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Form 10KSB
March 29, 2002

FY 2001

POSITRON CORPORATION

FORM 10-KSB

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-KSB

ANNUAL REPORT
UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2001
Commissions file number: 0-24092

POSITRON

A Texas Corporation
1304 Langham Creek Drive, Suite 300, Houston, Texas 77084
(281) 492-7100

IRS Employer Identification Number: 76-0083622

Securities registered under Section 12(b) of the Exchange Act: NONE
Securities registered under Section 12(g) of the Exchange Act: COMMON STOCK,
\$.01 PAR VALUE

Check whether the issuer (1) 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
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Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.[X]

Issuer's revenues for fiscal year ended December 31, 2001: \$2,540,000.

Aggregate market value of common stock held by non-affiliates of the Registrant as of March 18, 2002: \$6,839,063.

As of March 18, 2002, there were 62,173,303 shares of the Registrant's common stock, \$.01 par value outstanding

Documents incorporated by reference: None

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PART I

ITEM 1. DESCRIPTION OF BUSINESS

GENERAL

Positron Corporation (the "Company") was incorporated in the State of Texas on December 20, 1983, and commenced commercial operations in 1986. The Company designs, manufactures, markets and services advanced medical imaging devices utilizing positron emission tomography ("PET") technology under the trade-name POSICAM(TM) systems. Unlike other currently available imaging technologies, PET technology permits the measurement of the biological processes of organs and tissues as well as producing anatomical and structural images. POSICAM(TM) systems, which incorporate patented and proprietary technology, enable physicians to diagnose and treat patients in the areas of cardiology, neurology and oncology. The Food and Drug Administration ("FDA") approved the initial POSICAM(TM) system for marketing in 1985, and as of December 31, 2001, the Company has sold twenty one (21) POSICAM(TM) systems, of which fourteen (14) are in leading medical facilities in the United States and five (5) are installed in international medical institutions. The Company has repurchased a system which is being held in inventory for resale. The Company presently markets its POSICAM(TM) systems at list prices of up to \$1.7 million depending upon the configuration and equipment options of the particular system.

The following table provides summary information regarding the Company's installed base of POSICAM(TM) systems, which were operational as of December 31, 2001:

Site	Location	Clinical Application	In D
Saint Joseph's Hospital	Atlanta, GA	Cardiology	
Cleveland Clinic Foundation	Cleveland, OH	Cardiology/Neurology/Oncology	
Memorial Hospital	Jacksonville, FL	Cardiology/Oncology/Neurology	
Kennestone Hospital	Marietta, GA	Cardiology/Oncology/Neurology	
Medical City Dallas	Dallas, TX	Cardiology/Oncology/Neurology	
Yale/Veterans Administration	New Haven, CT	Neurology/Oncology/Cardiology	
Beth Israel	New York, NY	Cardiology/Oncology/Neurology	
Crawford Long Hospital	Atlanta, GA	Cardiology/Oncology	
Hermann Hospital	Houston, TX	Cardiology/Oncology/Neurology	
Bergan Mercy Hospital	Omaha, NE	Cardiology/Oncology/Neurology	
Buffalo Cardiology & Pulmonary Assoc.	Buffalo, NY	Cardiology/Oncology	
Hadassah Hospital	Israel	Cardiology/Oncology/Neurology	
Baptist Hospital	Nashville, TN	Cardiology/Oncology/Neurology	
Nishidai Clinic (3 systems)	Japan	Cardiology/Oncology/Neurology	
National Institute of Radiological Sciences	Japan	Cardiology/Oncology/Neurology	
Coronary Disease Reversal & Prevention	Buffalo, NY	Cardiology/Oncology/Neurology	
McAllen PET Imaging Center	McAllen, TX	Cardiology/Oncology	

PET technology is an advanced imaging technique, which permits the measurement of the biological processes of organs and tissues, as well as producing anatomical and structural images. Other advanced imaging techniques, such as magnetic resonance imaging ("MRI") and computed tomography ("CT"), produce anatomical and structural images, but do not image or measure biological

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processes. The ability to measure biological abnormalities in tissues and organs allows physicians to detect disease at an early stage, and provides information, which would otherwise be unavailable, to diagnose and treat disease. The Company believes that PET technology can lower the total cost of diagnosing and tracing certain diseases by providing a means for early diagnosis and reducing expensive, invasive or unnecessary procedures, such as angiograms or biopsies which, in addition to being costly and painful, may not be necessary or appropriate.

Commercialization of PET technology commenced in the mid-1980s and the Company is one of several commercial manufacturers of PET imaging systems in the United States. Although the other manufacturers are substantially larger, the Company believes that its POSICAM(TM) systems have proprietary operational and performance characteristics, which may provide certain performance advantages over other commercially available PET systems. Such performance advantages include: (i) high count-rate capability and high sensitivity, which result in

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faster, more accurate imaging; (ii) enhanced ability to use certain types of radiopharmaceuticals, which reduces reliance on a cyclotron and enhances patient throughput; (iii) ability to minimize patient exposure to radiation; and (iv) ability to minimize false positive and false negative diagnoses of disease. The medical imaging industry in which the Company is engaged is, however, subject to rapid and significant technological change. There can be no assurance that the POSICAM(TM) systems can be upgraded to meet future innovations in the PET industry or that new technologies will not emerge, or existing technologies will not be improved, which would render the Company's products obsolete or non-competitive. See "Item 1. Description of Business - Risks Associated with Business Activities-Substantial Competition and Effects of Technological Change".

The Company's initial focus was the clinical cardiology market, where its POSICAM(TM) systems have been used to assess the presence and extent of coronary artery disease, such as the effect of arterial blockages and heart damage due to heart attacks. In 1994 and 1995, the Company made technological advances which allowed it to market its products to the neurological and oncological markets. Neurological applications of POSICAM(TM) systems include diagnoses of certain brain disorders, such as epileptic seizures, dementia, stroke, Alzheimer's disease, Pick's disease and Parkinson's disease. In oncology, POSICAM(TM) systems are used in the diagnosis and evaluation of melanoma and tumors of the bone and various organs and tissues such as the brain, lungs, liver, colon, breasts and lymphatic system.

MEDICAL IMAGING INDUSTRY OVERVIEW

Diagnostic imaging allows a physician to assess disease, trauma or dysfunction without the necessity of surgery. The diagnostic imaging industry includes ultrasound, X-ray, MRI, CT, and nuclear medicine (which includes PET and Single-Photon Emission Computed Tomography ("SPECT")). MRI technology uses powerful magnetic fields to provide anatomical and structural images of the brain, the spine and other soft tissues, as well as determining the location and size of tumors. CT scans use X-ray beams to obtain anatomical and structural images of bones and organs. Nuclear medicine focuses on providing information about the function and biological processes of organs and tissues through the use of radiopharmaceuticals.

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The first prototype PET scanner was developed in the mid 1970s and the first commercial PET scanner was constructed in 1978. Approximately 400 dedicated PET systems are currently operational in the United States and approximately 200 additional dedicated PET systems are in commercial use internationally.

PET TECHNOLOGY

The PET imaging process begins with the injection of a radiopharmaceutical (a drug containing a radioactive agent) by a trained medical person into a patient's bloodstream. After being distributed within the patient's body, the injected radiopharmaceutical undergoes a process of radioactive decay, whereby positrons (positively charged electrons) are emitted and subsequently converted along with free electrons into two gamma rays or photons. These paired gamma events are detected by the POSICAM(TM) systems as coincidence events. The source of the photons is determined and is reconstructed into a color image of the scanned organ utilizing proprietary computer software. Since certain functional processes, such as blood flow, metabolism or other biochemical processes, determine the concentration of the radiopharmaceutical throughout the body, the intensity or color at each point in the PET image directly maps the vitality of the respective function at that point within an organ.

