

Stereotaxis, Inc.
Form 10-Q
November 13, 2018

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2018

**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: 001-36159

STEREOTAXIS, INC.

(Exact name of registrant as specified in its charter)

Delaware **94-3120386**
(State of **(I.R.S. employer**
Incorporation) **identification no.)**

4320 Forest Park Avenue Suite 100
63108
St. Louis, Missouri
(Address of principal executive offices) (Zip Code)

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). [X] Yes [] No

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

Large accelerated filer [] Accelerated filer []
Non-accelerated filer [] Smaller reporting company [X]
Emerging growth company []

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. []

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

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The number of outstanding shares of the registrant's common stock on October 31, 2018 was 59,052,782.

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ITEM 1. FINANCIAL STATEMENTS**STEREOTAXIS, INC.****BALANCE SHEETS**

	September 30, 2018 (Unaudited)	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 11,570,566	\$ 3,686,302
Accounts receivable, net of allowance of \$300,510 and \$361,350 in 2018 and 2017, respectively	5,088,111	4,287,255
Inventories, net	1,202,457	1,146,971
Prepaid expenses and other current assets	970,397	750,085
Total current assets	18,831,531	9,870,613
Property and equipment, net	452,639	592,688
Intangible assets, net	109,979	159,470
Other assets	226,939	44,432
Total assets	\$ 19,621,088	\$ 10,667,203
Liabilities and stockholders' equity (deficit)		
Current liabilities:		
Accounts payable	\$ 1,574,035	\$ 1,654,101
Accrued liabilities	2,822,958	3,195,247
Deferred revenue	6,365,676	5,702,769
Warrants	-	19,574,977
Total current liabilities	10,762,669	30,127,094
Long-term deferred revenue	502,893	611,863
Other liabilities	621,573	535,369
Total liabilities	11,887,135	31,274,326
Convertible Preferred stock:		
Convertible Preferred stock, par value \$0.001; 10,000,000 shares authorized, 23,900 shares outstanding at 2018 and 2017	5,960,475	5,960,475
Stockholders' equity (deficit):		
Common stock, par value \$0.001; 300,000,000 shares authorized, 59,044,164 and 22,805,731 shares issued at 2018 and 2017, respectively	59,044	22,806
Additional paid in capital	478,071,950	450,748,403
Treasury stock, 4,015 shares at 2018 and 2017	(205,999)	(205,999)
Accumulated deficit	(476,151,517)	(477,132,808)
Total stockholders' equity (deficit)	1,773,478	(26,567,598)
Total liabilities and stockholders' equity (deficit)	\$ 19,621,088	\$ 10,667,203

See accompanying notes.

STEREOTAXIS, INC.**STATEMENTS OF OPERATIONS****(Unaudited)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenue:				
Systems	\$715,484	\$1,597,537	\$1,043,510	\$3,644,871
Disposables, service and accessories	6,839,995	6,546,198	21,035,002	19,943,562
Total revenue	7,555,479	8,143,735	22,078,512	23,588,433
Cost of revenue:				
Systems	596,869	888,800	1,257,980	2,029,760
Disposables, service and accessories	1,036,589	1,032,569	3,029,875	3,350,480
Total cost of revenue	1,633,458	1,921,369	4,287,855	5,380,240
Gross margin	5,922,021	6,222,366	17,790,657	18,208,193
Operating expenses:				
Research and development	2,000,780	1,619,749	5,995,800	4,976,892
Sales and marketing	2,819,101	3,079,562	9,911,514	10,479,626
General and administrative	1,215,920	1,355,258	3,753,703	4,921,513
Total operating expenses	6,035,801	6,054,569	19,661,017	20,378,031
Operating income (loss)	(113,780)	167,797	(1,870,360)	(2,169,838)
Other income (expense)	-	(4,459,042)	2,590,361	(1,029,479)
Interest expense (net)	(2,515)	(43,077)	(33,271)	(135,336)
Net income (loss)	\$(116,295)	\$(4,334,322)	\$686,730	\$(3,334,653)
Cumulative dividend on convertible preferred stock	(361,447)	(337,963)	(1,072,553)	(1,070,812)
Net loss attributable to common stockholders	\$(477,742)	\$(4,672,285)	\$(385,823)	\$(4,405,465)
Net loss per share attributable to common stockholders:				
Basic	\$(0.01)	\$(0.21)	\$(0.01)	\$(0.20)
Diluted	\$(0.01)	\$(0.21)	\$(0.01)	\$(0.20)
Weighted average number of common shares and equivalents:				
Basic	59,008,219	22,750,405	49,733,553	22,551,496
Diluted	59,008,219	22,750,405	49,733,553	22,551,496

Certain prior year amounts have been reclassified to conform to the 2018 presentation.
See accompanying notes.

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

	Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities		
Net income (loss)	\$686,730	\$(3,334,653)
Adjustments to reconcile net income to cash used in operating activities:		
Depreciation	394,154	412,793
Amortization of intangibles	49,491	149,491
Amortization of deferred finance costs	24,657	74,793
Share-based compensation	465,851	625,854
Loss on asset disposal	1,449	20,772
Adjustment of warrants	(2,590,361)	1,029,479
Changes in operating assets and liabilities:		
Accounts receivable	(800,856)	617,873
Inventories	(55,486)	775,577
Prepaid expenses and other current assets	(131,116)	(46,427)
Other assets	(1,799)	(7,105)
Accounts payable	(80,066)	(889,868)
Accrued liabilities	(372,289)	(979,526)
Deferred revenue	553,937	(2,497,775)
Other liabilities	86,204	176,905
Net cash used in operating activities	(1,769,500)	(3,871,817)
Cash flows from investing activities		
Purchase of fixed assets	(255,554)	(72,082)
Net cash used in investing activities	(255,554)	(72,082)
Cash flows from financing activities		
Payments of deferred financing costs	-	(100,000)
Proceeds from issuance of stock, net of issuance costs	44,621	29,573
Proceeds from warrant exercise	9,864,697	-
Net cash provided by (used in) financing activities	9,909,318	(70,427)
Net increase (decrease) in cash and cash equivalents	7,884,264	(4,014,326)
Cash and cash equivalents at beginning of period	3,686,302	8,501,392
Cash and cash equivalents at end of period	\$11,570,566	\$4,487,066

See accompanying notes.

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-CAS[™], V-Loop[™], V-Sono[™], V-CAS Deflect[™], QuikCAS[™], and Cardiodrive[®] are trademarks of Stereotaxis, Inc. All other trademarks that appear in this report are the property of their respective owners.

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 Remote Magnetic Navigation System (“*Niobe* ES system”), *Odyssey* Information Management Solution (“*Odyssey* Solution”), and the *Vdrive* Robotic Navigation System (“*Vdrive* system”), and related devices.

