of the following:

| | December 31, 2009 | December 31, 2008 |
|---|---|---|
| Note payable to Katie Petroleum. Interest accrues at prime plus 1%, which was 4.25% and 5.0%, at December 31, 2009 and 2008, respectively. Interest only was payable monthly through February 1, 2004. The original amount of the note of $3,000,000 was discounted for presentation purposes by $299,346 for stock options issued in conjunction with the debt and $412,500 for the intrinsic value of a beneficial conversion feature of the debt. Beginning March 1, 2004, the loan has been payable in equal installments of principal and interest payments (except for changes in the interest rate) of approximately $37,000 and matures on September 30, 2012. Guaranteed by an officer. Approximately $163,736 of the principal payment was converted into 40,934 shares of Common Stock as of March 1, 2006. Not otherwise collateralized. Convertible into Common Stock at $4.00 per share at the option of the holder. | $ 1,097,112 | $ 1,437,977 |
| Note payable to 1st International Bank for $2,500,000. The proceeds from the loan paid off the remaining $475,000 of a revolving credit agreement and funded a warehouse and related infrastructure. Payments were interest only during the first 12 months. After 12 months, payments are based on a 20-year amortization with a five-year maturity on March 29, 2010. The interest rate at December 31, 2009 and 2008 was 4.25% and 4.25%, respectively, and is based on the amount of funds kept on deposit with the bank. | 2,141,998 | 2,241,145 |

| | | |
|---|---|---|
| Accordingly, interest will vary from the Wall Street Journal Prime Rate (the WSJPR ) to the WSJPR plus 1%, with floors that may range from 4.25% to 6.50%. Compensating balances at 1st International affecting the interest rate will range from $0 to $500,000. The Company had in excess of $500,000 on deposit with 1st International Bank throughout the year. The note is secured by the Company s land and buildings. | | |
| Note payable to DaimlerChrysler Services North America LLC. Sixty (60) monthly payments at $1,009. Interest is 5.49%. Collateralized by a 2005 Freightliner truck. | 1,005 | 12,711 |
| Note payable to GMAC. Sixty (60) monthly payments at $427. Interest is zero percent. Collateralized by a 2005 Chevrolet van. | 3,762 | 8,561 |

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| | 2009 | 2008 |
|---|---|---|
| Interim construction loan from Lewisville State Bank, a division of 1st International Bank, for a maximum of $4,210,000, which provided funding for the expansion of the warehouse, additional office space, and a new Controlled Environment. The note bore interest at WSJPR plus 0.25%. The loan was renewed on December 10, 2009 with a 20 year amortization and 10 year maturity. The loan is secured by the Company s land and buildings. The interest rate is 5.968%. | 4,209,608 | 2,847,006 |
| | 7,453,485 | 6,547,400 |
| Less: current portion | (2,628,652) | (451,865) |
| | $ 4,824,833 | $ 6,095,535 |

The aggregate maturities of long-term debt as of December 31, 2009, are as follows:

| | |
|---|---|
| 2010 | $ 2,628,652 |
| 2011 | 519,611 |
| 2012 | 447,755 |
| 2013 | 132,504 |
| 2014 | 140,862 |
| Thereafter | 3,584,101 |
| | $ 7,453,485 |

**8. COMMITMENTS AND CONTINGENCIES**

On August 12, 2005, the Company filed a lawsuit against Abbott in the U.S. District Court in the Eastern District of Texas, Texarkana Division. The Company is alleging fraud and breach of contract in connection with the National Marketing and Distribution Agreement dated as of May 4, 2000, which was terminated on October 15, 2003. It is seeking damages which it estimates to be in millions of dollars of lost profits, out of pocket expenses, and other damages. In addition, it is seeking punitive damages, pre- and post-judgment interest, and attorneys fees. Following Abbott s unsuccessful attempt to get the case dismissed and ordered to arbitration, Abbott filed an answer and counterclaim on July 15, 2008, alleging several breaches of contract, breach of implied warranty of merchantability, and breach of express warranty, seeking in excess of $6,000,000 in compensatory damages as well as seeking attorneys fees. The Company denies the validity of Abbott s counterclaims. Discovery has already taken place and is substantially completed. The District Court has issued a revised scheduling order calling for trial in May 2010.