In cardiology, PET imaging is an accurate, non-invasive method of diagnosing or assessing the severity of coronary artery disease. Unlike other imaging technologies, PET technology allows a physician to determine whether blood flow to the heart muscle is normal, thereby identifying narrowed coronary arteries, and whether damaged heart muscle is viable and may benefit from treatment such as bypass surgery or angioplasty. In addition, dynamic and gated imaging can display and measure the ejection fraction and wall motion of the heart.

In neurology, PET imaging is now being used as a surgical planning tool to locate the source of epileptic disturbances in patients with uncontrollable seizures. In other neurological applications, PET is used in the diagnosis of dementia, Alzheimer's disease, Pick's disease and Parkinson's disease, and in the evaluation of stroke severity.

In oncology, PET imaging has historically been used to measure the metabolism of tumor masses after surgery or chemotherapy. Clinical experience has shown that PET is more accurate than CT scans or MRI in determining the effectiveness of chemotherapy and radiotherapy in the treatment of cancer. PET scans are becoming commonly used to assess suspected breast cancer and whether the lymph system has become involved. Whole body PET scans are now routinely performed to

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survey the body for cancer. This application enables oncologists to see the total picture of all metastases in a patient, thereby allowing them to properly tailor the course of treatment.

The radiopharmaceuticals employed in PET imaging are used by the organ in its natural processes, such as blood flow and metabolism, without affecting its normal function, and quickly dissipate from the body. Radiopharmaceuticals used in PET procedures expose patients to a certain amount of radiation, which is measured in units of milliRads. Exposure to radiation can cause damage to living tissue, and the greater the radiation exposure, the greater the potential for damage. Certain PET procedures expose a patient to less radiation than would be associated with other imaging technologies. A PET cardiac scan, using the radiopharmaceutical Rubidium-82, results in exposure of approximately 96

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milliRads, and a neurological PET scan results in exposure of approximately 390 milliRads. In contrast, a typical chest X-ray results in exposure of approximately 150 milliRads and a CT scan results in exposure of approximately 500 to 4,000 milliRads, depending on the procedure.

Radiopharmaceuticals used in PET technology can be created using many natural substances including carbon, oxygen, nitrogen and fluorine. The PET procedure to be performed determines the type of radiopharmaceutical used.

Radiopharmaceuticals are made ready for use at a clinic, hospital, or commercial nuclear pharmacy by either a cyclotron or generator. Cyclotrons require an initial capital investment of up to \$2 million, an additional capital investment for site preparation, and significant annual operating expenses. Generators require an initial capital investment of approximately \$60,000, no additional capital investment for site preparation, and monthly operating expenses of approximately \$30,000. While POSICAM(TM) systems have been designed flexibly to be used with both cyclotron and generator processed radiopharmaceuticals, they have proprietary design features that enhance their ability to use generator processed radiopharmaceuticals. As a result, clinics or hospitals intending to focus on certain cardiac PET applications can avoid the significant capital and operating expenses associated with a cyclotron.

MARKETING STRATEGY

The Company's initial marketing strategy targeted clinical cardiology based on research conducted at the University of Texas. This research showed the commercial potential of clinical cardiology applications of PET imaging. With the development of the POSICAM(TM) HZ, POSICAM(TM) HZL series and now the mPower(TM) series of systems, Positron is pursuing the full oncology, cardiology and neurology related PET application markets. The Company believes that it can capture additional market share by leveraging its strong reputation in the cardiology marketplace to continue to strengthen its leadership position in this sector, while building its expertise and reputation in the oncology and neurology application markets.

To market its systems, Positron relies on referrals from users of its existing base of installed scanners, trade show exhibits, trade journal advertisements, clinical presentations at professional and industry conferences, and published articles in trade journals. In 2000, the Company discontinued its direct sales approach and is now working with and adding key distributors who have geographic or market expertise. The approach allows the Company to pay for sales expense at the time of sales. Positron incurs minimal expense for sales until there is a completed sale. Positron continued to broaden its communications with the market in support of sales through its developing distribution network and using the internet and directed mailings. We believe that this approach will be cost effective and allow Positron to compete cost effectively with larger competitors. There is no assurance that the Company's marketing strategy is sufficiently aggressive to compete against larger, better funded competitors.

THE POSICAM(TM) SYSTEM

At the heart of the POSICAM(TM) system is its detector assembly, which detects the gammas from positron emissions, and electronic circuits that pinpoint the location of each emission. POSICAM(TM) systems are easy to use and are neither physically confining nor intimidating to patients. POSICAM(TM) scans are commonly performed on an outpatient basis.

The Company's POSICAM(TM) system compares favorably with PET systems produced by other manufacturers based upon count rate and sensitivity. Count rate and sensitivity of an imaging system determine its ability to detect, register and assimilate the greatest number of meaningful positron emission events in the shortest period of time. The high count-rate capability and sensitivity of the POSICAM(TM) systems result in good diagnostic accuracy as measured by fewer

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false positives and false negatives. Further benefits of high count-rate and sensitivity include faster imaging and the ability to use short half-life radiopharmaceuticals, thereby reducing patient exposure to radiation and

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potentially reducing the capital cost to some purchasers by eliminating the need for a cyclotron for certain cardiac applications.

The detector assembly consists of crystals, which scintillate (emit light) when exposed to gamma photons from positron-electron annihilations, and photomultiplier tubes, which are coupled to the crystals and convert the scintillations into electrical impulses. The Company employs its own patented staggered crystal array design for the POSICAM(TM) detectors. Unlike competing PET systems, this feature permits the configuration of the detector crystals to collect overlapping slices and more accurately measure the volume of interest by eliminating image sampling gaps. This is important since under-sampling, or gaps in sampling, can contribute to an inaccurate diagnosis. The crystal design also reduces "dead time" - the time interval following the detection and registration of an event during which a subsequent event cannot be detected. The basic unit of identification within each crystal module is small, thereby reducing the probability of multiple hits during a dead period for higher levels of radioactive flux (activity in the patient).

The POSICAM(TM) system creates a high number of finely spaced image slices. An image slice is a cross-sectional view that is taken at an arbitrary angle to the angle of the organ being scanned, and not necessarily the angle a physician wishes to view. The POSICAM(TM) computer can then adjust the cross-sectional view to create an image from any desired angle. The high number of finely spaced image slices created by the POSICAM(TM) system enhances the accuracy of the interpreted image set.

An integral part of a POSICAM(TM) system is its proprietary data acquisition microprocessor and its application system software. The Company's software can reconstruct an image in five seconds or less. The Company has expended substantial effort and resources to develop computer software that is user-friendly and clinically oriented. The only personnel needed to perform clinical studies with the POSICAM(TM) systems are a trained nurse, a trained technician and an overseeing physician for patient management and safety.

