POSITRON CORP
Form 10KSB
April 05, 2006
FY 2005 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, 2005**
Commissions file number: 0-24092

Positron Corporation
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 is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. o

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 ¨

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. ¨

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

Issuer's revenues for fiscal year ended December 31, 2005: $762,000.

Aggregate market value of common stock held by non-affiliates of the Registrant as of March 22, 2006: $8,476,007.

As of March 22, 2006, there were 78,275,046 shares of the Registrant's common stock, $.01 par value outstanding.

Documents incorporated by reference: Certain portions of the registrant’s Proxy Statement for its Annual Meeting of Stockholders to be held on May 18, 2006 are incorporated by reference hereof.

Transitional Small Business Disclosure Format (check one): Yes ¨ No x

## 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™ systems. POSICAM(TM) systems incorporate patented and proprietary software and technology for the diagnosis and treatment of patients in the areas of cardiology, oncology and neurology. Positron Corporation offers unique combination of low cost technology and disease specific software solutions differentiating themselves from all other medical device manufacturers. 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™ 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™ system for marketing in 1985, and as of December 31, 2005, the Company has sold twenty eight (28) POSICAM™ systems, of which eleven (11) are in leading medical facilities in the United States and six (6) are installed in international medical institutions. The Company has reacquired one system, which is being held in inventory for resale. The Company presently markets its POSICAM™ 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™ systems, which were operational as of December 31, 2005:

| Site | Location | Clinical Application | Install Date |
|---|---|---|---|
| Crawford Long Hospital | Atlanta, GA | Cardiology/Oncology | 1992 |
| Hermann Hospital | Houston, TX | Cardiology/Oncology/Neurology | 1993 |
| Buffalo Cardiology & Pulmonary Assoc. | Williamsville, NY | Cardiology/Oncology | 1995 |
| Baptist Hospital | Nashville, TN | Cardiology/Oncology/Neurology | 1996 |
| Nishidai Clinic (3 systems) | Japan | Cardiology/Oncology/Neurology | 2000 |
| National Institute of Radiological Sciences | Japan | Cardiology/Oncology/Neurology | 2000 |
| Nishidai Clinic (2 systems) | Japan | Cardiology/Oncology/Neurology | 2002 |
| Crawford Long Hospital | Atlanta, GA | Cardiology/Oncology | 2002 |
| Lancaster Cardiology Medical Group | Lancaster, CA | Cardiology/Oncology | 2003 |
| Health Imaging Services | Cullman, AL | Cardiology/Oncology | 2003 |
| Hermann Hospital | Houston, TX | Cardiology/Oncology | 2003 |
| Decatur Health Imaging | Decatur, AL | Cardiology/Oncology/Neurology | 2004 |
| Baptist Hospital | Nashville, TN | Cardiology/Oncology/Neurology | 2004 |
| Laredo Molecular Imaging | Laredo, TX | Cardiology/Oncology/Neurology | 2004 |

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 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™ 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 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™ 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™ 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™ 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™ 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.

The first prototype PET scanner was developed in the mid 1970s and the first commercial PET scanner was constructed in 1978. Approximately 1,600 dedicated PET systems are currently operational in the United States and approximately 500 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™ 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 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 organs in their natural processes, such as blood flow and metabolism, without affecting their 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 milliRads, while a neurological PET scan using 18-FDG, 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™ systems have been designed flexibly to be used with both cyclotron and generator-produced radiopharmaceuticals, they have proprietary design features that enhance their ability to use generator-produced 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™ HZ, POSICAM™ HZL series and now the mPower™ 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. The Company uses both sales personnel and key distributors who have geographic or market expertise. 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™ System**

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

The Company's POSICAM™ system compares favorably with PET systems produced by other manufacturers based upon count rate and sensitivity. The 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™ systems result in good diagnostic accuracy as measured by fewer 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 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, in combination with 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™ 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™ 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™ 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™ system enhances the accuracy of the interpreted image set.

An integral part of a POSICAM™ 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™ systems are a trained nurse, a trained technician and an overseeing physician for patient management and safety.

**POSICAM™ HZ, HZL and mPower™**

In addition to the basic POSICAM™ system, the Company offers two advanced versions, the POSICAM™ HZ and the POSICAM™ HZL, which are now being further enhanced to become the mPower™ 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™ systems employ new detector concepts to satisfy these needs while maintaining the high count rate capability and sensitivity of the basic POSICAM™. In May 1991, the Company received approval from the FDA to market the POSICAM™ HZ, and in May 1993, the Company received a patent for the innovative light guide and detector staggering concepts used in the POSICAM™ HZ and HZL. In July 1993, the Company received FDA approval to market in the United States the POSICAM™ HZL, which has a larger axial field of view than the POSICAM™ HZ, facilitating whole body scanning and the scanning of large organs. In July 2002, the Company received FDA approval to market in the United States the POSICAM™ mPower™ system.

The Company believes that the special features of the POSICAM™ HZL and mPower™ 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™ 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 three (3) 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™ 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™ systems, however at year end 2005, the company had eight (8) service contracts in force and one (1) system under manufacturers warranty. The Company intends to negotiate the extension of all of the service contracts expiring in 2006; 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™ systems during 2005 and 2004.

**Competition**

The Company faces competition primarily from three very large 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. ("Siemens") which recently announced the acquisition of its joint venture partner, CTI, Inc., and ADAC Medical Systems, which was acquired by Philips Medical ("Philips"). GE, Siemens and 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 Technological Change". In addition, two Japanese manufacturers, Hitachi and Shimadzu, have manufactured and sold PET scanners in Japan and are beginning to sell in the United States. These manufacturers represent additional sources of competition that have greater financial, technological and personnel resources than the Company.

