NEOPROBE CORP
Form 10QSB
November 14, 2001

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-QSB

(Mark One)

[x] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED: SEPTEMBER 30, 2001

OR

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT
FOR THE TRANSITION PERIOD FROM _____TO_____

COMMISSION FILE NUMBER: 0-26520

NEOPROBE CORPORATION
(Exact name of small business issuer as specified in its charter)

DELAWARE	31-1080091
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)

425 METRO PLACE NORTH, SUITE 300, DUBLIN, OHIO 43017
(Address of principal executive offices)

614.793.7500
(Issuer's telephone number)

26,285,892 SHARES OF COMMON STOCK, PAR VALUE $.001 PER SHARE
(Number of shares of issuer's common equity outstanding as of the close of business on November 1, 2001)

Transitional Small Business Disclosure Format (check one) Yes [ ] No [X]

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NEOPROBE CORPORATION
BALANCE SHEETS

ASSETS	SEPTEMBER 30, 2001 (UNAUDITED)	DECEMBER 31, 2000
Current assets:		
Cash and cash equivalents	$4,863,507	$4,643,347
Accounts receivable, net	47,171	365,061
Inventory	1,651,368	941,120
Prepaid expenses and other	41,873	234,232
Total current assets	6,603,919	6,183,760
Property and equipment	2,121,601	2,039,187
Less accumulated depreciation and amortization	1,441,851	1,174,167
	679,750	865,020
Intangible assets, net	516,665	524,035
Total assets	$7,800,334	$7,572,815

CONTINUED

NEOPROBE CORPORATION
BALANCE SHEETS, CONTINUED

LIABILITIES AND STOCKHOLDERS' EQUITY	SEPTEM 200 (UNAUD
Current liabilities:	
Notes payable to finance company	$
Capital lease obligations, current	12
Accrued liabilities	1,190
Accounts payable	534
Deferred license revenue, current	800
Total current liabilities	2,537
Capital lease obligations	23
Deferred license revenue	1,600
Total liabilities	4,161

Commitments and contingencies	
Stockholders' equity:	
Preferred stock; $.001 par value; 5,000,000 shares authorized at September 30, 2001 and December 31, 2000; none issued and outstanding (500,000 shares designated as Series A, $.001 par value, at September 30, 2001 and and December 31, 2000; none outstanding)	
Common stock; $.001 par value; 50,000,000 shares authorized; 26,284,892 shares issued and outstanding at September 30, 2001; 26,264,103 shares issued and outstanding at December 31, 2000	26
Additional paid-in capital	120,682
Accumulated deficit	(117,069
Total stockholders' equity	3,639
Total liabilities and stockholders' equity	$ 7,800

See accompanying notes to the financial statements

NEOPROBE CORPORATION
STATEMENTS OF OPERATIONS
(UNAUDITED)

	THREE MONTHS ENDED SEPTEMBER 30,		
	2001	2000	2001
Revenues:			
Net sales	$ 1,592,303	$ 2,124,991	$ 5,064,2
License revenue	200,000	200,000	625,0
Total revenues	1,792,303	2,324,991	5,689,2
Cost of goods sold	1,089,852	1,230,742	3,479,4
Gross profit	702,451	1,094,249	2,209,8
Operating expenses:			
Research and development	30,206	60,266	201,3
Marketing and selling	--	42,397	--
General and administrative	538,861	533,074	1,702,4

Total operating expenses	569,067	635,737	1,903,7
Income from operations	133,384	458,512	306,0
Other income (expenses):			
Interest income	28,693	53,573	111,6
Interest expense	(2,278)	(4,468)	(8,9
Other	241,470	22,769	250,9
Total other income	267,885	71,874	353,6
Net income before taxes	401,269	530,386	659,7
Income taxes	--	26,296	--
Net income	401,269	504,090	659,7
Loss on retirement of preferred stock	--	--	--
Income attributable to common stockholders	$ 401,269	$ 504,090	$ 659,7
Income per common share:			
Basic	$ 0.02	$ 0.02	$ 0.
Diluted	$ 0.02	$ 0.02	$ 0.
Weighted average shares outstanding:			
Basic	25,898,264	25,855,341	25,896,3
Diluted	26,114,054	26,075,393	26,119,8