In April 2008, the Company sued Occupational and Medical Innovations Limited ( OMI ) in the U.S. District Court for the Eastern District of Texas, Tyler Division, alleging that OMI had infringed two U.S. patents (6,572,584 and 7,351,224). The Company also alleged theft of confidential information, intentional interference with contracts, and engaging in false advertising that wrongfully disparaged and mischaracterized the syringe products. The Company further alleged that OMI made false allegations regarding the source of origin of its safety syringe products being offered in the U.S. On December 18, 2009, the jury delivered a verdict in the Company s favor on the patent infringement and misappropriation of trade secrets claims against OMI. On March 4, 2010, the Court entered a final judgment and ordered that the Company recover damages and prejudgment interest from OMI based on OMI s misappropriation of trade secrets in the amount of $3,153,575. In addition, the Court entered a permanent injunction enjoining OMI, its manufacturers, distributors and service providers from infringing patent no. 6,572,584, by making, importing, selling or using any of OMI s syringes in the U.S. and its territories. OMI has entered into an administrative proceeding in Australia which is the equivalent of bankruptcy and has filed a similar proceeding in the Eastern District of Texas, which make the actual recovery of the damages unlikely.

In June 2007, the Company sued Becton Dickinson and Company ( BD ) in the U.S. District Court for the Eastern District of Texas, Marshall Division, alleging infringement of three patents (5,578,011; 5,632,733; and 6,090,077) and violations by BD of the federal and state antitrust laws, and of the Lanham Act. The Company subsequently dropped the 5,578,011 patent allegations from the lawsuit. In January 2008, the Court

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severed the patent claims from the other claims pending resolution of the patent dispute. In April 2008, the Company and the officer sued BD in the U.S. District Court for the Eastern District of Texas, Marshall Division, alleging infringement of another recently issued patent (7,351,224). BD counterclaimed for non-infringement and invalidity of the asserted patent. The Court consolidated this case with the above-stated case filed in June 2007. On November 9, 2009, the jury returned a verdict finding that the patents asserted by the Company were valid and infringed by BD and awarded $5,000,000 in damages. No final judgment has been entered in this case. The Company is seeking injunctive relief.

In September 2007, BD and MDC Investment Holdings, Inc. ( MDC ) sued the Company in the United States District Court for the Eastern District of Texas, Texarkana Division, initially alleging that the Company is infringing two U.S. patents of MDC (6,179,812 and 7,090,656) that are licensed to BD. BD and MDC seek injunctive relief and unspecified damages. The Company counterclaimed for declarations of non-infringement, invalidity, and unenforceability of the asserted patents. The plaintiffs subsequently dropped allegations with regard to patent no. 7,090,656 and the Company subsequently dropped its counterclaims for unenforceability of the asserted patents. The Court conducted a claims construction hearing on September 25, 2008 and issued its claims construction order on November 14, 2008. No trial date has been set.

In September 2008, the Company and an officer sued Safety Medical International ( SMI ) in the United States District Court for the Eastern District of Texas, Tyler Division, alleging infringement of U.S. patent nos. 6,572,584 and 7,351,224, and seeking injunctive relief, unspecified monetary damages, and reimbursement of attorneys fees. SMI has counterclaimed, seeking declaratory judgments of non-infringement and invalidity of the asserted patents. SMI is not seeking monetary damages. SMI has filed for bankruptcy, and this lawsuit, including all claims and counterclaims, was dismissed as a result of those proceedings, which have concluded.

**9. INCOME TAXES**

The provision for income taxes consists of the following:

| | For the Years Ended December 31, | | |
|---|---|---|---|
| | **2009** | **2008** | **2007** |
| Current tax provision (benefit) | | | |
| Federal | $ (3,655,637) | $ | $ (143,459) |
| State | (181,953) | | (1,310,158) |
| Total current provision (benefit) | (3,837,590) | | (1,453,617) |
| | | | |
| Deferred tax provision (benefit) | | | |
| Federal | | | |
| State | | | |
| Total deferred tax provision (benefit) | | | |
| Total income tax provision (benefit) | $ (3,837,590) | $ | $ (1,453,617) |

The Company recognized a tax benefit in 2007 primarily due to the net effect of a state tax refund for prior years that had not been previously recognized.

The Company recognized a tax benefit in 2009 primarily due to a federal tax carryback related to 2009.

Deferred taxes are provided for those items reported in different periods for income tax and financial reporting purposes. The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities are presented below:

The Company has $14,277,070 in tax benefits attributable to carryback losses for federal tax purposes. The loss carryforwards will begin to expire in 2027 for federal tax purposes and will begin to expire for state tax purposes in 2012.