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. As of September 30, 2018, the Company had an installed base of 127 *Niobe* ES systems.

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. 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, such as the *Niobe System*, *Odyssey Workstation*, *Cardiodrive*, and various disposable interventional devices have received regulatory clearance in the U.S., Europe, Canada, China, Japan and various other countries. We have received the regulatory clearance, licensing and/or CE Mark approvals that allow us to market the *Vdrive* and *Vdrive Duo* systems with the *V-CAS*, *V-Loop* and *V-Sono* devices in the U.S., Canada and European Union. The *V-CAS Deflect* catheter advancement system has been CE Marked for sale in the European Union.

We have successfully integrated our *Niobe* system with digital fluoroscopy systems to provide advanced interventional lab visualization and instrument control through user-friendly computerized interfaces. The maintenance of these arrangements, or the establishment of equivalent alternatives, is critical to our commercialization efforts. The commercial availability of both currently compatible digital imaging fluoroscopy systems is unlikely to continue for multiple years and efforts are being made to ensure the availability of integrated next generation systems and/or equivalent alternatives; however, we cannot provide assurance as to the timeline of the ongoing availability of such compatible systems or our ability to obtain equivalent alternatives on competitive terms or at all.

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 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

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results for the nine month period ended September 30, 2018 are not necessarily indicative of the results that may be expected for the year ended December 31, 2018 or for future operating periods.

These interim financial statements and the related notes should be read in conjunction with the annual financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 as filed with the Securities and Exchange Commission (SEC) on March 20, 2018.

Going Concern, Liquidity and Management's Plan

The Company believes the cash on hand at September 30, 2018 will be sufficient to meet its obligations as they become due in the ordinary course of business for at least 12 months following the date these financial statements are issued. The Company has sustained operating losses throughout its corporate history and expects that its 2018 expenses will exceed its 2018 gross margin. The Company expects to continue to incur operating losses and negative cash flows until revenues reach a level sufficient to support ongoing operations or expense reductions are in place. The Company's liquidity needs will be largely determined by the success of clinical adoption within the installed base of *Niobe* systems as well as by new placements of capital systems.

Financial Instruments

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

The Company measures certain financial assets and liabilities at fair value on a recurring basis. 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 10 for additional details.

Revenue and Costs of Revenue

The Company adopted ASC 606, Revenue from Contracts with Customers, on January 1, 2018 using the modified retrospective method. As part of the Company's adoption of ASC 606, the Company elected to use the following practical expedients (i) applying the modified retrospective method only to open contracts as of December 31, 2017; (ii) not to adjust the promised amount of consideration for the effects of a significant financing component when the Company expects, at contract inception, that the period between the Company's transfer of a promised product or service to a customer and when the customer pays for that product or service will be one year or less; (iii) to expense costs as incurred for costs to obtain a contract when the amortization period would have been one year or less; and (iv) not to assess whether promised goods or services are performance obligations if they are immaterial in the context of the contract with the customer.

Upon adoption of the new revenue guidance, the Company recorded a cumulative-effect reduction to accumulated deficit of \$0.3 million on January 1, 2018 relating primarily to the deferral of previously expensed costs to obtain a contract. The Company capitalized sales commissions paid in connection with multi-year service contracts and is amortizing such asset over the economic life of those contracts. Previously, sales commissions on multi-year service contracts were expensed as incurred. The impact of this change on operating expenses in any given period will depend, in part, on the amount of such commissions incurred and capitalized in relation to the amount of ongoing amortization expense. For the nine months ended September 30, 2018, the Company recorded less than \$0.1 million in additional commission expense as a result of adopting the new standard. The Company did not otherwise experience significant changes in the timing or method of revenue recognition for any of its material revenue streams.

We generate revenue from initial capital sales of systems as well as recurring revenue from the sale of our proprietary disposable devices, from royalties paid to the Company on the sale by Biosense Webster of co-developed catheters, and from other recurring revenue including ongoing license and service contracts.

We account for a contract with a customer when there is a legally enforceable contract between the Company and the customer, the rights of the parties are identified, the contract has commercial substance, and collectability of the contract consideration is probable. We record our revenue based on consideration specified in the contract with each customer, net of any taxes collected from customers that are remitted to government authorities.

For contracts containing multiple products and services the Company accounts for individual products and services as separate performance obligations if they are distinct, which is if a product or service is separately identifiable from other items in the bundled package, and if a customer can benefit from it on its own or with other resources that are readily available to the customer. The Company recognizes revenues as the performance obligations are satisfied by transferring control of the product or service to a customer.

For multiple-element arrangements, revenue is allocated to each performance obligation based on its relative standalone selling price. Standalone selling prices are based on observable prices at which the Company separately sells the products or services. If a standalone selling price is not directly observable, then the Company estimates the standalone selling price considering market conditions and entity-specific factors including, but not limited to, features and functionality of the products and services and market conditions. The Company regularly reviews standalone selling prices and updates these estimates as necessary.

Systems:

Contracts related to the sale of systems typically contain separate obligations for the delivery of system(s), installation and an implied obligation to provide software enhancements if and when available for one year following installation. Revenue is recognized when the Company transfers control to the customer, which is generally at the point when acceptance occurs that indicates customer acknowledgment of delivery or installation, depending on the terms of the arrangement. Revenue from the implied obligation to deliver software enhancements if and when available is

recognized ratably over the first year following installation of the system as the customer receives the right to software updates throughout the period and is included in Other Recurring Revenue. The Company's system contracts generally do not provide a right of return. Systems are generally covered by a one-year assurance type warranty; warranty costs were not material for the periods presented. Revenue from system delivery and installation represented 5% and 15% of revenue for the nine months ended September 30, 2018 and 2017, respectively.

Disposables:

Revenue from sales of disposable products is recognized when control is transferred to the customers, which generally occurs at the time of shipment, but can also occur at the time of delivery depending on the customer arrangement. Disposable products are covered by an assurance type warranty that provides for the return of defective products. Warranty costs were not material for the periods presented. Disposable revenue represented 33% and 32% of revenue for the nine months ended September 30, 2018 and 2017, respectively.

Royalty:

The Company is entitled to royalty payments from Biosense Webster, payable quarterly based on net revenues from sales of the co-developed catheters. Royalty revenue from the co-developed catheters represented 10% and 9% of revenue for the nine months ended September 30, 2018 and 2017.

Other Recurring Revenue:

Other recurring revenue includes revenue from product maintenance plans, other post warranty maintenance, and the implied obligation to provide software enhancements if and when available for one year following installation. Revenue from services and software enhancements is deferred and amortized over the service or update period, which is typically one year. Revenue related to services performed on a time-and-materials basis is recognized when performed. Other recurring revenue represented 52% and 44% of revenue for the nine months ended September 30, 2018 and 2017, respectively.