See accompanying notes to the financial statements

NEOPROBE CORPORATION
STATEMENTS OF CASH FLOWS
(UNAUDITED)

	NINE MONTHS ENDED SEPTEMBER 30,	
	2001	2000
Cash flows from operating activities:		
Net income	$ 659,741	$ 1,116,541
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	314,074	289,985
Other	14,225	(38,788
Change in operating assets and liabilities:		

Accounts receivable	317,890	(623,348
Inventory	(768,336)	575,634
Accounts payable	(197,480)	(437,558
Deferred license revenue	(600,000)	(600,000
Other assets and liabilities	657,472	(50,235
Net cash provided by operating activities	397,586	232,231
Cash flows from investing activities:		
Proceeds from sale of investment in affiliate	--	1,500,000
Purchases of property and equipment	(52,533)	(132,876
Proceeds from sales of property and equipment	2,175	102,516
Patent costs	(14,189)	(19,726
Net cash (used in) provided by investing activities	(64,547)	1,449,914
Cash flows from financing activities:		
Settlement of obligation to preferred stockholder	--	(2,500,000
Proceeds from issuance of common stock, net	834	803
Payments under line of credit	--	(480,000
Payments of notes payable	(105,332)	(154,626
Payments under capital leases	(8,382)	(159,998
Net cash used in financing activities	(112,880)	(3,293,821
Net increase (decrease) in cash and cash equivalents	220,159	(1,611,676
Cash and cash equivalents, beginning of period	4,643,347	4,882,537
Cash and cash equivalents, end of period	$ 4,863,507	$ 3,270,861

See accompanying notes to the financial statements

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NOTES TO THE FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION:

The information presented for September 30, 2001 and 2000, and for the periods then ended is unaudited, but includes all adjustments (which consist only of normal recurring adjustments) that the management of Neoprobe Corporation (Neoprobe or the Company) believes to be necessary for the fair presentation of results for the periods presented. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the U.S. Securities and Exchange Commission. The results for the interim period are not necessarily indicative of results to be expected for the year. The financial statements should be read in conjunction with the Company's audited financial statements for the year ended December 31, 2000, which were included as part of the Company's Annual Report on Form 10-KSB. Certain 2000 amounts have been reclassified to conform with the 2001 presentation.

2. COMPREHENSIVE INCOME (LOSS):

The Company had no accumulated other comprehensive income (loss) activity during the three-month and nine-month periods ended September 30, 2001 and 2000.

3. EARNINGS PER SHARE:

Basic earnings per share is calculated using the weighted average number of common shares outstanding during the periods. Diluted earnings per share is calculated using the weighted average number of common shares outstanding during the periods, adjusted for the effects of convertible securities, options and warrants, if dilutive.

	THREE MONTHS ENDED SEPTEMBER 30, 2001		NINE MONTHS END SEPTEMBER 30, 20	
	BASIC EARNINGS PER SHARE	DILUTED EARNINGS PER SHARE	BASIC EARNINGS PER SHARE	E
Outstanding shares	26,284,892	26,284,892	26,284,892	
Effect of weighting changes in outstanding shares	(16,628)	(16,628)	(18,550)	
Contingently issuable shares	(370,000)	(370,000)	(370,000)	
Stock options	--	215,790	--	
Adjusted shares	25,898,264	26,114,054	25,896,342	

	THREE MONTHS ENDED SEPTEMBER 30, 2000		NINE MONTHS E SEPTEMBER 30,	
	BASIC EARNINGS PER SHARE	DILUTED EARNINGS PER SHARE	BASIC EARNINGS PER SHARE	E
Outstanding shares	26,264,103	26,264,103	26,264,103	
Effect of weighting changes in outstanding shares	(18,762)	(18,762)	(245,748)	
Contingently issuable shares	(390,000)	(390,000)	(390,000)	
Stock options	--	215,599	--	
Warrants	--	4,453	--	
Adjusted shares	25,855,341	26,075,393	25,628,355	

The following table summarizes options to purchase common stock of the Company that were outstanding during the three-month and nine-month periods ended September 30, 2001 and 2000, but that were not included in the computation of diluted income per share because their effect was anti-dilutive.

