Stereotaxis, Inc.
Form 10-Q
November 09, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2006.

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______.

Commission File Number: 000-50884

STEREOTAXIS, INC.

(Exact name of registrant as specified in its charter)

Delaware **(State of Incorporation)**	**94-3120386** **(I.R.S. employer identification no.)**
4320 Forest Park Avenue	
Suite 100	
St. Louis, Missouri **(Address of principal executive offices)**	**63108** **(Zip Code)**

Registrant s telephone number, including area code: (314) 678-6100

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 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. x Yes ¨ No

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

¨ Large accelerated filer x Accelerated filer ¨ Non-accelerated filer

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

The number of outstanding shares of the registrant s common stock on October 31, 2006 was 34,519,958.

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STEREOTAXIS, INC.

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ITEM 1. FINANCIAL STATEMENTS

STEREOTAXIS, INC.

BALANCE SHEETS

	September 30, 2006 (Unaudited)	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 22,629,306	$ 3,598,493
Short-term investments	17,187,498	7,137,094
Accounts receivable, net of allowance of $116,930 and $29,576 in 2006 and 2005, respectively	12,951,933	5,897,072
Current portion of long-term receivables	156,927	461,520
Inventory	9,044,835	9,404,792
Prepaid expenses and other current assets	2,522,990	5,128,852
Total current assets	64,493,489	31,627,823
Property and equipment, net	4,300,087	3,078,313
Intangible assets, net	1,577,778	1,677,778
Long-term receivables		146,520
Other assets	324,006	127,755
Total assets	$ 70,695,360	$ 36,658,189
Liabilities and stockholders equity		
Current liabilities:		
Current maturities of long-term debt	$ 833,333	$ 1,000,000
Accounts payable	3,856,880	4,866,156
Accrued liabilities	7,661,311	5,648,693
Deferred contract revenue	7,260,997	4,216,255
Total current liabilities	19,612,521	15,731,104
Long-term debt, less current maturities	1,388,889	1,972,222
Long-term deferred contract revenue	766,494	801,005
Other liabilities	73,360	28,016
Stockholders equity:		
Preferred stock, par value $0.001; 10,000,000 shares authorized at 2006 and 2005, none outstanding at 2006 and 2005		
Common stock, par value $0.001; 100,000,000 shares authorized at 2006, and 2005; 34,540,388 and 27,835,611 issued at 2006 and 2005, respectively	34,540	27,836
Additional paid-in capital	246,814,637	179,286,612
Deferred compensation		(2,569,760)
Treasury stock, 40,151 and 36,519 shares at 2006 and 2005, respectively	(205,999)	(162,546)
Notes receivable from sales of stock		(180,619)
Accumulated deficit	(197,790,477)	(158,231,069)
Accumulated other comprehensive income (loss)	1,395	(44,612)
Total stockholders equity	48,854,096	18,125,842
Total liabilities and stockholders equity	$ 70,695,360	$ 36,658,189

See accompanying notes.

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STEREOTAXIS, INC.

STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Revenue:				
Systems revenue	$ 6,370,082	$ 1,164,570	$ 10,212,780	$ 11,257,060
Disposables, service and accessories revenue	1,270,231	523,769	2,973,346	1,663,906
Total revenue	7,640,313	1,688,339	13,186,126	12,920,966
Cost of revenue	3,675,522	791,436	7,089,938	6,426,245
Gross margin	3,964,791	896,903	6,096,188	6,494,721
Operating expenses:				
Research and development	5,576,769	4,900,054	17,247,408	12,593,401
General and administration	4,244,995	4,082,567	12,550,143	10,571,889
Sales and marketing	5,879,047	3,987,917	16,467,817	11,597,686
Royalty settlement				2,923,111
Total operating expenses	15,700,811	12,970,538	46,265,368	37,686,087
Operating loss	(11,736,020)	(12,073,635)	(40,169,180)	(31,191,366)
Interest income	527,812	228,077	1,638,643	794,053
Interest expense	(145,365)	(60,737)	(1,028,871)	(180,821)
Net loss	$ (11,353,573)	$ (11,906,295)	$ (39,559,408)	$ (30,578,134)
Net loss per common share:				
Basic and diluted	$ (0.34)	$ (0.44)	$ (1.21)	$ (1.12)
Weighted average shares used in computing net loss per common share:				
Basic and diluted	33,541,140	27,365,263	32,641,732	27,268,772

See accompanying notes.

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STEREOTAXIS, INC.

STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended September 30, 2006	2005
Cash flows from operating activities:		
Net loss	$ (39,559,408)	$ (30,578,134)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation	880,841	563,854
Amortization	552,062	78,592
Noncash compensation	3,186,943	424,752
Interest receivable from sale of stock	48,992	
Noncash interest receivable	(2,006)	11,019
Loss on asset disposal	6,968	46,928
Changes in operating assets and liabilities:		
Accounts receivable	(7,054,861)	(304,013)
Long-term receivables	451,113	(421,135)
Inventories	359,957	(2,914,440)
Prepaid expenses and other current assets	1,931,549	(636,849)
Other assets	(196,251)	(1,318)
Accounts payable	(1,009,276)	2,246,640
Accrued liabilities	2,012,618	1,995,391
Deferred contract revenue	3,010,231	844,435
Other	45,344	9,719
Net cash used in operating activities	(35,335,184)	(28,634,559)
Cash flows from investing activities:		
Sale of equipment	10,071	
Purchase of equipment	(2,119,654)	(908,873)
Proceeds from the maturity/sale of available-for-sale investments	16,504,217	26,893,000
Purchase of available-for-sale investments	(26,287,430)	(8,097,777)
Net cash (used in) provided by investing activities	(11,892,796)	17,886,350
Cash flows from financing activities:		
Payments under long-term debt	(750,000)	(743,767)
Proceeds from issuance of stock and warrants, net of issuance costs	66,917,546	975,470
Purchase of treasury stock	(43,453)	
Payments received on notes receivable from sale of common stock	134,700	
Net cash provided by financing activities	66,258,793	231,703
Net increase (decrease) in cash and cash equivalents	19,030,813	(10,516,506)
Cash and cash equivalents at beginning of period	3,598,493	16,907,516
Cash and cash equivalents at end of period	$ 22,629,306	$ 6,391,010

See accompanying notes.

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STEREOTAXIS, INC.

NOTES TO FINANCIAL STATEMENTS

(Unaudited)

Basis of Presentation

The accompanying unaudited financial statements of Stereotaxis, Inc. (the Company) have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all the disclosures required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, they include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results for the interim periods presented. Operating results for the three and nine month periods ended September 30, 2006 are not necessarily indicative of the results that may be expected for the year ended December 31, 2006 or for future operating periods. These interim financial statements and the related notes should be read in conjunction with the annual financial statements and notes included in the Company s Annual Report on Form 10-K as filed with the Securities and Exchange Commission on March 16, 2006 for the year ended December 31, 2005. Certain prior period amounts have been reclassified to conform to the 2006 presentation.

Net Loss Per Common Share

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

The Company has deducted shares subject to repurchase and unearned restricted shares from the calculation of shares used in computing net loss per share, basic and diluted. The Company has excluded all outstanding options, stock appreciation rights and warrants from the calculation of diluted loss per common share because all such securities are anti-dilutive for all periods presented. As of September 30, 2006, the Company had 2,487,589 shares of common stock issuable upon the exercise of outstanding options and stock appreciation rights at a weighted average exercise price of $7.08 per share and 702,696 shares of common stock issuable upon the exercise of outstanding warrants at a weighted average exercise price of $8.33 per share. The Company had a weighted average of 572,076 unearned restricted shares excluded from the calculation of net loss per common share for the nine months ended September 30, 2006.

Stock-Based Compensation

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

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

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

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

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

As a result of adopting SFAS 123(R), the Company recorded approximately $1.1 million and $3.2 million of share based compensation during the three and nine months ended September 30, 2006. As a result, the Company s net loss for the three and nine month periods ended September 30, 2006 was approximately $0.3 million and $1.2 million lower, respectively, than if it had continued to account for share-based compensation under APB Opinion No. 25. Net loss per share for the three and nine month periods ended September 30, 2006 are $0.01 and $0.04 lower, respectively than if the Company had continued to account for share-based compensation under APB Opinion No. 25.

At September 30, 2006, the total compensation cost related to options, stock appreciation rights and non-vested stock granted to employees under the Company s stock award plans but not yet recognized was approximately $8.7 million, net of estimated forfeitures of approximately $1.8 million. This cost will be amortized over four years on a straight-line basis over the estimated service periods and will be adjusted for subsequent changes in estimated forfeitures.

Stock Award Plans

The Company has various stock plans that permit the Company to provide incentives to employees and directors of the Company in the form of equity compensation. In 2002, the Board of Directors adopted a stock incentive plan (the 2002 Stock Incentive Plan) and a non-employee directors stock plan (the 2002 Director Plan). In 1994, the Board of Directors adopted the 1994 Stock Option Plan (the 1994 Stock Option Plan). Each of these plans was subsequently approved by the Company s stockholders. At September 30, 2006, the Board of Directors has reserved a total of 2,890,763 shares, of the Company s common stock to provide for current and future grants under the 2002 Stock Incentive Plan and the 2002 Director Plan and for all current grants under the 1994 Stock Option Plan. In 2002, the Board of Directors adopted a provision providing for an annual increase in the number of shares reserved for stock options of the lesser of 3.25% of outstanding common shares or 833,333 shares, on January 1 of each year through January 1, 2007.