	Three months ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Systems	\$715,484	\$1,597,537	\$1,043,510	\$3,644,871
Disposables, service and accessories	6,839,995	6,546,198	21,035,002	19,943,562
Total revenue	\$7,555,479	\$8,143,735	\$22,078,512	\$23,588,433

Transaction price allocated to remaining performance obligations relates to amounts allocated to products and services for which the revenue has not yet been recognized. A significant portion of this amount relates to the Company's systems contracts and obligations that will be recognized as revenue in future periods. These obligations are generally satisfied within two years after contract inception but may occasionally extend longer. Transaction price representing revenue to be earned on remaining performance obligations on system contracts was approximately \$1.0 million as of

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September 30, 2018. Performance obligations arising from contracts for disposables, royalty and service are generally expected to be satisfied within one year after entering into the contract.

The following information summarizes the Company's contract assets and liabilities:

	September 30, 2018	December 31, 2017
Contract Assets - Unbilled Receivables	\$ 139,973	\$ 2,917
Product shipped, revenue deferred	661,402	941,724
Deferred service and license fees	6,207,167	5,372,908
Total deferred revenue	6,868,569	6,314,632
Less: Long-term deferred revenue	(502,893)	(611,863)
Total current deferred revenue	\$6,365,676	\$5,702,769

The Company invoices its customers based on the billing schedules in its sales arrangements. Contract assets primarily represent the difference between the revenue that was earned but not billed on service contracts and revenue from system contracts that was recognized based on the relative selling price of the related performance obligations and the contractual billing terms in the arrangements. Deferred revenue is primarily related to service contracts, for which the service fees are billed up-front, generally quarterly or annually, and for amounts billed in advance for system contracts for which some performance obligations remain outstanding. For service contracts, the associated deferred revenue is generally recognized ratably over the service period. For system contracts, the associated deferred revenue is recognized when the remaining performance obligations are satisfied. The Company did not have any impairment losses on its contract assets for the periods presented.

Revenue recognized for the nine months ended September 30, 2018 and 2017, that was included in the deferred revenue balance at the beginning of each reporting period was \$5,125,372 and \$7,652,148, respectively.

Assets Recognized from the Costs to Obtain a Contract with a Customer

The Company has determined that sales incentive programs for the Company's sales team meet the requirements to be capitalized as the Company expects to generate future economic benefits from the related revenue generating contracts after the initial capital sales transaction. The costs capitalized as contract acquisition costs included in prepaid expenses and other assets, in the Company's balance sheet was \$0.3 million as of September 30, 2018. The Company did not incur any impairment losses during any of the periods presented.

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.

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. Restricted shares granted to employees are valued at the fair market value at the date of grant. The Company amortizes the fair market value to expense over the service period. 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.

Net Income (Loss) per Common Share ("EPS")

Basic net income (loss) per share is computed by dividing net income (loss) attributable to common shareholders by the number of common shares outstanding during the period. In periods where there is net income, we apply the two-class method to calculate basic and diluted net income (loss) per share of common stock, as our Convertible Preferred Stock is a participating security. The two-class method is an earnings allocation formula that treats a

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participating security as having rights to earnings that otherwise would have been available to common stockholders. In periods where there is a net loss, the two-class method of computing earnings per share does not apply as our Convertible Preferred Stock does not contractually participate in our losses. We compute diluted net income (loss) per common share using net income (loss) as the “control number” in determining whether potential common shares are dilutive, after giving consideration to all potentially dilutive common shares, including stock options, warrants, unvested restricted stock units outstanding during the period and potential issuance of stock upon the conversion of our Convertible Preferred Stock issued and outstanding during the period, except where the effect of such securities would be antidilutive.

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

	Three months ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income (loss)	\$ (116,295)	\$ (4,334,322)	\$ 686,730	\$ (3,334,653)
Cumulative dividend on convertible preferred stock	(361,447)	(337,963)	(1,072,553)	(1,070,812)
Net loss attributable to common stockholders	\$ (477,742)	\$ (4,672,285)	\$ (385,823)	\$ (4,405,465)
Weighted average number of common shares and equivalents:	59,008,219	22,750,405	49,733,553	22,551,496
Basic EPS	\$ (0.01)	\$ (0.21)	\$ (0.01)	\$ (0.20)
Diluted EPS	\$ (0.01)	\$ (0.21)	\$ (0.01)	\$ (0.20)

The Company did not include any portion of unearned restricted stock units, 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.

As of September 30, 2018, the Company had 1,154,325 shares of common stock issuable upon the exercise of outstanding options and stock appreciation rights at a weighted average exercise price of \$2.80 per share, 2,280,364 shares of common stock issuable upon the exercise of outstanding warrants at a weighted average exercise price of \$2.04 per share, 41,187,582 shares of common stock issuable upon the conversion of Series A Convertible Preferred Stock and accumulated dividends, and 653,399 shares of unvested restricted share units.

Reclassifications

In 2018, we adjusted our operating expense categories to improve our alignment with common industry reporting practice, and as a result, certain amounts in prior periods have been reclassified to conform to the current period presentation. For the nine months ended September 30, 2017, approximately \$1.4 million of regulatory and clinical research expenses previously included in General and Administrative expense have been reclassified to Research and Development expense, and approximately \$0.4 million of international training expense previously included in General and Administrative expense has been reclassified to Sales and Marketing expense. These reclassifications had

no effect on reported income or losses.

Recently Issued Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, “Leases (ASC 842),” which sets out the principles for the recognition, measurement, presentation, and disclosure of leases for both parties to a contract (i.e. lessees and lessors). The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase by the lessee. This classification will determine whether lease expense is recognized based on an effective interest method or on a straight line basis over the term of the lease, respectively. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for similar to existing guidance for operating leases today. The new standard requires lessors to account for leases using an approach that is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. ASC 842 supersedes the previous leases standard, ASC 840 Leases. The standard is effective for interim and annual periods beginning after December 31, 2018 (January 1, 2019 for the Company), with early adoption permitted. The Company is in the process of evaluating the impact of this accounting standard update.

3. Inventories

Inventories consist of the following:

	September 30, 2018	December 31, 2017
Raw materials	\$2,708,752	\$2,528,270
Work in process	51,341	4,836
Finished goods	3,012,800	2,515,637
Reserve for obsolescence	(4,570,436)	(3,901,772)
Total inventory	\$1,202,457	\$1,146,971

During 2018, Stereotaxis recorded non-cash obsolescence charges on the receipt of committed inventory related to its *Niobe ES* product line.