POSITAM(TM) HZ, HZL AND MPOWER(TM). In addition to the basic POSICAM(TM) system, the Company offers two advanced versions, the POSICAM(TM) HZ and the POSICAM(TM) HZL, which are now being further enhanced to become the mPower(TM) product line. Oncologists and neurologists require enhanced resolution and a large field of view to detect small tumors and scan large organs, such as the liver. The mPower(TM) systems employ new detector concepts to satisfy these needs while maintaining the high count rate capability and sensitivity of the basic POSICAM(TM). In May 1991, the Company received approval from the FDA to market the POSICAM(TM) HZ, and in May 1993, the Company received a patent for the innovative light guide and detector staggering concepts used in the POSICAM(TM) HZ and HZL. In July 1993, the Company received FDA approval to market in the United States the POSICAM(TM) HZL, which has a larger axial field of view than the POSICAM(TM) HZ, facilitating whole body scanning and the scanning of large organs. The Company is currently in the process of filing a new 510(k) with the FDA for enhancements in the systems that will be seen in the mPower(TM) product.

The Company believes that the special features of the POSICAM(TM) HZL and

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MPOWER(TM) systems enhance their usefulness in oncology and neurology applications. Furthermore, many price sensitive hospitals and health care providers may seek to leverage external resources for the delivery of PET diagnostic services for their patients. To respond to this market need, the Company intends to expand into the mobile PET market, for which the Company has previously received 510(k) approval from the FDA. In addition, the POSICAM(TM) system has been registered with the State of Texas Department of Health, Bureau of Radiation Control, as a Device suitable for both stationary and mobile use.

CUSTOMER SERVICE AND WARRANTY

The Company has six (6) field service engineers in the United States who have primary responsibility for supporting and maintaining the Company's installed equipment base. In addition, the Company has field engineers involved in site planning, customer training, sales of hardware upgrades, sales and administration of service contracts, telephone technical support and customer service.

The Company typically provides a one-year warranty to purchasers of POSICAM(TM) systems. However, in the past, the Company offered multi-year warranties to facilitate sales of its systems. Following the warranty period, the Company offers purchasers a comprehensive service contract under which the Company provides all parts and labor, system software upgrades and unlimited service calls. The Company offers to provide service to all of its POSICAM(TM) systems, eleven (11) of which are under formal service contracts: three (3) service contracts are automatically renewed on a month-to-month basis; and, eight (8) expire in 2002. The Company is currently negotiating to extend all of the

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service contracts expiring in 2002; however, there can be no assurance that such extensions will be obtained.

The Company's service goal is to maintain maximum system uptime. Success of a clinical site is largely dependent on patient volume during normal working hours and, therefore, equipment uptime and reliability are key factors in this success. Records compiled by the Company show an average uptime of more than 95% for all installed POSICAM(TM) systems during 2001 and 2000.

COMPETITION

The Company faces competition from three other commercial manufacturers of PET systems and from other imaging technologies. The Company does not believe that MRI and CT scan imaging represent significant competing technologies, but rather complementary technologies to PET, since PET, MRI and CT scans each provide information not available from the others. However, magnetic resonance angiography ("MRA") is seen by some cardiologists to be competitive with PET myocardial perfusion imaging ("MPI").

The Company's primary competition from commercial manufacturers of PET systems comes from General Electric Medical Systems ("GEMS") a division of General Electric Company ("GE"), Siemens Medical Systems, Inc. in a joint venture with CTI, Inc. of Knoxville, Tennessee ("CTI/Siemens"), and ADAC Medical Systems, which was acquired by Philips Medical ("ADAC/Philips"). GE, CTI/Siemens and ADAC/Philips have substantially greater financial, technological and personnel resources than the Company. See "Item 1. Description of Business-Risk Associated with Business Activities-Substantial Competition and Effects of

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Technological Change". In addition, two Japanese manufacturers, Hitachi and Shimadzu, have manufactured and sold PET scanners in Japan but not in the United States. These manufacturers represent additional sources of competition that have greater financial, technological and personnel resources than the Company.

GE and CTI/Siemens each introduced a scanner in 2001 that combined CT scanning and PET in one gantry. This scanner type could put Positron at a competitive disadvantage. High field MRI technology, an advanced version of MRI, is in the development stage, but is a potential competitor to PET in certain neurology and oncology applications. Presently, high field MRI may be useful in performing certain research (non-clinical) applications such as blood flow studies to perform "brain mapping" to localize the portions of the brain associated with individual functions (such as motor activities and vision). However, high field MRI does not have the capability to assess metabolism. The Company cannot presently predict the future competitiveness of high field MRI.

THIRD-PARTY REIMBURSEMENT

POSICAM(TM) systems are purchased or leased primarily by medical institutions and clinics, which provide health care services to their patients. Such institutions or patients typically bill or seek reimbursement from various third-party payers such as Medicare, Medicaid, other governmental programs and private insurance carriers for the charges associated with the provided healthcare services. The Company believes that the market success of PET imaging depends largely upon obtaining favorable coverage and reimbursement policies from such programs and carriers.

MEDICARE/MEDICAID REIMBURSEMENT. Prior to March 1995, Medicare and Medicaid did not provide reimbursement for PET imaging. Decisions as to such policies for major new medical procedures are typically made by the Center for Medicare and Medicaid Services ("CMS") formerly the U.S. Health Care Financing Administration, based in part on recommendations made to it by the Office of Health Technology Assessment ("OHTA"). Historically, OHTA has not completed an evaluation of a procedure unless all of the devices and/or drugs used in the procedure have received approval or clearance for marketing by the FDA. Decisions as to the extent of Medicaid coverage for particular technologies are made separately by the various state Medicaid programs, but such programs tend to follow Medicare national coverage policies. In 1999, CMS approved reimbursement on a trial basis for a limited cardiac, oncological, and neurological diagnostic procedures. In December 2000, CMS expanded its coverage in cardiology, oncology and neurology for centers utilizing true PET scanners. In July 2001, CMS further expended its coverage of these procedures and virtually eliminated reimbursement for SPECT imagers performing PET scans. This helped to strengthen the market for "true" PET scanners. In 2001, CMS also implemented its procedures to differentiate hospital based outpatient services from free-standing outpatient services. Under this new program, hospital based PET centers are to be paid less for providing PET services than free-standing centers. This program was to be finalized in 2002. Although expanding, Medicare and Medicaid reimbursement for PET imaging continues to be restrictive. Although HCFA broadened coverage in 2000, the agency has maintained that it

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intends to evaluate the effectiveness of PET and may change its policy toward reimbursement at some future date. The Company believes that restrictive reimbursement policies have had a very significant adverse affect on widespread use of PET imaging and have, therefore, adversely affected the Company's

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business, financial condition, results of operations and cash flows.

In 1996, CMS approved reimbursement for one PET procedure in cardiology. In 1998, four additional procedures in cardiology, oncology and neurology were approved. In February 1999, three additional procedure reimbursements were approved in oncology. In December 2000, six additional procedure reimbursements were approved in oncology, one in cardiology and one in neurology. In 2001, further refinements of the reimbursement policies were introduced with expansion in oncology. Whether CMS will continue to approve additional reimbursable procedures, whether private insurers will follow CMS's lead are unknown at this time. PET scanner demand in the US increased markedly after the announcement of increasing reimbursement. It is unknown at this time if the increase in demand will be sustained as reimbursement expands.

In March 2000, the FDA issued a "Draft Guidance" finding FDG and NH3 (radiopharmaceuticals used in the Company's PET scanner) to be safe and effective for broad oncology and cardiology indications. There is no assurance, however, that the FDA's findings in the future will not change or that additional radiopharmaceuticals will be approved.

