Patient Safety Technologies, Inc
Form 10-Q
May 22, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2007

OR

¨ 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

PATIENT SAFETY TECHNOLOGIES, INC.
(Exact name of registrant as specified in its charter)

Delaware	**13-3419202**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

27555 Ynez Road, Suite 330, Temecula, CA 92591
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (951) 587-6201

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 past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨.

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

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

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

There were 9,937,059 shares of the registrant's common stock outstanding as of May 8, 2007.

PATIENT SAFETY TECHNOLOGIES, INC.

FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2007

TABLE OF CONTENTS

"SAFE HARBOR" STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

We believe that it is important to communicate our plans and expectations about the future to our stockholders and to the public. Some of the statements in this report are forward-looking statements about our plans and expectations of what may happen in the future, including in particular the statements about our plans and expectations in Part I of this report under the heading “Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.” Statements that are not historical facts are forward-looking statements. These forward-looking statements are made pursuant to the “safe-harbor” provisions of the Private Securities Litigation Reform Act of 1995. You can sometimes identify forward-looking statements by our use of forward-looking words like “may,” “should,” “expects,” “intends,” “plans,” “anticipates,” “believes,” “estimates,” “predicts,” “potential,” or “continue” or the negative of these terms similar expressions.

Although we believe that the plans and expectations reflected in or suggested by our forward-looking statements are reasonable, those statements are based only on the current beliefs and assumptions of our management and on information currently available to us and, therefore, they involve uncertainties and risks as to what may happen in the future. Accordingly, we cannot guarantee you that our plans and expectations will be achieved. Our actual results and stockholder values could be very different from and worse than those expressed in or implied by any forward-looking statement in this report as a result of many known and unknown factors, many of which are beyond our ability to predict or control. These factors include, but are not limited to, those contained in Part II of this report under “Item 1A. Risk Factors.” All written and oral forward-looking statements attributable to us are expressly qualified in their entirety by these cautionary statements.

Our forward-looking statements speak only as of the date they are made and should not be relied upon as representing our plans and expectations as of any subsequent date. Although we may elect to update or revise forward-looking statements at some time in the future, we specifically disclaim any obligation to do so, even if our plans and expectations change.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

PATIENT SAFETY TECHNOLOGIES, INC. AND SUBSIDIARIES

Consolidated Balance Sheets (Unaudited)

	March 31, 2007	December 31, 2006
ASSETS		
CURRENT ASSETS		
Cash	$ 1,410,705	$ 3,775
Accounts receivable	198,648	65,933
Inventories	42,825	42,825
Prepaid expenses	437,640	78,834
Other current assets	16,620	13,125
TOTAL CURRENT ASSETS	2,106,438	204,492
Restricted certificate of deposit	87,500	87,500
Notes receivable	153,668	153,668
Property and equipment, net	375,308	328,202
Assets held for sale, net	3,178,765	3,189,674
Goodwill	1,687,527	1,687,527
Patents, net	4,007,615	4,088,850
Long-term investments	1,441,533	1,441,533
TOTAL ASSETS	$ 13,038,354	$ 11,181,446
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Notes payable, current portion - net	$ 4,279,138	$ 3,517,149
Accounts payable	1,083,540	1,295,849
Accrued liabilities	928,974	824,466
TOTAL CURRENT LIABILITIES	6,291,652	5,637,464
Notes payable, less current portion - net	1,495,000	2,527,562
Deferred tax liabilities	1,443,821	1,473,066
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		

Convertible preferred stock, $1.00 par value, cumulative 7% dividend: 1,000,000 shares authorized; 10,950 issued and outstanding at March 31, 2007 and December 31, 2006 (Liquidation preference of $1,229,139 at March 31, 2007 and $1,209,976 at December 31, 2006, respectively)		10,950		10,950
Common stock, $0.33 par value: 25,000,000 shares authorized; 9,832,200 shares issued and outstanding as of March 31, 2007; 7,489,026 shares issued and 6,874,889 shares outstanding at December 31, 2006		3,244,626		2,471,379
Additional paid-in capital		31,480,431		29,654,341
Accumulated deficit		(30,928,126)		(29,483,910)
		3,807,881		2,652,760
Less: 614,137 shares of treasury stock, at cost, at December 31, 2006		—		(1,109,406)
TOTAL STOCKHOLDERS' EQUITY		3,807,881		1,543,354
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	13,038,354	$	11,181,446

The accompanying notes are an integral part of these consolidated interim financial statements.