THREE MONTHS ENDED SEPTEMBER 30, 2001		NINE MONTHS ENDED SEPTEMBER 30, 2001	
EXERCISE PRICE	OPTIONS OUTSTANDING	EXERCISE PRICE	OPTIO OUTSTA
$ 0.60 - $ 1.25	387,551	$ 0.60 - $ 1.25	
$ 1.50 - $ 2.50	227,373	$ 1.50 - $ 2.50	
$ 3.25 - $ 6.00	35,651	$ 3.25 - $ 6.00	
$ 13.38 - $ 15.75	16,848	$ 13.38 - $ 15.75	
	667,423		

THREE MONTHS ENDED SEPTEMBER 30, 2000		NINE MONTHS ENDED SEPTEMBER 30, 2000	
EXERCISE PRICE	OPTIONS OUTSTANDING	EXERCISE PRICE	O OUT
$ 0.75 - $ 2.50	583,011	$ 1.03 - $ 2.50	
$ 3.00 - $ 6.00	270,570	$ 3.00 - $ 6.00	
$ 13.38 - $ 15.75	93,696	$ 13.38 - $ 17.44	
	947,277		

4. INVENTORY:

The components of inventory are as follows:

	SEPTEMBER 30, 2001	DECEMBER 31, 2000
Materials and component parts	$ 754,507	$ 418,087
Finished goods	1,186,374	696,432
Less obsolescence reserve	(289,513)	(173,399)

$ 1,651,368	$ 941,120

5. LINE OF CREDIT:

On January 26, 2001, the Company entered into a revolving credit facility with a bank that provided for a maximum line of credit of $1.5 million. The Company terminated the line of credit on November 8, 2001. There were no borrowings outstanding at any time while the credit facility was in effect. No fees were incurred to terminate the credit facility.

6. INCOME TAXES:

For the nine months ended September 30, 2001, the reversal of certain temporary differences related to accrued expenses and deferred revenue resulted in the generation of a loss for income tax purposes. As a result, no current income tax expense is reflected in the statement of operations for

the nine months ended September 30, 2001. The Company has provided a full valuation allowance against net deferred tax assets at September 30, 2001 and December 31, 2000.

7. STOCK OPTIONS:

During the first half of 2001, the Board of Directors granted options to employees and certain directors of the Company for 715,000 shares of common stock, exercisable at an average price of $0.42 per share, vesting over three years. On July 5, 2001, the Directors cancelled 337,500 options, all of which were priced above $3.00 per share. As of September 30, 2001, the Company has 1.9 million non-qualified options outstanding under two stock option plans. Of the outstanding options, 594,000 options have vested as of September 30, 2001, at an average exercise price of $1.44 per share.

8. SEGMENT INFORMATION:

The Company owns or has rights to intellectual property involving three primary areas of cancer diagnosis and treatment including: hand-held gamma detection instruments currently used primarily in the application of intraoperative lymphatic mapping (ILM), diagnostic radiopharmaceutical products to be used in the Company's proprietary RIGS(R) process, and cell expansion processes associated with activated cellular therapy (ACT). The Company generated $25,000 and $50,000 in revenue during the first nine months of 2001 and 2000, respectively, under an option agreement to license its RIGS technology, but incurred no significant RIGS-related expenses during those periods. The Company had no significant revenue or expenses in either the first nine months of 2001 or 2000 related to its ACT initiative. Other revenue and costs included in the Company's financial statements for the nine-month periods ended September 30, 2001 and 2000 relate to the Company's ILM initiative.

9. ACQUISITION AGREEMENT:

On August 29, 2001, the Company entered into a memorandum of understanding with Biosonix, Ltd. (Biosonix), an Israeli corporation, and its shareholders to acquire all of the outstanding shares of

Biosonix. In exchange, the Company will issue up to 11.8 million shares of common stock of the Company to the shareholders of Biosonix. The Company expects to sign definitive agreements regarding the acquisition during November 2001 and to close the acquisition on or before December 31, 2001, subject to the satisfaction of certain conditions, including government approvals of the transaction in Israel and the United States.