4. Prepaid Expenses and Other Assets

Prepaid expenses and other assets consist of the following:

	September 30, 2018	December 31, 2017
Prepaid expenses	\$311,021	\$575,501
Prepaid commissions	333,940	-
Deferred financing costs	-	24,658
Deposits	552,375	194,358
Total prepaid expenses and other assets	1,197,336	794,517
Less: Noncurrent prepaid expenses and other assets	(226,939)	(44,432)
Total current prepaid expenses and other assets	\$970,397	\$750,085

Effective with the January 1, 2018 adoption of ASC 606, the Company determined that sales commissions paid in connection with multi-year service contracts met the requirements to be capitalized as the Company expects to generate future economic benefits from the related revenue generating contracts. Previously, sales commissions on multi-year service contracts were expensed as incurred. The Company is amortizing this asset over the economic life of the related contracts.

5. Property and Equipment

Property and equipment consist of the following:

	September 30, 2018	December 31, 2017
Equipment	\$6,839,384	\$7,295,698
Leasehold improvements	2,592,338	2,592,339
	9,431,722	9,888,037
Less: Accumulated depreciation	(8,979,083)	(9,295,349)
Net property and equipment	\$452,639	\$592,688

6. Intangible Assets

As of September 30, 2018, the Company had total intangible assets of \$3,143,291. Accumulated amortization at September 30, 2018, was \$3,033,312.

7. Accrued Liabilities

Accrued liabilities consist of the following:

	September 30, 2018	December 31, 2017
Accrued salaries, bonus, and benefits	\$1,466,306	\$1,641,491
Accrued rent	162,896	441,417
Accrued licenses and maintenance fees	578,409	581,672
Accrued warranties	148,290	164,365
Accrued taxes	272,498	234,668
Accrued professional services	494,242	367,072
Other	321,890	299,931
Total accrued liabilities	3,444,531	3,730,616
Less: Long term accrued liabilities	(621,573)	(535,369)
Total current accrued liabilities	\$2,822,958	\$3,195,247

Our primary company facilities are located in St. Louis, Missouri where we currently lease approximately 52,000 square feet of office and 12,000 square feet of demonstration and assembly space. In the third quarter of 2013, the Company modified the existing lease agreement to terminate approximately 13,000 square feet of unimproved space. The costs associated with the termination were \$515,138 and were accrued as a rent liability as of September 30, 2013. As of September 30, 2018, the remaining accrued costs associated with the termination were \$23,864.

In August 2016, the Company entered into an agreement to sublease approximately 11,000 square feet of office space immediately and an additional 16,000 square feet of office space beginning in January, 2017, with the term of the sublease ending on December 31, 2018. The initial costs associated with the sub lease were \$69,180, and as of September 30, 2018, the remaining accrued costs were \$6,723.

8. Long-Term Debt and Credit Facilities

The Company has had a working capital line of credit with its primary lender, Silicon Valley Bank, since 2004. The revolving line of credit is secured by substantially all of the Company's assets. The maximum available under the line is \$5.0 million subject to the value of collateralized assets. The Company is required under the revolving line of credit to maintain its primary operating account and the majority of its cash and investment balances in accounts with its primary lender.

On April 26, 2018, the Company entered into a First Amendment to Third Amended and Restated Loan and Security Agreement with Silicon Valley Bank to extend the maturity of the revolving line of credit to April 25, 2019. The maximum availability under the revolving line of credit remains at \$5.0 million, and provides for an interest rate during a "streamline period" equal to the prime rate subject to a floor of 4.5%. A "streamline period" occurs when the Company has, for each consecutive day in the immediately preceding monthly period, maintained a liquidity ratio greater than 1.75:1.00, and continuing so long as the streamline period has been maintained. Upon the termination of a streamline period, the Company must maintain the streamline threshold each consecutive day for one fiscal quarter, prior to entering into a subsequent streamline period. During non-streamline periods, the interest rate is the prime rate plus 1.5%, subject to a floor of 4.5%. In addition, the amendment requires that the liquidity ratio shall at all times include not less than \$1.5 million of the Borrower's unrestricted cash and cash equivalents maintained at the Bank prior to giving effect to any advance.

As of September 30, 2018, the Company had no outstanding balance 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, 2018, the Company had a borrowing capacity of \$3.2 million based on the Company's collateralized assets. The Company's total liquidity as of September 30, 2018, was \$14.8 million which included cash and cash equivalents of \$11.6 million.

9. Convertible Preferred Stock and Stockholders' Equity

The holders of common stock are entitled to one vote for each share held and to receive dividends whenever funds are legally available and when declared by the Board of Directors subject to the rights of holders of all classes of stock having priority rights as dividends and the conditions of the revolving line of credit agreement. No dividends have been declared or paid as of September 30, 2018.

Convertible Preferred Stock and Warrants

In September 2016, the Company issued 24,000 shares of Series A Convertible Preferred Stock, par value \$0.001 with a stated value of \$1,000 per share which are convertible into shares of the Company's common stock at an initial conversion rate of \$0.65 per share and (ii) warrants to purchase an aggregate of 36,923,078 shares of common stock. The convertible preferred shares are entitled to vote on an as-converted basis with the common stock, subject to specified beneficial ownership issuance limitations. The convertible preferred shares bear dividends at a rate of six percent (6%) per annum, which are cumulative and accrue daily from the date of issuance on the \$1,000 stated value. Such dividends will not be paid in cash except in connection with any liquidation, dissolution or winding up of the Company or any redemption of the convertible preferred shares. Each holder of convertible preferred shares has the right to require us to redeem such holder's convertible preferred shares upon the occurrence of specified events, which include certain business combinations, the sale of all or substantially all of the Company's assets, or the sale of more than 50% of the outstanding shares of the Company's common stock. In addition, the Company has the right to redeem the convertible preferred shares in the event of a defined change of control. The convertible preferred shares rank senior to our common stock as to distributions and payments upon the liquidation, dissolution, and winding up of the Company. Since the convertible preferred shares are subject to conditions for redemption that are outside the Company's control, the convertible preferred shares are presently reported in the mezzanine section of the balance sheet.

The warrants issued in conjunction with the convertible preferred stock have an exercise price equal to \$0.70 per share subject to adjustments as provided under the terms of the warrants. The warrants are exercisable through September 29, 2021, subject to specified beneficial ownership issuance limitations. Prior to their modification in February 2018, the warrants were puttable upon the occurrence of certain events outside of the Company's control, and were classified as liabilities under ASC 480-10. The calculated fair value of the warrants was periodically re-measured with any changes in value recognized in "Other income (expense)" in the Statements of Operations. See Note 10 for additional details.

The warrants were modified on February 28, 2018 to allow for a reduction in the exercise price from \$0.70 per share to \$0.28 per share for a period between March 1, 2018 and March 5, 2018. Additionally, the beneficial ownership limitation related to the warrants was modified and the right of holders to require the Company to redeem their SPA Warrants in exchange for cash in certain circumstances was eliminated. Following these modifications, the warrants were no longer subject to liability accounting and were reclassified to equity. During the restricted exercise period, Stereotaxis received exercise notices for 35,791,927 warrants and received an aggregate of \$10.0 million in cash from the warrant exercise. As a result of these transactions, total stockholders' equity increased by \$27 million and common shares outstanding increased by 35,791,927 shares.