PRIVATE INSURER REIMBURSEMENT. Until the expansion of coverage of CMS, most insurance carriers considered PET imaging to be an investigational procedure and did not reimburse for procedures involving PET imaging. However, this perspective has begun to change as a result of Medicare's expanding acceptance of reimbursements for certain PET procedures. The Company believes that certain private insurance carriers are expanding coverage as experience is gained with PET imaging procedures. While they may not have broad PET reimbursement policies in place today, those providing some reimbursement for PET scans do so on a case-by-case basis.

Any limitation of Medicare, Medicaid or private payer coverage for PET procedures using the POSICAM(TM) system will likely have a material adverse effect on the Company's business, financial condition, results of operations and cash flows.

MANUFACTURING

The Company believes that it currently has the ability to assemble its POSICAM(TM) scanners in a 9,000 square foot area of its 12,800 square foot corporate facility located in Houston, Texas. Scanners are generally produced by assembling parts furnished to the Company by outside suppliers. The Company believes that it can assemble and test a typical POSICAM(TM) system in two to three months. The Company cannot assure that its facilities will remain adequate.

There are several essential components of the Company's POSICAM(TM) and mPower(TM) systems which are obtained from limited or sole sources, including bismuth germinate oxide ("BGO") crystals, which detect gamma photons from positron emissions, and photomultiplier tubes, which convert light energy emitted by such crystals into electrical impulses for use in the image reconstruction process. During 2000, the Company qualified a second vendor for BGO crystal assemblies. This has reduced the Company's exposure in this critical component. While the Company attempts to make alternate supply arrangements for photomultiplier tubes and other critical components, in the event that the supply of any of these components is interrupted, there is no assurance that those arrangements can be made and will provide sufficient quantities of components on a timely or uninterrupted basis. Further, there is no assurance that the cost of supplies will not rise significantly or that components from alternate suppliers will continue to meet the Company's needs and quality control requirements.

RESEARCH AND DEVELOPMENT

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The Company's POSICAM(TM) systems are based upon proprietary technology initially developed at the University of Texas Health Science Center ("UTHSC") in Houston, Texas, under a \$24 million research program begun in 1979 and funded by UTHSC and The Clayton Foundation for Research ("Clayton Foundation"), a Houston-based, non-profit organization. Since that time, the Company has funded further product development and commercialization of the system. These research and development activities are costly and critical to the Company's ability to develop and maintain improved systems. The Company's research and development expenses were approximately \$1,125,000 and \$1,071,000 for years 2001 and 2000,

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respectively. The Company's inability to conduct such activities in the future may have a material adverse affect on the Company's business as a whole.

PATENT AND ROYALTY ARRANGEMENTS

The Company acquired the know-how and patent rights for positron imaging from three entities: the Clayton Foundation, K. Lance Gould (formerly a director) and Nizar A. Mullani (also formerly a director.) Pursuant to agreements with each of them, the Company was obligated to pay royalties of 4.5% in the aggregate of gross revenues from sales, uses, leases, licensing or rentals of the relevant technology. In 1993, each royalty holder agreed to reduced royalty payments to 3% in the aggregate in exchange for receiving certain loans and entering into certain consulting agreements. The consulting agreements provided that if the Company defaulted in its obligations under those agreements, Dr. Gould and Mr. Mullani would be entitled to reinstatement of their earlier royalties. In April 1998, the Company received a demand letter from Mr. Mullani alleging defaults under his consulting agreement. The Company believed that such defaults, if any, may also have occurred regarding Dr. Gould's agreement, although he made no formal demand. In 1999 and 2000, the Company reached separate agreements with Dr. Gould, Mr. Mullani and the Clayton Foundation regarding payment of royalties, both retroactively and for the future. The Company issued 168,000 shares of its common stock in February 2000 and paid approximately \$39,000 to Dr. Gould in complete settlement of all past royalty obligations. In May 2000, the Company paid approximately \$275,000 to Mr. Mullani to settle all past royalty obligations. In July 2000, the Company issued 266,466 shares of its' common stock to the Clayton Foundation in complete settlement of all obligations for past royalties due.

Two of the Company's patents, issued in January 1986 and February 1987 and expiring in January 2003 and February 2004, respectively, relate to the staggered crystal array design of its original POSICAM(TM) systems. One additional patent issued in June 1987 and expiring in June 2004 relates to technology which the Company, by obtaining the patent, has reserved the right to use. The Company maintains certain of its patents in Germany and has applied for certain patents in Japan.

The Company seeks to protect its trade secrets and proprietary know-how through confidentiality agreements with its consultants. The Company requires each consultant to enter into a confidentiality agreement containing provisions prohibiting the disclosure of confidential information to anyone outside the Company, and requiring disclosure to the Company of any ideas, developments, discoveries or investigations conceived during service as a consultant and the assignment to the Company of patents and proprietary rights to such matters related to the business and technology of the Company.

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BACKLOG

As of December 31, 2001, backlog consisted of an outstanding order for one POSICAMTM HZL system. In conjunction with this order, the Company received a \$345,000 deposit from the customer in October 2001.

PRODUCT LIABILITY AND INSURANCE

Medical device companies are subject to a risk of product liability and other liability claims in the event that the use of their products results in personal injury claims. The Company has not experienced any product liability claims to date. The Company maintains liability insurance with coverage of \$1 million per occurrence and an annual aggregate maximum of \$2 million.

EMPLOYEES

As of December 31, 2001, the Company employed thirty-two (32) full-time employees and two (2) full-time consultants: seven (7) in engineering, six (6) in customer support, twelve (12) in manufacturing, three (3) in sales and marketing, and four (4) in the executive and administration department. None of the Company's employees are represented by a union. The Company believes its relations with its employees are good.

RISKS ASSOCIATED WITH BUSINESS ACTIVITIES

HISTORY OF LOSSES. To date the Company has been unable to sell POSICAM(TM) systems in quantities sufficient to be operationally profitable. Consequently, the Company has sustained substantial losses. During the year ended December 31, 2001, the Company had a net loss of approximately \$3,706,000, compared to

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net income of \$81,000 during 2000. At December 31, 2001, the Company had an accumulated deficit of approximately \$54,700,000. There can be no assurances that the Company will ever achieve the level of revenues needed to be operationally profitable in the future and if profitability is achieved, that it will be sustained. Due to the sizable sales price of each POSICAM(TM) system and the limited number of systems that have been sold or placed in service in each fiscal period, the Company's revenues have fluctuated, and may likely continue to fluctuate significantly from quarter to quarter and from year to year.

RECRUITING AND RETENTION OF QUALIFIED PERSONNEL. The Company's success is dependent to a significant degree upon the efforts of its executive officers and key employees. The loss or unavailability of the services of any of its key personnel could have a material adverse effect on the Company. The Company's success is also dependent upon its ability to attract and retain qualified personnel in all areas of its business, particularly management, research and development, sales and marketing and engineering. There can be no assurance that the Company will be able to continue to hire and retain a sufficient number of qualified personnel. If the Company is unable to retain and attract such qualified personnel, its business, operating results and cash flows could be adversely affected.

WORKING CAPITAL. At December 31, 2001, the Company had cash and cash equivalents and short-term investments that totaled \$635,000 compared to \$2,201,000 at December 31, 2000. The Company concluded a private placement in

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August 1999, which resulted in an equity infusion of approximately \$11,400,000 net to the Company. In 2001, the Company received \$2,000,000 in proceeds on a note payable to a stockholder. In spite of the equity infusion and loan proceeds, the Company believes that it is possible that it may continue to experience operating losses and accumulate deficits in the foreseeable future.