GE, Siemens and Philips have introduced a scanner that combines CT scanning and PET in one unit. This scanner type has 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™ systems are primarily purchased 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 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. Through 2004, CMS has continued to approve additional procedures for reimbursement. Effective January 30, 2005, CMS announced PET coverage for cervical cancer. Although expanding, Medicare and Medicaid reimbursement for PET imaging continues to be restrictive. 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 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, and 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 18-FDG and 13-$NH_3$ (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™ system will likely have a material adverse effect on the Company's business, financial condition, results of operations and cash flows.

**Manufacturing**

***The Company has formed a Joint Venture with Neusoft Medical Systems Co., Ltd.***

The Company recently entered into a joint venture with a Chinese company for the production of its PET scanners. On June 30, 2005 the Company entered into a Joint Venture Contract with Neusoft Medical Systems Co., Inc. of Shenyang, Lianoning Province, People's Republic of China ("Neusoft"). Pursuant to the Joint Venture Contract the parties formed a jointly-owned company, Neusoft Positron Medical Systems Co., Ltd. (the "JV Company"), to engage in the manufacturing of PET and CT/PET medical imaging equipment. The JV Company received its business license and was organized in September 2005.

The Company and Neusoft are active in researching, developing, manufacturing, marketing and/or selling Positron Emission Tomography ("PET") technology and both parties seek to mutually benefit from each other's strengths, and intend to cooperate in the research, development and manufacturing of PET technology. The purpose and scope of the JV Company's business is to research, develop and manufacture Positron Emission Tomography systems (PET), and an integrated X-ray Computed Tomography system (CT) and PET system (PET/CT), and to otherwise provide relevant technical consultation and services.

The parties to the joint venture contributed an aggregate of US $2,000,000 in capital contributions. Neusoft's aggregate contribution to the capital of the JV Company is 67.5% of the total registered capital of the Company, or US$ 1,350,000, and was made in cash. The Company's aggregate contribution to the capital of the JV Company is 32.5% of the total registered capital of the Company, or US$ 650,000, of which US$ 250,000 was made in cash, and US$ 400,000 was made in the form of a technology license. Positron has moved available to the JV Company certain

of its PET technology, while Neusoft made available to the JV Company certain CT technology for the development and production of an integrated PET/CT system. The parties will share the profits, losses and risks of the JV Company in proportion to and, in the event of losses, to the extent of their respective contributions to the registered capital of the JV Company.

***Sales of Neusoft Positron Medical Systems Co., Ltd. Products***

The joint venture will sell products manufactured by the JV Company to both joint venture parties for further resale in the marketplace. After the ramp-up period of the JV Company, each party has rights to and risk obligations for its capacity of products required from the JV Company. The parties intend that the manufacturing capacity of the JV Company will be shared on an equivalent basis to each party's contribution to the registered capital of the JV Company, as measured by the manufacturing work and resources needed by the JV Company for the resulting products.

Under its Joint Venture Contract with Neusoft, the Company has the exclusive right to sell PET system products developed by the JV Company in Canada, the U.S. and Mexico under its registered trademarks, and PET/CT products developed by the JV Company in Canada and under the trademark of "Neusoft Positron." The Company and Neusoft have equal rights to sell PET/CT products developed by the JV Company in the U.S. and Mexico under the trademark of "Neusoft Positron." Neusoft has the exclusive right to sell products developed by the JV Company in China under its registered trademarks. Each of Neusoft and the Company has the right to sell products developed by the JV Company in the countries and regions worldwide with the exception of China, Canada, the U.S. and Mexico where select exclusive rights apply.

While the parties believe that the joint venture will meet their objectives, there can be no assurance that the joint venture will meet such objectives, including the development, production and timely delivery of PET and PET/CT systems.

The Company believes that although manufacturing and select research and development has been outsourced, if necessary, it has the ability to assemble its POSICAM™ scanners in its 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™ system in two to three months.

There are several essential components of the Company's POSICAM™ and mPower™ 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**

The Company's POSICAM™ 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 $446,000 and $401,000 for the years 2005 and 2004, 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 up to 4.0% in the aggregate of gross revenues from sales, uses, leases, licensing or rentals of the relevant technology. Royalty obligations amounting to approximately $352,000 were included in liabilities at December 31, 2005.

The Company has several historic domestic and international patents pertaining to positron emission tomography technology and currently maintains two active U.S. patents relating to the unique construction and arrangement of the photo detector module array used in its devices. The older of these two patents was issued in March of 1988 and will expire in June of 2006. The second patent was issued in May 1993 and expires in December of 2011.

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.

**Backlog**

As of December 31, 2005, the Company had no outstanding orders for mPower™ systems.

**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 comprehensive liability insurance coverage for its products and premises exposures with an A++ industry leading insurance carrier.

**Employees**

As of December 31, 2005, the Company employed ten (10) full-time employees and three (3) consultants: four (4) in engineering, one (1) in customer support, four (4) in manufacturing, four (4) in the executive and administration department. None of the Company's employees are represented by a union.

**Risks Associated with Business Activities**

***History of Losses***. To date the Company has been unable to sell POSICAM™ systems in quantities sufficient to be operationally profitable. Consequently, the Company has sustained substantial losses. During the year ended December 31, 2005, the Company had a net loss of approximately $3,806,000, compared to a net loss of $1,658,000 during 2004. At December 31, 2005, the Company had an accumulated deficit of approximately $62,239,000. 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™ 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. The opinion of the Company's independent auditors for the year ended December 31, 2005 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.