Stock Award Plans

The Company has various stock plans that permit the Company to provide incentives to employees and directors of the Company in the form of equity compensation. In July 2012, the Compensation Committee of the Board of Directors adopted the 2012 Stock Incentive Plan (the "Plan") which was subsequently approved by the Company's shareholders. This plan replaced the 2002 Stock Incentive Plan which expired on March 25, 2012.

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On June 5, 2013, June 10, 2014, May 24, 2016, and May 23, 2017, the shareholders approved amendments to the Plan, which were previously approved and adopted by the Compensation Committee of the Board of Directors of the Company. Under each of the amendments on June 5, 2013 and June 10, 2014, the number of shares authorized for issuance under the Plan was increased by one million shares. The amendment on May 24, 2016 increased the number of shares authorized for issuance under the Plan by 1.5 million shares, and the amendment on May 23, 2017 increased the number of shares authorized for issuance under the Plan by 4.0 million shares. At September 30, 2018, the Company had 4,453,764 remaining shares of the Company's common stock to provide for current and future grants under its various equity plans.

At September 30, 2018, 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 \$0.8 million. This cost will be amortized over a period of up to four years over the underlying estimated service periods and will be adjusted for subsequent changes in actual forfeitures and anticipated vesting periods.

A summary of the option and stock appreciation rights activity for the nine month period ended September 30, 2018 is as follows:

	Number of Options/SARs	Range of Exercise Price	Weighted Average Exercise Price per Share
Outstanding, December 31, 2017	413,301	\$0.62 - \$54.90	\$ 9.04
Granted	902,500	\$0.74 - \$0.83	\$ 0.75
Exercised	(2,916)) \$0.62	\$ 0.62
Forfeited	(158,560)) \$0.62 - \$54.90	\$ 7.41
Outstanding, September 30, 2018	1,154,325	\$0.62 - \$43.90	\$ 2.80

A summary of the restricted stock unit activity for the nine month period ended September 30, 2018 is as follows:

	Number of Restricted Stock Units	Weighted Average Grant Date Fair Value per Unit
Outstanding, December 31, 2017	680,363	\$ 1.11

Granted	422,167	\$ 0.80
Vested	(382,356)	\$ 1.24
Forfeited	(66,775)	\$ 1.12
Outstanding, September 30, 2018	653,399	\$ 0.84

10. 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 Measurement Using			
	Total	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Liabilities at September 30, 2018:				
Warrants issued August 2013	\$—	\$ —	\$ —	\$—
Warrants issued September 2016	—	—	—	—
Total liabilities at fair value:	\$—	\$ —	\$ —	\$—
Liabilities at December 31, 2017:				
Warrants issued August 2013	\$5,746	\$ —	\$ —	\$5,746
Warrants issued September 2016	19,569,231	—	—	19,569,231
Total liabilities at fair value:	\$19,574,977	\$ —	\$ —	\$19,574,977

Level 1

The Company does not have any material financial assets or liabilities classified as Level 1.

Level 2

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

Level 3

In conjunction with the Company's August 2013 and September 2016 financing transactions, the Company issued warrants to purchase shares of the Company's common stock. Due to the provisions included in the warrant agreements at the time of issuance, the warrants did not meet the exemptions for equity classification and as such, the Company accounted for these warrants as derivative instruments. The calculated fair value of the warrants issued in conjunction with the August 2013 financing transactions is classified as a liability and is periodically re-measured with any changes in value recognized in "Other income (expense)" in the Statements of Operations. As detailed in Note 9, the remaining warrants from the September 2016 transaction were modified on February 28, 2018 and reclassified to equity.

The remaining warrants from the August 2013 transaction (Exchange Warrants) expire in November 2018 and were revalued as of September 30, 2018 using the following assumptions: 1) volatility of 70.17%; 2) risk-free interest rate of 2.19%; and 3) a closing stock price of \$1.21.

The significant unobservable input used in the fair value measurement of the Company's warrants is volatility. Significant increases (decreases) in the volatility in isolation would result in significantly higher (lower) liability fair value measurements.

The following table sets forth a summary of changes in the fair value of the Company's Level 3 financial liabilities for the nine month period ended September 30, 2018:

	Warrants issued August 2013	Warrants issued September 2016	Total Liabilities
Balance at beginning of period	\$ 5,746	\$ 19,569,231	\$ 19,574,977
Issues	-	-	-
Reclassifications	-	(16,984,616)	(16,984,616)
Settlements	-	-	-
Revaluation	(5,746)	(2,584,615)	(2,590,361)
Balance at end of period	\$-	\$-	\$-

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.

11. Product Warranty Provisions

The Company's standard policy is to warrant all *Niobe*, *Odyssey*, and *Vdrive* 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.

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

	September 30, 2018	December 31, 2017
Warranty accrual, beginning of the fiscal period	\$ 164,365	\$ 222,845
Accrual adjustment for product warranty	19,941	32,679
Payments made	(36,016)	(91,159)
Warranty accrual, end of the fiscal period	\$ 148,290	\$ 164,365

12. 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.

13. Subsequent Events

None.

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, 2017. Operating results are not necessarily indicative of results that may occur in future periods.

This report includes various forward-looking statements that are subject to risks and uncertainties, many of which are beyond our control. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth in "Item 1A. Risk Factors." Forward-looking statements discuss matters that are not historical facts. Forward-looking statements include, but are not limited to, discussions regarding our operating strategy, sales and marketing strategy, regulatory strategy, industry, economic conditions, financial condition, liquidity, 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 "believe", "expects", "anticipates", "intends", "estimates", "projects", "can", "could", "may", "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 are 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 cardiology instrument control system for use in a hospital's interventional surgical suite to enhance the treatment of arrhythmias and coronary artery disease. The *Epoch* Solution is comprised of the *Niobe* ES robotic system, *Odyssey* Solution, and the *Vdrive* system. We believe that the *Epoch* Solution represents a revolutionary technology in the interventional surgical suite, or "interventional lab," and has the potential to become the standard of care for a broad range of complex cardiology procedures. We also believe that our technology represents an important advance in the ongoing trend toward digital instrumentation in the interventional lab and provides substantial, clinically important improvements, and cost efficiencies over manual interventional methods, which require years of physician training and often result in long and unpredictable procedure times and sub-optimal therapeutic outcomes.