NASDAQ SMALLCAP MARKET ELIGIBILITY FAILURE TO MEET MAINTENANCE REQUIREMENTS: DELISTING OF SECURITIES FROM THE NASDAQ SYSTEM. The Company's common stock was previously listed on the NASDAQ SmallCap Market. The Board of Governors of the National Association of Securities Dealers, Inc. ("NASD") has established certain standards for the continued listing of a security on the NASDAQ SmallCap Market. The standards required for the Company to maintain such listing include, among other things, that the Company have total capital and surplus of at least \$2,000,000. In 1997, the Company failed to maintain its NASDAQ stock market listing and may not meet the substantially more stringent requirements to be re-listed for some time in the future. There can be no assurances that the Company will ever meet the capital and surplus requirements needed to be re-listed under the NASDAQ SmallCap Market System.

Trading of the Company's common stock is currently conducted on the NASD's Electronic Bulletin Board. Trading in the common stock is covered by rules promulgated under the Exchange Act for non-NASDAQ and non-exchange listed securities. Under such rules, broker/dealers who recommend such securities to persons other than established customers and accredited investors must make a special written suitability determination for the purchaser and receive the purchaser's written agreement to a transaction prior to sale. Securities are exempt from these rules if the market price is at least \$5.00 per share. As of December 31, 2001, the closing price of the Company's common stock was \$0.095. In addition, the SEC has adopted regulations that generally define a penny stock to be any equity security that has a market price of less than \$5.00 per share, subject to certain exceptions. The Company's common stock is currently subject to such penny stock rules. The regulations require the delivery, prior to any transaction involving a penny stock, of a disclosure schedule explaining the penny stock market and the risks associated therewith. As a penny stock, the market liquidity for the Company's common stock is severely affected due to the limitations placed on broker/dealers that sell the common stock in the public market.

SUBSTANTIAL COMPETITION AND EFFECTS OF TECHNOLOGICAL CHANGE. The industry in which the Company is engaged is subject to rapid and significant technological change. There can be no assurance that POSICAM(TM) systems can be upgraded to meet future innovations in the PET industry or that new technologies will not emerge, or existing technologies will not be improved, which would render the Company's products obsolete or non-competitive. The Company faces competition in the United States PET market primarily from GE, CTI/Siemens and ADAC/Philips, each of which has significantly greater financial and technical resources and production and marketing capabilities than the Company. In addition, there can be no assurance that other established medical imaging companies, any of which would likely have greater resources than the Company, will not enter the market. The Company also faces competition from other imaging technologies, which are more firmly established and have a greater market acceptance, including SPECT. There can be no assurance that the Company will be able to compete successfully against any of its competitors.

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NO ASSURANCE OF MARKET ACCEPTANCE. The POSICAM(TM) systems involve new technology that competes with more established diagnostic techniques. The

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purchase and installation of a PET system involves a significant capital expenditure on the part of the purchaser. A potential purchaser of a PET system must have an available patient base that is large enough to provide the utilization rate needed to justify such capital expenditure. There can be no assurance that PET technology or the Company's POSICAM(TM) systems will be accepted by the target markets, or that the Company's sales of POSICAM(TM) systems will increase or that the Company will be profitable.

PATENTS AND PROPRIETARY TECHNOLOGY. The Company holds certain patent and trade secret rights relating to various aspects of its PET technology, which are of material importance to the Company and its future prospects. There can be no assurance, however, that the Company's patents will provide meaningful protection from competitors. Even if a competitor's products were to infringe on patents held by the Company, it would be costly for the Company to enforce its rights, and the efforts at enforcement would divert funds and resources from the Company's operations. Furthermore, there can be no assurance that the Company's products will not infringe on any patents of others.

In addition, the Company requires each of its consultants to enter into a confidentiality agreement designed to assist in protecting the Company's proprietary rights. There can be no assurance that these agreements will provide meaningful protection or adequate remedies for the Company's trade secrets or proprietary know-how in the event of unauthorized use or disclosure of such information, or that others will not independently develop substantially equivalent proprietary information and techniques or otherwise gain access to the Company's trade secrets and proprietary know-how.

GOVERNMENT REGULATION. Various aspects of testing, manufacturing, labeling, selling, distributing and promoting our systems and the radiopharmaceuticals used with them are subject to regulation on the federal level by the FDA and in Texas by the Texas Department of Health and other similar state agencies. In addition, sales of medical devices outside the United States may be subject to foreign regulatory requirements that vary widely from country to country. The FDA regulates medical devices based on their device classification. Positron's device is listed as a Class II medical device, the safety and effectiveness for which are regulated by the use of special controls such as published performance standards. To date, the FDA has not published performance standards for PET systems. If the FDA does publish performance standards for PET systems, there can be no assurance that the standards will not have a potentially adverse effect on our product, including substantial delays in manufacturing or disrupting the Company's marketing activities. Other FDA controls, reporting requirements and regulations also apply to manufacturers of medical devices, including: reporting of adverse events and injuries, and the mandatory compliance with the Quality System Regulations commonly known as Good Manufacturing Practices.

In addition to the regulatory requirements affecting the day-to-day operations of the Company's product, the FDA requires medical device manufacturers to submit pre-market clearance information about their proposed new devices and/or proposed significant changes to their existing device prior to their introduction into the stream of commerce. This process, commonly referred to as a 510(k) Clearance, is an extensive written summary of performance information, comparative information with existing medical devices, product labeling information, safety and effectiveness information, intended use information, and the like. Until the FDA has had the opportunity to thoroughly review and "clear" the submission, commercial distribution of the product is specifically disallowed. Although the FDA is required to respond to all pre-market notifications within ninety days of receiving them, the FDA often takes longer to respond. Once the FDA has cleared the device, it notifies the manufacturer in terms of a "substantial equivalence" letter. The manufacturer may begin marketing the new or modified device when it receives the substantial equivalence letter. If the FDA requires additional information or has specific

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questions, or if the Company is notified that the device is not "substantially equivalent" to a device that has already been cleared, the Company may not begin to market the device. A non-substantial equivalence determination or request for additional information of a new or significantly modified product could materially affect the Company's financial results and operations. There can be no assurance that any additional product or enhancement that the Company may develop will be approved by the FDA. Delays in receiving regulatory approval could have a material adverse effect on the Company's business.

Moreover, the FDA routinely inspects medical device manufacturers to determine compliance with Quality System Regulations, and conducted such a routine inspection of the Company's operation in November 2001. The inspection resulted in issuance of five inspectional observations. The Company is in the process of addressing all five inspectional observations and providing responses to the FDA. The Company is cooperating fully and intends to continue to work with the FDA on all compliance matters. However, there can be no assurance that any of the Company's corrective actions or responses to the FDA will be determined adequate by the FDA, or that any such corrective actions and responses will meet

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expected dates of completion for compliance.

In addition to complying with federal requirements, the Company is required under Texas state law to register with the State Department of Health with respect to maintaining radiopharmaceuticals on premises for testing, research and development purposes. Positron submitted a new application to the Texas Department of Health for a Radioactive Material License on July 10, 2000 and was granted a Radioactive Material License with an expiration date of July 31, 2007. While in the past the Company has received notice of only minor violations which were promptly and easily corrected, and while the Company believes that it has taken adequate measures to prevent the recurrence of any violations, there is no assurance that violations may not occur in the future, which could have a material adverse effect on the Company's operations. In addition, Texas state law requires a safety evaluation of devices that contain radioactive materials. The Company submitted an application for such an evaluation to the Texas Department of Health, Bureau of Radiation Control. As a result, Positron's medical diagnostic scanner has been placed on the Registry of Radioactive Sealed Sources and Devices as of September 20, 2001.