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| | December 31, | |
|---|---|---|
| | 2009 | 2008 |
| Deferred tax assets | | |
| Net operating loss carryforwards | $ 5,414,579 | $ 5,285,164 |
| Accrued expenses and reserves | 1,045,120 | 1,240,050 |
| Employee stock option expense | 422,476 | 31,669 |
| Inventory | 242,807 | 435,578 |
| Non-employee stock option expense | 183,570 | 198,425 |
| Charitable contribution carryforwards | 26,164 | 21,118 |
| Deferred tax assets | 7,334,716 | 7,212,004 |
| Deferred tax liabilities | | |
| Property and equipment | (687,512) | (1,178,618) |
| Deferred tax liabilities | (687,512) | (1,178,618) |
| Net deferred assets | 6,647,204 | 6,033,386 |
| Valuation allowance | (6,647,204) | (6,033,386) |
| Net deferred tax liabilities | $ | $ |

A reconciliation of income taxes based on the federal statutory rate and the provision (benefit) for income taxes is summarized as follows:

| | December 31, | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| Income tax (benefit) at the federal statutory rate | (35.0)% | (35.0 )% | (35.0 )% |
| State tax (benefit), net of federal (benefit) | (2.9 ) | (2.9 ) | (2.9 ) |
| Increase (decrease) in valuation allowance | 4.6 | 32.1 | 27.2 |
| Permanent differences | 3.0 | 0.4 | 1.0 |
| Cancellation of options under Exchange Offer | | 5.4 | |
| State tax refund and accruals | (0.8) | | (12.0 ) |
| Return to accrual adjustments | 0.5 | | 3.2 |
| Other | 1.6 | | 1.2 |
| Effective tax (benefit) rate | (29.0)% | % | (17.3 )% |

The Company files income tax returns in the U.S. federal jurisdiction and in various state and local jurisdictions. The Company s federal income tax returns for all tax years ended on or after December 31, 2006, remain subject to examination by the Internal Revenue Service. The Company s state and local income tax returns are subject to examination by the respective state and local authorities over various statutes of limitations, most ranging from three to five years from the date of filing.

**10. STOCKHOLDERS EQUITY**

**Preferred Stock**

The Company has one class of Preferred Stock outstanding: Class B Convertible Preferred Stock ( Class B Stock ). The Class B Stock has five series: Series I, Series II, Series III, Series IV, and Series V.

Class B

The Company has authorized 5,000,000 shares of $1 par value Class B Stock which have been allocated among Series I, II, III, IV, and V in the amounts of 144,000; 219,700; 130,245; 552,500; and 1,238,821 shares, respectively. The remaining 2,714,734 authorized shares have not been assigned a series.

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Series I Class B

There were 1,000,000 shares of $1 par value Series I Class B Convertible Preferred Stock ( Series I Class B Stock ) issued and 144,000 outstanding at December 31, 2009 and 2008. Holders of Series I Class B Stock are entitled to receive a cumulative annual dividend of $.50 per share, payable quarterly if declared by the Board of Directors. In 2004, the Company paid $2,550,000 in dividends. In 2007, the Company paid $262,819 in dividends. At December 31, 2009 and 2008 approximately $180,000 and $108,000, respectively, of dividends which had not been declared were in arrears.

Series I Class B Stock is redeemable after three years from the date of issuance at the option of the Company at a price of $7.50 per share, plus all accrued and unpaid dividends. Each share of Series I Class B Stock may, at the option of the stockholder, be converted to one share of Common Stock after three years from the date of issuance or in the event the Company files an initial registration statement under the Securities Act of 1933. Pursuant to these terms, no shares of Series I Class B Stock were converted into Common Stock in 2009. In the event of voluntary or involuntary dissolution, liquidation, or winding up of the Company, holders of Series I Class B Stock then outstanding are entitled to $6.25 per share, plus all accrued and unpaid dividends prior to any distributions to holders of Series II Class B Convertible Preferred Stock ( Series II Class B Stock ), Series III Class B Convertible Preferred Stock ( Series III Class B Stock ), Series IV Class B Convertible Preferred Stock ( Series IV Class B Stock ), Series V Class B Convertible Preferred Stock ( Series V Class B Stock ), or Common Stock.