The 2002 Stock Incentive Plan allows for the grant of incentive stock options, non-qualified stock options, stock appreciation rights and restricted shares to employees, directors, and consultants. Options expire no later than ten years from the date of grant. Stock appreciation rights expire no later than five years from the date of grant. The exercise price of each stock option is not less than 100% of the fair value of the stock subject to the option on the date the option is granted. The vesting provisions of individual options may vary, but incentive stock options generally vest 25% on the first anniversary of each grant and 1/48 per month over the next three years. Non-qualified stock options generally vest ratably over a period of two to four years. Stock appreciation rights granted generally vest 25% on the first anniversary of such grant and 1/48 per month over the next three years and expire no later than five years from the date of grant.

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

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

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A summary of the option and stock appreciation rights activity for the nine months ended September 30, 2006 is as follows:

	Number of Shares	Range of Exercise Price	Weighted Average Exercise Price per Share
Outstanding, December 31, 2005	2,456,488	$ 0.25-$11.54	$ 6.09
Granted	367,500	$ 9.90-$12.35	$ 11.45
Exercised	(282,975)	$ 0.25-$11.54	$ 3.85
Forfeited	(53,424)	$ 5.94-$12.03	$ 8.62
Outstanding, September 30, 2006	2,487,589	$ 0.25-$12.35	$ 7.08

As of September 30, 2006, the weighted average remaining term of outstanding options and stock appreciation rights was 5.9 years. Of the 2,487,589 options and stock appreciation rights that were outstanding as of September 30, 2006, 1,526,697 were vested with a weighted average exercise price of $5.83 per share and a weighted average remaining term of 6.1 years.

The intrinsic value of options and stock appreciation rights is calculated as the difference between the exercise price of the underlying awards and the quoted price of the Company s common stock for the 2,165,239 options that were in-the-money at September 30, 2006. The intrinsic value of the options outstanding at September 30, 2006 was approximately $8.6 million based on a closing share price of $10.35 on September 30, 2006. The intrinsic value of fully vested options and stock appreciation rights vested and outstanding at September 30, 2006 was approximately $6.9 million based on a closing price of $10.35 on September 30, 2006. During the three and nine months ended September 30, 2006, the aggregate intrinsic value of options exercised under the Company s stock option plans was approximately $0.4 million and $1.9 million, respectively.

During the three and nine months ended September 30, 2006, the Company realized $0.3 million and $1.1 million, respectively, from the exercise of stock options.

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

A summary of the restricted share grant activity for the nine months ended September 30, 2006 is as follows:

	Number of Shares	Weighted Average Grant Price per Share
Outstanding, December 31, 2005	359,100	$ 7.70
Granted	354,660	$ 11.68
Vested	(20,425)	$ 7.79
Forfeited	(61,795)	$ 9.19
Outstanding, September 30, 2006	631,540	$ 9.78

A summary of the restricted stock outstanding as of September 30, 2006 is as follows:

	Number of Shares

Time based restricted shares	149,492
Performance based restricted shares	482,048
Outstanding, September 30, 2006	631,540

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The intrinsic value of restricted shares outstanding at September 30, 2006 was approximately $6.5 million based on a closing share price of $10.35 as of September 30, 2006. During the three and nine months ended September 30, 2006, the aggregate intrinsic value of restricted shares vested was approximately $1,000 and $61,000 respectively, determined at the date of vesting.

2004 Employee Stock Purchase Plan

The 2004 Employee Stock Purchase Plan was effective upon the initial public offering of the Company s stock in August 2004. Shares of common stock totaling 277,777 were reserved for issuance pursuant to the plan. The Company offered employees the opportunity to participate in the plan beginning January 1, 2005 with an initial purchase date of June 30, 2005. Eligible employees have the opportunity to participate in a new purchase period every six months. Under the terms of the plan, employees can purchase shares of stock at 85% of the fair market value of the stock at the beginning or the end of the purchase period. As of September 30, 2006, 104,458 shares had been purchased under this plan.

Pro Forma Net Loss

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

	3 Months Ended September 30, 2005	9 Months Ended September 30, 2005
Net loss as reported	$ (11,906,295)	$ (30,578,134)
Add stock-based compensation included in net loss	249,917	424,752
Deduct stock-based compensation under fair value method	(987,771)	(2,355,617)
Pro-forma net loss	$ (12,644,149)	$ (32,508,999)
Net loss per share, as reported	$ (0.44)	$ (1.12)
Net loss per share, pro-forma	$ (0.46)	$ (1.19)

For the purpose of the above pro forma disclosure, the fair value of each option or stock appreciation right was estimated on the date of grant using the Black-Scholes option pricing model using the following principal assumptions: dividend yield of 0%, expected volatility ranging from 50% to 120%, risk free interest rates ranging from 3.08% to 5.39% and an initial expected life ranging from five to ten years. Expected volatility was based on the historical volatility of the Company s stock. The risk-free rate for the expected term of the option was based on the U.S. Treasury rate at the date of grant.