1

PATIENT SAFETY TECHNOLOGIES, INC. AND SUBSIDIARIES

Consolidated Statements of Operations and Comprehensive Loss (Unaudited)

	For The Three Months Ended March 31,	
	2007	**2006**
REVENUES	$ 307,158	$ 54,993
OPERATING EXPENSES		
Cost of sales	214,210	—
Salaries and employee benefits	498,280	2,385,250
Professional fees	303,473	612,307
Rent	38,582	33,287
Insurance	42,772	27,359
Taxes other than income taxes	27,158	31,245
Amortization of patents	81,235	81,235
General and administrative	203,682	223,939
Total operating expenses	1,409,392	3,394,622
Operating loss	(1,102,234)	(3,339,629)
OTHER INCOME (EXPENSES)		
Interest, dividend income and other	4,287	1,094
Realized (loss) on investments, net	—	(136,262)
Interest expense	(267,584)	(34,683)
Unrealized gain on marketable securities, net	—	76,915
Loss from continuing operations before income taxes	(1,365,531)	(3,432,565)
Income tax benefit	29,245	29,245
Loss from continuing operations	(1,336,286)	(3,403,320)
Loss from discontinued operations	(88,767)	(170,212)
Net loss	(1,425,053)	(3,573,532)
Preferred dividends	(19,163)	(19,163)
Loss available to common shareholders	$ (1,444,216)	$ (3,592,695)
Basic and diluted net loss per common share		
Continuing operations	$ (0.17)	$ (0.57)
Discontinued operations	$ (0.01)	$ (0.03)
Net loss	$ (0.18)	$ (0.60)

Weighted average common shares outstanding - basic and diluted		7,789,581		6,003,103
Comprehensive loss:				
Net loss	$	(1,425,053)	$	(3,573,532)
Other comprehensive (loss), unrealized (loss) on available-for-sale investments		—		(745,715)
Total comprehensive loss	$	(1,425,053)	$	(4,319,247)

The accompanying notes are an integral part of these consolidated interim financial statements.

PATIENT SAFETY TECHNOLOGIES, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited)

	For The Three Months Ended March 31,	
	2007	**2006**
Cash flows from operating activities:		
Net loss	$ (1,425,053)	$ (3,573,532)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	31,911	8,519
Amortization of patents	81,235	81,235
Non-cash interest	169,427	75,245
Realized loss on investments, net	—	136,262
Unrealized gain on marketable securities	—	(76,915)
Stock-based compensation to employees and directors	249,900	1,935,967
Stock-based compensation to consultants	61,703	418,012
Income tax benefit	(29,245)	(29,245)
Changes in operating assets and liabilities:		
Accounts receivable	(132,715)	900,000
Marketable securities, net	—	749,544
Prepaid expenses	141,194	(17,873)
Other current assets	(3,495)	(66)
Assets held for sale, net	10,909	—
Accounts payable	(212,309)	(241,702)
Accrued liabilities	85,345	167,935
Due to broker	—	(526,807)
Net cash (used in) provided by operating activities	(971,193)	6,579
Cash flows from investing activities:		
Purchase of property and equipment	(79,017)	(2,102,853)
Proceeds from sale of long-term investments	—	20,508
Net cash used in investing activities	(79,017)	(2,082,345)
Cash flows from financing activities:		
Proceeds from issuance of common stock and warrants	2,897,140	—
Proceeds from notes payable	10,000	2,685,893
Payments and decrease on notes payable	(450,000)	(631,637)
Net cash provided by financing activities	2,457,140	2,054,256
Net increase (decrease) in cash	1,406,930	(21,510)
Cash at beginning of period	3,775	79,373
Cash at end of period	$ 1,410,705	$ 57,863

The accompanying notes are an integral part of these consolidated interim financial statements.

