

Stereotaxis, Inc.
Form 10-Q
November 08, 2012
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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, 2012.

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

For the transition period from to .

Commission File Number: 000-50884

STEREOTAXIS, INC.

(Exact name of registrant as specified in its charter)

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Delaware
(State 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. Yes No

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

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

Large accelerated filer Accelerated filer

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

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

The number of outstanding shares of the registrant's common stock on November 1, 2012 was 7,855,875.

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STEREOTAXIS, INC.

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Table of Contents**ITEM 1. FINANCIAL STATEMENTS****STEREOTAXIS, INC.****BALANCE SHEETS**

	September 30, 2012 (Unaudited)	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	\$ 9,913,203	\$ 13,954,919
Accounts receivable, net of allowance of \$617,007 and \$667,529 in 2012 and 2011, respectively	10,509,641	11,104,038
Current portion of long-term receivables	60,927	59,679
Inventories	6,729,190	6,036,051
Prepaid expenses and other current assets	3,373,893	3,081,484
Total current assets	30,586,854	34,236,171
Property and equipment, net	2,460,353	3,323,856
Intangible assets, net	2,054,278	2,279,153
Long-term receivables	32,734	51,892
Other assets	39,112	40,760
Total assets	\$ 35,173,331	\$ 39,931,832
Liabilities and stockholders deficit		
Current liabilities:		
Short-term debt and current maturities of long-term debt	\$ 13,679,615	\$ 21,173,321
Accounts payable	4,576,667	5,610,181
Accrued liabilities	5,316,391	5,703,166
Deferred revenue	7,452,018	8,220,306
Warrants and debt conversion features	1,477,475	125,415
Total current liabilities	32,502,166	40,832,389
Long-term debt, less current maturities	17,182,813	17,290,531
Long-term deferred revenue	742,805	634,713
Other liabilities	1	3,094
Stockholders deficit:		
Preferred stock, par value \$0.001; 10,000,000 shares authorized at 2012 and 2011, none outstanding at 2012 and 2011		
Common stock, par value \$0.001; 100,000,000 shares authorized at 2012 and 2011, 7,816,354 and 5,543,157 shares issued at 2012 and 2011, respectively	7,816	5,543
Additional paid in capital	365,272,941	356,779,007
Treasury stock, 4,015 shares at 2012 and 2011	(205,999)	(205,999)
Accumulated deficit	(380,329,212)	(375,407,446)
Total stockholders deficit	(15,254,454)	(18,828,895)
Total liabilities and stockholders deficit	\$ 35,173,331	\$ 39,931,832

See accompanying notes.

Table of Contents**STEREOTAXIS, INC.****STATEMENTS OF OPERATIONS****(Unaudited)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenue:				
Systems	\$ 5,040,025	\$ 2,037,742	\$ 14,082,637	\$ 11,350,461
Disposables, service and accessories	6,521,374	6,506,272	20,274,888	19,020,396
Total revenue	11,561,399	8,544,014	34,357,525	30,370,857
Cost of revenue:				
Systems	2,429,764	1,723,874	6,948,145	6,428,783
Disposables, service and accessories	1,057,057	933,380	3,560,585	2,749,796
Total cost of revenue	3,486,821	2,657,254	10,508,730	9,178,579
Gross margin	8,074,578	5,886,760	23,848,795	21,192,278
Operating expenses:				
Research and development	1,904,648	3,529,321	6,925,928	10,234,757
Sales and marketing	4,096,842	6,885,786	16,318,911	24,936,641
General and administrative	3,007,598	4,527,489	10,349,817	13,384,313
Total operating expenses	9,009,088	14,942,596	33,594,656	48,555,711
Operating loss	(934,510)	(9,055,836)	(9,745,861)	(27,363,433)
Other income	598,494	2,611,067	9,679,848	3,251,822
Interest income	1,982	1,817	5,353	7,137
Interest expense	(1,581,247)	(830,118)	(4,861,106)	(2,413,214)
Net loss	\$ (1,915,281)	\$ (7,273,070)	\$ (4,921,766)	\$ (26,517,688)
Net loss per common share:				
Basic	\$ (0.25)	\$ (1.33)	\$ (0.74)	\$ (4.84)
Diluted	\$ (0.25)	\$ (1.33)	\$ (0.74)	\$ (4.84)
Weighted average shares used in computing net loss per common share:				
Basic	7,701,332	5,487,824	6,651,255	5,479,351
Diluted	7,701,332	5,487,824	6,651,255	5,479,351

See accompanying notes.

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

	Nine Months Ended September 30,	
	2012	2011
Cash flows from operating activities		
Net loss	\$ (4,921,766)	\$ (26,517,688)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation	989,501	1,095,613
Amortization	224,875	224,875
Amortization of warrants	1,978,264	995,926
Share-based compensation	1,979,159	1,741,184
Loss on asset disposal	4,122	83,705
Non-cash royalty (income), net		(2,353,718)
Adjustment of warrants and debt conversion features	(9,679,848)	(3,251,822)
Changes in operating assets and liabilities:		
Accounts receivable	594,397	9,381,579
Other receivables	17,910	(5,719)
Inventories	(693,139)	(425,031)
Prepaid expenses and other current assets	(279,595)	246,982
Other assets	1,648	(3,284)
Accounts payable	(1,033,514)	(1,789,687)
Accrued liabilities	(560,126)	(813,483)
Deferred revenue	(660,196)	1,436,934
Other liabilities	(3,093)	(5,647)
Net cash used in operating activities	(12,041,401)	(19,959,281)
Cash flows from investing activities		
Purchase of equipment	(130,103)	(972,881)
Net cash used in investing activities	(130,103)	(972,881)
Cash flows from financing activities		
Payments under term note	(3,000,000)	(1,000,000)
Proceeds from revolving line of credit	42,246,305	52,309,376
Payments of revolving line of credit	(49,363,204)	(45,409,376)
Proceeds from subordinated convertible debt, net of issuance costs	7,738,351	
Proceeds/Payments from Cowen Debt	2,500,000	
Payments of Cowen Debt	(1,114,095)	
Payments of Biosense Debt		(3,448,210)
Proceeds from issuance of stock and warrants, net of issuance costs	9,122,431	211,416
Net cash provided by financing activities	8,129,788	2,663,206
Net decrease in cash and cash equivalents	(4,041,716)	(18,268,956)
Cash and cash equivalents at beginning of period	13,954,919	35,248,819
Cash and cash equivalents at end of period	\$ 9,913,203	\$ 16,979,863

See accompanying notes.

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STEREOTAXIS, INC.

NOTES TO FINANCIAL STATEMENTS

(Unaudited)

Notes to Financial Statements

In this report, Stereotaxis, the Company, Registrant, we, us, and our refer to Stereotaxis, Inc. and its wholly-owned subsidiaries. *Epoch*, *Niobe Odyssey*[®], *Odyssey Cinema*, *Vdrive*, *Vdrive Duo*, *V-Loop*, and *V-Sono* are trademarks of Stereotaxis, Inc.

1. Description of Business

Stereotaxis designs, manufactures and markets the *Epoch* Solution, which is an advanced remote robotic navigation system for use in a hospital's interventional surgical suite, or interventional lab, that we believe revolutionizes the treatment of arrhythmias and coronary artery disease by enabling enhanced safety, efficiency and efficacy for catheter-based, or interventional, procedures. The *Epoch* Solution is comprised of the *Niobe* ES Robotic Magnetic Navigation System (*Niobe* ES system), *Odyssey* Information Management Solution (*Odyssey* Solution), and the *Vdrive* Robotic Navigation System (*Vdrive*).

The *Niobe* 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.

In addition to the *Niobe* system and its components, Stereotaxis also has developed the *Odyssey* Solution, which consolidates all lab information enabling doctors to focus on the patient for optimal procedure efficiency. The system also features a remote viewing and recording capability called *Odyssey Cinema*, which is an innovative solution delivering synchronized content for optimized workflow, advanced care and improved productivity. This tool includes an archiving capability that allows clinicians to store and replay entire procedures or segments of procedures. This information can be accessed from locations throughout the hospital local area network and over the global *Odyssey* Network providing physicians with a tool for clinical collaboration, remote consultation and training.

Our *Vdrive* system provides navigation and stability for diagnostic and therapeutic devices designed to improve interventional procedures. The *Vdrive* system complements the *Niobe* ES system control of therapeutic catheters for fully remote procedures and enables single-operator workflow and is sold as two options, the *Vdrive* system and the *Vdrive Duo* system. In addition to the *Vdrive* system and the *Vdrive Duo* system, we also manufacture and market various disposable components which can be manipulated by these systems.

We promote the full *Epoch* Solution in a typical hospital implementation, subject to regulatory approvals or clearances. The full *Epoch* Solution implementation requires a hospital to agree to an upfront capital payment and recurring payments. The upfront capital payment typically includes equipment and installation charges. The recurring payments typically include disposable costs for each procedure, equipment service costs beyond warranty period, and software licenses and *Odyssey* Network fees. In hospitals where the full *Epoch* Solution has not been implemented, equipment upgrade or expansion can be implemented upon purchasing of the necessary upgrade or expansion.

The core components of Stereotaxis systems have received regulatory clearance in the U.S., Europe, Canada and elsewhere; the *V-Loop* circular catheter manipulator is currently in human clinical trials and the *V-Sono* ICE Catheter Manipulator is under regulatory review by the U.S. Food and Drug Administration.

Since our inception, we have generated significant losses. As of September 30 2012, we had incurred cumulative net losses of approximately \$380 million. The Company expects such losses to continue through at least the year ended December 31, 2012. In May 2011, the Company introduced the *Niobe* ES, which is the latest generation of the *Niobe* Robotic Magnetic Navigation System and will replace the *Niobe* II system going forward. Due to the fact that the *Niobe* ES system and upgrades from *Niobe* II to *Niobe* ES systems were not available to customers until December 2011, the product change created a rapid shift away from sales of the current *Niobe* II system, resulting in lower System Revenue in 2011. As of September 30, 2012, the Company had performed 60 installations to upgrade *Niobe* II systems to *Niobe* ES systems and has received positive feedback from the physicians at these sites. The Company reduced operating expenses by \$3.7 million or 29% from the first quarter 2012 levels to the third quarter 2012 and anticipates achieving a 15% to 20% reduction from first quarter 2012 levels in the fourth quarter 2012.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited financial statements of Stereotaxis, Inc. 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 nine month period ended September 30, 2012 are not necessarily indicative of the results that may be expected for the year ended December 31, 2012 or for future operating periods.