Series II Class B

There were 1,000,000 shares of $1 par value Series II Class B Stock issued and there were 219,700 shares outstanding at December 31, 2009 and 2008. Holders of Series II Class B Stock are entitled to receive a cumulative annual dividend of $1.00 per share, payable quarterly if declared by the Board of Directors. Holders of Series II Class B Stock generally have no voting rights until dividends are in arrears and unpaid for twelve consecutive quarters. In such case, the holders of Series II Class B Stock have the right to elect one-third of the Board of Directors of the Company. In 2004, the Company paid $4.6 million in dividends. In 2007, the Company paid $790,725 in dividends. At December 31, 2009 and 2008, approximately $551,000 and $331,000 respectively, of dividends which had not been declared were in arrears.

Series II Class B Stock is redeemable after three years from the date of issuance at the option of the Company at a price of $15.00 per share plus all accrued and unpaid dividends. Each share of Series II Class B Stock may, at the option of the stockholder, be converted to one share of Common Stock after three years from the date of issuance or in the event the Company files an initial registration statement under the Securities Act of 1933. Pursuant to these terms, no shares of Series II Class B Stock were converted into Common Stock in 2009. In the event of voluntary or involuntary dissolution, liquidation, or winding up of the Company, holders of Series II Class B Stock then outstanding are entitled to $12.50 per share, plus all accrued and unpaid dividends, after distribution obligations to holders of Series I Class B Stock have been satisfied and prior to any distributions to holders of Series III Class B Stock, Series IV Class B Stock, Series V Class B Stock, or Common Stock.

Series III Class B

There were 1,160,445 shares of $1 par value Series III Class B Stock issued and 130,245 shares outstanding at December 31, 2009 and 2008. Holders of Series III Class B Stock are entitled to receive a cumulative annual dividend of $1.00 per share, payable quarterly if declared by the Board of Directors. At December 31, 2009 and 2008, approximately $3,246,000 and $3,117,000, respectively, of dividends which have not been

declared were in arrears.

Series III Class B Stock is redeemable after three years from the date of issuance at the option of the Company at a price of $15.00 per share, plus all accrued and unpaid dividends. Each share of Series III Class B Stock may, at the option of the stockholder, be converted to one share of Common Stock after three years from the date of issuance or in the event the Company files an initial registration statement under the Securities Act of 1933. Pursuant to these terms, no shares of Series III Class B Stock were converted into Common Stock in

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2009. In the event of voluntary or involuntary dissolution, liquidation, or winding up of the Company, holders of Series III Class B Stock then outstanding are entitled to $12.50 per share, plus all accrued and unpaid dividends, after distribution obligations to Series I Class B Stock and Series II Class B Stock have been satisfied and prior to any distributions to holders of Series IV Class B Stock, Series V Class B Stock, or Common Stock.

Series IV Class B

There were 1,133,800 shares issued and 552,500 shares outstanding at December 31, 2009 and 2008. Holders of Series IV Class B Stock are entitled to receive a cumulative annual dividend of $1.00 per share, payable quarterly, if declared by the Board of Directors. Holders of Series IV Class B Stock generally have no voting rights. At December 31, 2009 and 2008, approximately $7,583,000 and $7,030,000, respectively, of dividends which have not been declared were in arrears.

Series IV Class B Stock is redeemable after three years from the date of issuance at the option of the Company at a price of $11.00 per share plus all accrued and unpaid dividends. Each share of Series IV Class B Stock may, at the option of the stockholder any time subsequent to three years from date of issuance, be converted into one share of Common Stock, or in the event the Company files an initial registration statement under the Securities Act of 1933. Pursuant to these terms, no shares of Series IV Class B Stock were converted into Common Stock in 2009. In the event of voluntary or involuntary liquidation, dissolution, or winding up of the Company, holders of Series IV Class B Stock then outstanding are entitled to receive liquidating distributions of $11.00 per share, plus accrued and unpaid dividends after distribution obligations to Series I Class B Stock, Series II Class B Stock, and Series III Class B Stock have been satisfied and prior to any distribution to holders of Series V Class B Stock, or Common Stock.

Series V Class B

There were 2,416,221 shares issued and 1,238,821 outstanding at December 31, 2009 and 2008. Holders of Series V Class B Stock are entitled to receive a cumulative annual dividend of $0.32 per share, payable quarterly, if declared by the Board of Directors. Holders of Series V Class B Stock generally have no voting rights. At December 31, 2009 and 2008, approximately $3,693,000 and $3,297,000, respectively, of dividends which have not been declared were in arrears.