3

PATIENT SAFETY TECHNOLOGIES, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows (continued)

	For The Three Months Ended March 31,			
	2007		2006	
Supplemental disclosures of cash flow information:				
Cash paid during the period for interest	$	963	$	12,946
Supplemental schedule of non cash investing and financing activities:				
Dividends accrued	$	19,163	$	19,163
Capitalized interest	$	—	$	30,453
Insuance of common stock for prepayment of inventory	$	500,000	$	—
Purchase of the remaining 50% interest in ASG, through issuance of common stock, resulting in the following asset acquired and liabilities assumed during the quarter ended March 31, 2006 as follows:				
				ASG
Goodwill			$	357,008
Common stock issued			$	(610,000)
Minority interest			$	252,992
Liabilities assumed			$	—

The accompanying notes are an integral part of these consolidated interim financial statements.

4

Patient Safety Technologies, Inc. and Subsidiaries
Notes to Consolidated Interim Financial Statements - Unaudited
March 31, 2007

1. DESCRIPTION OF BUSINESS

Patient Safety Technologies, Inc. (***"PST"*** or the ***"Company"***) is a Delaware corporation. Until March 31, 2005, the Company was a Business Development Company (***"BDC"***) under the Investment Company Act of 1940, as amended. On March 30, 2005, stockholder approval was obtained to withdraw the Company's election to be treated as a BDC and on March 31, 2005, the Company filed an election to withdraw its election with the Securities and Exchange Commission (***"SEC"***). The Company currently has two wholly-owned operating subsidiaries: Surgicount Medical, Inc. (***"Surgicount"***), a California corporation; and Automotive Services Group, Inc., (formerly known as Ault Glazer Bodnar Merchant Capital, Inc.) a Delaware corporation.

The Company's primary focus is development, manufacturing and distribution of products and services focused primarily in the health care and medical products field, particularly the patient safety markets. Surgicount is a developer and manufacturer of patient safety products and services. The SurgiCount Safety-Sponge™ System is a patented turn-key array of modified surgical sponges, line-of-sight scanning SurgiCounters, and printPAD printers integrated together to form a comprehensive counting and documentation system.

The Company also operates a car wash through Automotive Services Group, Inc. (***"Automotive Services Group"***), which holds the Company's investment in Automotive Services Group, LLC (***"ASG"***), its wholly-owned subsidiary. As discussed in Note 4, during the fourth quarter of 2006 the Company began marketing the assets held in ASG for sale. In addition, the Company holds various other unrelated investments including investments in real estate and in a financial services company, which it is in the process of liquidating as part of a strategic plan adopted during 2006 to dispose of all of the Company's non patient safety related assets.

2. LIQUIDITY AND GOING CONCERN

The accompanying unaudited consolidated interim financial statements have been prepared assuming that the Company will continue as a going concern. At March 31, 2007, the Company has an accumulated deficit of approximately $30.9 million and a working capital deficit of approximately $4.2 million. For the three months ended March 31, 2007, the Company incurred a loss of approximately $1.4 million and has utilized approximately $1.0 million in cash in its operations. Further, as of March 31, 2007, the Company has only generated minimal revenues from its medical products and healthcare solutions segments. These conditions raise substantial doubt about the Company's ability to continue as a going concern. The Company has relied on liquidating investments and short-term debt financings to fund a large portion of its operations. In order to ensure the continued viability of the Company, equity financing and profitable operations must be obtained in order to repay the existing short-term debt and to provide a sufficient source of operating capital. Although the Company has received equity financing during the three months ended March 31, 2007, the Company is currently seeking additional financing and believes that it will be successful. However, no assurances can be made that it will be successful obtaining a sufficient amount of equity financing to continue to fund its operations or that the Company will achieve profitable operations and positive cash flow from its medical products segment. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

3. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited consolidated interim financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and do not include all the information and disclosures required by accounting principles generally accepted in the United States of America. The consolidated interim financial information is unaudited, but reflects all normal adjustments that are, in the opinion of management, necessary to provide a fair statement of results for the interim periods presented. The consolidated balance sheet as of December 31, 2006 was derived from the Company's audited financial statements. The consolidated interim financial statements should be read in conjunction with the consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2006. Results of the three months ended March 31, 2007 are not necessarily indicative of the results to be expected for the full year ending December 31, 2007. All intercompany transactions have been eliminated in consolidation.