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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 for the year ended December 31, 2011 as filed with the Securities and Exchange Commission (SEC) on March 15, 2012.

As described in Note 10, on July 10, 2012, the Company effected a one-for-ten reverse stock split of the Company's common stock. All information set forth in the financial statements and related notes gives effect to such reverse stock split.

Revenue and Costs of Revenue

For arrangements with multiple deliverables, the Company allocates the total revenue to each deliverable based on the provisions of general accounting principles for revenue recognition and multiple-deliverable revenue arrangements and recognizes revenue for each separate element as the criteria for revenue recognition are met. Each element is assigned an estimated selling price using vendor-specific objective evidence, third party evidence, or management's estimate.

Under our revenue recognition policy, a portion of revenue for the *Niobe*, *Odyssey Vision*, *Odyssey Cinema*, and *Vdrive* systems is recognized upon delivery, provided that title has passed, there are no uncertainties regarding acceptance, persuasive evidence of an arrangement exists, the sales price is fixed and determinable, and collection of the related receivable is reasonably assured. Revenue for *Niobe*, *Odyssey Vision Standard HD*, *Odyssey Vision Quad*, *Odyssey Enterprise Cinema*, and *Vdrive* systems is recognized upon delivery due to the fact that third parties became qualified to perform installations. Revenue is recognized for other types of *Odyssey* systems upon completion of installation, since there are no qualified third party installers. When installation is the responsibility of the customer, revenue from system sales is recognized upon shipment since these arrangements do not include an installation element or right of return privileges. The Company does not recognize revenue in situations in which inventory remains at a Stereotaxis warehouse or in situations in which title and risk of loss have not transferred to the customer. However, the Company may deliver systems to a non-hospital site at the customer's request as outlined in the terms and conditions of the sales agreement, in which case the Company evaluates whether the substance of the transaction meets the delivery and performance requirements for revenue recognition under bill and hold guidance. Amounts collected prior to satisfying the above revenue recognition criteria are reflected as deferred revenue.

Revenue from services and license fees, whether sold individually or as a separate unit of accounting in a multiple-deliverable arrangement, is deferred and amortized over the service or license fee period, which is typically one year. Revenue from services is derived primarily from the sale of annual product maintenance plans. We recognize revenue from disposable device sales or accessories upon shipment and establish an appropriate reserve for returns. The return reserve, which is applicable only to disposable devices, is estimated based on historical experience which is periodically reviewed and updated as necessary. In the past, changes in estimate have had only a de minimus effect on revenue recognized in the period. We believe that the estimate is not likely to change significantly in the future.

Costs of systems revenue include direct product costs, installation labor and other costs, estimated warranty costs, and initial training and product maintenance costs. These costs are recorded at the time of sale. Costs of disposable revenue include direct product costs and estimated warranty costs and are recorded at the time of sale. Cost of revenue from services and license fees are recorded when incurred.

Net Loss per Common Share

Basic and diluted 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. On July 10, 2012, the Company effected a one-for-ten reverse stock split of the Company's common stock. The net loss per common share, shares outstanding, and weighted average shares outstanding reported in the financial statements and notes to the financial statements for the periods ending September 30, 2012 and 2011 are presented on a post-split basis. See Note 10 for additional discussion of the reverse stock split.

The following table sets forth the computation of basic and diluted EPS:

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Numerator:				
Numerator for basic EPS	\$ (1,915,281)	\$ (7,273,070)	\$ (4,921,766)	\$ (26,517,688)
Effect of dilutive securities:				

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Numerator for diluted EPS	\$ (1,915,281)	\$ (7,273,070)	\$ (4,921,766)	\$ (26,517,688)
Denominator:				
Denominator for basic EPS weighted average shares	7,701,332	5,487,824	6,651,255	5,479,351
Effect of dilutive securities:				
Denominator for diluted EPS	7,701,332	5,487,824	6,651,255	5,479,351
Basic EPS	\$ (0.25)	\$ (1.33)	\$ (0.74)	\$ (4.84)
Diluted EPS	\$ (0.25)	\$ (1.33)	\$ (0.74)	\$ (4.84)

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The Company did not include any portion of unearned restricted shares, outstanding options, stock appreciation rights or warrants in the calculation of diluted loss per common share because all such securities are anti-dilutive for all periods presented. The application of the two-class method of computing earnings per share under general accounting principles for participating securities is not applicable during these periods because the Company's those securities do not contractually participate in its losses.

As of September 30, 2012, the Company had 400,641 shares of common stock issuable upon the exercise of outstanding options and stock appreciation rights at a weighted average exercise price of \$44.70 per share and 6,099,476 shares of common stock issuable upon the exercise of outstanding warrants at a weighted average exercise price of \$9.98 per share. The Company had a weighted average of 102,504 and 99,577 unearned restricted shares outstanding for the three and nine months ended September 30, 2012.

Fair Value Measurements

The Company measures certain financial assets and liabilities at fair value on a recurring basis, including cash equivalents and warrants. General accounting principles for fair value measurement established a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets and liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). See Note 11 for additional details.

The following methods and assumptions were used by the Company in estimating its fair value disclosures for other financial instruments as of September 30, 2012 and December 31, 2011.

Cash and cash equivalents, accounts receivable, accounts payable and accrued expenses have carrying values which approximate fair value due to the short maturity or the financial nature of these instruments.

Long and short-term debt fair value estimates are based on estimated borrowing rates to discount the cash flows to their present value. See Note 9 for disclosure of the fair value of debt.

Share-Based Compensation

The Company accounts for its grants of stock options, stock appreciation rights, restricted shares, and restricted stock units and for its employee stock purchase plan in accordance with the provisions of general accounting principles for share-based payments. These accounting principles require 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.

The Company utilizes the Black-Scholes valuation model to determine the fair value of stock options and stock appreciation rights at the date of grant. The resulting compensation expense is recognized over the requisite service period, which is generally 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. 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.

Reclassifications

Common stock and additional paid-in capital in the prior year's financial statements have been reclassified to reflect the one-for-ten reverse stock split effected on July 10, 2012. Refer to Note 10 for additional discussion of the reverse stock split.

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In December 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-11, Disclosures about Offsetting Assets and Liabilities. The Update enhances the disclosure of offsetting assets and liabilities by requiring companies to disclose both the gross and net information about instruments and transactions eligible for offset as well as those subject to an agreement similar to master netting arrangements. This guidance is effective for the Company's interim and annual periods beginning January 1, 2013. The Company is currently evaluating the impact of adoption on the financial statements.

In June 2011, the FASB issued new accounting guidance related to the presentation of comprehensive income that increases comparability between U.S. GAAP and International Financial Reporting Standards (IFRS). This guidance eliminates the current option to report other comprehensive income (OCI) and its components in the statement of changes in stockholders' equity. This guidance was effective for the Company's interim and annual periods beginning January 1, 2012. As the Company has no items of other comprehensive income, the Company is not required to report comprehensive income or other comprehensive income.

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS. The Update amends the guidance on fair value measurements to develop common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. GAAP and IFRS. The Update does not require additional fair value measurements and is not intended to establish valuation standards or affect valuation practices outside of financial reporting. This guidance was effective during interim and annual periods beginning after December 15, 2011. The adoption of this ASU did not have a material effect on our financial position or results of operations.

3. Inventory

Inventory consists of the following:

	September 30, 2012	December 31, 2011
Raw materials	\$ 3,554,576	\$ 2,264,603
Work in process	499,121	131,980
Finished goods	2,739,627	3,790,625
Reserve for obsolescence	(64,134)	(151,157)
Total inventory	\$ 6,729,190	\$ 6,036,051

4. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist of the following:

	September 30, 2012	December 31, 2011
Prepaid expenses	\$ 396,687	\$ 460,297
Deferred cost of revenue	239,896	289,312
Derivative asset	816	
Other assets	2,736,494	2,331,875
Total prepaid expenses and other current assets	\$ 3,373,893	\$ 3,081,484

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

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The derivative asset represents the fair value of a debt conversion feature that is part of the subordinated convertible debentures agreement. Refer to Notes 9 and 11 for discussion of the debentures and fair value measurement, respectively.

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Property and equipment consist of the following:

	September 30, 2012	December 31, 2011
Equipment	\$ 8,964,059	\$ 8,977,623
Equipment held for lease	303,411	547,416
Leasehold improvements	2,473,881	2,473,880
	11,741,351	11,998,919
Less: Accumulated depreciation	(9,280,998)	(8,675,063)
Net property and equipment	\$ 2,460,353	\$ 3,323,856

6. Intangible Assets

On June 4, 2010, the Company entered into an agreement to issue 450,000 shares of its common stock to a consultant (the Purchaser) in exchange for intellectual property rights related to the Company's products. The Company issued 200,000 shares upon execution of the agreement and will issue an aggregate of 250,000 shares in annual installments on the first three anniversaries of the agreement. The unissued shares meet the criteria for equity classification under Accounting Standards Codification (ASC) 480 Distinguishing Liabilities from Equity and therefore are recorded in additional paid-in capital. There was no cash consideration paid for the securities. The securities were issued in consideration of the assignment to the Company of the Purchaser's rights in certain intellectual property, including patent applications, in all inventions and discoveries in the Company's business field (as defined in the agreement) that had been developed under various other agreements, which were terminated. The securities were sold by the Company in a private placement exempt from registration under Section 4(2) of the Securities Act of 1933 and Regulation D promulgated thereunder. There were no underwriters or placement agents involved in the transaction.

As of September 30, 2012, the Company had total intangible assets, including those described above, of \$3.7 million. Accumulated amortization at September 30, 2012 was \$1.6 million.

