

SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **1996-11-14** | Period of Report: **1996-09-30**
SEC Accession No. **0000950134-96-006230**

([HTML Version](#) on secdatabase.com)

FILER

LIFEQUEST MEDICAL INC

CIK: **860131** | IRS No.: **742559866** | State of Incorporation: **DE** | Fiscal Year End: **1231**
Type: **10-Q** | Act: **34** | File No.: **000-20532** | Film No.: **96665044**
SIC: **3842** Orthopedic, prosthetic & surgical appliances & supplies

Mailing Address
9601 MCALLISTER FRWY
SUITE 1120
SAN ANTONIO TX 78216

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9601 MCALLISTER FRWY
SUITE 1120
SAN ANTONIO TX 78216
2103662100

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

For the Quarterly Period Ended September 30, 1996

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 0-20532

LIFEQUEST MEDICAL, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

74-2559866
(I.R.S. Employer
Identification No.)

9601 McAllister Freeway, Suite 1120
San Antonio, Texas 78216
(Address of principal executive offices)
(Zip Code)

(210) 366-2100
(Registrant's telephone number, including area code)

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 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 the number of shares outstanding of each of the issuer's classes of
Common Stock, as of the latest practicable date.

On November 5, 1996, there were outstanding 3,793,205 shares of Common Stock,
\$.001 par value, of the registrant.

LIFEQUEST MEDICAL, INC. AND SUBSIDIARIES

FORM 10-Q

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PART I - FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

LIFEQUEST MEDICAL, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

<TABLE>
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ASSETS	December 31, 1995	September 30, 1996
	-----	-----
		(Unaudited)
<S>	<C>	<C>
Current Assets:		
Cash and cash equivalents	\$ 317,915	\$ 199,221
Short-term investments	4,817,221	3,406,733
Accounts receivable	100,395	125,318
Interest receivable	95,655	93,800
Inventories	23,643	156,889
Prepaid and other assets	98,968	19,660
	-----	-----
Total current assets	5,453,797	4,001,621
	-----	-----
Property and Equipment:		
Capital leased equipment	521,867	--

Leasehold improvements	65,229	71,252
Machinery and equipment	--	627,972
Furniture and fixtures	206,124	271,993
Less-Accumulated depreciation	(565,906)	(644,834)

	227,314	326,383
	-----	-----

Intangible Assets:

Licensed technology rights	427,273	427,273
	-----	-----

Total assets	\$ 6,108,384	\$ 4,755,277
	=====	=====

</TABLE>

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PART I - FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements (continued)

LIFEQUEST MEDICAL, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

<TABLE>

<CAPTION>

LIABILITIES AND STOCKHOLDERS' EQUITY

<S>

Current Liabilities:

Current portion of:

Long-term debt

Capital lease obligations

Accounts payable

Accrued expenses

Due to stockholders

Total current liabilities

Long-term Debt, Less Current Portion

Capital Lease Obligations, Less Current Portion

Total liabilities

Minority Interest

Commitments

Stockholder's Equity:

Common Stock, \$.001 par value; 10,000,000 shares authorized;
shares issued and outstanding: 3,754,835 (1995)

and 3,793,205 (1996)

Additional paid-in capital

Accumulated deficit

Total stockholders' equity

December 31,
1995

September 30,
1996

<C>

<C>

\$ 59,189
108,364

\$ 707,894
--

432,510
32,730
27,599

36,469
17,296
15,952

660,392

777,611

5,509

--

222,942

--

888,843

777,611

141,364

125,447

3,754

3,793

17,640,456

17,671,359

(12,566,033)

(13,822,933)

5,078,177

3,852,219

Total liabilities and stockholders' equity

\$ 6,108,384

\$ 4,755,277

</TABLE>

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

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LIFEQUEST MEDICAL, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