The *Niobe* ES system is the latest generation of the *Niobe* Remote Magnetic Navigation System ("*Niobe* system"). This system is designed to enable physicians to complete more complex interventional procedures by providing image-guided delivery of catheters and guidewires through the blood vessels and chambers of the heart to treatment sites. This is achieved using externally applied magnetic fields that govern the motion of the working tip of the catheter or guidewire, resulting in improved navigation, efficient procedures and reduced x-ray exposure. The core

components of the *Niobe* system have received regulatory clearance in the U.S., Canada, Europe, China, Japan, and various other countries. As of September 30, 2018, the Company had an installed base of 127 *Niobe* ES systems.

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. The *Odyssey* Solution may be acquired in conjunction with a *Niobe* system or on a stand-alone basis for installation in interventional labs and other locations where clinicians often desire the benefits of the *Odyssey* Solution that we believe can improve clinical workflows and related efficiencies.

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 (*V-Loop*, *V-Sono*, *V-CAS*, and *V-CAS Deflect*) which can be manipulated by these systems.

We have successfully integrated our *Niobe* system with digital fluoroscopy systems to provide advanced interventional lab visualization and instrument control through user-friendly computerized interfaces. The maintenance of these arrangements, or the establishment of equivalent alternatives, is critical to our commercialization efforts. The commercial availability of both currently compatible digital imaging fluoroscopy systems is unlikely to continue for multiple years and efforts are being made to ensure the availability of integrated next generation systems and/or equivalent alternatives; however, we cannot provide assurance as to the timeline of the ongoing availability of such compatible systems or our ability to obtain equivalent alternatives on competitive terms or at all.

Going Concern, Liquidity and Management's Plan

The Company believes the cash on hand at September 30, 2018 will be sufficient to meet its obligations as they become due in the ordinary course of business for at least 12 months following the date these financial statements are issued. The Company has sustained operating losses throughout its corporate history and expects that its 2018 expenses will exceed its 2018 gross margin. The Company expects to continue to incur operating losses and negative cash flows until revenues reach a level sufficient to support ongoing operations or expense reductions are in place. The Company's liquidity needs will be largely determined by the success of clinical adoption within the installed base of *Niobe* systems as well as by new placements of capital systems.

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, 2017.

Revenue Recognition

The Company adopted ASC 606, Revenue from Contracts with Customers, on January 1, 2018. We generate revenue from the initial capital sales of the *Niobe*, *Odyssey*, and *Vdrive* systems as well as recurring revenue from the sale of our proprietary disposable devices from royalties paid to the Company on the sale by Biosense Webster of co-developed catheters, and from other recurring revenue including ongoing license and service contracts.

We account for a contract with a customer when there is a legally enforceable contract between the Company and the customer, the rights of the parties are identified, the contract has commercial substance, and collectability of the contract consideration is probable. We record our revenue based on consideration specified in the contract with each customer, net of any taxes collected from customers that are remitted to government authorities.

For contracts containing multiple products and services the Company accounts for individual products and services as separate performance obligations if they are distinct, which is if a product or service is separately identifiable from other items in the bundled package, and if a customer can benefit from it on its own or with other resources that are readily available to the customer. The Company recognizes revenues as the performance obligations are satisfied by transferring control of the product or service to a customer.

For multiple-element arrangements, revenue is allocated to each performance obligation based on its relative standalone selling price. Standalone selling prices are based on observable prices at which the Company separately sells the products or services. If a standalone selling price is not directly observable, then the Company estimates the standalone selling price considering market conditions and entity-specific factors including, but not limited to, features and functionality of the products and services and market conditions. The Company regularly reviews standalone selling prices and updates these estimates if necessary.

Systems:

Contracts related to the sale of systems typically contain separate obligations for the delivery of system(s), installation and an implied obligation to provide software enhancements if and when available for one year following installation. Revenue is recognized when the Company transfers control to the customer, which is generally at the point when acceptance occurs that indicates customer acknowledgment of delivery or installation, depending on the terms of the arrangement. Revenue from the implied obligation to deliver software enhancements if and when available is recognized ratably over the first year following installation of the system as the customer receives the right to software updates throughout the period and is included in Other Recurring Revenue. The Company's system contracts generally do not provide a right of return. Systems are generally covered by a one-year warranty; warranty costs were not material for the periods presented.

Disposables:

Revenue from sales of disposable products is recognized when control is transferred to the customers, which generally occurs at the time of shipment, but can also occur at the time of delivery depending on the customer arrangement. Disposable products are covered by a warranty that provides for the return of defective products. Warranty costs were not material for the periods presented.

Royalty:

The Company is entitled to royalty payments from Biosense Webster, payable quarterly based on net revenues from sales of the co-developed catheters.

Other Recurring Revenue:

Other recurring revenue includes revenue from product maintenance plans, other post warranty maintenance, and the implied obligation to provide software enhancements if and when available for one year following installation. Revenue from services and software enhancements is deferred and amortized over the service or update period, which is typically one year. Revenue related to services performed on a time-and-materials basis is recognized when performed.

The Company invoices its customers based on the billing schedules in its sales arrangements. Contract assets primarily represent the difference between the revenue that was recognized based on the relative selling price of the related performance obligations and the contractual billing terms in the arrangements. Deferred revenue is primarily related to service contracts, for which the service fees are billed up-front, generally quarterly or annually, and for amounts billed in advance for system contracts for which some performance obligations remain outstanding. For service contracts, the associated deferred revenue is generally recognized ratably over the service period. For system contracts, the associated deferred revenue is recognized when the remaining performance obligations are satisfied. See Note 2 for additional detail on Deferred Revenue. The Company did not have any impairment losses on its contract assets for the periods presented.

Assets Recognized from the Costs to Obtain a Contract with a Customer

The Company has determined that sales incentive programs for the Company's sales team meet the requirements to be capitalized as the Company expects to generate future economic benefits from the related revenue generating contracts after the initial capital sales transaction. The costs capitalized as contract acquisition costs included in prepaid expenses and other assets in the Company's balance sheets were \$0.3 million as of September 30, 2018. The Company did not incur any impairment losses during any of the periods presented.

Cost of Contracts

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.

Results of Operations

Comparison of the Three Months Ended September 30, 2018 and 2017

Revenue. Revenue decreased from \$8.1 million for the three months ended September 30, 2017 to \$7.6 million for the three months ended September 30, 2018, a decrease of 7%. Revenue from the sale of systems decreased from \$1.6 million to \$0.7 million, a decrease of approximately 55%. We recognized a total of \$0.7 million revenue for *Odyssey* systems during the 2018 period. System revenue for the prior period included one *Niobe* system and a total of \$0.6 million for *Odyssey* systems. Revenue from sales of disposable interventional devices, service, and accessories increased to \$6.8 million for the three months ended September 30, 2018 from \$6.5 million for the three months ended September 30, 2017, an increase of approximately 4% due to increased service revenue from time-and-material billings.