7. Accrued Liabilities

Accrued liabilities consist of the following:

	September 30, 2012	December 31, 2011
Accrued salaries, bonus, and benefits	\$ 2,333,502	\$ 3,229,382
Accrued research and development	34,586	27,044
Accrued legal and other professional fees	140,662	25,000
Other	2,807,641	2,421,740
Total accrued liabilities	\$ 5,316,391	\$ 5,703,166

Table of Contents**STEREOTAXIS, INC.****NOTES TO FINANCIAL STATEMENTS (Continued)****(Unaudited)****8. Deferred Revenue**

Deferred revenue consists of the following:

	September 30, 2012	December 31, 2011
Product shipped, revenue deferred	\$ 1,872,655	\$ 2,001,160
Customer deposits	447,700	1,156,900
Deferred service and license fees	5,874,468	5,696,959
	8,194,823	8,855,019
Less: Long-term deferred revenue	(742,805)	(634,713)
Total current deferred revenue	\$ 7,452,018	\$ 8,220,306

9. Long-Term Debt and Credit Facilities

Debt outstanding consists of the following:

	September 30, 2012		December 31, 2011	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Revolving line of credit, due March 2013	\$ 8,172,899	\$ 8,251,201	\$ 15,290,510	\$ 15,371,063
Term note, due December 2013	5,000,000	5,000,000	8,000,000	8,000,000
Cowen debt	16,386,627	16,386,627	15,173,342	15,173,342
Subordinated convertible debentures	1,302,902	1,302,902		
Total debt	30,862,428	30,940,730	38,463,852	38,544,405
Less current maturities	(13,679,615)	(13,757,917)	(21,173,321)	(21,253,874)
Total long term debt	\$ 17,182,813	\$ 17,182,813	\$ 17,290,531	\$ 17,290,531

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Revolving line of credit

The revolving line of credit and the Company's term notes (collectively, the Credit Agreements) are secured by substantially all of the Company's assets. The Company is also required under the Credit Agreements to maintain its primary operating account and the majority of its cash and investment balances in accounts with the primary lender.

In December 2010, the Company amended its agreement with its primary lender to extend the maturity of the current working capital line of credit from March 31, 2011 to March 31, 2012, retaining the \$30 million total availability under the line per the 2009 amendment. The revised agreement retained the \$10 million sublimit for borrowings supported by guarantees from stockholders who are affiliates of two members of its board of directors (Lenders) and considered to be related parties. Under the revised facility the Company is required to maintain a minimum tangible net worth and liquidity ratio as defined in the agreement. Interest on the facility accrued at the rate of prime plus 0.5% subject to a floor of 6% for the amount under guarantee and prime plus 1.75% subject to a floor of 7% for the remaining amounts.

In September 2011, the Company amended its agreement with its primary lender. The amendment reduced the availability amount of all credit extensions, other than the term loan, from \$30 million to \$20 million, and modified the interest rate applicable to the term loan from the lender's prime rate plus 3.5% to the lender's prime rate plus 5.5%.

On November 30, 2011, the Company entered into a Second Amended and Restated Loan and Security Agreement with its primary lender (Amended Loan Agreement). Under the Amended Loan Agreement, the Company agreed to revised tangible net worth and liquidity ratio covenants. Further, certain intellectual property assets of the Company were added to the collateral which secures repayment of the loan. Finally, the Amended Loan Agreement permits the Company to repay Cowen Healthcare Royalty Partners II, L.P. (Cowen) under the Agreement with the royalties due to the Company under the Biosense Agreement (the Biosense Agreement), as described below.

On March 30, 2012, the Company amended its agreement with its primary lender. The amendment extended the maturity date of the working capital line of credit from March 31, 2012 to April 30, 2012 and reduced the Company's borrowing availability by \$3,333,333. The Company also extended until April 30, 2012 the \$10 million guarantee provided by the Lenders. As a result of this extension, the Company issued the Lenders warrants to purchase 75,735 shares of common stock at \$6.60 per share.

On May 1, 2012, the Company and its primary lender entered into an agreement in which the lender extended the maturity of the revolving line of credit from April 30, 2012 to May 15, 2012. The Company also amended its agreement with the Lenders to extend the \$10 million loan guarantee through May 15, 2012. The Company granted warrants to purchase an aggregate of 60,976 shares of Common Stock in exchange for the extension of the guarantee.

On May 10, 2012, upon closing of financing transactions for gross proceeds of \$18.5 million, the Company entered into the Third Loan Modification Agreement with its primary lender. The amendment extended the revolving credit facility maturity to March 31, 2013 and revised the financial covenants. Additionally, the revolving line of credit was decreased from \$20 million to \$13 million. The reduction was as result of the pay down of \$7 million of the guarantees provided by the Lenders.

As of September 30, 2012, the Company had \$8.2 million outstanding under the revolving line of credit. Draws on the line of credit are made based on the borrowing capacity one week in arrears. As of September 30, 2012, the Company had a borrowing capacity of \$8.2 million based on the Company's collateralized assets, including amounts already drawn. As such, the Company had no remaining borrowing availability at September 30, 2012. As of September 30, 2012, the Company was in compliance with all covenants of the bank loan agreement and had no remaining availability on its Lender loan and guarantee.

Term note

Under the 2010 amendment to the loan agreement, the Company entered into a \$10 million term loan maturing on December 31, 2013, with \$2 million of principal due in 2011 and \$4 million of principal due in each of 2012 and 2013. Interest on the term loan accrued at the rate of prime plus 3.5%. Under the September 2011 amendment of the loan agreement, the interest rate on the term loan was increased to prime plus 5.5%. Under this agreement, the Company provided its primary lender with warrants to purchase 11,111 shares of common stock. The warrants are exercisable at \$36.00 per share, beginning on December 17, 2010 and expiring on December 17, 2015. The fair value of these warrants of \$228,332, calculated using the Black Scholes method, will be deferred and amortized to interest expense ratably over the life of the term loan.

Cowen Debt

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In November 2011, the Company entered into a loan agreement with Cowen. Under the agreement the Company borrowed from Cowen \$15 million. The Company may borrow up to an additional \$5 million in the aggregate based on the achievement by the Company of certain milestones related to *Niobe* system sales in 2012. The loan will be repaid through, and secured by, royalties payable to the Company under its Development, Alliance and Supply Agreement with Biosense Webster, Inc. The Biosense Agreement relates to the development and distribution of magnetically enabled catheters used with Stereotaxis *Niobe* system in cardiac ablation procedures. Under the terms of the Agreement, Cowen will be entitled to receive 100% of all royalties due to the Company under the Biosense Agreement until the loan is repaid. The loan is a full recourse loan, matures on December 31, 2018, and bears interest at an annual rate of 16% payable quarterly with royalties received under the Biosense Agreement. If the payments received by the Company under the Biosense Agreement are insufficient to pay all amounts of interest due on the loan, then such deficiency will increase the outstanding principal amount on the loan. After the loan obligation is repaid, the royalties under the Biosense Agreement will again be paid to the Company. The loan is also secured by certain assets and intellectual property of the Company. The Agreement also contains customary affirmative and negative covenants. The use of payments due to the Company under the Biosense Agreement was approved by our primary lender under the Amended Loans Agreement described above.

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On August 8, 2012, the Company borrowed an additional \$2.5 million based upon achievement of a milestone related to *Niobe* system sales for the nine months ended June 30, 2012.

Subordinated Convertible Debentures

In May 2012, the Company entered into a securities purchase agreement with certain institutional investors whereby the Company agreed to sell an aggregate of approximately \$8.5 million in aggregate principal amount of unsecured, subordinated, convertible debentures (the *Debentures*), which became convertible into shares of the Company's common stock at a conversion price of \$3.361 per share (or approximately 2.5 million shares in the aggregate), on July 10, 2012, the date that the Company received shareholder approval for the transaction. The purchasers of the *Debentures* also received six-year warrants to purchase an aggregate of approximately 2.5 million shares of the Company's common stock at an exercise price of \$3.361 per share. The *Debentures* bear interest at 8% per year and mature on May 7, 2014. In addition, the Company has the ability to issue shares of its common stock in lieu of cash interest payments under certain circumstances, and intends to do so at such time as the Company has registered the shares for resale.

The Company recorded the *Debentures* on the balance sheet net of the debt discount of \$7.5 million. The debt discount is due to warrants issued in conjunction with the *Debentures* and the debt conversion features. Upon issuance of the *Debentures*, the fair value of the warrants and derivative liability were \$4.1 million and \$3.5 million, respectively. The debt discount will be amortized over the life of the loan using the effective interest method and the warrants and derivative liability will be recorded at fair value on each reporting period. Refer to Note 11 for additional discussion of the fair value of the warrants and conversion features.

Biosense Webster Advance

In July 2008, the Company and Biosense Webster entered into an amendment to their existing agreements relating to the development and sale of catheters. Pursuant to the amendment, Biosense Webster agreed to pay to the Company \$10.0 million as an advance on royalty amounts that were owed at the time the amendment was executed or would be owed in the future by Biosense Webster to the Company pursuant to the royalty provisions of one of the existing agreements. The Company and Biosense Webster also agreed that an aggregate of up to \$8.0 million of certain agreed upon research and development expenses that were owed at the time the amendment was executed or may be owed in the future by the Company to Biosense Webster pursuant to the existing agreement would be deferred and will be due, together with any unrecouped portion of the \$10.0 million royalty advance, no later than December 31, 2011. Interest on the outstanding and unrecouped amounts of the royalty advance and deferred research and development expenses accrued at an interest rate of the prime rate plus 0.75%. Outstanding royalty advances and deferred research and development expenses and accrued interest thereon were recouped by Biosense Webster by deductions from royalty amounts otherwise owed to the Company from Biosense Webster pursuant to the existing agreement. Approximately \$18.0 million had been advanced by Biosense Webster to the Company pursuant to the amendment. As of December 31, 2011, these amounts plus interest accrued thereon had been repaid in full, in accordance with the agreement.

10. Stockholders' Equity

Reverse Stock Split

On July 10, 2012, the Company filed a Certificate of Amendment to our Amended and Restated Certificate of Incorporation to implement a one-for-ten reverse split of our common stock (the *Reverse Stock Split*). The ratio for the *Reverse Stock Split* was determined by our Board of Directors pursuant to the approval of the stockholders at the Company's special meeting of stockholders held on July 10, 2012, authorizing the Board to effect a reverse stock split within a range of one-for-four to one-for-ten shares of the Company's common stock. The *Reverse Stock Split* was effective as of July 10, 2012, and the Company's common stock began trading on the NASDAQ Global Market on a post-split basis on July 11, 2012.