Comprehensive Loss

Comprehensive loss for the three-month period ended September 30, 2006 and 2005 was $(11,320,368) and $(11,894,694), respectively. Comprehensive loss for the nine-month period ended September 30, 2006 and 2005 was $(39,513,401) and $(30,555,286), respectively. The only adjustment to net loss in arriving at comprehensive loss is the unrealized gain or loss on investments available for sale.

Investments

Investments consist of the following available-for-sale securities at fair value:

	September 30, 2006	December 31, 2005
Short-term investments:		
Corporate debt	$ 1,819,734	$ 1,791,370
U.S. Government agency	10,751,028	5,345,724
Commercial paper	2,552,446	

Certificates of deposit	2,064,290	
Total short-term investments	$ 17,187,498	$ 7,137,094

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Inventory

Inventory consists of the following:

	September 30, 2006	December 31, 2005
Raw materials	$ 3,507,463	$ 2,803,516
Work in process	30,735	111,632
Finished goods	5,766,904	6,533,082
Reserve for obsolescence	(260,267)	(43,438)
Total inventory	$ 9,044,835	$ 9,404,792

Prepaid Expenses and Other Assets

Prepaid expenses and other assets consist of the following:

	September 30, 2006	December 31, 2005
Prepaid expenses	$ 1,769,371	$ 3,129,967
Other assets	1,077,625	2,126,640
	2,846,996	5,256,607
Less: Long-term other assets	(324,006)	(127,755)
Total prepaid expenses and other current assets	$ 2,522,990	$ 5,128,852

Property and Equipment

Property and equipment consist of the following:

	September 30, 2006	December 31, 2005
Equipment	$ 5,567,688	$ 3,876,947
Equipment held for lease	303,412	303,412
Leasehold improvements	1,309,715	1,162,582
	7,180,815	5,342,941
Less accumulated depreciation	(2,880,728)	(2,264,628)
Property and equipment, net	$ 4,300,087	$ 3,078,313

Equipment held for lease consists of medical equipment provided to customers under operating lease arrangements, where the Company is the lessor.

Stockholders Equity

In February 2006, the Company completed a public offering of 5,500,000 shares of its common stock at $12.00 per share which included the exercise by the underwriters of an option to purchase an additional 500,000 shares. In conjunction with these transactions, the Company received approximately $61.9 million in net proceeds after deduction of underwriting discounts and commissions and payment of offering expenses.

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Commitments and Contingencies

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

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

The following discussion and analysis should be read in conjunction with our financial statements and notes thereto included in this report on Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2005. Operating results are not necessarily indicative of results that may occur in future periods.

This report includes various forward-looking statements that are subject to risks and uncertainties, many of which are beyond our control. Our actual results could differ materially from those anticipated in these forward looking statements as a result of various factors, including those set forth below under Part II Item 1A Risk Factors . Forward-looking statements discuss matters that are not historical facts and include, but are not limited to, discussions regarding our operating strategy, sales and marketing strategy, regulatory strategy, industry, economic conditions, financial condition, liquidity and capital resources and results of operations. Such statements include, but are not limited to, statements preceded by, followed by or that otherwise include the words believes, expects, anticipates, intends, estimates, projects, can, could, may, will, would, or similar expressions. For those statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. You should not unduly rely on these forward-looking statements, which speak only as of the date on which they were made. They give our expectations regarding the future, but are not guarantees. We undertake no obligation to update publicly or revise any forward-looking statements, whether as a result of new information, future events or otherwise, unless required by law.

Overview

Stereotaxis designs, manufactures and markets an advanced cardiology instrument control system for use in a hospital s interventional surgical suite to enhance the treatment of arrhythmias and coronary artery disease. The Stereotaxis System is designed to enable physicians to complete more complex interventional procedures by providing image guided delivery of catheters and guidewires through the blood vessels and chambers of the heart to treatment sites. This is achieved using externally applied magnetic fields that govern the motion of the working tip of the catheter or guidewire, resulting in improved navigation, efficient procedures and reduced x-ray exposure. The core components of the Stereotaxis System have received regulatory clearance in the U.S., Canada and Europe.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based on our financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures. We review our estimates and judgments on an on-going basis. We base our estimates and judgments on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates. We believe the following accounting policies are critical to the judgments and estimates we use in preparing our financial statements. For a complete listing of our critical accounting policies, please refer to our Annual Report on Form 10-K for the year ended December 31, 2005.