Series V Class B Stock is redeemable after two years from the date of issuance at the option of the Company at a price of $4.40 per share plus all accrued and unpaid dividends. Each share of Series V Class B Stock may, at the option of the stockholder any time subsequent to the date of issuance, be converted into Common Stock. Pursuant to the terms of the certificate of designation, no shares of Series V Class B Stock were converted into Common Stock in 2009. In the event of voluntary or involuntary liquidation, dissolution, or winding up of the Company, holders of Series V Class B Stock then outstanding are entitled to receive liquidating distributions of $4.40 per share, plus accrued and unpaid dividends after distribution obligations to Series I Class B Stock, Series II Class B Stock, Series III Class B Stock, and Series IV Class B Stock have been satisfied and prior to any distribution to the holders of the Common Stock.

**Common stock**

The Company is authorized to issue 100,000,000 shares of no par value Common Stock, of which 23,825,149 and 23,800,064 shares were issued and outstanding at December 31, 2009 and 2008, respectively.

**11. RELATED PARTY TRANSACTIONS**

The Company had a lease with Mill Street Enterprises ( Mill Street ), a sole proprietorship owned by a person, who ceased to be a 10% shareholder in 2008, for offices and storage in Lewisville, Texas. During the year ended December 31, 2007, the Company paid $14,500 under this lease. This lease term expired in June 2007.

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The Company paid MediTrade International Corporation, a company controlled by a person, who ceased to be a 10% shareholder in 2008 on a month-to-month consulting agreement whereby MediTrade is paid $7,500 per month plus expenses. Total amounts paid to MediTrade for the years ending December 31, 2009, 2008, and 2007 totaled $111,883.57; $98,401; and $129,618, respectively.

The Company has a license agreement with the Chief Executive Officer of the Company. See Note 5.

During the years ended December 31, 2009, 2008, and 2007, the Company paid $50,793; $40,191; and $30,397, respectively, to family members of its Chief Executive Officer for various consulting services.

**12. STOCK OPTIONS**

**Stock options**

Prior to 2008, the Company had three stock option plans that provided for the granting of stock options to officers, employees, and other individuals. Two of those plans have terminated. A 2008 Stock Option Plan was approved for the granting of stock options to employees, Directors, and consultants. During 1999, the Company approved the 1999 Stock Option Plan. Options for the purchase of 131,880 shares of Common Stock granted under the 1999 Stock Option Plan are outstanding. The 1999 Stock Option Plan terminated pursuant to its terms in 2009. The 2008 Plan is the only plan with stock options currently being awarded. The Company has reserved an aggregate 3,000,000 shares of Common Stock for issuance upon the exercise of options under the 2008 Stock Option Plan.

On September 26, 2008, the Company s shareholders approved an Exchange Offer whereby employees, including executive officers, and Directors could exchange certain outstanding underwater options for options issued under the 2008 Stock Option Plan. Pursuant to the Exchange Offer, eligible participants (totaling 103) tendered, and the Company accepted for cancellation, eligible options to purchase an aggregate of 1,925,365 shares of the Company s Common Stock representing 99.4% of the total shares of Common Stock underlying options eligible to exchange in the Exchange Offer. The Company issued new options under the 2008 Stock Option Plan to purchase an aggregate of 962,683 shares of Common Stock in exchange for the cancellation of the tendered options. Options issued to employees vest in mid 2010. Options issued to non-employee Directors vested in 2009.

In July 2009, the Company issued options for the purchase of a total of 1,886,425 shares to Directors, Executive Officers, employees, and consultants under the 2008 Stock Option Plan. Of this amount, incentive stock options for the purchase of 269,956 shares of Common Stock and Non Qualified Stock Options for the purchase of 229,494 shares of Common Stock were issued to Executive Officers and Directors. Additionally, in 2009, an option to purchase Three Million (3,000,000) shares issued to Thomas J. Shaw outside these plans was approved by shareholders.

The Company also had options for common shares outstanding under the 1996 Incentive Stock Option Plan and the 1996 Stock Option Plan for Directors and Other Individuals through November 2008. The two 1996 plans and all options issued thereunder have terminated or have been exchanged for options granted under the 2008 Plan.

The Compensation and Benefits Committee administers all plans and determines and/or recommends to the Board exercise prices at which options are granted. All executive compensation, including the granting of stock options, is determined by the Compensation and Benefits Committee. Shares issued upon exercise of options come from the Company s authorized but unissued Common Stock. The options vest over periods up to three years from the date of grant and generally expire ten years after the date of grant. Unvested options issued under the 2008 Stock Option Plan expire immediately after termination of employment.

**Employee options**

A summary of Director, officer, and employee options granted and outstanding under the Plans is presented below:

Table of Contents

| | Years Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2009 | | 2008 | | 2007 | |
| | Shares | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price |