As a result of the *Reverse Stock Split*, each ten shares of the Company's issued and outstanding common stock were automatically combined and converted into one issued and outstanding share of common stock. The *Reverse Stock Split* affected all issued and outstanding shares of the Company's common stock, as well as common stock underlying stock options, stock appreciation rights, restricted stock, restricted stock units, warrants and convertible debentures outstanding immediately prior to the effectiveness of the *Reverse Stock Split*. The *Reverse Stock Split* reduced the number of shares of the Company's common stock outstanding from approximately 78 million to 7.8 million at the time of the *Reverse Stock Split*. In addition, the Amendment increased the number of authorized shares of the Company's common stock from 100 million to 300 million. The *Reverse Stock Split* did not alter the par value of common stock, which remained \$0.001 per share, or modify any voting rights or other terms of the Company's common stock. Unless otherwise indicated, all information set forth herein gives effect to such *Reverse Stock Split*.

PIPE Transaction

In May 2012, the Company entered into a Stock and Warrant Purchase Agreement with certain institutional investors whereby it agreed to sell an aggregate of approximately 21.7 million shares of the Company's common stock (the "PIPE Common Stock") at a price of \$0.3361 per share, together with six-year warrants at a price of \$0.125 per share to purchase an aggregate of approximately 21.7 million shares of common stock having an exercise price of \$0.3361 per share (the "PIPE Warrants"). Each purchaser received a PIPE Warrant to purchase one share of common stock for every share of PIPE Common Stock purchased.

As described above, on July 10, 2012, the Company effected a one-for-ten Reverse Stock Split of the Company's common stock. As a result, the PIPE Common Stock was combined and converted into an aggregate of approximately 2.17 million shares of the Company's common stock, and the PIPE Warrants became exercisable for an aggregate of approximately 2.17 million shares with an exercise price of \$3.361 per share.

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Net proceeds from the sale of the securities were approximately \$9.1 million, after placement agent fees and other offering expenses. The Company used the funds to repay \$7 million of the revolving credit facility guaranteed by the Lenders and plans to use the balance for working capital and general corporate purposes.

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 that are described in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2011. In August 2012, the Board of Directors adopted a stock incentive plan (the 2012 Stock Incentive Plan) and a non-employee directors' stock plan (2012 Director Plan). Each of these plans was subsequently approved by the Company's stockholders. At September 30, 2012, the Board of Directors had 48,895 remaining shares of the Company's common stock to provide for current and future grants under its various equity plans.

At September 30, 2012, 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 \$5.7 million, net of estimated forfeitures of approximately \$3.6 million. This cost will be amortized over a period of up to four years on a straight-line basis over the underlying estimated service periods and will be adjusted for subsequent changes in estimated forfeitures and anticipated vesting periods.

A summary of the option and stock appreciation rights activity for the nine months ended September 30, 2012 is as follows:

	Number of Options/SARs	Range of Exercise Price	Weighted Average Exercise Price per Share
Outstanding, December 31, 2011	562,733	\$ 10.00 - \$125.50	\$ 48.53
Granted	11,548	\$ 1.69 - \$8.10	\$ 4.43
Exercised		\$ 0.00 - \$0.00	
Forfeited	(173,640)	\$ 1.69 - \$125.50	\$ 54.45
Outstanding, September 30, 2012	400,641	\$ 1.69 - \$116.40	\$ 44.70

A summary of the restricted share grant activity for the nine months ended September 30, 2012 is as follows:

	Number of Shares	Weighted Average Grant Date Fair Value per Share
Outstanding, December 31, 2011	52,659	\$ 34.17
Granted	85,250	\$ 8.00
Vested	(3,959)	\$ 37.27
Forfeited	(29,180)	\$ 20.61
Outstanding, September 30, 2012	104,770	\$ 16.53

A summary of the restricted stock unit activity for the nine months ended September 30, 2012 is as follows:

	Number of Restricted Shares Units	Weighted Average Grant Date Fair Value per Unit
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Outstanding, December 31, 2011	98,820	\$	10.89
Granted	486,926	\$	1.89
Vested	(29,919)	\$	10.89
Forfeited	(27,861)	\$	9.57
Outstanding, September 30, 2012	527,966	\$	2.66

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A summary of the restricted stock outstanding as of September 30, 2012 is as follows:

	Number of Shares
Time based restricted shares	10,150
Performance based restricted shares	94,620
Outstanding, September 30, 2012	104,770

11. Fair Value Measurements

The Company measures certain financial assets and liabilities at fair value on a recurring basis, including cash equivalents and warrants. General accounting principles for fair value measurement established a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets and liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy are described below:

Level 1: Values are based on unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Values are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, or other model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3: Values are generated from model-based techniques that use significant assumptions not observable in the market.

The following table sets forth the Company's assets and liabilities measured at fair value on a recurring basis by level within the fair value hierarchy. As required by the Fair Value Measurements and Disclosures topic of the Accounting Standards Codification, assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	Fair Value at September 30, 2012			
	Total	Level 1	Level 2	Level 3
Assets at Fair Value:				
Cash equivalents	\$ 100,159	100,159		
Derivative asset	816			816
Total Assets at Fair Value	\$ 100,975	100,159		816
Liabilities at Fair Value:				
Warrants issued December 29, 2008	\$ 114,174			114,174
Warrants issued May 10, 2012	1,166,910			1,166,910
Derivative liability	196,391			196,391
Total Liabilities at Fair Value:	\$ 1,477,475			1,477,475

Level 1

The Company's financial assets consist of cash equivalents invested in money market funds in the amount of \$100,159 and \$55,629 at September 30, 2012 and December 31, 2011, respectively. These assets are classified as Level 1 as described above and total interest income recorded for these investments was insignificant during both the three and nine months ended September 30, 2012 and the three and nine months ended September 30, 2011. There were no transfers in or out of Level 1 during the three and nine months ended September 30, 2012.

Level 2

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The Company does not have any financial assets or liabilities classified as Level 2.

Level 3

In conjunction with its December 29, 2008 registered direct offering, the Company issued warrants to purchase 179,241 shares of the Company's common stock that contained a provision that required a reduction of the exercise price if certain equity events occurred. Under the provisions of general accounting principles for derivatives and hedging activities and determining whether an instrument (or embedded feature) is indexed to an entity's own stock, such a reset provision does not meet the exemptions for equity classification and as such, the Company accounts for these warrants as derivative instruments. The calculated fair value of the warrants is classified as a liability and is periodically remeasured with any changes in value recognized in Other income (expense) in the Statement of Operations. General accounting principles for determining whether an instrument (or embedded feature) is indexed to an entity's own stock became effective for the Company as of January 1, 2009. Accordingly, the fair value of the warrants as of that date was reclassified from stockholders' equity into current liabilities.

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In accordance with general accounting principles for fair value measurement, the Company's warrants in the amount of \$114,174 were measured at fair value on a recurring basis as of September 30, 2012 and were valued using Level 3 valuation inputs. A Black-Scholes model was used to value the Company's warrants at September 30, 2012 using the following assumptions: 1) dividend yield of 0%; 2) volatility of 95%; 3) risk-free interest rate of 0.31%; and 4) expected life of 1.75 years.

In the Company's May 2012 financing transaction, the Company issued subordinated convertible debentures and warrants. The optional conversion feature of the subordinated convertible debentures is classified as a derivative liability within Warrants and derivative liabilities on the Company's balance sheet. The warrants issued in conjunction with the Debentures and PIPE are also considered a liability. Due to the provisions included in the warrant agreements, the warrants do not meet the exemptions for equity classification and as such, the Company accounts for these warrants as derivative instruments. The warrants and derivative liability are periodically remeasured with any changes in value recognized in Other income (expense) in the Statement of Operations.

Per the terms of the Debentures agreement, the Company may require each holder to convert up to 50% of the Debentures if the common stock closes above \$15.00, or 100% of the Debentures if the common stock closes above \$20.00 (in each case, as adjusted for stock splits, recapitalizations and similar events) during a 20 consecutive trading day period and the resale registration statement has been declared effective by the SEC and is available for the issuance of the common stock upon conversion of the Debentures. In the event of any forced conversion by the Company, the minimum amount that the Company can force the holders to convert shall be \$2.5 million of Debentures in the aggregate. This mandatory redemption clause is classified as a derivative asset within Prepaid and other current assets on the Company's balance sheet. The derivative asset is periodically remeasured with any changes in value recognized in Other income (expense) in the Statement of Operations.

In accordance with general accounting principles for fair value measurement, the Company's warrants, derivative liability, and derivative asset were measured at fair value on a recurring basis as of September 30, 2012 and were valued using Level 3 valuation inputs. A Monte-Carlo simulation was used to value the derivative asset and liabilities upon issuance on May 10, 2012 using the following assumptions: 1) volatility of 80%; 2) risk-free interest rate of 1.035%; and 3) a closing stock price of \$3.413. The derivative asset and liabilities were revalued as of September 30, 2012 using the following assumptions: 1) volatility of 85%; 2) risk-free interest rate of 0.747%; and 3) a closing stock price of \$1.43.

The following table sets forth a summary of changes in the fair value of the Company's Level 3 financial asset and liabilities for the nine months ended September 30, 2012:

	Derivative Asset	Total Assets	Warrants issued December 29, 2008	Warrants issued May 10, 2012	Derivative Liability	Total Liabilities
Balance at beginning of period ⁽¹⁾	\$ 18,508	\$ 18,508	\$ 125,415	\$ 7,573,466	\$ 3,476,134	\$ 11,175,015
Settlements						
Revaluation	(17,692)	(17,692)	(11,241)	(6,406,556)	(3,279,743)	(9,697,540)
Balance at end of period	\$ 816	\$ 816	\$ 114,174	\$ 1,166,910	\$ 196,391	\$ 1,477,475

⁽¹⁾ The beginning of the period is December 31, 2011 for warrants issued December 29, 2008. The beginning of the period for the derivative asset, warrants issued May 10, 2012, and derivative liability is May 10, 2012.

The Company currently does not have derivative instruments to manage its exposure to currency fluctuations or other business risks. The Company evaluates all of its financial instruments to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. All derivative financial instruments are recognized in the balance sheet at fair value.

12. Product Warranty Provisions

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

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Accrued warranty, which is included in other accrued liabilities, consists of the following:

	September 30, 2012
Warranty accrual, December 31, 2011	\$ 691,832
Warranty expense incurred	449,401
Payments made	(575,801)
Warranty accrual, September 30, 2012	\$ 565,432

13. 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.