Revenue Recognition

We recognize systems revenue from system sales made directly to end users upon installation, provided there are no uncertainties regarding acceptance, persuasive evidence of an arrangement exists, the sales price is fixed and determinable, and collection of the related receivable is reasonably assured. When installation is required for revenue recognition, the determination of acceptance is made by our employees based on criteria set forth in the terms of the sale. Revenue from system sales made to distributors is recognized upon shipment since these arrangements do not include an installation

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element or right of return privileges. If uncertainties exist regarding collectability, we recognize revenue when those uncertainties are resolved. Amounts collected prior to satisfying the above revenue recognition criteria are reflected as deferred revenue. Amounts due beyond 12 months are reflected as long term receivables in the balance sheet. Revenue from services is derived primarily from the sale of annual product maintenance plans. Revenue from services, whether sold individually or as a separable unit of accounting in a multi-element arrangement, is deferred and amortized over the service period, which is typically one year. We recognize revenue from disposable device sales or accessories upon shipment and establish an appropriate reserve for returns.

For arrangements with multiple deliverables, we allocate the total revenue to each deliverable based on its relative fair value in accordance with the provisions of Emerging Issues Task Force (EITF) Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables,* and recognize revenue for each separate element as the above criteria are met.

Stock-based Compensation

Effective January 1, 2006, the Company adopted the fair value recognition provisions of Financial Accounting Standards Board Statement No. 123(R), *Share-Based Payment* (SFAS 123(R)), using the modified prospective transition method to account for its grants of stock options, stock appreciation rights, restricted shares and share purchases under its employee stock purchase plan. Prior to January 1, 2006, the Company accounted for those plans under the provisions of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees,* and related interpretations in accounting for stock-based employee compensation as permitted by SFAS 123, *Accounting for Stock-Based Compensation.* SFAS 123(R) supersedes APB Opinion No. 25 and requires the determination of the fair value of the share-based compensation at the grant date and the recognition of the related expense over the period in which the share-based compensation vests.

Stock compensation expense, which is a noncash charge, results from stock option and stock appreciation rights grants made to employees, directors and consultants at the fair value of the option granted, from grants of restricted shares to employees and from share purchases by employees under our employee stock purchase plan. The fair value of options and stock appreciation rights granted was determined using the Black-Scholes valuation method which gives consideration to the estimated value of the underlying stock at the date of grant, the exercise price of the option, the expected dividend yield and volatility of the underlying stock, the expected life of the option and the corresponding risk-free interest rate. When we were a private company, the deemed fair value of the underlying common stock was determined by management and the Board of Directors based on their best estimates using information from preferred stock financing transactions or other significant changes in the business. The fair value of the grants of restricted shares, all of which were granted after we became a public company, was determined based on the closing price of our stock on the date of grant. Stock compensation expense for options, stock appreciation rights and for time-based restricted share grants is amortized on a straight-line basis over the vesting period of the underlying issue, generally over four years except for grants to directors which generally vest over one to two years. Stock compensation expense for performance-based restricted shares is amortized on a straight-line basis over the anticipated vesting period and is subject to adjustment based on the actual achievement of objectives. Compensation expenses related to option grants to non-employees is periodically remeasured through the vesting date. Compensation expense is recognized only for those options expected to vest, with forfeitures estimated based on our historical experience and future expectations.

The amount of compensation expense to be recorded in future periods may increase if we make additional grants of options, stock appreciation rights or restricted shares or if employees continue to purchase shares under our employee stock purchase plan or if we determine that actual forfeiture rates are less than anticipated. The amount of expense to be recorded in future periods may decrease if we do not achieve the performance objectives by which certain restricted shares are contingent, if the requisite service periods are not completed or if the actual forfeiture rates are greater than anticipated.

Additional detail regarding the adoption of SFAS 123(R) may be found in the notes to the financial statements.

Results of Operations

Comparison of the Three Months Ended September 30, 2006 and 2005

Revenue. Revenue increased to $7.6 million for the three months ended September 30, 2006 from $1.7 million for the three months ended September 30, 2005, an increase of approximately 353%. Revenue from the sale of systems increased because of an increase in the number of systems delivered from one to seven. Revenue from sales of disposable interventional devices, service and accessories increased to $1.3 million for the three months ended September 30, 2006 from $524,000 for the three months ended September 30, 2005, an increase of approximately 143%. This increase was principally attributable to the increased base of installed systems as well as additional revenue related to recently approved interventional devices.

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Purchase orders and other commitments for our magnetic navigation system were approximately $44 million at September 30, 2006. The Company does not include orders for disposables, service or other revenues in the backlog data. There can be no assurance that we will recognize revenue in any particular period or at all because some of our purchase orders and other commitments are subject to contingencies that are outside our control. In addition, these orders and commitments may be revised, modified or cancelled, either by their express terms, as a result of negotiations, or by project changes or delays.

Cost of Revenue. Cost of revenue increased to $3.7 million for the three months ended September 30, 2006 from $0.8 million for the three months ended September 30, 2005, an increase of approximately 364%. This increase in cost of revenue was attributable to the increased number of systems sold and associated cost of systems sold. Although the average selling price of the systems was approximately 12% greater than in the year ago quarter, gross margin remained relatively constant at 52% for the current quarter compared to 53% for the 2005 quarter as the unit cost of the systems sold was approximately 8% higher than the 2005 quarter due to higher overhead costs.