Patient Safety Technologies, Inc. and Subsidiaries
Notes to Consolidated Interim Financial Statements - Unaudited (continued)

Revenue Recognition

The Company complies with SEC Staff Accounting Bulletin (***"SAB"***) 101, *Revenue Recognition in Financial Statements*, amended by SAB 104, *Revenue Recognition*. Consulting service contract revenue is recognized when the service is performed. Consequently, the recognition of such consulting service contract revenue is deferred until each phase of the contract is complete. Revenues generated by the Company's automated car wash subsidiary, Automotive Services Group are recognized at the time of service. Revenues from sales of the Safety-Sponge™ System are recorded upon shipment.

Goodwill and Intangible Assets

In accordance with SFAS No. 142, *Goodwill and Intangible Assets* , goodwill is tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis in the Company's fourth fiscal quarter or more frequently if indicators of impairment exist. The performance of the test involves a two-step process. The first step of the impairment test involves comparing the fair value of the Company's reporting units with each respective reporting unit's carrying amount, including goodwill. The fair value of reporting units is generally determined using the income approach. If the carrying amount of a reporting unit exceeds the reporting unit's fair value, the second step of the goodwill impairment test is performed to determine the amount of any impairment loss. The second step of the goodwill impairment test involves comparing the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. As discussed in Note 5, during the year ended December 31, 2006, the Company believed there were indicators of impairment present for its car wash services segment and after performing the tests described above, recorded impairment charges.

Long-Lived Assets

The Company evaluates long-lived assets for impairment in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* which requires impairment evaluation on long-lived assets used in operations when indicators of impairment are present. Reviews are performed to determine whether the carrying value of assets is impaired, based on a comparison to undiscounted expected future cash flows. If this comparison indicates that there is impairment, the impaired asset is written down to fair value, which is typically calculated using discounted expected future cash flows and a discount rate based upon the Company's weighted average cost of capital adjusted for risks associated with the related operations. Impairment is based on the excess of the carrying amount over the fair value of those assets.

Stock-Based Compensation

The Company adopted SFAS No. 123(R), *Share-Based Payment*, as of January 1, 2005 using the modified retrospective application method as provided by SFAS 123(R) and accordingly, financial statement amounts for the prior periods in which the Company granted employee stock options have been restated to reflect the fair value method of expensing prescribed by SFAS 123(R). During the three months ended March 31, 2007 and 2006, the Company had stock-based compensation expense of $250,000 and $1,936,000, respectively, related to issuances to the Company's employee and directors, included in reported net losses for these periods. The total amount of stock-based compensation for the three months ended March 31, 2007 of $250,000 included expenses related to restricted stock grants valued at $192,000 and stock options valued at $58,000. The total amount of stock based compensation for the three months ended March 31, 2006 of $1,936,000 included expenses related to restricted stock grants valued at $1,014,000 and stock options valued at $922,000.

During the three months ended March 31, 2007 and 2006, the Company had stock-based compensation expense, from issuances of restricted stock and warrants to consultants of the Company of $62,000 and $418,000, respectively.

Patient Safety Technologies, Inc. and Subsidiaries
Notes to Consolidated Interim Financial Statements - Unaudited (continued)

A summary of stock option activity for the three months ended March 31, 2007 is presented below:

	Shares Available for Grant	Number of Shares	Outstanding Options Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value
December 31, 2006	**26,026**	**1,704,000**	**$ 4.50**	**8.73**	
Restricted Stock Awards	(79,032)				
Grants	(75,000)	75,000	$ 1.60	9.91	
Cancellations	189,000	(189,000)	$ 5.11	8.26	
March 31, 2007	**60,994**	**1,590,000**	**$ 4.23**	**8.35**	**$ —**
Options exercisable at:					
December 31, 2006		832,625	$ 4.90	8.54	$ —
March 31, 2007		719,375	$ 4.89	8.12	$ —

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (i.e., the difference between our closing stock price on March 31, 2007 and the exercise price, times the number of shares) that would have been received by the option holders had all option holders exercised their options on March 31, 2007. There have not been any options exercised during the three months ended March 31, 2007.