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

BUSINESS AND DEVELOPMENT ACTIVITIES

During the first nine months of 2001, the Company continued development work on enhancements to its current gamma detection instrument product line. In addition, non-instrument-related research activities increased significantly in 2001 over the first nine months of 2000. A significant portion of these non-instrument-related activities are currently being funded by outside sources.

The Company has an option to license a lymphatic targeting agent currently being studied by a Phase I clinical trial being sponsored and conducted by researchers at the University of California at San Diego (UCSD). UCSD's Phase I trial is being funded through a grant from the Susan G. Komen Breast Cancer Foundation. Enrollment in this study began late in the second quarter and has continued during the third and fourth quarters. The Company expects the trial to be completed in early 2002. The Company's option expires in August 2002. Should the Company, based on its interpretation of preliminary or final results from the trial, exercise its option rights, the Company and UCSD have agreed to negotiate in good faith the terms of a definitive license agreement within ninety days of the notification to exercise. There can be no assurance that the clinical trial will be completed within the stated time frame, or ever, or that results from the trial will support further research or ultimately result in a marketable product, or that the Company and UCSD will reach a satisfactory license agreement.

In addition, the Company was notified during the third quarter of 2001 that researchers had received clearance from the U.S. Food and Drug Administration to begin patient enrollment in a Phase I clinical trial involving a second generation of the RIGScan CR antibody for colorectal cancer. This research is

being sponsored and funded by OncoSurg, Inc. (formerly NuRigs, Ltd.), a Delaware company to whom the Company has optioned the development rights for RIGScan CR. Although the option initially required periodic payments to be made to the Company, because the preclinical activities performed by OncoSurg over the past year cost significantly more than had been originally estimated, the Company agreed to defer the quarterly option payments due the Company during 2001 so that OncoSurg may use these funds for clinical trial purposes. OncoSurg began enrollment in the trial during the third quarter and hopes to complete enrollment by the end of 2001. There can be no assurance that the clinical trial will be completed within the stated time frame, or ever, or that results from the trial will support further research or ultimately result in a marketable product. See also Results of Operations.

During the second quarter of 2001, the Company also announced a research collaboration with Aastrom Biosciences (Aastrom). This research is intended to determine whether Aastrom's Replicell(TM) system is able to duplicate cell expansion results experienced in previous Phase I clinical testing of Neoprobe's ACT technology for oncology. The Company and Aastrom are collaborating in the preparation of a protocol for the evaluation of the Replicell system in the ACT process. The Company anticipates that preparations will not be complete until later in 2001 and that the evaluation studies will not begin until the first or second quarter of 2002 at the earliest. The Company believes that positive results from this evaluation, if they occur, would provide a more effective and efficient delivery mechanism for ACT and potentially reinvigorate interest in the underlying ACT technology platform. There can be no assurance that the evaluation will be completed within the stated time frame, or ever, or that results from the evaluation will support further research or ultimately result in a marketable product.

During the third quarter of 2001, the Company entered into a memorandum of understanding with Biosonix and its shareholders to acquire all of the outstanding shares of Biosonix. In exchange, the Company will issue up to 11.8 million shares of common stock of the Company to the shareholders of Biosonix. The Company expects to sign definitive agreements regarding the acquisition during November 2001 and to close the acquisition on or before December 31, 2001, subject to the satisfaction of certain conditions, including government approvals of the transaction in Israel and the United States.

Biosonix has developed a novel Angle-independent Dual Beam Flow (ADBF) technology that enables surgeons and other medical personnel to measure in real-time, and in a simple non-invasive manner, the volume of blood flowing in the vascular circulation as well as a range of additional hemodynamic parameters. Based on the ADBF core technology that utilizes digital multi-gated Doppler ultrasound, Biosonix is in the process of commercialization of several blood flow devices to answer the specific needs of different clinical settings, including the operating room, intensive care unit, emergency room, neurosurgery and vascular surgery. Biosonix' first product, the FlowGuard(TM), has received CE mark clearance for distribution in certain European markets. Neoprobe and Biosonix are preparing for the placement of Biosonix products in key medical institutions in the United States and Europe to support regulatory submissions and prepare for the commercial launch of the products. However, there can be no assurance that the Biosonix products will receive the necessary marketing approvals from the relevant regulatory bodies or that if approved, that such products will achieve market acceptance and produce a positive return.