Research and Development Expenses. Research and development expenses increased to $5.6 million for the three months ended September 30, 2006 from $4.9 million for the three months ended September 30, 2005, an increase of approximately 14%. The increase was due principally to an increase in research and development projects, including continued integration and development related to disposable interventional devices, further development of the NIOBE platform technology and user interface improvements.

General and Administrative Expenses. General and administrative expenses remained relatively unchanged at $4.2 million for the three months ended September 30, 2006 from $4.1 million for the three months ended September 30, 2005.

Sales and Marketing Expenses. Sales and marketing expenses increased to $5.9 million for the three months ended September 30, 2006 from $4.0 million for the three months ended September 30, 2005, an increase of approximately 47%. The increase related primarily to increased salary, benefits and travel expenses associated with expanded headcount and sales and marketing programs.

Interest Income. Interest income increased to $528,000 for the three months ended September 30, 2006 from $228,000 for the three months ended September 30, 2005, an increase of 131% due to greater invested balances generated from the common stock offering in the first quarter of 2006 and higher realized rates of return on our investments.

Interest Expense. Interest expense increased approximately 139% to $145,000 for the three months ended September 30, 2006 from $61,000 for the three months ended September 30, 2005 substantially due to higher average outstanding balances due on our loans.

Comparison of the Nine Months Ended September 30, 2006 and 2005

Revenue. Revenue increased to $13.2 million for the nine months ended September 30, 2006 from $12.9 million for the nine months ended September 30, 2005, an increase of approximately 2%. Revenue from the sale of systems decreased principally due to a decrease in the number of systems sold from 12 to 11. Revenue from sales of disposable interventional devices, service and accessories increased to $3.0 million for the nine months ended September 30, 2006 from $1.7 million for the nine months ended September 30, 2005, an increase of approximately 79%. This increase was attributable to the increased base of installed systems as well as additional revenue related to recently approved interventional devices.

Cost of Revenue. Cost of revenue increased to $7.1 million for the nine months ended September 30, 2006 from $6.4 million for the nine months ended September 30, 2005. This increase in cost of revenue was principally due to unabsorbed overhead costs associated with the reduced production and installation schedules during the first two quarters of the year. Although the average selling price of the system increased by approximately 5% in 2006 as contrasted with 2005, margin declined slightly from 50% during the nine months ended September 30, 2005 to 46% in the comparable period in 2006 due primarily to the unabsorbed overhead.

Research and Development Expenses. Research and development expenses increased to $17.2 million for the nine months ended September 30, 2006 from $12.6 million for the nine months ended September 30, 2005, an increase of approximately 37%. The increase was due principally to an increase in research and development projects, including continued integration and development related to disposable interventional devices, further development of the NIOBE platform technology and user interface improvements.

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General and Administrative Expenses. General and administrative expenses increased to $12.6 million for the nine months ended September 30, 2006 from $10.6 million for the nine months ended September 30, 2005, an increase of 19%. The increase relates to increased stock compensation costs due to the adoption of SFAS 123(R) and expanded activity in training, clinical compliance and regulatory affairs.

Sales and Marketing Expenses. Sales and marketing expenses increased to $16.5 million for the nine months ended September 30, 2006 from $11.6 million for the nine months ended September 30, 2005, an increase of approximately 42%. The increase related primarily to increased salary, benefits and travel expenses associated with expanded headcount and sales and marketing programs.

Royalty Settlement. Royalty settlement expenses related to the resolution of a patent licensing dispute with the University of Virginia were $2.9 million during the nine months ended September 30, 2005. There were no such settlement expenses in 2006.

Interest Income. Interest income increased to $1.6 million for the nine months ended September 30, 2006 from $794,000 for the nine months ended September 30, 2005, an increase of 106%. Interest income increased due to greater invested balances and higher realized rates on investments during the nine months ended September 30, 2006.

Interest Expense. Interest expense increased approximately 469% to $1.0 million for the nine months ended September 30, 2006 from $181,000 for the nine months ended September 30, 2005 primarily due to the amortization of commitment fees related to the affiliate line of credit entered into in the fourth quarter of 2005.

Liquidity and Capital Resources

Liquidity refers to the liquid financial assets available to fund our business operations and pay for near-term obligations. These liquid financial assets consist of cash and cash equivalents, as well as investments. In addition to our cash and cash equivalent balances, we maintained $17.2 million and $7.1 million of investments in corporate debt securities, U.S. government agency notes, commercial paper and certificates of deposit at September 30, 2006 and December 31, 2005, respectively. At September 30, 2006, we had working capital of approximately $44.9 million, compared to $15.9 million at December 31, 2005.