In 2011, the Company entered into a letter of credit to support a commitment in the amount of less than \$0.1 million. This letter of credit is valid through 2015.

14. Subsequent Events

While the Company remains focused on continuing the third quarter positive operating and financial trends, the Company also recognizes the need to strengthen its balance sheet. As a result, an independent financial advisor has been engaged to assist management and the Board of Directors in reviewing all possible strategic and financial alternatives, including the sale of non-core assets or distribution rights and geographic partnerships. There can be no assurance as to whether any particular strategic or financing alternative will be recommended by the Board, and the Company does not intend to disclose information on the progress of this evaluation until such time as deemed appropriate by the Board.

Table of Contents**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, 2011. Operating results are not necessarily indicative of results that may occur in future periods. As described in Note 10 to the financial statements, on July 10, 2012, the Company effected a one-for-ten Reverse Stock Split of the Company's common stock. All information set forth in the following discussion and analysis gives effect to such Reverse Stock Split.

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 in Item 1A Risk Factors and in our Annual Report on Form 10-K for the year ended December 31, 2011. 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 the *Epoch* Solution, which is an advanced remote robotic navigation system for use in a hospital's interventional surgical suite, or interventional lab, that we believe revolutionizes the treatment of arrhythmias and coronary artery disease by enabling enhanced safety, efficiency and efficacy for catheter-based, or interventional, procedures. The *Epoch* Solution is comprised of the *Niobe* ES Robotic Magnetic Navigation System (*Niobe* ES system), *Odyssey* Information Management Solution (*Odyssey* Solution), and the *Vdrive* Robotic Navigation System (*Vdrive*).

The *Niobe* 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.

In addition to the *Niobe* system and its components, Stereotaxis also has developed the *Odyssey* Solution, which consolidates all lab information enabling doctors to focus on the patient for optimal procedure efficiency. The system also features a remote viewing and recording capability called *Odyssey Cinema*, which is an innovative solution delivering synchronized content for optimized workflow, advanced care and improved productivity. This tool includes an archiving capability that allows clinicians to store and replay entire procedures or segments of procedures. This information can be accessed from locations throughout the hospital local area network and over the global *Odyssey* Network providing physicians with a tool for clinical collaboration, remote consultation and training.

Our *Vdrive* system provides navigation and stability for diagnostic and therapeutic devices designed to improve interventional procedures. The *Vdrive* system complements the *Niobe* ES system control of therapeutic catheters for fully remote procedures and enables single-operator workflow and is sold as two options, the *Vdrive* system and the *Vdrive Duo* system. In addition to the *Vdrive* system and the *Vdrive Duo* system, we also manufacture and market various disposable components which can be manipulated by these systems.

We promote the full *Epoch* Solution in a typical hospital implementation, subject to regulatory approvals or clearances. The full *Epoch* Solution implementation requires a hospital to agree to an upfront capital payment and recurring payments. The upfront capital payment typically includes equipment and installation charges. The recurring payments typically include disposable costs for each procedure, equipment service costs beyond warranty period, and software licenses and *Odyssey* Network fees. In hospitals where the full *Epoch* Solution has not been implemented, equipment upgrade or expansion can be implemented upon purchasing of the necessary upgrade or expansion.

The core components of Stereotaxis systems have received regulatory clearance in the U.S., Europe, Canada and elsewhere; the *V-Loop* circular catheter manipulator is currently in human clinical trials and *V-Sono* ICE catheter manipulator is under regulatory review by the U.S. Food and Drug Administration.

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Since our inception, we have generated significant losses. As of September 30, 2012, we had incurred cumulative net losses of approximately \$380 million. The Company expects such losses to continue through at least the year ended December 31, 2012. In May 2011, the Company introduced the *Niobe* ES, which is the latest generation of the *Niobe* Robotic Magnetic Navigation System and will replace the *Niobe* II system going forward. Due to the fact that the *Niobe* ES system and upgrades from *Niobe* II to *Niobe* ES systems were not available to customers until December 2011, the product change created a rapid shift away from sales of the current *Niobe* II system, resulting in lower System Revenue in 2011. As of September 30, 2012, the Company had performed 60 installations to upgrade *Niobe* II systems to *Niobe* ES systems and has received positive feedback from the physicians at these sites. The Company reduced operating expenses by \$3.7 million or 29% from first quarter 2012 levels in the 2012 third quarter and anticipates achieving a 15% to 20% reduction from first quarter levels in the fourth quarter of 2012.

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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, 2011.

Revenue Recognition

For arrangements with multiple deliverables, the Company allocates the total revenue to each deliverable based on the provisions of general accounting principles for revenue recognition and multiple-deliverable revenue arrangements and recognizes revenue for each separate element as the criteria for revenue recognition are met. Each element is assigned an estimated selling price using vendor-specific objective evidence, third party evidence, or management's estimate.

Under our revenue recognition policy, a portion of revenue for the *Niobe*, *Odyssey Vision*, *Odyssey Cinema*, and *Vdrive* systems is recognized upon delivery, provided that title has passed, there are no uncertainties regarding acceptance, persuasive evidence of an arrangement exists, the sales price is fixed and determinable, and collection of the related receivable is reasonably assured. Revenue for *Niobe*, *Odyssey Vision Standard HD*, *Odyssey Vision Quad*, *Odyssey Enterprise Cinema*, and *Vdrive* systems is recognized upon delivery due to the fact that third parties became qualified to perform installations. Revenue is recognized for other types of *Odyssey* systems upon completion of installation, since there are no qualified third party installers. When installation is the responsibility of the customer, revenue from system sales is recognized upon shipment since these arrangements do not include an installation element or right of return privileges. The Company does not recognize revenue in situations in which inventory remains at a Stereotaxis warehouse or in situations in which title and risk of loss have not transferred to the customer. However, the Company may deliver systems to a non-hospital site at the customer's request as outlined in the terms and conditions of the sales agreement, in which case the Company evaluates whether the substance of the transaction meets the delivery and performance requirements for revenue recognition under bill and hold guidance. Amounts collected prior to satisfying the above revenue recognition criteria are reflected as deferred revenue.

Revenue from services and license fees, whether sold individually or as a separate unit of accounting in a multiple-deliverable arrangement, is deferred and amortized over the service or license fee period, which is typically one year. Revenue from services is derived primarily from the sale of annual product maintenance plans. We recognize revenue from disposable device sales or accessories upon shipment and establish an appropriate reserve for returns. The return reserve, which is applicable only to disposable devices, is estimated based on historical experience which is periodically reviewed and updated as necessary. In the past, changes in estimate have had only a de minimus effect on revenue recognized in the period. We believe that the estimate is not likely to change significantly in the future.

Costs of systems revenue include direct product costs, installation labor and other costs, estimated warranty costs, and initial training and product maintenance costs. These costs are recorded at the time of sale. Costs of disposable revenue include direct product costs and estimated warranty costs and are recorded at the time of sale. Cost of revenue from services and license fees are recorded when incurred.

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Results of Operations

Comparison of the Three Months Ended September 30, 2012 and 2011

Revenue. Revenue increased from \$8.5 million for the three months ended September 30, 2011 to \$11.6 million for the three months ended September 30, 2012, an increase of approximately 35%. Revenue from the sale of systems rose from \$2.0 million to \$5.0 million, an increase of approximately 147%. We recognized revenue on two *Niobe* ES, a total of \$0.6 million for *Niobe* ES upgrades, \$0.5 million for *Vdrive* systems and a total of \$1.6 million for *Odyssey* and *Odyssey Cinema* systems during the 2012 period, versus one *Niobe* system and a total of \$1.0 million for *Odyssey* and *Odyssey Cinema* systems during the 2011 period. Revenue from sales of disposable interventional devices, service and accessories was flat at \$6.5 million for the three months ended September 30, 2012 and 2011 with disposable sales, royalty and service revenue being consistent.

Cost of Revenue. Cost of revenue increased from \$2.7 million for the three months ended September 30, 2011 to \$3.5 million for the three months ended September 30, 2012, an increase of approximately 31%. Cost of revenue for systems sold rose from \$1.7 million for the three months ended September 30, 2011 to \$2.4 million for the three months ended September 30, 2012, an increase of approximately 41%. This increase was primarily due to one more *Niobe* system and higher *Odyssey* and *Odyssey Cinema* system sales. Cost of revenue for disposables, service and accessories increased from \$0.9 million for the three months ended September 30, 2011 to \$1.1 million for the three months ended September 30, 2012, an increase of approximately 13%. The increase was primarily due to *Niobe* ES upgrades received in exchange for new or extended premium service contracts. As a percentage of our total revenue, overall gross margin increased to 70% for the three months ended September 30, 2012 from 69% for the three months ended September 30, 2011. Gross margin for systems was 52% for the three months ended September 30, 2012 compared to 15% for the three months ended September 30, 2011. The improvement is primarily attributable to higher production volumes and related cost absorption. Gross margin for disposables, service and accessories was 84% for the current quarter compared to 86% for the three months ended September 30, 2011. The decline is mainly due to the additional cost of *Niobe* ES upgrades received in exchange for new or extended premium service contracts.

Research and Development Expenses. Research and development expenses declined from \$3.5 million for the three months ended September 30, 2011 to \$1.9 million for the three months ended September 30, 2012, a decrease of approximately 46%. The decrease is primarily due to the completion of major development efforts of the *Epoch* Solution and *Odyssey* system upgrades in 2011, as well as reduced headcount expenses as part of the Company's efforts to reduce 2012 operating expenses.

Sales and Marketing Expenses. Sales and marketing expenses decreased from \$6.9 million for the three months ended September 30, 2011 to \$4.1 million for the three months ended September 30, 2012, a decline of approximately 41%. The decrease was due to primarily due to reduced headcount and related travel and relocation expenses as well as lower marketing and consulting expenses as part of the Company's efforts to reduce operating expenses.

General and Administrative Expenses. General and administrative expenses include regulatory, clinical, finance, information systems, legal, general management and training expenses. General and administrative expenses decreased to \$3.0 million from \$4.5 million for the three months ended September 30, 2012 and 2011, respectively, a decrease of approximately 34%. The decrease was primarily due to reduced headcount and related travel and relocation expenses as well as lower spending on registrations in Japan as our products approach the end of clinical trials, bad debt expense and foreign currency effects.