***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*** The Company had cash and cash equivalents of $209,000 at December 31, 2005. The Company received an additional $2,375,000 and $1,550,000 in loan proceeds from affiliated entities in 2005 and 2004,

respectively. In spite of the loan proceeds, the Company believes that it is possible that it may continue to experience operating losses and accumulate deficits in the foreseeable future. If we are unable to obtain financing to meet our cash needs we may have to severely limit or cease our business activities or may seek protection from our creditors under the bankruptcy laws.

***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 OTC 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 30, 2005, the closing price of the Company's common stock was $0.09. 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™ 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.

***No Assurance of Market Acceptance.*** The POSICAM™ systems involve new technology that competes with more established diagnostic techniques. The 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™ systems will be accepted by the target markets, or that the Company's sales of POSICAM™ 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, remanufacturing, 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 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. The Company submitted an application for such a 510(k) clearance on June 18, 2002 and was granted a new 510(k) on July 12, 2002, number K022001.

After being issued an FDA warning letter in April 2004, the Company was able to quickly respond and correct observations noted. Therefore, in June of 2005, the FDA removed the restrictions placed upon the Company by the April 2004 Warning Letter as a result of the corrections and improvements in the March 2005 inspection. The Company has satisfied the compliance requirements set forth by the FDA.

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. During a July 2005 Radiation audit, the company was noted for minor violations, which were addressed and corrected. At this time the company is in full compliance with Texas Radiation Codes, however, 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™ systems, the 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 $1 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.

***Significant Transactions.***

***Transactions with IMAGIN Diagnostic Centres, Inc.***

Financing Agreements dated May 21, 2004

On May 26, 2004 and June 17, 2004, the Company sold two separate secured convertible promissory notes under a Note Purchase Agreement dated May 21, 2004, to IMAGIN Diagnostic Centres, Inc. ("IMAGIN") in the principal amounts of $400,000 and $300,000, respectively. Interest accrued on the outstanding principal at the rate of ten percent (10%) per annum and was payable annually to the extent of positive cash flow on the anniversary dates of these notes. The principal and any unpaid interest was due on the earlier to occur of May 21, 2006 or when declared due and payable by IMAGIN upon occurrence of an event of default. The notes were initially convertible into new shares of Series C Preferred Stock that, in turn was convertible into an aggregate of 35,000,000 shares of the Company's common stock. These notes were collateralized by all of the assets of the Company. On October 21, 2005, $770,000 in principal and accrued and unpaid interest was converted into 770,000 shares of Series C Preferred Stock. These shares of Series C Preferred Stock were subsequently assigned by IMAGIN to Positron Acquisition Corp. Full convertibility of the shares of Series C Preferred Stock into common stock will require an amendment to the Company's Articles of Incorporation which must be approved by the shareholders.

In a second stage of the May 2004 financing IMAGIN agreed to purchase additional secured convertible promissory notes in the aggregate principal amount of $1,300,000. These notes were to be purchased over a six and a half month period, commencing July 15, 2004 and are due and payable on May 21, 2006. These notes are initially convertible into new shares of Series D Preferred Stock that, in turn is convertible into an aggregate of 52,000,000 shares of the Company's common stock. As of June 30, 2005, principal of $1,208,500 had been advanced related to these notes. On June 30, 2005, IMAGIN converted $575,000 of these promissory notes into shares of Series D Preferred Stock that, in

turn were converted into 23,000,000 shares of the Company's common stock. This conversion reduced the principal owed under these promissory notes from $1,208,500 to $633,500. The remaining $633,500 of principal convertible notes plus notes for $63,350 in accrued interest was assigned by IMAGIN to Positron Acquisition Corp. Full convertibility of the shares of Series D Preferred Stock into common stock will require an amendment to the Company's Articles of Incorporation, which must be approved by the shareholders.

The agreements with IMAGIN provided for a $200,000 transaction fee payable to IMAGIN upon completion of the financing. Under terms of these agreements, this fee obligation was to be reduced by an amount equal to $0.02 multiplied by the number of warrants issued to IMAGIN. The agreements with IMAGIN also provided for the issuance of new warrants for the purchase of 4,575,000 shares of common stock, which resulted in a $91,500 decrease in this fee obligation to $108,500. This fee obligation is included in the principal of the notes.

Patrick G. Rooney, Chairman of the Board of the Company is the son of Patrick Rooney, Director of Corporate Development of IMAGIN Diagnostic Centres, Inc. Patrick G. Rooney was appointed to the Board of Directors of the Company in connection with the financing with IMAGIN.

Financing Agreements dated August 8, 2005

On August 8, 2005, the Company sold to IMAGIN 10% secured convertible promissory notes under a Note Purchase Agreement, dated the same date, in the aggregate principal amount of $400,000. As of September 30, 2005, IMAGIN has purchased $400,000 of these notes. These notes are due and payable on August 7, 2008. These notes are convertible into an aggregate of 20,000,000 shares of the Company’s common stock. Full convertibility of the notes into shares of common stock will require an amendment to the Company’s Articles of Incorporation which must be approved by the shareholders.

Pursuant to the terms of the agreements, the Company granted to IMAGIN a security interest in all of its assets to secure payment of the convertible promissory notes. The security interest is subordinate to the security interest previously granted in the same collateral to IMAGIN and Solaris Opportunity Fund, L.P. (“Solaris”).

Financing Agreements dated October 31, 2005

On October 31, 2005, the Company sold to IMAGIN 10% secured convertible promissory notes under a Note Purchase Agreement, dated the same date, in the aggregate principal amount of $400,000. As of January 2006, IMAGIN has purchased $400,000 of these notes. These notes are due and payable on October 31, 2008. These notes are convertible into an aggregate of 20,000,000 shares of the Company’s common stock. Full convertibility of the notes into shares of common stock will require an amendment to the Company’s Articles of Incorporation which must be approved by the shareholders.