The Company's operations and the operations of PET systems are subject to regulation under federal and state health safety laws, and purchasers and users of PET systems are subject to federal and state laws and regulations regarding the purchase of medical equipment such as PET systems. All laws and regulations, including those specifically applicable to the Company, are subject to change. The Company cannot predict what effect changes in laws and regulations might have on its business. Failure to comply with applicable laws and regulatory requirements could have material adverse effect on the Company's business, financial conditions, results of operations and cash flows.

Further, sales of medical devices outside the country may be subject to foreign regulatory requirements. These requirements vary widely from country to country. There is no assurance that the time and effort required to meet those varying requirements may not adversely affect Positron's ability to distribute its systems in some countries.

CERTAIN FINANCING ARRANGEMENTS. In order to sell its POSICAM(TM) systems, the

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Company has from time to time found it necessary to participate in ventures with certain customers or otherwise assist customers in their financing arrangements. The venture arrangements have involved lower cash prices for the Company's systems in exchange for interests in the venture. These arrangements expose the Company to the attendant business risks of the ventures. The Company has, in certain instances, sold its systems to financial intermediaries, which have, in turn, leased the system. Such transactions may not give rise to the same economic benefit to the Company as would have occurred had the Company made a direct cash sale at its regular market price on normal sale terms. There can be no assurance that the Company will not find it necessary to enter similar transactions to effect future sales. Moreover, the nature and extent of the Company's interest in such ventures or the existence of remarketing or similar obligations could require the Company to account for such transactions as "financing arrangements" rather than "sales" for financial reporting purposes. Such treatment could have the effect of delaying the recognition of revenue on such transactions and may increase the volatility of the Company's financial results.

PRODUCT LIABILITY AND INSURANCE. The use of the Company's products entails risks of product liability. There can be no assurance that product liability claims will not be successfully asserted against the Company.

The Company maintains liability insurance coverage in the amount of \$1 million per occurrence and an annual aggregate maximum of \$2 million. However, there can be no assurance that the Company will be able to maintain such insurance in the future or, if maintained, that such insurance will be sufficient in amount to cover any successful product liability claims. Any uninsured liability could have a material adverse effect on the Company.

NO DIVIDENDS. The Company has never paid cash dividends on its common stock and does not intend to pay cash dividends on its common stock in the foreseeable future.

ITEM 2. DESCRIPTION OF PROPERTY

The Company occupies a 12,800 square foot facility in Houston, Texas. That facility includes area for system assembly and testing, a computer room for hardware and software product design, and office space. The rental rate for the facility is \$6,744 per month through April 30, 2001 and the monthly rate increases to \$7,171 for the period from May 1, 2001 through March 31, 2003. The Company anticipates that the facility will be sufficient for 2002 operating activities.

ITEM 3. LEGAL PROCEEDINGS

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PROFUTURES CAPITAL BRIDGE FUND, L.P.

On September 26, 2000, ProFutures Capital Bridge Fund, L.P. ("ProFutures") filed a complaint against the Company in Colorado state court for declaratory relief and breach of contract. ProFutures alleges in its complaint that the Company breached four stock purchase warrants when, on February 14, 2000, the Company registered only 1,500,000 shares of stock underlying ProFutures warrants instead of the 4,867,571 that ProFutures claims it is entitled to purchase. ProFutures claims that it is entitled to purchase these additional shares of stock under the anti-dilution provisions in its warrants and as the result of the Company

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sale of additional shares of stock and issuance of additional warrants. Prior to being sued by ProFutures, the Company notified ProFutures that its Board of Directors had determined that as a result of the Imatron Transaction that ProFutures was entitled to purchase an additional 965,894 shares of common stock under its warrants. ProFutures seeks in its complaint for a declaration that it is entitled to purchase the additional shares of stock under its warrants and for damages for breach of the warrants in an unspecified amount. The Company believes that ProFutures' claim that it is entitled to purchase additional shares is without merit. The Company has retained counsel and intends to vigorously defend the ProFutures' lawsuit. The Company cannot, however, provide assurance as to the outcome. If it is decided that ProFutures is entitled under its warrants to purchase some or all of the claimed additional shares of stock, upon the exercise of the warrants, the Company's shareholders would suffer additional dilution and the price of the Company's common stock could drop.

On January 5, 2002, ProFutures filed a second complaint against the Company, also naming its directors S. Lewis Meyer and Gary H. Brooks and its investor Imatron Inc. ("Imatron") as co-defendants, in Colorado Sate Court for fraudulent transfer and injunctive relief based upon alleged violations of various sections of the Texas Business and Commerce code. The defendants removed the case to the United States District Court for the District of Colorado and filed a motion to dismiss, which is pending as of this date. ProFutures alleges in its complaint that the Company committed fraud when they entered into a loan agreement with Imatron on June 29, 2001, wherein Imatron agreed to loan the Company \$2,000,000. As security for the loan, the Company granted Imatron a first priority security interest in all of the Company assets. ProFutures alleges that the loan transaction was an illegal transfer pursuant to Texas law on the basis that the defendants knew the amount of monetary damages claimed by ProFutures in the related September 26, 2000, Colorado state litigation at the time of the June 29, 2001, loan transaction and that the loan transaction was an effort to hinder, delay and defraud ProFutures with respect to that pre-existing monetary damage claim. ProFutures seeks the following relief: declarations from the court that the loan transfer is fraudulent and therefore void; injunctions prohibiting the Company from making any further payments to Imatron and prohibiting Imatron from enforcing its rights under the agreement. The Company believes that ProFutures' claims are without merit and has retained counsel to vigorously defend against the claims. The Company cannot, however, provide assurance as to the outcome. If the court holds in favor of ProFutures on this matter there could be a material adverse effect on the business of the Company.

CHINA XINXING

In July 2001 and February 2002, the Company received demands from China Xinxing, a company located in Shanghai, China, for payment of an arbitration award in favor of China Xinxing and against the Company, in the total amount of approximately \$297,000. The award was rendered on or about August 25, 2000 by arbitrators affiliated with the Shanghai Sub-commission of the China International Economic and Trade Arbitration Commission (CIETAC Case No. SM9872, Award No. (2000) HMZZ 1154). The award represents the amount of a refund (together with arbitration costs) of an advance payment made by China Xinxing under a contract with the Company dated September 12, 1996. In its February 2002 demand, China Xinxing threatened to file suit in the United States to obtain confirmation and enforcement of the award. The amount of the arbitration award is included in accrued liabilities at December 31, 2001.

10P10, L.P.

In December 2001, 10P10, L.P. the Company's landlord for its premises located at 16350 Park Ten Place, Suite 150, Houston, Texas, filed a complaint against the Company alleging breach of lease agreement. The Company disputes the amount of lease commissions and construction costs charged by 10P10, L.P. in conjunction with the subleasing of the premises. The claim amount of

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The Company was incorporated in December 1983 and commenced commercial operations in 1986. Since that time, the Company has generated revenues primarily from the sale and service contract revenues derived from the Company's POSICAM(TM) system, 14 of which are currently in operation in certain medical facilities in the United States and 5 are operating in international medical institutions. The Company has never been able to sell its POSICAM(TM) systems in sufficient quantities to achieve operating profitability.