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Other Income. Other income represents the change in market value of certain warrants classified as a derivative and recorded as a current liability under general accounting principles for determining whether an instrument (or embedded feature) is indexed to an entity's own stock. Other income also includes the adjustment in fair value of the derivative asset and liability related to the conversion features embedded in the subordinated convertible debentures. The primary drivers of fluctuations in this balance are changes in the Company's stock price from one period to the next.

Interest Expense. Interest expense increased to \$1.6 million for the three months ended September 30, 2012 from \$0.8 million for the three months ended September 30, 2011, due to the Cowen financing in November 2011 and additional \$2.5 million borrowing in August 2012, and the issuance of \$8.5 million in Debentures in May 2012. Interest expense also includes the amortization of the debt discount on the Debentures totaling \$0.2 million for the three months ended September 30, 2012.

Comparison of the Nine months Ended September 30, 2012 and 2011

Revenue. Revenue rose from \$30.4 million for the nine months ended September 30, 2011 to \$34.4 million for the nine months ended September 30, 2012, an increase of approximately 13%. Revenue from the sale of systems increased from \$11.4 million to \$14.1 million, an improvement of approximately 24%. We recognized revenue on six *Niobe* ES, a total of \$2.7 million for *Niobe* ES upgrades, and a total of \$4.8 million for *Odyssey* systems during the 2012 period, versus five *Niobe* systems and a total of \$5.3 million for *Odyssey* systems during the 2011 period. Revenue from sales of disposable interventional devices, service and accessories increased to \$20.3 million for the nine months ended September 30, 2012 from \$19.0 million for the nine months ended September 30, 2011, approximately 7% higher. The increase was attributable to improved utilization due to *Niobe* ES upgrades and to a lesser extent the increased base of installed systems, the resulting disposable sales, offset by lower royalty income resulting from a reduction in the royalty rate effective January 1, 2012.

Cost of Revenue. Cost of revenue increased from \$9.2 million for the nine months ended September 30, 2011 to \$10.5 million for the nine months ended September 30, 2012, a rise of approximately 14%. As a percentage of our total revenue, overall gross margin decreased from 70% for the nine months ended September 30, 2011 to 69% for the nine months ended September 30, 2012 as higher systems margins offset lower disposable, service and accessories margins and a higher mix of lower margin systems revenue. Cost of revenue for systems sold increased from \$6.4 million for the nine months ended September 30, 2011 to \$6.9 million for the nine months ended September 30, 2012, a rise of approximately 8%, primarily due to higher *Niobe* ES and *Vdrive* system sales. Gross margin for systems was 51% for the nine months ended September 30, 2012 compared to 43% for the nine months ended September 30, 2011. The improvement is primarily attributable to higher production volumes and related cost absorption. Cost of revenue for disposables, service and accessories increased to \$3.6 million during the 2012 period from \$2.7 million during the 2011 period, resulting in a decrease in gross margin to 82% from 86% between these periods. The decrease in gross margin is due to a higher mix of lower margin disposables revenue, lower royalties and providing *Niobe* ES upgrades in exchange for new or extended premium service contracts.

Research and Development Expenses. Research and development expenses decreased from \$10.2 million for the nine months ended September 30, 2011 to \$6.9 million for the nine months ended September 30, 2012, a decline of approximately 32%. The decrease is primarily due to the completion of major development efforts of the *Epoch* Solution and *Odyssey* system upgrades in 2011, as well as reduced headcount expenses as part of the Company's efforts to reduce 2012 operating expenses.

Sales and Marketing Expenses. Sales and marketing expenses declined from \$24.9 million for the nine months ended September 30, 2011 to \$16.3 million for the nine months ended September 30, 2012, a decrease of approximately 35%. The decrease was principally due to reduced headcount and related travel and relocation expenses as well as reduced marketing and consulting expenses as part of the Company's efforts to reduce operating expenses.

General and Administrative Expenses. General and administrative expenses include regulatory, clinical, finance, information systems, legal, general management and training expenses. General and administrative expenses decreased to \$10.3 million from \$13.4 million for the nine months ended September 30, 2012 and 2011, respectively, a decline of approximately 23%. The decrease was primarily due to reduced headcount and related travel and relocation expenses, lower spending on registrations in Japan as our products approach the end of clinical trials, and decreased bad debt expense and consulting costs, partially offset by foreign currency effects.

Other Income. Other income represents the change in market value of certain warrants classified as a derivative and recorded as a current liability under general accounting principles for determining whether an instrument (or embedded feature) is indexed to an entity's own stock. Other income also includes the adjustment in fair value of the derivative asset and liability related to the conversion features embedded in the subordinated convertible debentures. The primary drivers of fluctuations in this balance are changes in the Company's stock price from one period to the next.

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Interest Expense. Interest expense increased to \$4.9 million for the nine months ended September 30, 2012 from \$2.4 million for the nine months ended September 30, 2011, due to the Cowen financing in November 2011 and additional \$2.5 million borrowing in August 2012, and the issuance of \$8.5 million in Debentures in May 2012. Interest expense also includes the amortization of the debt discount on the Debentures totaling \$0.4 million for the nine months ended September 30, 2012.

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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. At September 30, 2012 we had \$9.9 million of cash and equivalents. We had a working capital deficit of approximately \$1.9 million and \$6.6 million as of September 30, 2012 and December 31, 2011, respectively. The decrease in working capital deficit is due principally to the financing transaction completed in May 2012, as discussed in Notes 9 and 10.

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The following table summarizes our cash flow by operating, investing and financing activities for each of nine month periods ended September 30, 2012 and 2011 (in thousands):

	Nine Months Ended September 30,	
	2012	2011
Cash Flow used in Operating Activities	\$ (12,041)	\$ (19,959)
Cash Flow used in Investing Activities	\$ (130)	\$ (973)
Cash Flow provided by Financing Activities	\$ 8,130	\$ 2,663

Net cash used in operating activities. We used approximately \$12.0 million and \$20.0 million of cash for operating activities during the nine months ended September 30, 2012 and 2011, respectively. This decrease was primarily driven by a lower net loss of \$21.6 million and a decrease of \$2.4 million due to the net presentation of the Biosense Webster royalty in operating activities in 2011 partially offset by a \$10.3 million net increase in working capital principally due to higher accounts receivable and lower deferred revenue and \$6.4 million increase in the non-cash gain associated with the adjustment of warrants and debt conversion features.

Net cash used in investing activities. We used approximately \$0.1 million of cash for purchases of equipment for the nine month period ended September 30, 2012 compared to \$1.0 million for the nine month period ended September 30, 2011. The decrease was due to higher expenditures in 2011 for equipment related to new product development as well as equipment used for trade shows.

Net cash provided by financing activities. We generated approximately \$8.1 million of cash for the nine month period ended September 30, 2012 compared to \$2.7 million generated for the nine month period ended September 30, 2011. This increase in cash generated was primarily due to \$7.7 million from the issuance of subordinated convertible debentures and warrants, \$9.1 million from stock and warrants and \$2.5 million in additional borrowing from Cowen partially offset by \$7.1 million net payments under our revolving line of credit, \$3.0 million related to the term note, and \$1.1 million for Cowen debt.

In May 2012, the Company entered into financing agreements for gross proceeds of approximately \$18.5 million. Upon closing the financing transactions, the Company amended its agreement with its primary lender. See Notes 9 and 10 for additional details.

We expect to have negative cash flow from operations throughout 2012. We also expect to continue the development and commercialization of our existing products and, to a lesser extent, our research and development programs and the advancement of new products into clinical development. We expect that our sales and marketing, research and development, and general and administrative expenses will decrease throughout 2012. Although our operating expenses have significantly declined in 2012, we cannot assure that our existing cash, cash equivalents and borrowing facilities will be sufficient to fund our operating expenses and capital equipment requirements through the next 12 months. We may be required to raise capital or pursue other financing strategies to continue our operations. We are striving to generate positive cash flow from operations. However, until we can generate significant cash flow from our operations, we expect to continue to fund our operations with cash resources primarily generated from the proceeds of our past and future public offerings, private sales of our equity securities, working capital and equipment financing loans, and other financing strategies. 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. We also cannot assure that additional financing will be available on a timely basis on terms acceptable to us or at all. If adequate funds are not available to us, through the extension of our existing debt facility or otherwise, we may not be able to maintain customer and vendor relationships; hire, train and retain employees; maintain or expand our operations; or respond to competitive pressures. Further, 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 sales, 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.

While the Company remains focused on continuing the third quarter positive operating and financial trends, the Company also recognizes the need to strengthen its balance sheet. As a result, an independent financial advisor has been engaged to assist management and the Board of Directors in reviewing all possible strategic and financial alternatives, including the sale of non-core assets or distribution rights and geographic partnerships. There can be no assurance as to whether any particular strategic or financing alternative will be recommended by the Board, and the Company does not intend to disclose information on the progress of this evaluation until such time as deemed appropriate by the Board.

Table of Contents*Borrowing facilities**Revolving line of credit*

The revolving line of credit and the Company's term notes (collectively, the Credit Agreements) are secured by substantially all of the Company's assets. The Company is also required under the Credit Agreements to maintain its primary operating account and the majority of its cash and investment balances in accounts with the primary lender.

In December 2010, the Company amended its agreement with its primary lender to extend the maturity of the current working capital line of credit from March 31, 2011 to March 31, 2012, retaining the \$30 million total availability under the line per the 2009 amendment. The revised agreement retained the \$10 million sublimit for borrowings supported by guarantees from stockholders who are affiliates of two members of its board of directors (Lenders) and considered to be related parties. Under the revised facility the Company is required to maintain a minimum tangible net worth and liquidity ratio as defined in the agreement. Interest on the facility accrued at the rate of prime plus 0.5% subject to a floor of 6% for the amount under guarantee and prime plus 1.75% subject to a floor of 7% for the remaining amounts.

In September 2011, the Company amended its agreement with its primary lender. The amendment reduced the availability amount of all credit extensions, other than the term loan, from \$30 million to \$20 million, and modified the interest rate applicable to the term loan from the lender's prime rate plus 3.5% to the lender's prime rate plus 5.5%.