<TABLE>
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	Three Months Ended September 30		Nine Months Ended September 30	
	1995	1996	1995	1996
<S>	<C>	<C>	<C>	<C>
Revenues:				
Net sales	\$ 228,760	\$ 193,079	\$ 657,697	\$ 662,193
Cost And Expenses:				
Cost of sales	233,899	113,838	590,107	393,355
Research and development	105,317	100,820	590,297	278,752
Selling, general and administrative	387,689	324,717	1,550,229	1,197,543
Interest	17,329	11,984	47,578	40,863
Depreciation and amortization	36,973	29,197	105,834	78,929
	781,207	580,556	2,884,045	1,989,442
Loss from operations	(552,447)	(387,477)	(2,226,348)	(1,327,249)
Other income (expense):				
Investment income	86,589	48,904	270,879	169,808
Merger and acquisition costs	--	(6,238)	--	(115,375)
Net Loss Before Minority Interest and Extraordinary Item	(465,858)	(344,811)	(1,955,469)	(1,272,816)
Minority interest in net loss of consolidated subsidiary	31,994	630	92,126	15,916
Net Loss Before Extraordinary Item	(433,864)	(344,181)	(1,863,343)	(1,256,900)
Extraordinary Item:				
Gain on extinguishment of debt	--	--	24,686	--
Net Loss	\$ (433,864)	\$ (344,181)	\$ (1,838,657)	\$ (1,256,900)
Net Loss Per Share of Common Stock	\$ (.12)	\$ (.09)	\$ (.49)	\$ (.33)
Weighted Average Shares Used In Computing Net Loss Per Share of Common Stock	3,754,835	3,793,205	3,754,835	3,786,140

</TABLE>

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

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LIFEQUEST MEDICAL, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

<TABLE>
<CAPTION>

	Nine Months Ended September 30	
	1995	1996
<S>	<C>	<C>
Cash Flow From Operating Activities:		
Net Loss	\$ (1,838,657)	\$ (1,256,900)
Adjustments to reconcile net loss to net cash used in operating activities -		
Depreciation and amortization	105,834	78,929
Issuance of stock options in connection with First-Med acquisition	20,849	--
Marketing agreement expense	--	17,500
Gain on extinguishment of debt	(24,686)	--
Minority interest in net loss of consolidated subsidiary	(92,126)	(15,916)
Changes in operating assets and liabilities-		
(Increase) decrease in accounts receivable	183,685	(24,923)
(Increase) decrease in interest receivable	(148,171)	1,855
(Increase) decrease in inventories	208,308	(133,246)
Decrease in prepaid and other assets	126,816	79,308
(Increase) in accounts receivable from related party	(39,696)	--
(Decrease) increase in accounts payable	16,671	(396,041)
(Decrease) increase in accrued expenses	21,509	(15,434)
Net cash used in operating activities	(1,459,664)	(1,664,868)
Cash Flows From Investing Activities:		
Additions to property and equipment	(25,526)	(177,997)
Sale of investments	1,303,531	1,410,488
Net cash provided by investing activities	1,278,005	1,232,491
Cash Flows From Financing Activities:		
Additional capital contributed by minority interest	27,695	--
Funds advanced by stockholder	14,815	--
Proceeds from issuance of notes payable	33,161	750,000
Proceeds from exercise of stock options	--	13,440
Payment on due to stockholder	--	(11,647)
Payments on notes payable	(100,577)	(438,110)
Net cash provided (used) by financing activities	(24,906)	313,683
Net Increase (Decrease) In Cash And Cash Equivalents	(206,565)	(118,694)
Cash And Cash Equivalents, beginning of period	698,931	317,915
Cash And Cash Equivalents, end of period	\$ 492,366	\$ 199,221

</TABLE>

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

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LIFEQUEST MEDICAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(Unaudited)

<TABLE>
<CAPTION>

	Nine Months Ended September 30,	
	1995	1996
<S>	<C>	<C>
Supplemental Disclosures Of Cash Flow Information:		
Cash paid during the period for -		
Interest	\$47,578	\$40,863
Income taxes	-	-

</TABLE>

Noncash Investing And Financing Activities:

The Company issued 350,000 shares of common stock in connection with the merger discussed in Note 3.

A stockholder gave a marketing consultant 16,854 equivalent shares of the Company's stock in exchange for the consultant's services in connection with the merger discussed in Note 3. The stock had an estimated fair market value of approximately \$18,000.

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

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LIFEQUEST MEDICAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 1996

NOTE 1 - BASIS OF PRESENTATION

The consolidated financial statements include the accounts of LifeQuest Medical, Inc. (the "Company"), LifeQuest Endoscopic Technologies, Inc. ("LQET"), a wholly owned subsidiary of the Company (Note 3), and the Company's 82% ownership interest in ValQuest Medical, Inc. All significant intercompany accounts and transactions have been eliminated in consolidation. The

consolidated financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. However, all adjustments have been made which are, in the opinion of the Company, necessary for a fair presentation of the results of operations for the periods covered. In addition, all such adjustments are of a normal recurring nature. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading. It is recommended that these consolidated financial statements be read in conjunction with the financial statements and the notes thereto for the fiscal year ended December 31, 1995, included in the Company's Form 10-K.