In May 1998, the Company entered into a series of agreements (the "Imatron Transaction") with Imatron, a New Jersey corporation and technology-based company engaged principally in the business of designing, manufacturing and marketing a high performance computed tomography system, pursuant to which on January 22, 1999, Imatron acquired majority ownership of the Company. In conjunction with the execution of definitive agreements in May 1998, Imatron began making working capital advances available to the Company of up to \$500,000 in order to enable the Company to meet a portion of its current obligations. The loan agreement was thereafter amended by oral agreement to increase the working capital advances available under the loan agreement up to an additional \$100,000. As of December 31, 1998, the Company had borrowed \$600,000 pursuant

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to those agreements. The loan bore interest at 1/2% over the prime rate and was secured by all of Positron's assets.

Pursuant to the agreement, Imatron acquired 9,000,000 shares of the Company's common stock on January 22, 1999, representing, at that time, a majority ownership of the outstanding common stock of the Company on a fully-diluted and as-if-converted basis, excluding out-of-the-money warrants and options determined at that time. In exchange, the Company received from Imatron (a) nominal cash; (b) an immediate loan of up to \$500,000 in working capital to assist the Company in meeting then current financial obligations; (c) an agreement that Imatron would undertake all reasonable efforts to have its affiliate, Imatron Japan, Inc. assist the Company in the sale of 10 POSICAM(TM) systems over the next three years; (d) an agreement that Imatron would help facilitate the recapitalization of the Company to support its re-entry into the medical imaging market by using its best efforts to arrange for additional third-party equity financing for the Company over an eighteen-month period in an aggregate amount of not less than \$8,000,000; and (e) a new management team selected by Imatron.

Consummation of the issuance of shares to Imatron was conditioned upon, among other things (a) the resignation of each officer of Positron, (b) the resignation of at least three of the four Positron directors and the appointment of Imatron's nominees to fill such vacancies, and (c) Positron shareholder approval of an amendment to Positron's Articles of Incorporation to increase its authorized common stock to 100,000,000 shares of common stock. All of those conditions were met, and the shares were issued on January 22, 1999. Through Imatron's efforts, private placements were concluded in August 1999 resulting in a net equity infusion of approximately \$11.4 million to Positron.

As part of the consummation of the Imatron Transaction in January 1999, all of the Company's officers resigned and all directors, except for Gary B. Wood, resigned from the Board. S. Lewis Meyer was appointed as Chairman of the Company's Board of Directors. Mr. Meyer is neither an employee nor an executive officer of the Company. Gary H. Brooks was also appointed to serve on the

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Company's Board of Directors. Additionally, Mr. Brooks was appointed as President, Secretary, and Acting Chief Financial Officer. The Company's shareholders approved an amendment to Positron's Articles of Incorporation to increase its authorized common stock to 100,000,000 shares.

RESULTS OF OPERATIONS

The operations of the Company for the year ended December 31, 2001 resulted in a net loss of \$3,706,000 compared to a net income of \$81,000 in 2000. Operating results were positively impacted in 2000 by the recognition of \$779,000 in profits from the sale of five systems, \$1,192,000 in gains that resulted from the resolution of warranty matters with customers and a \$580,000 bad debt recovery.

REVENUES: The Company generated \$872,000 in revenues from the sale of one system in the year ended December 31, 2001 compared to revenues of \$5,200,000 from the sale of five systems in 2000. Revenues from service and components increased by \$144,000 to \$1,668,000 in 2001 compared to \$1,524,000 in 2000 due to normal fluctuations in customer service needs.

COST OF SALES AND SERVICES: The Company incurred costs of \$1,331,000 on the sale of one system and \$775,000 on the write-down of inventory items in 2001 compared to costs of \$4,421,000 related to the sale of the five systems in 2000. Service and component costs increased by \$151,000 to \$800,000 in 2001 compared to \$649,000 in 2000.

OPERATING EXPENSES: Selling, general and administrative expenses decreased \$488,000 to \$2,154,000 in 2001 from \$2,642,000 in 2000. The Company increased research and development costs by \$54,000 to \$1,125,000 in 2001 compared to \$1,071,000 in 2000.

OTHER INCOME (EXPENSES): Interest expense increased \$87,000 to \$93,000 in 2001 from \$6,000 in 2000 primarily as a result of interest charges on the note payable to a stockholder. Interest income in 2001 decreased \$228,000 to \$45,000 from \$273,000 in 2000 as a result of significant reductions in the amounts of invested funds in 2001. Operating results in 2000 were affected by \$1,192,000 in gains that resulted from the resolution of warranty matters with customers and a \$580,000 bad debt recovery, less costs of \$293,000 related to a judgment against the Company for the refund of a deposit to a customer. Extraordinary gains of \$394,000 were recognized on the extinguishments of debt in 2000.

NET OPERATING LOSS CARRYFORWARDS

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The Company has incurred losses since its inception and, therefore, has not been subject to federal income taxes. As of December 31, 2001, the Company had net operating loss ("NOL") carryforwards for income tax purposes of approximately \$6,906,000, which expire in 2002 through 2021. Under the provisions of Section 382 of the Internal Revenue Code the greater than 50% ownership changes that occurred in the Company in connection with the Imatron Transaction and in connection with the private placement of the Company's common stock limited the Company's ability to utilize its NOL carryforward to reduce future taxable income and related tax liabilities. Additionally, because United States tax laws limit the time during which NOL carryforwards may be applied against future taxable income, the Company will be unable to take advantage of approximately \$42,000,000 of NOL's that it had previously accumulated to offset taxable

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income.

LIQUIDITY AND CAPITAL RESERVES

Since its inception the Company has been unable to sell POSICAM™ systems in quantities sufficient to be operationally profitable. Consequently, the Company has sustained substantial losses. At December 31, 2001 the Company had an accumulated deficit of \$54,700,000. Due to the sizable prices of the Company's systems and the limited number of systems sold or placed in service each year, the Company's revenues have fluctuated significantly year to year.

At December 31, 2001 the Company had cash and cash equivalents of \$635,000 compared to cash and cash equivalents and short-term investments of \$2,201,000 at December 31, 2000. In 2001, the Company received proceeds of \$2,000,000 from a note payable to a stockholder. The Company utilized a significant amount of its available cash in 2001 to fund operating activities. It is possible that the Company will continue to experience operating losses and accumulate deficits in the future.

The opinion of the Company's independent auditor for the year ended December 31, 2001, expressed substantial doubt as to the company's ability to continue as a going concern. The Company will need to increase system sales to become profitable or obtain additional capital.

INFORMATION REGARDING AND FACTORS AFFECTING FORWARD LOOKING STATEMENTS

The Company is including the following cautionary statement in this Annual Report on Form 10-KSB to make applicable and take advantage of the safe harbor provision of the Private Securities Litigation Reform Act of 1995 for any forward looking statements made by, or on behalf of the Company. Forward looking statements include statements concerning plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements which are other than statements of historical facts. Certain statements contained herein are forward looking statements and, accordingly, involve risks and uncertainties which could cause actual results or outcomes to differ materially from those expressed in the forward looking statements.