Pursuant to the terms of the agreements, the Company granted to IMAGIN a security interest in all of its assets to secure payment of the convertible promissory notes. The security interest is subordinate to the security interest previously granted in the same collateral to IMAGIN and Solaris.

Joint Venture dated December 28, 2005

On December 28, 2005, the Company entered into a Memorandum of Understanding with IMAGIN and Quantum Molecular Pharmaceutical, Inc. ("QMP"), a Canadian company and majority-owned subsidiary of IMAGIN. The Memorandum provides that the parties will form a joint venture to be called Quantum Molecular Technologies JV. Initially, the joint venture will be owned 20%, 29% and 51% by the Company, IMAGIN and QMP, respectively. The Company has the right to increase its interest in the joint venture to a maximum of 51% by the issuance to QMP of up to 150 million shares of the Company's common stock. In consideration for the Company's 20% interest in the joint venture, the Company is obligated to loan to the joint venture sufficient funds, in the form of senior debt, to meet the joint venture's capital requirements as determined by the Company. In turn, IMAGIN and QMP have committed to purchase up to $4 million in preferred equity in the Company.

The joint venture will be formed to develop a new generation of PET technologies using concepts and research and development activities conceived and to be implemented by Dr. Irving Weinberg, an exclusive consultant to QMP. The Company will have the right to manufacture and sell any PET products developed by the joint venture in exchange for royalty payments still to be negotiated.

Dr. Weinberg has been at the forefront of the evolution of PET, tracing his roots back to the UCLA group that created the PET industry. Later, as a practicing radiologist and entrepreneur, Dr. Weinberg designed and built the first breast-specific PET scanner, which was able to detect the earliest form of breast cancer better than any other modality.

Dr. Weinberg's participation is directly attributable to the efforts of J. David Wilson, who at the time of the joint venture and capital commitment between QMT and the Company, was CEO of the Company and Quantum Molecular Pharmaceutical, which is a majority owner of Quantum Molecular Technologies.

There can be no assurance that the joint venture will meet the parties objectives. The issuance of shares of preferred stock and any common stock to IMAGIN and QMP will involve substantial dilution to the Company's current shareholders.

***Transactions with Solaris Opportunity Fund, L.P.***

Financing Agreements dated February 28, 2005

On February 28, 2005, the Company entered into a series of agreements with Solaris pursuant to which Solaris agreed to purchase an aggregate of $1,000,000 face amount of the Company's 10% secured convertible promissory notes. As of September 30, 2005, Solaris had purchased all $1,000,000 of these notes. These notes are due and payable on March 6, 2007. The notes are initially convertible into new shares of Series E Preferred Stock that, in turn are convertible into an aggregate of 22,000,000 shares of the Company's common stock. Full convertibility of the shares of Series E Preferred Stock into common stock will require an amendment to the Company's Articles of Incorporation, which must be approved by the shareholders.

Pursuant to the terms of the agreements, the Company granted to Solaris a security interest in all of its assets to secure payment of the convertible promissory notes. The security interest is subordinate to the security interest previously granted in the same collateral to IMAGIN.

We have been advised by Solaris that it has since sold the $1,000,000 principal amount of these notes to IMAGIN.

Financing Agreements dated June 27, 2005

On June 27, 2005, the Company entered into a series of agreements with Solaris pursuant to which Solaris agreed to purchase an aggregate of $400,000 face amount of the Company's 10% secured convertible promissory notes. As of September 30, 2005, Solaris had purchased all $400,000 of these notes. These notes are due and payable on March 6, 2007. The notes are initially convertible into new shares of Series F Preferred Stock that, in turn are convertible into an aggregate of 20,000,000 shares of the Company's common stock. Full convertibility of the shares of Series F Preferred Stock into common stock will require an amendment to the Company's Articles of Incorporation, which must be approved by the shareholders.

Pursuant to the terms of the agreements, the Company granted to Solaris a security interest in all of its assets to secure payment of the convertible promissory notes. The security interest is subordinate to the security interest previously granted in the same collateral to IMAGIN and Solaris.

Patrick G. Rooney, Chairman of the Board of the Company, is the managing director of the manager of Solaris.

## Item 2. Description of Property

The Company is headquartered in Houston, Texas, where it currently leases a 7,963 square foot facility. That facility includes area for system assembly and testing, a computer room for hardware and software product design, and office space. This facility lease has continued on a month-to-month basis since March 31, 2004 at the $4,671 monthly rental rate. The Company anticipates that the facility will be sufficient for its 2006 operating activities.

## Item 3. Legal Proceedings

None.

**Item 4. Submission of Matters to a Vote of Security Holders**

No matter was submitted to a vote of the Company's stockholders, through the solicitation of proxies or otherwise, during the fourth quarter of fiscal year 2005.

## PART II

### Item 5. Market for Common Equity and Related Stockholder Matters

The Company's common stock is currently traded and quoted on the NASDAQ OTC Bulletin Board under the symbol POSC. The Company's common stock was previously traded on the NASDAQ SmallCap Market but was delisted in 1997 because the Company was unable to comply with various financial and compliance requirements for continued inclusion on the NASDAQ SmallCap Market. See "Item 1. Description of Business - Risks Associated with Business Activities."