RESULTS OF OPERATIONS

Revenue for the first nine months of 2001 decreased $1.2 million to $5.7 million from $6.9 million for the same period in 2000. The primary reason for the decrease in revenue relates to scheduled changes in the transfer pricing to the Company's primary customer, Ethicon Endo-Surgery, Inc. (Ethicon), that occurred following the end of the first commercial year of the distribution agreement that ended December 31, 2000 and an approximate 6% decline in overall sales volumes of control units and probes compared to the first nine months of the prior year. The Company expects fourth quarter sales volumes to be consistent with the first quarter of 2001 and product gross margins to remain consistent with the first nine months of 2001.

Research and development expenses during the first nine months of 2001 were $201,000 or 11% of operating expenses as compared to 10% of operating expenses for the first nine months of 2000, excluding $190,000 in severance and non-recurring unreimbursed development costs incurred in 2000. General and administrative expenses were $1.7 million or 89% of operating expenses. Overall, operating

expenses for the first nine months of 2001 decreased $474,000 or 20% over the same period in 2000. The Company anticipates that total operating expenses for the remaining quarter of 2001 will be consistent with the first nine months of 2001.

Three months ended September 30, 2001 and 2000

Revenues and Margins. Net product sales decreased $533,000 or 25% to $1.6 million during the third quarter of 2001 from $2.1 million during the same period in 2000. Gross margins on product sales decreased to 32% of net sales for the third quarter of 2001 from 42% of net sales for the same period in 2000. The declines in net product sales and gross margin in the third quarter of 2001 as compared to the same period in 2000 are primarily attributable to decreases in product sales volumes and the transfer prices at which the Company sells its products to Ethicon.

The Company's distribution agreement with Ethicon provides for transfer prices based on a percentage of the end customer average sales prices (ASP) received by Ethicon, subject to certain floor transfer pricing terms. The distribution agreement provided for a lower percentage of ASP to be shared with the Company following the first full commercial year of the distribution agreement that ended December 31, 2000. Due primarily to the lower percentage of ASP, the Company's calculated share of ASP fell below the floor price for substantially all products beginning in the second quarter of 2001. As a result, revenue during the third quarter was recorded based on the floor transfer prices for substantially all products. In addition, the cost to manufacture the Company's products also increased slightly from 2000 to 2001 due largely to higher electronic and crystal component costs. Revenues in the third quarters of 2001 and 2000 also included $200,000 from the pro-rata recognition of license fees related to the distribution agreement with Ethicon.

Research and Development Expenses. Research and development expenses decreased $30,000 or 50% to $30,000 during the third quarter of 2001 from $60,000 during the same period in 2000. The decrease is a result of lower externally contracted product development activities, offset by additional internal headcount dedicated to activities associated with the Company's gamma detection instrument product line.

Marketing and Selling Expenses. Marketing and selling expenses decreased 100% during the third quarter of 2001 from $42,000 during the same period in 2000 due to elimination of marketing personnel following the commencement of the Company's distribution agreement with Ethicon in the fourth quarter of 1999.

General and Administrative Expenses. General and administrative expenses increased $6,000 or 1% to $539,000 during the third quarter of 2001 from $533,000 during the same period in 2000. The increase was primarily the result of net reductions in various overhead cost categories during the third quarter of 2001, and the inclusion of $24,000 of gains on the sale of certain property and equipment during the same period in 2000.