The Company's expectations, beliefs and projections are expressed in good faith and are believed by the Company to have a reasonable basis, including without limitations, management's examination of historical operating trends, data contained in the Company's records and other data available from third parties, but there can be no assurance that management's expectations, beliefs or projections will result or be achieved or accomplished. In addition to other factors and matters discussed elsewhere herein, the following are important factors that, in the view of the Company, could cause actual results to differ materially from those discussed in the forward looking statements: the ability of the Company to attain widespread market acceptance of its POSICAM(TM) systems; the ability of the Company to obtain acceptable forms and amounts of financing to fund future operations; demand for the Company's services; and competitive factors. The Company disclaims any obligation to update any forward looking statements to reflect events or circumstances after the date hereof.

ITEM 7. FINANCIAL STATEMENTS

The required Financial Statements and the notes thereto are contained in a separate section of this report beginning with the page following the signature page.

ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Ham, Langston & Brezina, L.L.P. has been the Company's principal independent

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accountants since 1997. No disagreements exist between the Company and Ham, Langston & Brezina, L.L.P. on any matters of accounting principles or practices, financial statement disclosure, or auditing scope or procedure.

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PART III

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT

DIRECTORS AND EXECUTIVE OFFICERS

The directors, executive officers and key employees of the Company as of March 18, 2002 consist of the following individuals:

NAME	AGE	POSITION
S. Lewis Meyer	57	Director, Chairman of the Board
Gary H. Brooks	53	Director, President, Chief Executive Officer and Secretary (appointed CEO effective February 1, 2002)
Sachio Okamura	49	Director (appointed April 1, 2001)
Wayne E. Webster	49	Vice President Marketing, Sales, & Service (appointed January 16, 2001)
Ross K. Hartz	49	Vice President of Engineering
Michael L. Golden	48	Chief Financial Officer (appointed March 1, 2002)

S. Lewis Meyer was appointed as Chairman of the Board on January 22, 1999 in connection with a series of agreements entered into by the Company and Imatron Inc. in May 1998. In January 1999 Imatron purchased 9,000,000 shares of Company common stock, representing a majority of the Company's common stock at the time ("Imatron Transaction"). While the Chairman of its Board of Directors, Mr. Meyer is neither an employee nor an executive of the Company. Mr. Meyer served as Chief Executive Officer of Imatron from June 1993 through December 2001. From April 1991 until joining Imatron he was Vice President, Operations of Otsuka Electronics (U.S.A.), Inc., Fort Collins, Colorado, a manufacturer of clinical MR systems and analytical NMR spectrometers. From August 1990 to April 1991 he was a founding partner of Medical Capital Management, a company engaged in providing consulting services to medical equipment manufacturers, imaging services providers and related medical professionals. Prior thereto he was Founder, President and Chief Executive Officer of American Health Services Corp., (now Insight Health Services) a developer and operator of diagnostic imaging and treatment centers. Mr. Meyer is a director of FiNet.com, Inc. and the Chairman of its Compensation Committee. Mr. Meyer received his B.S. degree in Physics from the University of the Pacific, Stockton, California in 1966, an M.S. degree in Physics from Purdue University in 1968, and a Ph.D. in Physics from Purdue University in 1971.

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Gary H. Brooks has served as a director since January 22, 1999, on which date he was also appointed as President, Secretary and Acting Chief Financial Officer of the Company. In February 2002, Mr. Brooks was appointed Chief Executive Officer of the Company. Prior to joining the Company on a full-time basis, Mr. Brooks served as Vice President of Finance and Administration, Chief Financial Officer and Secretary for Imatron since December 1993. Prior to joining Imatron, he was Chief Financial Officer and Director for five years at Avocet, a privately-held sports electronics manufacturer located in Palo Alto, California. Mr. Brooks received his B.A. in Zoology in 1971 from the University of California, Berkeley, and an M.B.A. in Finance and Accounting in 1973 from the University of California, Los Angeles.

Sachio Okamura has served as a director since his appointment to the Board of the Company on April 1, 2001. Mr. Okamura has performed bio-medical consulting services for Okamura Associates, Inc. from 1993 through the present date. These consulting services have included regulatory, distribution, licensing, joint venture, investment, merger and acquisition activities involving businesses in the United States and Japan. Mr. Okamura was in charge of bio-medical business development for various offices of Mitsubishi Corporation from 1978 through

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1993. Mr. Okamura received a BS in Biochemistry in 1975 from the University of California, Davis and a Master of International Business from the American Graduate School of International Management in 1978.

Wayne E. Webster joined the Company in March 2000 as Eastern Regional Sales Manager and was appointed as Vice President of Sales, Marketing, and Service on January 16, 2001. In his current positron, he is responsible for strategic planning and development of sales and marketing and service for the installed base of imaging systems. From 1992 to 1999, Mr. Webster served as President and CEO of PracSys Corporation, a Massachusetts venture capital funded startup, involved in the development of particle accelerators for medical and industrial uses. From 1985 to 1990, he served as Executive Vice President of Scanditronix, Inc., one of the three original companies serving the PET imaging and pharmaceutical markets. Mr. Webster received a BA in Biology and Chemistry in 1974 from Salem State College.

Ross K. Hartz joined the Company as the Director of Hardware Engineering in 1987, and has served several roles within the Company. Since February 2001, Mr. Hartz has held the positron of Vice President of Engineering. From 1980 through 1987, Mr. Hartz was the Chief Engineer for the PET Project in the Division of Cardiology at the University of Texas Health Science Center in Houston. Mr. Hartz received a BS in Electrical Engineering in 1975 from the University of Arizona, followed by an MS in Electrical Engineering with a Biomedical Certificate in 1997 from Washington University in St. Louis, Missouri.

Michael L. Golden joined the Company as Controller in August 2000 and was appointed as Chief Financial Officer in March 2002. From 1991 to 2000, as an individual practitioner, he performed accounting, financial reporting and consulting activities for client companies. From 1983 to 1991, he served as Assistant Controller and Vice President/Controller of the Houston based real estate firm of Century Development Corporation. From 1978 to 1983, Mr. Golden served on the audit staff of the Houston office of Touche Ross & Co. Mr. Golden received a BS in Marketing in 1975 from Louisiana State University and a MBA in

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Accounting in 1978 from Texas A&M University. He is a Certified Public Accountant.

Dr. Gary B. Wood served as a director from April 1990 to March 2001, when he resigned as a director of the Company.

Antonio P. Falcao served as a director from December 1999 until his death in December 2001.

ITEM 10. EXECUTIVE COMPENSATION

The following tables set forth certain information with respect to compensation paid by the Company and certain information regarding stock options issued to certain of the individuals who have acted as executive officers of the Company during 2001, 2000 and 1999.

SUMMARY COMPENSATION TABLE

Name and Principal Position	Fiscal Year	Salary (\$)	(a)	Bonus	Other Annual Compensation	Restricted Stock Awards	Options/SARs	LTIP Payouts
Gary H. Brooks, President, Chief Executive Officer and Secretary	2001	\$ 211,000		--	--	--	--	--
	2000	\$ 201,833		--	--	--	--	--
	1999	\$ 80,484	(c)	--	--	--	--	--
Wayne E. Webster Vice President Marketing, Sales, & Service	2001	\$ 157,000	(e)	--	--	--	1,460,000	--
	2000	\$ 80,397					40,000	
Ross K. Hartz Vice President of Engineering	2001	\$ 156,685		--	--	--	--	--
	2000	\$ 144,742		\$33,982	--	--	--	--
	1999	\$ 166,700		--	--	--	300,000	--