The following table summarizes our cash flow by operating, investing and financing activities for each of nine month periods ended September 30, 2006 and 2005 (in thousands):

	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Cash Flow used in operating activities	$ (35,335)	$ (28,635)
Cash Flow (used in) provided by investing activities	(11,893)	17,886
Cash Flow provided by financing activities	66,259	232

Net cash used in operating activities. We used approximately $35.3 million and $28.6 million of cash for operating activities during the nine months ended September 30, 2006 and 2005, respectively, primarily as a result of operations during these periods. Cash used for working capital purposes was $0.4 million during the nine months ended September 30, 2006 compared to $0.8 million generated from working capital purposes during the same period in 2005. The use of working capital was due principally to an increase in accounts receivable generated from the increase in revenue and order activity during the nine months ended September 30, 2006 offset by an increase in deferred revenue related to orders billed for which, in accordance with our revenue recognition policy, revenue was not recognized.

Net cash (used in) provided by investing activities. We used approximately $11.9 million of cash in investing activities during the nine months ended September 30, 2006, principally for the purchase of investments. During the nine months ended September 30, 2005, we generated $17.9 million of cash, substantially all from the maturity or sale of investments.

Net cash provided by financing activities. We generated approximately $66.3 million from financing activities during the nine months ended September 30, 2006 primarily from the proceeds of our common stock offering in the first quarter of 2006, offset by scheduled repayment of our equipment loans. We received approximately $232,000 from financing activities during the nine months ended September 30, 2005, due principally to the purchase of common stock under the terms of our stock option plans and our employee stock purchase program offset by scheduled repayment of our equipment loans.

As of September 30, 2006, we had outstanding balances under various equipment loan agreements consisting of an aggregate of approximately $1.2 million. As of September 30, 2006, we had approximately $1.0 million outstanding under our working capital line of credit and had an unused line of $9.0 million with borrowing capacity of $9.0 million, secured by qualifying receivables and inventory balances.

These credit facilities are secured by substantially all of our assets. The credit agreements include customary affirmative, negative and financial covenants. For example, we are restricted from incurring additional debt, disposing of or pledging our assets, entering into merger or acquisition agreements, making certain investments, allowing fundamental changes to our business, ownership, management or business locations, and from making certain payments in respect of stock or other ownership interests, such as dividends and stock repurchases. Under our loan arrangements, we are required to maintain a ratio of quick assets (cash, cash equivalents, accounts receivable and short-term investments) to current liabilities minus deferred revenue of at least 1.25 to 1. We are also required under the credit agreements to maintain our primary operating account and the majority of our cash and investment balances in accounts with the lender. As of September 30, 2006, we are in compliance with all covenants of this agreement.

In November 2005, we entered into a six-month commitment with certain affiliates providing for the availability of up to $20.0 million in unsecured borrowings. This commitment was available to be drawn against at any time through May 10, 2006, the initial six-month commitment period. The commitment period, as well as the maturity date on any funds drawn under the commitment, was subject to one six-month extension, through November 2006, at our sole election. The lenders received five-year warrants to purchase shares of our common stock upon commitment of the funds. We did not draw funds under this agreement nor did we extend the commitment period beyond its May 2006 expiration.

In February 2006, we completed a public offering of 5,500,000 shares of our common stock at $12.00 per share which included the exercise by the underwriters of an option to purchase an additional 500,000 shares. In conjunction with these transactions, we received approximately $61.9 million in net proceeds after deduction of underwriting discounts and commissions and payment of offering expenses.

In August 2006, we filed a universal shelf registration statement for the issuance and sale from time to time to the public of up to $75 million in securities, including debt, preferred stock, common stock and warrants. The shelf registration was declared effective by the SEC in September 2006. We have not sold any securities pursuant to the shelf registration. Although we have no immediate plans to raise capital, we believe the shelf registration affords us the financial flexibility to react to future opportunities in the market. In addition, we filed a registration statement relating to the exercise of warrants previously issued in various private financings. To the extent such warrants are exercised on a cash basis, we will receive proceeds from the exercise of such warrants; however, we will not receive the proceeds from the sales of the underlying shares.

We expect to have negative cash flow from operations through 2007. Throughout 2006, we expect to continue the development and commercialization of our products, the continuation of our research and development programs and the advancement of new products into clinical development. We expect that our research and development expenditures will continue to increase above the 2005 levels during 2006 and our selling, general and administrative expenses will continue to increase in order to support our product commercialization efforts and to implement procedures required by our status as a public company. Until we can generate significant cash flow from our operations, we expect to continue to fund our operations with existing cash resources that were primarily generated from the proceeds of our public offerings, private sales of our equity securities and working capital and equipment financing loans. In the future, we may finance future cash needs through the sale of other equity securities, strategic collaboration agreements and debt financings. We cannot accurately predict the timing and amount of our utilization of capital, which will depend on a number of factors outside of our control.