Other Income. Other income increased $196,000 or 273% to $268,000 during the third quarter of 2001 from $72,000 during the same period in 2000. Other income during the third quarter of 2001 consisted primarily of a $238,000 refund of a portion of the limited guarantee made by the Company related to a loan made by a bank to Neoprobe (Israel) Ltd. (Neoprobe Israel). The Company had previously put cash on deposit with the bank as security for the limited guarantee. The full amount of the limited guarantee was written off in 1998 in conjunction with the Company's decision to liquidate Neoprobe Israel as the Company did not expect to receive any of the cash deposit back from the bank. The Company had requested a full accounting for the deposit following the sale by the receiver earlier in the year of the Neoprobe Israel facility. In connection with the refunded cash deposit, the bank also granted the Company a general release from all obligations related to the loan. Other income during the third quarter of 2000 consisted primarily of interest income. Interest income decreased because the Company received a lower interest rate on its invested cash during the third quarter of 2001 as compared to the same period in 2000, consistent with marketplace activity over the two periods.

Nine months ended September 30, 2001 and 2000

Revenues and Margins. Net product sales decreased $1.2 million or 19% to $5.1 million during the first nine months of 2001 from $6.2 million during the same period in 2000. Gross margins on product sales decreased to 31% of net sales for the first nine months of 2001 from 44% of net sales for the same period in 2000. The declines in net product sales and gross margin were the combined result of an approximate 6% decrease in overall sales volumes of control units and probes and the scheduled one-time reduction in transfer prices for the first nine months of 2001 as compared to the same period in 2000.

The Company's distribution agreement with Ethicon provides for transfer prices based on a percentage of the end customer average sales prices (ASP) received by Ethicon, subject to certain floor transfer pricing terms. The distribution agreement provided for a lower percentage of ASP to be shared with the Company following the first full commercial year of the distribution agreement that ended December 31, 2000. Due primarily to the lower percentage of ASP, the Company's calculated share of ASP fell below the floor price for substantially all products beginning in the second quarter of 2001. As a result, revenue during the second and third quarters was recorded based on the floor transfer prices for substantially all products and thus affected year-to-date revenue and margins for the first nine months of 2001. In addition, the cost to manufacture the Company's products increased slightly from 2000 to 2001 due largely to higher electronic and crystal component costs. Revenues in the first nine months of 2001 and 2000 also included $600,000 from the pro-rata recognition of license fees related to the distribution agreement with Ethicon and $25,000 and $50,000, respectively, from the recognition of quarterly milestone fees related to an option agreement to license certain of the Company's RIGS

technology.

Research and Development Expenses. Research and development expenses decreased $234,000 or 54% to $201,000 during the first nine months of 2001 from $436,000 during the same period in 2000. The decrease is primarily due to the inclusion of $40,000 in non-recurring severance costs and $150,000 in unreimbursed costs related to development of products in the first quarter of 2000.

Marketing and Selling Expenses. Marketing and selling expenses decreased 100% during the first nine months of 2001 from $205,000 during the same period in 2000 primarily due to elimination of marketing personnel and $40,000 of related severance charges incurred during the first quarter of 2000 following the commencement of the Company's distribution agreement with Ethicon in the fourth quarter of 1999.

General and Administrative Expenses. General and administrative expenses decreased $35,000 or 2% to $1.7 million during the first nine months of 2001 from $1.7 million during the same period in 2000. The decrease was primarily the result of net reductions in various overhead cost categories such as professional services, space costs, equipment rental and insurance,offset by the establishment of a $46,000 allowance for doubtful accounts related to the Company's license fee and expense reimbursement receivable from OncoSurg during the first nine months of 2001, and the inclusion of $57,000 of gains on the sale of certain property and equipment in the same period in 2000.

Other Income. Other income increased $212,000 or 150% to $354,000 during the first nine months of 2001 from $141,000 during the same period in 2000. Other income during the first nine months of 2001 consisted primarily of a $238,000 refund of a portion of the limited guarantee made by the Company related to a loan made by a bank to Neoprobe Israel. The Company had previously put cash on deposit with the bank as security for the limited guarantee. The full amount of the limited guarantee was written off in 1998 in conjunction with the Company's decision to liquidate Neoprobe Israel, as the Company did not expect to receive any of the cash deposit back from the bank. The Company had requested a full accounting for the deposit following the sale by the receiver earlier in the year of the Neoprobe Israel facility. In connection with the refunded cash deposit, the bank granted the Company a release from all obligations related to the loan. Other income during the first nine months of 2000 consisted primarily of interest income. Interest income decreased because the Company received a lower interest rate on its invested cash during the first nine months of 2001 as compared to the same period in 2000, consistent with marketplace activity over the two periods.