From inception through December 31, 1995, the Company was a development stage enterprise whose efforts and resources were devoted primarily to research and development activities related to its initial products.

NOTE 2 - NET LOSS PER SHARE

Net loss per share is computed by dividing net loss by the weighted average number of shares of Common Stock outstanding during the period. Common stock equivalents are not considered in the computation as their effect is antidilutive.

NOTE 3 - MERGER OF GM ENGINEERING, INC.

On February 13, 1996, but effective January 1, 1996, the Company completed the merger of GM Engineering, Inc., a California corporation ("GME") with and into LifeQuest Endoscopic Technologies, Inc., a Nevada corporation and newly formed wholly owned subsidiary of the Company. GME was acquired through the issuance of 350,000 shares of LifeQuest common stock. The transaction was recorded using the pooling of interests method of accounting, therefore the assets, liabilities, and operations of GME are included in the consolidated financial statements for all periods reported.

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Item 2. Management's Discussion And Analysis Of Financial Condition And Results Of Operations

Certain statements contained in "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations," including statements regarding the anticipated development and expansion of the Company's business, expenditures, the intent, belief or current expectations of the Company, its directors or its officers, primarily with respect to the future operating performance of the Company and other statements contained herein regarding matters that are not historical facts, are "forward-looking" statements (as such term is defined in the Private Securities Litigation Reform Act of 1995). Because such statements include risks and uncertainties, actual results may differ materially from those expressed or implied by such forward-looking statements. Factors that could cause actual results to differ materially from those expressed or implied by such forward-looking statements include, but are not limited to, those discussed in other filings made by the Company with the Securities and Exchange Commission.

OVERVIEW

From inception through December 31, 1995, the Company was a development stage enterprise whose efforts and resources were devoted primarily to research and development activities related to its initial products. During this development stage, the Company received minimal operating revenues and, thus, was unprofitable. As of September 30, 1996, the Company had an accumulated deficit of approximately \$13,823,000. There can be no assurance that the Company will be able to achieve or sustain profitability.

The Company's future operating results will depend on many factors, including the Company's ability to manufacture and market its products on a

cost-effective basis, demand for the Company's products and the level of competition in the market place.

In February 1996, the Company completed the merger of GM Engineering, Inc., a California corporation ("GM Engineering") with and into LifeQuest Endoscopic Technologies, Inc., a Nevada corporation ("LQET") and newly formed wholly owned subsidiary of the Company. GM Engineering was acquired through the issuance of 350,000 shares of LifeQuest common stock. The transaction was recorded using the pooling of interests method of accounting, therefore the assets, liabilities and operations of GM Engineering are included in the consolidated financial statements for all periods reported. LQET develops, manufactures, and markets surgical and related instruments used in minimally invasive surgery and, as GM Engineering, recorded sales of approximately \$1 million in fiscal 1995.

In May 1994, the Company and Valdor Fiber Optics ("Valdor") of San Jose, California, formed a corporate joint venture called ValQuest Medical, Inc. ("ValQuest"). In accordance with the terms of the joint venture agreement, Valdor transferred to ValQuest the exclusive worldwide rights to develop, manufacture, and market all present and future medical applications of Valdor's patented fiber optic connector technology. The Company paid \$100,000 to Valdor in consideration for the transfer of these rights to ValQuest. Valdor contributed such rights, which had an initial value of \$327,273 in the consolidated financial statements, to ValQuest in exchange for a 45% interest in ValQuest. The Company contributed \$400,000 to be used as working capital in exchange for a 55% interest in ValQuest. Currently, subsequent purchases of additional stock have increased the Company's ownership interest in ValQuest to 82%.

The Company submitted its PMA application to the Food and Drug Administration (FDA) for the Osteoport(R) device on July 19, 1993. On May 9, 1995, the FDA informed the Company that additional information will be required to enable completion of the Osteoport(R) PMA application review. Required information may include clarifications and further analysis of existing data and/or additional patient studies. However, the Company does not plan to initiate any further work on the Osteoport(R) device unless an appropriate corporate partner can be identified. This decision stems from management's current concern about the likelihood of incurring prohibitively high costs in clarifying and addressing FDA's requests for additional information since the July 1993 PMA submission.

LIQUIDITY AND CAPITAL RESOURCES

At September 30, 1996, the Company had cash, cash equivalents and investments of approximately \$3,606,000 and working capital of \$3,224,000. The Company believes these funds will be sufficient to complete the development and, subject to obtaining required regulatory approvals, commercialization of its current products. However, there can be no assurance that the available cash will prove to be sufficient to complete any of these activities.