While we believe our existing cash, cash equivalents and investments will be sufficient to fund our operating expenses and capital equipment requirements through the next 12 months, we cannot assure you that we will not require additional financing before that time. We also cannot assure you that such additional financing will be available on a timely basis on terms acceptable to us or at all, or that such financing will not be dilutive to our stockholders. If adequate funds are not available to us, we could be required to delay development or commercialization of new products, to license to third parties the rights to commercialize products or technologies that we would otherwise seek to commercialize ourselves or to reduce the marketing, customer support or other resources devoted to our products, any of which could have a material adverse effect on our business, financial condition and results of operations.

Off-Balance Sheet Arrangements

We do not currently have, nor have we ever had, any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we do not engage in trading activities involving non-exchange traded contracts. As a result, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in these relationships.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We have exposure to currency fluctuations. We operate mainly in the U.S., Europe and Asia and we expect to continue to sell our products both within and outside of the U.S. We expect to transact this business primarily in U.S. dollars and in Euros, although we may transact business in other currencies to a lesser extent. Future fluctuations in the value of these currencies may affect the price competitiveness of our products. In addition, because we have a relatively long installation cycle for our systems, we will be subject to risk of currency fluctuations between the time we execute a purchase order and the time we deliver the system and collect payments under the order, which could adversely affect our operating margins. We have not hedged exposures in foreign currencies or entered into any other derivative instruments. As a result, we will be exposed to some exchange risks for foreign currencies. For example, if the currency exchange rate were to fluctuate by 10%, we believe that our revenues could be affected by as much as 2 to 3%.

We also have exposure to interest rate risk related to our investment portfolio and our borrowings. The primary objective of our investment activities is to preserve principal while at the same time maximizing the income we receive from our invested cash without significantly increasing the risk of loss.

Our interest income is sensitive to changes in the general level of U.S. interest rates, particularly since the majority of our investments are in short-term debt instruments. We invest our excess cash primarily in U.S. government securities and marketable debt securities of financial institutions and corporations with strong credit ratings. These instruments generally have maturities of two years or less when acquired. We do not utilize derivative financial instruments, derivative commodity instruments or other market risk sensitive instruments, positions or transactions. Accordingly, we believe that while the instruments we hold are subject to changes in the financial standing of the issuer of such securities, we are not subject to any material risks arising from changes in interest rates, foreign currency exchange rates, commodity prices, equity prices or other market changes that affect market risk sensitive instruments.

We do not believe that inflation has had a material adverse impact on our business or operating results during the periods covered by this report.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures: The Company s management, with the participation of the Company s Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company s disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)), as of the end of the period covered by this report. Any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on such evaluation, the Company s Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company s disclosure controls and procedures provided reasonable assurance that the disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in reports that it files or submits under the Exchange Act.

Changes In Internal Control Over Financial Reporting: The Company s management, with the participation of the Company s Chief Executive Officer and Chief Financial Officer, also conducted an evaluation of the Company s internal control over financial reporting to determine whether any changes occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting. Based on that evaluation, there has been no such change during the period covered by this report.

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STEREOTAXIS, INC.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are involved from time to time in various lawsuits and claims arising in the ordinary course of business. Although the outcomes of these lawsuits and claims are uncertain, we do not believe any of them will have a material adverse effect on our business, financial condition or results of operations.

ITEM 1A. RISK FACTORS

There have been no material changes to our risk factors as disclosed in our Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2006 (as filed with the SEC on August 9, 2006).

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. ISSUER PURCHASES OF EQUITY SECURITIES

None

ITEM 3. DEFAULTS UPON SECURITIES

None.

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

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits: See Exhibit Index herein

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STEREOTAXIS, INC.

SIGNATURES

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

	STEREOTAXIS, INC. (Registrant)
Date: November 9, 2006	By: /s/ Bevil J. Hogg Bevil J. Hogg, President and Chief Executive Officer
Date: November 9, 2006	By: /s/ James M. Stolze James M. Stolze, Vice President and Chief Financial Officer

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EXHIBIT INDEX

Number	Description
3.1(1)	Restated Certificate of Incorporation of the Company
3.2(1)	Restated Bylaws of the Company
31.1	Rule 13a-14(a)/15d-14(a) Certification (pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, executed by Chief Executive Officer).
31.2	Rule 13a-14(a)/15d-14(a) Certification (pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, executed by Chief Financial Officer).
32.1	Section 1350 Certification (pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, executed by Chief Executive Officer).
32.2	Section 1350 Certification (pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, executed by Chief Financial Officer)

(1) This exhibit was previously filed as an exhibit to the Registrant s Quarterly Report on Form 10-Q for the quarter ended September 30, 2004 (filed November 12, 2004) (File No. 000-50884), and is incorporated herein by reference.