LIQUIDITY AND CAPITAL RESOURCES

Operating Activities. Cash provided by operations increased $165,000 to $398,000 during the first nine months of 2001 from $232,000 during the same period in 2000. Working capital increased to $4.1 million at September 30, 2001 from $3.8 million at December 31, 2000. The current ratio remained constant at 2.6 at September 30, 2001 and December 31, 2000.

Accounts receivable decreased to $47,000 at September 30, 2001 from $365,000 at December 31, 2000. The Company expects receivables levels to fluctuate in 2001 depending on the timing of purchases and payments

by Ethicon. Inventory levels increased to $1.7 million at September 30, 2001 as compared to $941,000 at December 31, 2000. Inventory is expected to increase slightly for the remainder of the year. The Company has been building its stock of certain critical long-lead components over 2001 in order to take advantage of significant quantity price breaks, and has continued to maintain appropriate levels of finished good safety stock to avoid interruption in supply of finished products to Ethicon.

Investing Activities. Cash used in investing activities in the first nine months of 2001 totaled $65,000 versus $1.4 million provided by investing activities during the same period in 2000. During January 2000, the Company sold an investment in an Israeli biotechnology company for $1.5 million. Capital expenditures in the first nine months of 2001 consisted primarily of technology infrastructure, production tooling, and loaner device upgrades. Capital expenditures in the first nine months of 2000 were split between purchases of production tools and equipment and technology infrastructure but were offset by the sale of excess furniture and fixtures accumulated from prior year headcount reductions. Capital needs to support instrument development and manufacturing activities for the remainder of 2001 are expected to be minimal.

Financing Activities. Financing activities used $113,000 in cash in the first nine months of 2001 versus $3.3 million during the same period in 2000. During the first quarter of 2000, the Company paid holders of Series B preferred stock $2.5 million in cash and issued them 3 million each of common shares and warrants to purchase common shares in exchange for retiring the outstanding preferred shares.

During January 2001, the Company executed a revolving line of credit with a bank that will provide the Company with access to up to $1.5 million to finance general working capital needs, subject to certain terms and covenants. The Company terminated the line of credit on November 8, 2001. No fees were incurred to terminate the credit facility.

In the event the Company significantly expands its product development efforts, either through the addition of incremental internal research or through the acquisition or licensing of complementary products, it may need to seek other sources of additional financing. Such financing may have a dilutive effect on current stockholders.

New Accounting Pronouncements. In July 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets. Under SFAS 141, any business combination initiated after June 30, 2001 must be accounted for as a purchase. For purchase business combinations that are consummated after June 30, 2001, goodwill and identifiable intangibles should be recorded and amortized in accordance with SFAS 142, i.e., goodwill and intangible assets with indefinite lives are not amortized and other identified intangibles are amortized. For any purchase business combination consummated on or before June 30, 2001, the accounting under APB 16 and APB 17 still applies. Goodwill and separately identifiable intangibles should be recorded and amortized until adopting SFAS 142, which is required for fiscal years beginning after December 15, 2001. A calendar year-end company would continue to amortize goodwill and all separately identifiable intangibles through December 31, 2001. Upon adoption of SFAS 142, a company would cease

amortizing goodwill and separately identifiable intangibles with indefinite lives and amortize other identifiable intangibles in accordance with the guidelines set forth in the standard. The Company intends to adopt SFAS 141 and 142 according to their prescribed deadlines but does not believe that adoption will have a material impact on the Company's financial position or results of operations.