The following range of the high and low reported closing sales prices for the Company's common stock for each quarter in 2005 and 2004, all as reported on the NASDAQ OTC Bulletin Board. These quotations reflect interdealer prices, without retail mark-up, mark-down or commission and may not represent actual transactions.

| | 2005 | | 2004 | |
|---|---|---|---|---|
| | High | Low | High | Low |
| First Quarter | $ 0.16 | $ 0.06 | $ 0.07 | $ 0.03 |
| Second Quarter | $ 0.09 | $ 0.05 | $ 0.13 | $ 0.02 |
| Third Quarter | $ 0.09 | $ 0.04 | $ 0.17 | $ 0.05 |
| Fourth Quarter | $ 0.09 | $ 0.05 | $ 0.14 | $ 0.09 |

There were approximately 260 shareholders of record of common stock as of March 22, 2006, including broker-dealers holding shares beneficially owned by their customers.

The Company has never paid cash dividends on its common stock. The Company does not intend to pay cash dividends on its common stock in the foreseeable future. The Series A, C, D, E and F Preferred Stock Statements of Designation prohibit the Company from paying any common stock dividends until all required dividends have been paid on the Series A and any outstanding Series C, D, E, and F Preferred Stock. As of December 31, 2005 and 2004, stated dividends that are undeclared and unpaid on the Series A Preferred Stock total $448,000 and $399,000. The Company anticipates that such dividends, if and when declared, will be paid in shares of Series A Preferred Stock. Dividends accumulate on the 770,000 shares of outstanding Series C Preferred Stock at a rate of 6% per annum and are payable on May 21st of each year. As of December 31, 2005, stated dividends that are undeclared and unpaid on the Series C Preferred Stock totaled $46,000. The Company anticipates that such dividends, when and if declared, will be paid in shares of common stock.

The Company's equity plan information required by this item is incorporated by reference from the information under the heading "Equity Compensation Plan Information" in the Company's Proxy Statement for its Annual Meeting of Stockholders to be held on May 18, 2006.

### Item 6.
### Management's Discussion and Analysis or Plan of Operation

**General**

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™ system, 11 of which are currently in operation in certain medical facilities in the United States

and 6 are operating in international medical institutions. The Company has never been able to sell its POSICAM™ systems in sufficient quantities to achieve operating profitability.

**Transactions with IMAGIN Diagnostic Centres, Inc.**

Financing Agreements dated May 21, 2004

On May 26, 2004 and June 17, 2004, the Company sold two separate secured convertible promissory notes under a Note Purchase Agreement dated May 21, 2004, to IMAGIN Diagnostic Centres, Inc. ("IMAGIN") in the principal amounts of $400,000 and $300,000, respectively. Interest accrued on the outstanding principal at the rate of ten percent (10%) per annum and was payable annually to the extent of positive cash flow on the anniversary dates of these notes. The principal and any unpaid interest was due on the earlier to occur of May 21, 2006 or when declared due and payable by IMAGIN upon occurrence of an event of default. The notes were initially convertible into new shares of Series C Preferred Stock that, in turn was convertible into an aggregate of 35,000,000 shares of the Company's common stock. These notes were collateralized by all of the assets of the Company. On October 21, 2005, $770,000 in principal and accrued and unpaid interest was converted into 770,000 shares of Series C Preferred Stock. These shares of Series C Preferred Stock were subsequently assigned by IMAGIN to Positron Acquisition Corp. Full convertibility of the shares of Series C Preferred Stock into common stock will require an amendment to the Company's Articles of Incorporation which must be approved by the shareholders.

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Joint Venture dated December 28, 2005

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Dr. Weinberg's participation is directly attributable to the efforts of J. David Wilson, who at the time of the joint venture and capital commitment between QMT and the Company, was CEO of the Company and Quantum Molecular Pharmaceutical, which is a majority owner of Quantum Molecular Technologies.

There can be no assurance that the joint venture will meet the parties objectives. The issuance of shares of preferred stock and any common stock to IMAGIN and QMP will involve substantial dilution to the Company's current shareholders.

**Transactions with Solaris Opportunity Fund, L.P.**

Financing Agreements dated February 28, 2005

On February 28, 2005, the Company entered into a series of agreements with Solaris pursuant to which Solaris agreed to purchase an aggregate of $1,000,000 face amount of the Company's 10% secured convertible promissory notes. As of September 30, 2005, Solaris had purchased all $1,000,000 of these notes. These notes are due and payable on

March 6, 2007. The notes are initially convertible into new shares of Series E Preferred Stock that, in turn are convertible into an aggregate of 22,000,000 shares of the Company's common stock. Full convertibility of the shares of Series E Preferred Stock into common stock will require an amendment to the Company's Articles of Incorporation which must be approved by the shareholders.

Pursuant to the terms of the agreements, the Company granted to Solaris a security interest in all of its assets to secure payment of the convertible promissory notes. The security interest is subordinate to the security interest previously granted in the same collateral to IMAGIN. We have been advised by Solaris that it has since sold the $1,000,000 principal amount of these notes to IMAGIN.

Financing Agreements dated June 27, 2005

On June 27, 2005, the Company entered into a series of agreements with Solaris pursuant to which Solaris agreed to purchase an aggregate of $400,000 face amount of the Company's 10% secured convertible promissory notes. As of September 30, 2005, Solaris had purchased all $400,000 of these notes. These notes are due and payable on March 6, 2007. The notes are initially convertible into new shares of Series F Preferred Stock that, in turn are convertible into an aggregate of 20,000,000 shares of the Company's common stock. Full convertibility of the shares of Series F Preferred Stock into common stock will require an amendment to the Company's Articles of Incorporation, which must be approved by the shareholders.

Pursuant to the terms of the agreements, the Company granted to Solaris a security interest in all of its assets to secure payment of the convertible promissory notes. The security interest is subordinate to the security interest previously granted in the same collateral to IMAGIN and Solaris.