Cost of Revenue. Cost of revenue decreased from \$1.9 million for the three months ended September 30, 2017 to \$1.6 million for the three months ended September 30, 2018, a decrease of approximately 15%. As a percentage of our total revenue, overall gross margin increased to 78% for the three months ended September 30, 2018 from 76% for the three months ended September 30, 2017. Cost of revenue for systems sold decreased from \$0.9 million for the three months ended September 30, 2017 to \$0.6 million for the three months ended September 30, 2018. Gross margin for systems decreased to \$0.1 million for the three months ended September 30, 2018 from \$0.7 million for the three months ended September 30, 2017 due to low sales volumes. Cost of revenue for disposables, service, and accessories remained unchanged at \$1.0 million for the three months ended September 30, 2018 and the three months ended September 30, 2017. Gross margin for disposables, service, and accessories was 85% for the current quarter compared to 84% for the three months ended September 30, 2017.

Research and Development Expenses. Research and development expenses increased from \$1.6 million for the three months ended September 30, 2017 to \$2.0 million for the three months ended September 30, 2018, an increase of approximately 24%. This increase was primarily due to spending for new projects.

Sales and Marketing Expenses. Sales and marketing expenses decreased from \$3.1 million for the three months ended September 30, 2017 to \$2.8 million for the three months ended September 30, 2018, a decrease of approximately 8%. This decrease was primarily due to a more efficient distribution of clinical adoption and marketing resources favorably impacting both headcount and contractor costs.

General and Administrative Expenses. General and administrative expenses include finance, information systems, legal, and general management. General and administrative expenses decreased from \$1.4 million for the three months ended September 30, 2017 to \$1.2 million for the three months ended September 30, 2018, a decrease of approximately 10%. This decrease was primarily due to reduced headcount costs.

Other Income (Expense). Other income (expense) represents the non-cash 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.

Interest Expense. Interest expense was relatively unchanged at less than \$0.1 million for the three months ended September 30, 2017 and September 30, 2018.

Comparison of the Nine Months Ended September 30, 2018 and 2017

Revenue. Revenue decreased from \$23.6 million for the nine months ended September 30, 2017 to \$22.1 million for the nine months ended September 30, 2018, a decrease of approximately 6%. Revenue from the sale of systems decreased from \$3.6 million to \$1.0 million, a decrease of approximately 71%, primarily due to lower *Niobe* sales volumes. We recognized a total of \$1.0 million for *Odyssey* and *Cinema* systems during the 2018 period. System revenue for the prior year period included revenue on two *Niobe* systems and a total of \$1.6 million on *Odyssey* and *Odyssey Cinema* systems. Revenue from sales of disposable interventional devices, service and accessories increased to \$21.0 million for the nine months ended September 30, 2018 from \$19.9 million for the nine months ended September 30, 2017, an increase of approximately 5% primarily due to increased service revenue from time-and-material billings.

Cost of Revenue. Cost of revenue decreased from \$5.4 million for the nine months ended September 30, 2017 to \$4.3 million for the nine months ended September 30, 2018, a decrease of approximately 20%. As a percentage of our total

revenue, overall gross margin increased to 81% for the nine months ended September 30, 2018 compared to 77% during the same nine month period of the prior year due to change in product mix in the current year period. Cost of revenue for systems sold decreased from \$2.0 million for the nine months ended September 30, 2017 to \$1.3 million for the nine months ended September 30, 2018, a decrease of approximately 38%, primarily due to decreased system sales volumes and installations across all product lines. Gross margin for systems decreased from \$1.6 million for the nine months ended September 30, 2017 to (\$0.2) million for the nine months ended September 30, 2018 due to low sales volumes. Cost of revenue for disposables, service and accessories decreased to \$3.0 million during the 2018 period from \$3.4 million during the 2017 period, resulting in an increase in gross margin to 86% from 83% between these periods driven by lower expenses incurred under service contracts in the current year period.

Research and Development Expenses. Research and development expenses increased from \$5.0 million for the nine months ended September 30, 2017 to \$6.0 million for the nine months ended September 30, 2018, an increase of approximately 20%. This increase was due to higher project-based expenses.

Sales and Marketing Expenses. Sales and marketing expenses decreased from \$10.5 million for the nine months ended September 30, 2017 to \$9.9 million for the nine months ended September 30, 2018, a decrease of approximately 5%. This decrease was primarily due to a more efficient distribution of clinical adoption and marketing resources favorably impacting both headcount and contractor costs.

General and Administrative Expenses. General and administrative expenses include finance, information systems, legal, and general management. General and administrative expenses decreased to \$3.8 million for the nine months ended September 30, 2018 from \$4.9 million for the nine months ended September 30, 2017, a decrease of 24%. This decrease was primarily driven by reduced headcount costs, including severance, as well as lower professional fees.

Other Income (Expense). Other income (expense) represents the non-cash 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.

Interest Expense. Interest expense in the current year period decreased approximately 75% from the nine months ended September 30, 2017, due to lower loan commitment fees.

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, 2018 we had \$11.6 million of cash and equivalents. We had working capital of \$8.1 million as of September 30, 2018 and a working capital deficit of \$20.3 million as of December 31, 2017. The increase in working capital was primarily driven by the warrant exercise in March 2018.

The following table summarizes our cash flow by operating, investing and financing activities for the nine months ended September 30, 2018 and 2017 (in thousands):

	Nine Months Ended September 30,	
	2018	2017
Cash flow used in operating activities	\$(1,770)	\$(3,872)
Cash flow used in investing activities	(256)	(72)
Cash flow provided by (used in) financing activities	9,909	(70)

Net cash used in operating activities. We used approximately \$1.8 million and \$3.9 million of cash for operating activities during the nine months ended September 30, 2018 and 2017, respectively. The decrease in cash used in operating activities was driven by reduced operating losses as well as lower use of working capital.

Net cash used in investing activities. We used approximately \$0.3 million of cash during the nine month period ended September 30, 2018 for leasehold improvements and purchases of equipment, and approximately \$0.1 million for purchases of equipment for the nine month period ended September 30, 2017.

Net cash provided by (used in) financing activities. We generated approximately \$9.9 million of cash for the nine month period ended September 30, 2018, compared to approximately \$70,000 used for the nine month period ended September 30, 2017. The cash generated for the nine months ended September 30, 2018 was primarily driven by the warrant exercise in March 2018. The cash used for the nine months ended September 30, 2017 was driven by payments of deferred financing costs offset by proceeds from issuance of stock, net of issuance costs.

The Company believes the cash on hand at September 30, 2018 will be sufficient to meet its obligations as they become due in the ordinary course of business for at least 12 months following the date these financial statements are issued. The Company has sustained operating losses throughout its corporate history and expects that its 2018 expenses will exceed its 2018 gross margin. The Company expects to continue to incur operating losses and negative cash flows until revenues reach a level sufficient to support ongoing operations or expense reductions are in place. The Company's liquidity needs will be largely determined by the success of clinical adoption within the installed base of *Niobe* systems as well as by new placements of capital systems.