On November 30, 2011, the Company entered into a Second Amended and Restated Loan and Security Agreement with its primary lender (Amended Loan Agreement). Under the Amended Loan Agreement, the Company agreed to revised tangible net worth and liquidity ratio covenants. Further, certain intellectual property assets of the Company were added to the collateral which secures repayment of the loan. Finally, the Amended Loan Agreement permits the Company to repay Cowen Healthcare Royalty Partners II, L.P. (Cowen) under the Agreement with the royalties due to the Company under the Biosense Agreement (the Biosense Agreement), as described below.

On March 30, 2012, the Company amended its agreement with its primary lender. The amendment extended the maturity date of the working capital line of credit from March 31, 2012 to April 30, 2012 and reduced the Company's borrowing availability by \$3,333,333. The Company also extended until April 30, 2012 the \$10 million guarantee provided by the Lenders. As a result of this extension, the Company issued the Lenders warrants to purchase 75,735 shares of common stock at \$6.60 per share.

On May 1, 2012, the Company and its primary lender entered into an agreement in which the lender extended the maturity of the revolving line of credit from April 30, 2012 to May 15, 2012. The Company also amended its agreement with the Lenders to extend the \$10 million loan guarantee through May 15, 2012. The Company granted warrants to purchase an aggregate of 60,976 shares of Common Stock in exchange for the extension of the guarantee.

On May 10, 2012, upon closing of financing transactions for gross proceeds of \$18.5 million, the Company entered into the Third Loan Modification Agreement with its primary lender. The amendment extended the revolving credit facility maturity to March 31, 2013 and revised the financial covenants. Additionally, the revolving line of credit was decreased from \$20 million to \$13 million. The reduction was as a result of the pay down of \$7 million of the guarantees provided by the Lenders.

As of September 30, 2012, the Company had \$8.2 million outstanding under the revolving line of credit. Draws on the line of credit are made based on the borrowing capacity one week in arrears. As of September 30, 2012, the Company had a borrowing capacity of \$8.2 million based on the Company's collateralized assets, including amounts already drawn. As such, the Company had no remaining borrowing availability at September 30, 2012. As of September 30, 2012, the Company was in compliance with all covenants of the bank loan agreement and had no remaining availability on its Lender loan and guarantee.

Term note

Under the 2010 amendment to the loan agreement, the Company entered into a \$10 million term loan maturing on December 31, 2013, with \$2 million of principal due in 2011 and \$4 million of principal due in each of 2012 and 2013. Interest on the term loan accrued at the rate of prime plus 3.5%. Under the September 2011 amendment of the loan agreement, the interest rate on the term loan was increased to prime plus 5.5%. Under this agreement, the Company provided its primary lender with warrants to purchase 11,111 shares of common stock. The warrants are exercisable at \$36.00 per share, beginning on December 17, 2010 and expiring on December 17, 2015. The fair value of these warrants of \$228,332, calculated using the Black Scholes method, will be deferred and amortized to interest expense ratably over the life of the term loan.

Cowen Debt

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In November 2011, the Company entered into a loan agreement with Cowen. Under the agreement the Company borrowed from Cowen \$15 million. The Company may borrow up to an additional \$5 million in the aggregate based on the achievement by the Company of certain milestones related to *Niobe* system sales in 2012. The loan will be repaid through, and secured by, royalties payable to the Company under its Development, Alliance and Supply Agreement with Biosense Webster, Inc. The Biosense Agreement relates to the development and distribution of magnetically enabled catheters used with Stereotaxis *Niobe* system in cardiac ablation procedures. Under the terms of the Agreement, Cowen will be entitled to receive 100% of all royalties due to the Company under the Biosense Agreement until the loan is repaid. The loan is a full recourse loan, matures on December 31, 2018, and bears interest at an annual rate of 16% payable quarterly with royalties

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received under the Biosense Agreement. If the payments received by the Company under the Biosense Agreement are insufficient to pay all amounts of interest due on the loan, then such deficiency will increase the outstanding principal amount on the loan. After the loan obligation is repaid, the royalties under the Biosense Agreement will again be paid to the Company. The loan is also secured by certain assets and intellectual property of the Company. The Agreement also contains customary affirmative and negative covenants. The use of payments due to the Company under the Biosense Agreement was approved by our primary lender under the Amended Loans Agreement described above.

On August 8, 2012, the Company borrowed an additional \$2.5 million from Cowen based upon achievement of a milestone related to *Niobe* system sales for the nine months ended June 30, 2012.

Subordinated Convertible Debentures

In May 2012, the Company entered into a securities purchase agreement with certain institutional investors whereby the Company agreed to sell an aggregate of approximately \$8.5 million in aggregate principal amount of unsecured, subordinated, convertible debentures (the *Debentures*), which became convertible into shares of the Company's common stock at a conversion price of \$3.361 per share (or approximately 2.5 million shares in the aggregate), on July 10, 2012, the date that the Company received shareholder approval for the transaction. The purchasers of the *Debentures* also received six-year warrants to purchase an aggregate of approximately 2.5 million shares of the Company's common stock at an exercise price of \$3.361 per share. The *Debentures* bear interest at 8% per year and mature on May 7, 2014. In addition, the Company has the ability to issue shares of its common stock in lieu of cash interest payments under certain circumstances, and intends to do so at such time as the Company has registered the shares for resale.

The Company recorded the *Debentures* on the balance sheet net of the debt discount of \$7.5 million. The debt discount is due to warrants issued in conjunction with the *Debentures* and the debt conversion features. The fair value of the warrants and derivative liability were \$4.1 million and \$3.5 million, respectively. The debt discount will be amortized over the life of the loan using the effective interest method. Refer to Note 11 for additional discussion of the fair value of the warrants and conversion features.

Biosense Webster Advance

In July 2008, the Company and Biosense Webster entered into an amendment to their existing agreements relating to the development and sale of catheters. Pursuant to the amendment, Biosense Webster agreed to pay to the Company \$10.0 million as an advance on royalty amounts that were owed at the time the amendment was executed or would be owed in the future by Biosense Webster to the Company pursuant to the royalty provisions of one of the existing agreements. The Company and Biosense Webster also agreed that an aggregate of up to \$8.0 million of certain agreed upon research and development expenses that were owed at the time the amendment was executed or may be owed in the future by the Company to Biosense Webster pursuant to the existing agreement would be deferred and will be due, together with any unrecouped portion of the \$10.0 million royalty advance, no later than December 31, 2011. Interest on the outstanding and unrecouped amounts of the royalty advance and deferred research and development expenses accrued at an interest rate of the prime rate plus 0.75%. Outstanding royalty advances and deferred research and development expenses and accrued interest thereon were recouped by Biosense Webster by deductions from royalty amounts otherwise owed to the Company from Biosense Webster pursuant to the existing agreement. Approximately \$18.0 million had been advanced by Biosense Webster to the Company pursuant to the amendment. As of December 31, 2011, these amounts plus interest accrued thereon had been repaid in full, in accordance with the agreement.

Common Stock

PIPE Transaction

In May 2012, the Company entered into a stock and warrant purchase agreement with certain institutional investors whereby it agreed to sell an aggregate of approximately 21.7 million shares of the Company's common stock (the *PIPE Common Stock*) at a price of \$0.3361 per share, together with six-year warrants at a price of \$0.125 per share to purchase an aggregate of approximately 21.7 million shares of common stock having an exercise price of \$0.3361 per share (the *PIPE Warrants*). Each purchaser received a *PIPE Warrant* to purchase one share of common stock for every share of *PIPE Common Stock* purchased.

As described in Note 10, on July 10, 2012, the Company effected a one-for-ten Reverse Stock Split of the Company's common stock. As a result, the *PIPE Common Stock* was combined and converted into an aggregate of approximately 2.17 million shares of the Company's common stock, and the *PIPE Warrants* became exercisable for an aggregate of approximately 2.17 million shares with an exercise price of \$3.361 per share.

Net proceeds from the sale of the securities were approximately \$9.1 million, after placement agent fees and other offering expenses. The Company used the funds to repay \$7 million of the revolving credit facility guaranteed by the Lenders and plans to use the balance for working

capital and general corporate purposes.

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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.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Exchange Risk

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. Although the majority of our revenue and expenses are transacted in U.S. dollars, a portion of our activities are conducted in Euros and to a lesser extent, in other currencies. As such, we have foreign exchange exposure with respect to non-U.S. dollar revenues and expenses as well as cash balances, accounts receivable and accounts payable balances denominated in non-US dollar currencies. Our international activities are subject to risks typical of international activities, including, but not limited to, differing economic conditions, changes in political climate, differing tax structures, other regulations and restrictions, and foreign exchange rate volatility. 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. As of September 30, 2012 we have not hedged exposures in foreign currencies or entered into any other derivative instruments.

For the nine months ended September 30, 2012, sales denominated in foreign currencies were approximately 16% of total revenue and as such, our revenue would have decreased by approximately \$0.6 million if the U.S. dollar exchange rate used would have strengthened by 10%. For the nine months ended September 30, 2012, expenses denominated in foreign currencies were approximately 11% of our total expenses and as such, our operating expenses would have decreased by approximately \$0.4 million if the U.S. dollar exchange rate used would have strengthened by 10%. In addition, we have assets and liabilities denominated in foreign currencies. A 10% strengthening of the U.S. dollar exchange rate against all currencies with which we have exposure at September 30, 2012 would have decreased the carrying amounts of those net assets by approximately \$0.2 million.

Interest Rate Risk

We have exposure to interest rate risk related to our investment portfolio. 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. When appropriate, 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 typically purchase 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 have exposure to market risk related to any investments we might hold. Market liquidity issues might make it impossible for the Company to liquidate its holdings or require that the Company sell the securities at a substantial loss. As of September 30, 2012, the Company did not hold any investments.

We have exposure to interest rate risk related to our borrowings as the interest rates for certain of our outstanding loans are subject to increase should the interest rate increase above a defined percentage. Because certain of our outstanding debt is subject to minimum interest rates ranging from 6.0% to 7.0%, a hypothetical increase in interest rates of 100 basis points would have resulted in a less than \$0.1 million increase in interest expense for the quarter ended September 30, 2012.

Inflation Risk

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.

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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 were effective.