Patrick G. Rooney, Chairman of the Board of the Company, is the managing director of the manager of Solaris.

**Results of Operations**

The operations of the Company for the year ended December 31, 2005 resulted in a loss of $3,806,000 compared to a loss of $1,658,000 in 2004.

***Revenues.*** The Company generated no revenues from sales of systems in 2005 compared to revenues of $1,150,000 on the sale of one system in the prior year. We earned revenues of $37,000 from upgrades of systems in 2005 compared to $691,000 in revenues from system upgrades in 2004. Our service revenues decreased $214,000 to $725,000 in the year ended December 31, 2005 from $939,000 in 2004. Service revenues in 2004 included fees of $200,000 relating to support provided to GE Medical Systems in conjunction with the sale of our Cardiac PET Software.

***Costs of Revenues***. Costs of revenues decreased by $495,000 to $1,288,000 in the year ended December 31, 2005 from $1,783,000 in the prior year. The Company incurred costs of $1,081,000 relating to the sale of one system in 2004. In addition, we incurred costs of $284,000 relating to upgrades of systems in 2004. The Company expensed $656,000 of excess inventory and field service parts as it ceased manufacturing activities at its Houston facility in 2005.

***Operating Expenses.*** The Company's operating expenses increased $27,000 to $2,526,000 for the year ended December 31, 2005 from $2,499,000 in 2004. Sales, general and administrative expenses increased $404,000 to $2,114,000 from $2,139,000 in the prior year. This increase in general and administrative expenses primarily resulted from increased legal fees and the recording of an obligation of $111,500 for severance pay in 2005. Research and development expenses increased $45,000 to $446,000 from $401,000 as a result of increased personnel costs. We reversed expense related to stock based compensation by $59,000 in the year ended December 31, 2005 relating to the application of the variable accounting rules to the re-pricing of warrants and options. We recorded expense of $363,000 relating to stock based compensation in 2004.

***Other Income (Expenses).*** We recognized interest expense of $985,000 is the year ended December 2005 compared to $157,000 of interest expense in 2004. Interest expense in 2005 and 2004 primarily relates to the notes payable to IMAGIN Diagnostic Centres, Inc., Solaris Opportunity Fund, L.P. and Positron Acquisition Corp. and includes amortization of loan costs, debt discounts and beneficial conversion features of $690,000 and $92,000 in 2005 and 2004 respectively. The Company recognized royalty income of $250,000 on the sale of its software license in 2005.

**Net Operating Loss Carryforwards**

The Company has incurred losses since its inception and, therefore, has not been subject to federal income taxes. As of December 31, 2005, the Company had net operating loss ("NOL") carryforwards for income tax purposes of approximately $15,000,000, which expire in 2006 through 2025. 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.

**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, 2005, the Company had an accumulated deficit of $62,169,000. 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, 2005, the Company had cash and cash equivalents of $209,000 compared to $133,000 at December 31, 2004. The Company received $1,550,000 and $2,375,000 in 2004 and 2005 respectively, in loan proceeds from affiliated entities. In spite of the loan proceeds, the Company believes that it is possible that it may continue to experience operating losses and accumulate deficits in the foreseeable future. If we are unable to obtain financing to meet our cash needs we may have to severely limit or cease our business activities or may seek protection from our creditors under the bankruptcy laws.

The opinion of the Company's independent auditor for the year ended December 31, 2005, 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.

**Related Party Transactions**

On December 28, 2005, the Company entered into a Memorandum of Understanding with IMAGIN and Quantum Molecular Pharmaceutical, Inc. ("QMP"), a Canadian company and majority-owned subsidiary of IMAGIN. The Memorandum provides that the parties will form a joint venture to be called Quantum Molecular Technologies JV. Initially, the joint venture will be owned 20%, 29% and 51% by the Company, IMAGIN and QMP, respectively. The Company has the right to increase its interest in the joint venture to a maximum of 51% by the issuance to QMP of up to 150 million shares of the Company's common stock. In consideration for the Company's 20% interest in the joint venture, the Company is obligated to loan to the joint venture sufficient funds, in the form of senior debt, to meet the joint venture's capital requirements as determined by the Company. In turn, IMAGIN and QMP have committed to purchase up to $4 million in preferred equity in the Company.

The joint venture will be formed to develop a new generation of PET technologies using concepts and research and development activities conceived and to be implemented by Dr. Irving Weinberg, an exclusive consultant to QMP. The Company will have the right to manufacture and sell any PET products developed by the joint venture in exchange for royalty payments still to be negotiated.

Dr. Weinberg has been at the forefront of the evolution of PET, tracing his roots back to the UCLA group that created the PET industry. Later, as a practicing radiologist and entrepreneur, Dr. Weinberg designed and built the first breast-specific PET scanner, which was able to detect the earliest form of breast cancer better than any other modality.

Dr. Weinberg's participation is directly attributable to the efforts of J. David Wilson, who at the time of the joint venture and capital commitment between QMT and the Company, was CEO of the Company and Quantum Molecular Pharmaceutical, which is a majority owner of Quantum Molecular Technologies.

There can be no assurance that the joint venture will meet the parties objectives. The issuance of shares of preferred stock and any common stock to IMAGIN and QMP will involve substantial dilution to the Company's current shareholders.