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RESULTS OF OPERATIONS THREE MONTHS ENDED SEPTEMBER 30, 1995 AND 1996

Net loss for the three months ended September 30, 1996 was \$344,000, a decrease of 21 percent from the \$434,000 net loss for the comparable period of 1995. The decline was primarily due to a reduction in expenses as detailed hereinafter.

Sales for the three months ended September 30, 1996 and 1995 were \$193,000 and \$229,000 respectively. The Company believes this decline was a temporary aberration caused by a sales disruption due to changes within the member group of the national distributor network.

Research and development expenses were relatively flat from quarter to quarter. The costs in 1995 were primarily due to expenses incurred in conjunction with development of the First-Med system. The Company anticipates the research and development focus for 1996 will continue to be enhancement of

LQET's current products and development of future products. Therefore, research and development costs should increase slightly during the fourth quarter of 1996.

Selling, general and administrative expenses, which consist primarily of salaries and other costs necessary to support the Company's infrastructure, decreased 16 percent to \$325,000 in 1996 from \$388,000 in 1995. This comparative decline is a result of management's continuing efforts to reduce expenses.

The minority interest in net loss of consolidated subsidiary of \$630 reflects the minority ownership share of the ValQuest net loss for the three months ended September 30, 1996.

Investment income represents interest earned on proceeds from private and public sales of the Company's equity securities and gains on sales of marketable securities.

Merger and acquisition costs include legal, accounting and testing expenses incurred during the acquisition of GM Engineering.

In March 1995, the FASB issued Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of, which requires impairment losses to be recorded on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount. Statement 121 also addresses the accounting for long-lived assets that are expected to be disposed of. Management does not believe, based on current circumstances, Statement 121 will have a material effect on the carrying amount of the Company's long-lived assets.

As of September 30, 1996, the Company had net operating loss carryforwards of approximately \$11,888,000 for federal income tax purposes which are available to reduce future taxable income and will expire in 2006 through 2011 if not utilized and \$13,175,000 for financial reporting purposes. For federal income tax purposes the Company deferred for future amortization certain acquisition and research and development costs in the amount of \$2,453,000. Such costs, which have been expensed for financial reporting purposes, will be amortized for tax purposes over future years when commercial operations commence. The Company received IRS approval of its request for a change of tax accounting method to expense research and development costs for expenditures incurred in 1992 and future years.

The Company's ability to use its NOL carryforwards to offset future taxable income is subject to restrictions enacted in the United States Internal Revenue Code of 1986 as amended (the "Code"). These restrictions provide for limitations on the Company's utilization of its NOL carryforwards following certain ownership changes described in the Code. As a result of ownership changes in 1996, the Company's existing NOL carryforwards are subject to the limitation. The amount subject to limitation at September 30, 1996, is approximately \$486,000.

NINE MONTHS ENDED SEPTEMBER 30, 1995 AND 1996

Trends that were evident in the quarter ended September 30, 1996, were also generally evident in the nine months ended September 30, 1996.

Net loss for the nine months ended September 30, 1996, was \$1,257,000, a decrease of 32 percent from the \$1,839,000 net loss for the comparable period of 1995.

However, despite a decline for the quarter, sales for the nine months ended September 30, 1996 increased to \$662,000 as compared to \$658,000 for the same period of 1995.

Research and development expenses decreased 53 percent to \$279,000 for the nine months ended September 30, 1996, from \$590,000 in the comparable period of

1995. Likewise, general and administrative expenses declined 23 percent to \$1,198,000 from \$1,550,000 for the comparable periods.

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PART II - OTHER INFORMATION

- Item 1. Legal Proceedings - Not applicable
- Item 2. Changes in Securities - Not applicable
- Item 3. Defaults Upon Senior Securities - Not applicable
- Item 4. Submission of Matters to a Vote of Security Holders - Not applicable
- Item 5. Other Information - Not applicable
- Item 6. Exhibits and Reports on Form 8-K
 - 27.3 Financial Data Schedule

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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.

LIFEQUEST MEDICAL, INC.

(Registrant)

Dated: November 5, 1996

By HERBERT H. SPOON

Herbert H. Spoon
President and Chief Executive
Officer
(Principal Executive Officer)

Dated: November 5, 1996

By RANDALL K. BOATRIGHT

Randall K. Boatright
Vice President and Chief
Financial Officer
(Principal Financial Officer
and Principal Accounting Officer)

INDEX TO EXHIBITS

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