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

As described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011, on October 7, 2011, a purported securities class action was filed against the Company, one of the Company's current executive officers and a past executive officer in the U.S. District Court for the Eastern District of Missouri by Kevin Pound, a purported shareholder of the Company. On December 29, 2011, the court granted an unopposed motion appointing Local 522 Pension Fund as Lead Plaintiff in the action and granting Lead Plaintiff leave to file an Amended Complaint, which Lead Plaintiff filed on March 19, 2012. The Amended Complaint alleges that, during the period from February 28, 2011 through August 9, 2011, the Company and certain of its officers made materially false and misleading statements regarding the Company's financial condition and future business prospects, in violation of sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended. The Amended Complaint seeks unspecified damages, costs, attorneys' fees and such other relief as the Court may deem appropriate. On May 18, 2012, the Company filed a motion to dismiss the Amended Complaint. On July 24, 2012, Lead Plaintiff filed its response to the motion to dismiss, and on August 30, 2012, the Company filed its reply brief in support of the motion to dismiss. The Company believes the complaint is without merit and intends to vigorously defend against it. However, litigation is inherently uncertain and it is too early in this proceeding to predict the outcome of this lawsuit or to reasonably estimate possible losses, if any, related thereto. In addition, the Company has obligations, under certain circumstances, to indemnify the individual defendants with respect to claims asserted against them and otherwise to the fullest extent permitted under Delaware law and the Company's bylaws and certificate of incorporation.

As described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011, on December 2, 2011, a purported shareholder derivative action was filed in the U.S. District Court for the Eastern District of Missouri by Carl Zorn, a purported shareholder of the Company, against the directors of the Company and the Company as a nominal defendant. The Complaint in this action alleges that the individual defendants breached their fiduciary duties to the Company, engaged in gross mismanagement and caused waste of corporate assets of the Company by allowing the Company and certain of its officers to make the same allegedly false and misleading statements regarding the Company's financial condition and future business prospects that are at issue in the purported class action. The Complaint seeks unspecified damages, restitution and other equitable relief, as well as costs and attorneys' fees from the named defendants on behalf of the Company. At the request of all parties, on March 22, 2012, the Court entered an order staying the case pending resolution of the motion to dismiss in the securities class action. The Company believes the complaint is without merit and intends to vigorously defend against it. However, litigation is inherently uncertain and it is too early in this proceeding to predict the outcome of this lawsuit or to reasonably estimate possible losses, if any, related thereto. In addition, the Company has obligations, under certain circumstances, to indemnify the individual defendants with respect to claims asserted against them and otherwise to the fullest extent permitted under Delaware law and the Company's bylaws and certificate of incorporation.

Additionally, we are involved from time to time in various lawsuits and claims arising in the normal 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

We may not be able to comply with debt covenants and may have to repay outstanding indebtedness.

We have financed our operations through equity and convertible debt transactions, a financing of our catheter royalty stream under the Cowen facility entered into in November 2011, as well as bank and other borrowings. We recently extended our revolving line of credit, which matures on March 31, 2013, and our Debentures mature on May 10, 2014. In addition, our current convertible debt and other borrowing agreements contain various covenants, including financial covenants under our credit agreement with our primary lender. The covenants in these various agreements are similar, but are not identical in all respects. If we violate our covenants, we could be required to repay the indebtedness as to which that default relates. In addition, as a result of various cross-default provisions in these agreements, a violation of the covenants under one or more of such agreements could trigger our obligation to repay all of our existing indebtedness. We could be unable to make these payments, which could lead to insolvency. Even if we are able to make these payments, it will lead to the lack of availability for additional borrowings under our bank loan agreement due to our borrowing capacity. There can be no assurance that we will be able to maintain compliance with these covenants or that we could replace this source of liquidity if these covenants were to be violated and our loans and other borrowed amounts were forced to be repaid.

We are no longer eligible to use Form S-3, which could impair our capital raising activities.

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As of the date of filing this Form 10-Q, we are not eligible to use Form S-3 as a result of payment default under our facility with our primary lender earlier this year. As a result, we cannot use Form S-3 to register resales of our securities for 12 months following our default, which occurred on April 30, 2012. In addition, we are limited in our ability to file shelf registration statements on SEC Form S-3. Moreover, our public float is below \$75 million and may remain below \$75 million for the foreseeable future. As a result, we may not be eligible to use Form S-3 for primary offerings even though we otherwise would regain the ability to use the form for resale registration statements 12 months following our payment default. We have relied significantly on shelf registration statements on SEC Form S-3 for most of our financings in recent years, and accordingly any such limitations may harm our ability to raise the capital we need. Under these circumstances, until we are again eligible to use Form S-3, we will be required to use a registration statement on Form S-1 to register securities with the SEC or issue such securities in a private placement, which could increase the cost of raising capital.

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Our principal stockholders continue to own a large percentage of our voting stock, and they have the ability to substantially influence matters requiring stockholder approval.

Our executive officers, directors and individuals or entities affiliated with them beneficially own or control a substantial percentage of the outstanding shares of our common stock. Moreover, as a result of the issuance of warrants to certain institutional investors, certain of our directors and their affiliated funds have the ability to obtain a substantial portion of our common stock. Accordingly, these executive officers, directors and their affiliates, acting as a group, will have substantial influence over the outcome of corporate actions requiring stockholder approval, including the election of directors, any merger, consolidation or sale of all or substantially all of our assets or any other significant corporate transaction. These stockholders may also delay or prevent a change of control, even if such a change of control would benefit our other stockholders. This significant concentration of stock ownership may adversely affect the trading price of our common stock due to investors perception that conflicts of interest may exist or arise.

Future issuances of our securities could dilute current stockholders ownership.

We recently filed registration statements relating to the resale of up to 4,070,032 shares of our common stock issuable upon conversion of, or otherwise underlying, the unsecured, subordinated, convertible debentures issued in May 2012, up to 3,404,121 shares of our common stock issuable upon exercise of six-year warrants held by the purchasers of the debentures (Convertible Debt Warrants), and up to 2,168,727 shares of stock issuable on exercise of the PIPE Warrants issued to certain institutional investors in May 2012, and an additional 517,422 shares issuable in connection with amendments two through six of the Note and Warrant Purchase Agreement issued to Alafi Capital Company and the Sanderling Venture Partners affiliates, and we recently increased the authorized number of shares of our common stock from 100,000,000 to 300,000,000. The exercise price of most of these securities (including all of the Debentures, the Convertible Debt Warrants and all of the PIPE Warrants) is \$3.361. A significant number of shares of our common stock are subject to stock options and stock appreciation rights, and we may request the ability to issue additional such securities to our employees. We may also decide to raise additional funds through public or private debt or equity financing to fund our operations. While we cannot predict the effect, if any, that future sales of debt, our common stock, other equity securities or securities convertible into our common stock or other equity securities or the availability of any of the foregoing for future sale, will have on the market price of our common stock, it is likely that sales of substantial amounts of our common stock (including shares issued upon the exercise of stock options, stock appreciation rights or the conversion of any convertible securities outstanding now or in the future), or the perception that such sales could occur, will adversely affect prevailing market prices for our common stock.

If we fail to continue to meet all applicable Nasdaq Global Market requirements and Nasdaq determines to delist our common stock, the delisting could adversely affect the market liquidity of our common stock, impair the value of your investment and harm our business.

Our common stock is currently listed on the Nasdaq Global Market. In order to maintain that listing, we must satisfy minimum financial and other requirements. On January 20, 2012, we received notice from the Nasdaq Listing Qualifications Department that our common stock had not met the \$1.00 per share minimum bid price requirement for 30 consecutive business days and that, if we were unable to demonstrate compliance with this requirement during the applicable grace periods, our common stock would be delisted after that time. Because the closing bid price of our common stock on the Nasdaq Global Market had been below \$1.00 each trading day since December 6, 2011, through July 10, 2012, we implemented the Reverse Stock Split of one-for-ten on July 10 following shareholder approval of that action in order to put our stock in compliance with the minimum bid price requirement. Although we received notification from Nasdaq on July 25 that we had regained compliance with the minimum bid price requirement, there is no assurance that our common stock price will not drop back down below the Nasdaq minimum per share price requirement in the future. In addition, on June 25, 2012, Nasdaq notified us that we no longer comply with the rule regarding market value of publicly held shares, as we did not maintain a publicly held market value of \$15 million for the 30 consecutive business days prior to the date of the letter. In accordance with applicable Nasdaq rules, we are being provided 180 calendar days, or until December 24, 2012, to regain compliance with that rule. However, we may be unable to do so in that time frame, or at all. It is also possible that we would otherwise fail to satisfy another Nasdaq requirement for continued listing of our common stock. If we fail to continue to meet all applicable Nasdaq Global Market requirements in the future and Nasdaq determines to delist our common stock, the delisting could adversely affect the market liquidity of our common stock, adversely affect our ability to obtain financing for the continuation of our operations and harm our business. Any such delisting could also impair the value of your investment.

Additional Risk Factors are discussed in our Annual Report on Form 10-K for the year ended December 31, 2011.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. [RESERVED]

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

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 8, 2012

By: */s/ MICHAEL P. KAMINSKI*
Michael P. Kaminski,
Chief Executive Officer

Date: November 8, 2012

By: */s/ SAMUEL W. DUGGAN II*
Samuel W. Duggan II,
Chief Financial Officer

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EXHIBIT INDEX

Number	Description
3.1	Restated Certificate of Incorporation of the Registrant, incorporated by reference to Exhibit 3.1 of the Registrant's Form 10Q (file No. 000-50884) for the fiscal quarter ended September 30, 2004.
3.2	Certificate of Amendment to Amended and Restated Certificate of Incorporation, incorporated by reference to Exhibit 3.1 of the Registrant's Form 8-K (File No. 000-50884) filed on July 10, 2012.
3.3	Restated Bylaws of the Registrant, incorporated by reference to Exhibit 3.2 of the Registrant's Form 10-Q (File No. 000-50884) for the fiscal quarter ended September 30, 2004.
10.1#	Stereotaxis, Inc. 2012 Stock Incentive Plan, filed herewith.
10.2#	Form of Restricted Share Unit Terms of Award under Stereotaxis, Inc. 2012 Stock Incentive Plan, filed herewith.
10.3#	Summary of Outside Directors' Compensation Program, filed herewith.
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).
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

- (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.