In October 2001, the FASB issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, which supersedes both SFAS 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of and the accounting and reporting provisions of APB Opinion No. 30, Reporting the Results of Operations -- Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, for the disposal of a segment of a business (as previously defined in that Opinion). SFAS 144 retains the fundamental provisions in SFAS 121 for recognizing and measuring impairment losses on long-lived assets held for use and long-lived assets to be disposed of by sale, while also resolving significant implementation issues associated with SFAS 121. For example, SFAS 144 provides guidance on how a long-lived asset that is used as part of a group should be evaluated for impairment, establishes criteria for when a long-lived asset is held for sale, and prescribes the accounting for a long-lived asset that will be disposed of other than by sale. SFAS 144 retains the basic provisions of APB 30 on how to present discontinued operations in the income statement but broadens that presentation to include a component of an entity (rather than a segment of a business). Unlike SFAS 121, an impairment assessment under SFAS 144 will never result in a write-down of goodwill. Rather, goodwill is evaluated for impairment under SFAS 142, Goodwill and Other Intangible Assets.

The Company is required to adopt SFAS 144 no later than the year beginning after December 15, 2001, and plans to adopt its provisions for the quarter ending March 31, 2002. Management does not expect the adoption of SFAS 144 for long-lived assets held for use to have a material impact on the Company's financial statements because the impairment assessment under SFAS 144 is largely unchanged from SFAS 121. The provisions of the Statement for assets held for sale or other disposal generally are required to be applied prospectively after the adoption date to newly initiated disposal activities. Therefore, management cannot determine the potential effects that adoption of SFAS 144 will have on the Company's financial statements.

FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 (the Act) provides a safe harbor for forward-looking statements made by or on behalf of our Company. Our Company and its representatives may from time to time make written or verbal forward-looking statements, including statements contained in this report and other Company filings with the Securities and Exchange Commission and in our reports to shareholders. Statements which relate to other than strictly historical facts, such as statements about the Company's plans and strategies, expectations for future financial performance, new and existing products and technologies, and markets for the Company's products are forward-looking statements within the meaning of the Act. Generally, the words "believe," "expect," "intend," "estimate," "anticipate," "will" and other similar expressions identify forward-looking statements. The forward-looking statements are and will

be based on management's then current views and assumptions regarding future events and operating performance, and speak only as of their dates. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

The following are some of the factors that could affect our financial performance or could cause actual results to differ materially from estimates contained in or underlying our Company's forward-looking statements:

- Neoprobe has suffered significant operating losses for several years in its history and it may not be able to continue to achieve profitability.

- Neoprobe products may not achieve the broad market acceptance they need in order to be a commercial success.

- Neoprobe may not be successful in completing acquisitions to expand its product line, or if completed, the acquired company may not result in increased stockholder value.

- Neoprobe relies on a third party for its worldwide marketing and distribution, who may not be successful in selling Neoprobe's products.

- Neoprobe relies on third parties to manufacture its products and Neoprobe will suffer if they do not perform.

- Neoprobe may have difficulty raising additional capital, which could deprive it of necessary resources.

- Neoprobe may lose out to larger and better-established competitors.

- Neoprobe's products may be displaced by newer technology.

- Neoprobe is in a highly regulated business and it could face severe problems if does not comply with all regulatory requirements in the global markets in which Neoprobe's products are sold.

- Neoprobe's intellectual property may not have or provide sufficient legal protections against infringement or loss of trade secrets.

PART II - OTHER INFORMATION

ITEM 6. Exhibits and Reports on Form 8-K

(a) LIST OF EXHIBITS

10. MATERIAL CONTRACTS

Exhibit 10.2.59

Employment Agreement between the Company and David C. Bupp, dated July 1, 2001.

11. STATEMENT REGARDING COMPUTATION OF PER SHARE EARNINGS

Exhibit 11.1

Computation of Income Per Share.

(b) REPORTS ON FORM 8-K

The registrant filed a current report on Form 8-K on September 12, 2001, reporting its entering into a memorandum of understanding with Biosonix, Ltd. and its shareholders for the acquisition of all the outstanding shares of Biosonix, Ltd.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NEOPROBE CORPORATION
Dated: November 14, 2001

By: /s/ DAVID C. BUPP

David C. Bupp
President and Chief Executive Officer
(Principal Executive Officer)

By: /s/ BRENT L. LARSON

Brent L. Larson
Vice President, Finance and Chief Financial Officer
(Principal Financial and Accounting Officer)