**IMAGIN Transaction**

Financing Agreements dated May 21, 2004

On May 26, 2004 and June 17, 2004, the Company sold two separate secured convertible promissory notes under a Note Purchase Agreement dated May 21, 2004, to IMAGIN in the principal amounts of $400,000 and $300,000, respectively. Interest accrued on the outstanding principal at the rate of ten percent (10%) per annum and was payable annually to the extent of positive cash flow on the anniversary dates of these notes. The principal and any unpaid interest was due on the earlier to occur of May 21, 2006 or when declared due and payable by IMAGIN upon occurrence of an event of default. The notes were initially convertible into new shares of Series C Preferred Stock that, in turn was convertible into an aggregate of 35,000,000 shares of the Company's common stock. These notes were collateralized by all of the assets of the Company. On October 21, 2005, $770,000 in principal and accrued and unpaid interest was converted into 770,000 shares of Series C Preferred Stock. These shares of Series C Preferred Stock were subsequently assigned by IMAGIN to Positron Acquisition Corp. Full convertibility of the shares of Series C Preferred Stock into common stock will require an amendment to the Company's Articles of Incorporation which must be approved by the shareholders.

In a second stage of the May 2004 financing IMAGIN agreed to purchase additional secured convertible promissory notes in the aggregate principal amount of $1,300,000. These notes were to be purchased over a six and a half month period, commencing July 15, 2004 and are due and payable on May 21, 2006. These notes are initially convertible into new shares of Series D Preferred Stock that, in turn is convertible into an aggregate of 52,000,000 shares of the Company's common stock. As of June 30, 2005, principal of $1,208,500 had been advanced related to these notes. On June 30, 2005, IMAGIN converted $575,000 of these promissory notes into shares of Series D Preferred Stock that, in turn were converted into 23,000,000 shares of the Company's common stock. This conversion reduced the principal owed under these promissory notes from $1,208,500 to $633,500. The remaining $633,500 of principal convertible notes plus notes for $63,350 in accrued interest was assigned by IMAGIN to Positron Acquisition Corp. Full convertibility of the shares of Series D Preferred Stock into common stock will require an amendment to the Company's Articles of Incorporation, which must be approved by the shareholders.

The agreements with IMAGIN provided for a $200,000 transaction fee payable to IMAGIN upon completion of the financing. Under terms of these agreements, this fee obligation was to be reduced by an amount equal to $0.02 multiplied by the number of warrants issued to IMAGIN. The agreements with IMAGIN also provided for the issuance of new warrants for the purchase of 4,575,000 shares of common stock, which resulted in a $91,500 decrease in this fee obligation to $108,500. This fee obligation is included in the principal of the notes.

Patrick G. Rooney, Chairman of the Board of the Company is the son of Patrick Rooney, Director of Corporate Development of IMAGIN Diagnostic Centres, Inc. Patrick G. Rooney was appointed to the Board of Directors of the Company in connection with the financing with IMAGIN.

Several agreements were reached involving option and warrants contracts for the purchase of common stock of the Company.

- The Company agreed to exchange 917,068 outstanding options currently held by its employees for new options that are exercisable for the purchase of common stock at a price of $0.02 per share. The new options issued to the employees are subject to four year vesting in equal monthly installments. This re-pricing will require the Company to apply the variable accounting rules established in Interpretation No. 44 of the Financial Accounting Standards Board ("FIN 44") to these options and record changes in compensation based upon movements in the stock price. The Company recognized $13,000 in compensation expense in 2004, in accordance with the variable accounting rules established in FIN 44. The market value of the company's common stock increased to $0.12 per share at December 31, 2004, resulting in an intrinsic value of $0.10 per share.
- The Company agreed to re-price the outstanding warrants currently held by its President & CEO for the purchase of 3,500,000 shares of common stock at $0.02 per share. The Company recognized $350,000 in compensation expense in 2004, in accordance with the variable accounting rules established in FIN 44. The market value of the Company's common stock increased to $0.12 per share at December 31, 2004, resulting in an intrinsic value of $0.10 per share. The Company will record changes in compensation based upon movements in the stock price.
- The Company agreed to issue a new warrant to its President & CEO for the purchase of 4,000,000 shares of common stock at $0.02 per share.
- The Company agreed to re-price outstanding warrants for the purchase of 9,150,000 shares of common stock. These warrants have been surrendered and new warrants will be issued to the same third party holders for the purchase of 4,575,000 shares of common stock at $0.02 per share. New warrants for the purchase of 4,575,000 shares of common stock at $0.02 per share (the remaining half of the surrendered warrants) will also be issued to IMAGIN.

In connection with the financing, IMAGIN entered into an additional agreement to purchase an aggregate of 10 PET scanners at a purchase price of $1,300,000 each. As a result of the regulatory difficulties encountered in connection with attempts to import and use scanners in Canada, the parties have since agreed to terminate IMAGIN's obligation to purchase these scanners.

Financing Agreements dated August 8, 2005

On August 8, 2005, the Company sold to IMAGIN 10% secured convertible promissory notes under a Note Purchase Agreement, dated the same date, in the aggregate principal amount of $400,000. As of September 30, 2005, IMAGIN has purchased $400,000 of these notes. These notes are due and payable on August 7, 2008. These notes are convertible into an aggregate of 20,000,000 shares of the Company's common stock. Full convertibility of the notes into shares of common stock will require an amendment to the Company's Articles of Incorporation which must be approved by the shareholders.

Pursuant to the terms of the agreements, the Company granted to IMAGIN a security interest in all of its assets to secure payment of the convertible promissory notes. The security interest is subordinate to the security interest previously granted in the same collateral to IMAGIN and Solaris.