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 and working capital, and equipment financing loans. In the future, we may finance cash needs through the sale of other equity securities or non-core assets, strategic collaboration agreements, debt financings, or

through distribution rights. We cannot assure you that such additional financing will be available on a timely basis on terms acceptable to us or at all, that we will be able to engage in equity financings because our common stock is no longer listed on a national securities exchange, or that such financing will not be dilutive to our stockholders. If adequate funds are not available to us, we could be required to delay development or commercialization of new products, to license to third parties the rights to commercialize products or technologies that we would otherwise seek to commercialize ourselves or to reduce the 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. In addition, we could be required to cease operations.

Capital Resources

As of September 30, 2018, our borrowing facilities were comprised of a revolving line of credit maintained with our primary lender, Silicon Valley Bank.

Revolving Line of Credit

The Company has had a working capital line of credit with its primary lender, Silicon Valley Bank, since 2004. The revolving line of credit is secured by substantially all of the Company's assets. The maximum available under the line is \$5.0 million subject to the value of collateralized assets. The Company is required under the revolving line of credit to maintain its primary operating account and the majority of its cash and investment balances in accounts with its primary lender.

On April 26, 2018, the Company entered into a First Amendment to Third Amended and Restated Loan and Security Agreement with Silicon Valley Bank to extend the maturity of the revolving line of credit to April 25, 2019. The maximum availability under the revolving line of credit remains at \$5.0 million, and provides for an interest rate during a “streamline period” equal to the prime rate subject to a floor of 4.5%. A “streamline period” occurs when the Company has, for each consecutive day in the immediately preceding monthly period, maintained a liquidity ratio greater than 1.75:1.00, and continuing so long as the streamline period has been maintained. Upon the termination of a streamline period, the Company must maintain the streamline threshold each consecutive day for one fiscal quarter, prior to entering into a subsequent streamline period. During non-streamline periods, the interest rate is the prime rate plus 1.5%, subject to a floor of 4.5%. In addition, the amendment requires that the liquidity ratio shall at all times include not less than \$1.5 million of the Borrower’s unrestricted cash and cash equivalents maintained at the Bank prior to giving effect to any advance.

As of September 30, 2018, the Company had no outstanding balance 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, 2018, the Company had a borrowing capacity of \$3.2 million based on the Company’s collateralized assets. The Company’s total liquidity as of September 30, 2018, was \$14.8 million which included cash and cash equivalents of \$11.6 million.

Common Stock

The holders of common stock are entitled to one vote for each share held and to receive dividends whenever funds are legally available and when declared by the Board of Directors subject to the rights of holders of all classes of stock having priority rights as dividends and the conditions of the revolving line of credit agreement. No dividends have been declared or paid as of September 30, 2018.

Convertible Preferred Stock and Warrants

In September, 2016, the Company issued 24,000 shares of Series A Convertible Preferred Stock, par value \$0.001 with a stated value of \$1,000 per share which are convertible into shares of the Company’s common stock at an initial conversion rate of \$0.65 per share and (ii) warrants to purchase an aggregate of 36,923,078 shares of common stock. The convertible preferred shares are entitled to vote on an as-converted basis with the common stock, subject to specified beneficial ownership issuance limitations. The convertible preferred shares bear dividends at a rate of six percent (6%) per annum, which are cumulative and accrue daily from the date of issuance on the \$1,000 stated value. Such dividends will not be paid in cash except in connection with any liquidation, dissolution or winding up of the Company or any redemption of the convertible preferred shares. Each holder of convertible preferred shares has the right to require us to redeem such holder’s convertible preferred shares upon the occurrence of specified events, which include certain business combinations, the sale of all or substantially all of the Company’s assets, or the sale of more than 50% of the outstanding shares of the Company’s common stock. In addition, the Company has the right to redeem the convertible preferred shares in the event of a defined change of control. The convertible preferred shares rank

senior to our common stock as to distributions and payments upon the liquidation, dissolution, and winding up of the Company. Since the convertible preferred shares are subject to conditions for redemption that are outside the Company's control, the convertible preferred shares are presently reported in the mezzanine section of the balance sheet.

The warrants issued in conjunction with the convertible preferred stock have an exercise price equal to \$0.70 per share subject to adjustments as provided under the terms of the warrants. The warrants are exercisable through September 29, 2021, subject to specified beneficial ownership issuance limitations. Prior to their modification in February, 2018, the warrants were puttable upon the occurrence of certain events outside of the Company's control, and were classified as liabilities under ASC 480-10. The calculated fair value of the warrants was periodically re-measured with any changes in value recognized in "Other income (expense)" in the Statements of Operations. See Note 10 for additional details.

The warrants were modified on February 28, 2018 to allow for a reduction in the exercise price from \$0.70 per share to \$0.28 per share for a period between March 1, 2018 and March 5, 2018 to encourage early exercise. Additionally, the beneficial ownership limitation related to the warrants was modified and the right of holders to require the Company to redeem their SPA Warrants in exchange for cash in certain circumstances was eliminated. Following these modifications, the warrants are no longer subject to liability accounting and were reclassified to equity. During the restricted exercise period, Stereotaxis received exercise notices for 35,791,927 warrants and received an aggregate of \$10.0 million in cash from the warrant exercise. As a result of these transactions, total stockholders' equity increased by \$27 million and common shares outstanding increased by 35,791,927 shares. The Consent and Amendment and the Amended and Restated Form of Warrants are available in a Form 8-K filed with the Securities and Exchange Commission on March 6, 2018.

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 have arisen if we had engaged in these relationships.

ITEM 3. [RESERVED]

None.

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.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

Additional Risk Factors are discussed in our Annual Report on Form 10-K for the year ended December 31, 2017.

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

Number	Description
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- | | |
|------|---|
| 3.1 | <u>Restated Articles of Incorporation of the Registrant, incorporated by reference to Exhibit 3.1 of the Registrant's Form 10-Q (File No. 000-50884) for the fiscal quarter ended September 30, 2004.</u> |
| 3.2 | <u>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.</u> |
| 3.3 | <u>Certificate of Designations, Preferences and Rights of Series A Convertible Preferred Stock, incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K (File No. 001-36159) filed on September 30, 2016.</u> |
| 3.4 | <u>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.</u> |
| 10.1 | <u>Employment Offer Letter for Kevin Barry, Chief Legal Officer, filed herewith.</u> |

10.2 Terms and Conditions of Employment for Kevin Barry, Chief Legal Officer, filed herewith.

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- 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.

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 13, 2018 By: */s/ David L. Fischel*
David L. Fischel
Chief Executive Officer

Date: November 13, 2018 By: */s/ Martin C. Stammer*
Martin C. Stammer
Chief Financial Officer