All options that the Company granted during the three months ended March 31, 2007 and 2006 were granted at the per share fair market value on the grant date. Vesting of options differs based on the terms of each option. The Company utilized the Black-Scholes option pricing model and the assumptions used for each period are as follows:

	Three Months ended March 31, 2007	2006
Weighted average risk free interest rate	4.50%	3.75%
Weighted average life (in years)	5.00	3.0
Volatility	100%	89%
Expected dividend yield	0%	0%
Weighted average grant-date fair value per share of options granted	$ 1.22	$ 2.51

As of March 31, 2007, total unrecognized compensation cost related to unvested stock options was $975,000. The cost is expected to be recognized over a weighted average period of 1.51 years.

Patient Safety Technologies, Inc. and Subsidiaries
Notes to Consolidated Interim Financial Statements - Unaudited (continued)

Beneficial Conversion Feature of Convertible Notes Payable

The convertible feature of certain notes payable provides for a rate of conversion that is below market value. Such feature is normally characterized as a Beneficial Conversion Feature (***"BCF"***). Pursuant to EITF Issue No. 98-5, *Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratio,* EITF No. 00-27, *Application of EITF Issue No. 98-5 To Certain Convertible Instruments* and APB 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants*, the estimated fair value of the BCF is recorded in the consolidated financial statements as a discount from the face amount of the notes. Such discounts are amortized to accretion of convertible debt discount over the term of the notes (or conversion of the notes, if sooner).

Earnings per Common Share

Loss per common share is based on the weighted average number of common shares outstanding. The Company complies with SFAS No. 128, *Earnings Per Share,* which requires dual presentation of basic and diluted earnings per share on the face of the consolidated statements of operations. Basic loss per common share excludes dilution and is computed by dividing income (loss) available to common stockholders by the weighted-average common shares outstanding for the period. Diluted loss per common share reflects the potential dilution that could occur if convertible preferred stock or debentures, options and warrants were to be exercised or converted or otherwise resulted in the issuance of common stock that then shared in the earnings of the entity.

Since the effects of outstanding options, warrants and the conversion of convertible preferred stock and convertible debt are anti-dilutive in all periods presented, shares of common stock underlying these instruments have been excluded from the computation of loss per common share.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. The actual results may differ from management's estimates.

Recent Accounting Pronouncements

In June 2006, the FASB issued FASB Interpretation Number 48 (***"FIN 48"***), *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position that an entity takes or expects to take in a tax return. Additionally, FIN 48 provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. Under FIN 48, an entity may only recognize or continue to recognize tax positions that meet a "more likely than not" threshold. FIN 48 was effective for the Company beginning January 1, 2007. In connection with the adoption of FIN 48, no liability for unrecognized income tax benefits was recorded and no interest and penalties related to uncertain tax positions was recognized. The tax years 2003 -2006 remain open to examination by the major taxing jurisdictions.

Patient Safety Technologies, Inc. and Subsidiaries
Notes to Consolidated Interim Financial Statements - Unaudited (continued)

4. DISCONTINUED OPERATIONS

As part of a strategic plan to dispose of all the Company's non-patient safety related assets, during the fourth quarter of 2006, the Company began marketing for sale the assets of Automotive Services Group, located in Alabama. The Company anticipates operating and generating operating cash flow from the one operating car wash until its disposition. The assets of Automotive Services Group met the "held for sale" and "discontinued operations" criteria in accordance with SFAS 144.

The following sets forth the discontinued operations for the three months ended March 31, 2007 and 2006 related to the held for sale assets of Automotive Services Group:

	Three Months Ended March 31,	
	2007	2006
Operating revenues	$ 159,864	$ 20,767
Operating expenses	134,929	93,259
Depreciation and amortization	10,909	—
Interest expense	102,793	97,720
Loss from discontinued operations	$ (88,767)	$ (170,212)

The following sets forth the assets that are held for sale that are related to the discontinued operations:

	March 31, 2007	December 31, 2006
Property and equipment, net	$ 3,178,765	$ 3,189,674
Goodwill	—	—
Other assets	—	—
Total assets of discontinued operations	$ 3,178,765	$ 3,189,674

5. OTHER CURRENT ASSETS

At March 31, 2007 and December 31, 2006, the Company had other current assets of $17,000 and $13,000, respectively, consisting primarily of security deposits.

6. GOODWILL AND PATENTS

The Company's goodwill relates to its SurgiCount subsidiary. Identifiable intangible assets, net, as of March 31, 2007 and December 31, 2006 are composed of patents:

	March 31, 2007	December 31, 2006