Financing Agreements dated October 31, 2005

On October 31, 2005, the Company sold to IMAGIN 10% secured convertible promissory notes under a Note Purchase Agreement, dated the same date, in the aggregate principal amount of $400,000. As of January 2006, IMAGIN has purchased $400,000 of these notes. These notes are due and payable on October 31, 2008. These notes are convertible into an aggregate of 20,000,000 shares of the Company's common stock. Full convertibility of the notes into shares of common stock will require an amendment to the Company's Articles of Incorporation which must be approved by the shareholders.

Pursuant to the terms of the agreements, the Company granted to IMAGIN a security interest in all of its assets to secure payment of the convertible promissory notes. The security interest is subordinate to the security interest previously granted in the same collateral to IMAGIN and Solaris.

**Transaction with Solaris Opportunity Fund, L.P.**

Financing Agreements dated February 28, 2005

On February 28, 2005, the Company entered into a series of agreements with Solaris pursuant to which Solaris agreed to purchase an aggregate of $1,000,000 face amount of the Company's 10% secured convertible promissory notes. As of September 30, 2005, Solaris had purchased all $1,000,000 of these notes. These notes are due and payable on March 6, 2007. The notes are initially convertible into new shares of Series E Preferred Stock that, in turn are convertible into an aggregate of 22,000,000 shares of the Company's common stock. Full convertibility of the shares of Series E Preferred Stock into common stock will require an amendment to the Company's Articles of Incorporation, which must be approved by the shareholders.

Pursuant to the terms of the agreements, the Company granted to Solaris a security interest in all of its assets to secure payment of the convertible promissory notes. The security interest is subordinate to the security interest previously granted in the same collateral to IMAGIN.

We have been advised by Solaris that it has since sold the $1,000,000 principal amount of these notes to IMAGIN.

Financing Agreements dated June 27, 2005

On June 27, 2005, the Company entered into a series of agreements with Solaris pursuant to which Solaris agreed to purchase an aggregate of $400,000 face amount of the Company's 10% secured convertible promissory notes. As of September 30, 2005, Solaris had purchased all $400,000 of these notes. These notes are due and payable on March 6, 2007. The notes are initially convertible into new shares of Series F Preferred Stock that, in turn are convertible into an aggregate of 20,000,000 shares of the Company's common stock. Full convertibility of the shares of Series F Preferred Stock into common stock will require an amendment to the Company's Articles of Incorporation, which must be approved by the shareholders.

Pursuant to the terms of the agreements, the Company granted to Solaris a security interest in all of its assets to secure payment of the convertible promissory notes. The security interest is subordinate to the security interest previously granted in the same collateral to IMAGIN and Solaris.

Patrick G. Rooney, Chairman of the Board of the Company, is the managing director of the manager of Solaris.

**New Accounting Pronouncements**

In December 2004, the Financial Accounting Standards Board ("the FASB") issued ("SFAS") No. 123(R), *Share-Based Payment.* SFAS 123(R) requires compensation costs related to share-based payment transactions to be recognized in the financial statements. With limited exceptions, the amount of compensation cost is to be measured based on the grant-date fair value of the equity or liability instruments issued. In addition, liability awards are to be remeasured each reporting period. Compensation cost will be recognized over the period that an employee provides service in exchange for the award. SFAS 123(R) is a revision of SFAS 123, *Accounting for Stock-Based Compensation*, as amended by SFAS 148, *Accounting for Stock-Based Compensation-Transition and Disclosure* and supersedes APB NO. 25, *Accounting for Stock Issued to Employees*. SFAS 123(R) is effective for private companies as of the

beginning of the first annual reporting period that begins after December 15, 2005. The Company adopted SFAS 123R effective January 1, 2006, using the modified prospective method. This method applies the fair value based method to new awards and to awards modified, repurchased or cancelled after the required effective date. Also, compensation cost for the portion of awards for which the requisite service has not been rendered that are outstanding as of the required effective date shall be recognized as the service is rendered on or after the required effective date. Any options issued subsequent to January 1, 2006 will be accounted for under SFAS 123R..

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs*. The new Statement amends ARB No. 43, Chapter 4, *Inventory Pricing*, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. This Statement requires that those items be recognized as current period charges and requires that allocation of fixed production overhead to the cost of conversion be based on the normal capacity of the production facilities. This Statement is effective for fiscal years beginning after June 15, 2005. The adoption of this statement is not expected to have a material impact on the Company's financial position or results of operations.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets - An Amendment of APB Opinion No. 29*. SFAS No. 153 amends APB Opinion No. 29 to eliminate the exception for exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. SFAS No. 153 is to be applied prospectively for nonmonetary exchanges occurring in fiscal periods beginning after June 15, 2005. The Company's adoption of SFAS No. 153 is not expected to have a material impact on its financial position or results of operations.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections—a replacement of APB Opinion No. 20 and FASB Statement No. 3.* This Statement replaces APB Opinion No.20, *Accounting Changes*, and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*, and changes the requirements for the accounting for and reporting of a change in accounting principle. This Statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. This Statement is effective for fiscal years beginning after December 15, 2005. The adoption of this statement is not expected to have a material impact on the Company's financial position or results of operations.

**Critical Accounting Policies**

In response to the Securities and Exchange Commission's Release No. 33-8040, "Cautionary Advice Regarding Disclosure About Critical Accounting Policies," we have identified critical accounting policies based upon the significance of the accounting policy to our overall financial statement presentation, as well as the complexity of the accounting policy and our use of estimates and subjective assessments. We have concluded our critical accounting policies are as follows:

***Inventory***

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out (FIFO) method of inventory valuation.

***Revenue Recognition***

Revenues from POSICAM™ system contracts are recognized when all significant costs have been incurred and the system has been shipped to the customer. Revenues from maintenance contracts are recognized over the term of the contract. Service revenues are recognized upon performance of the services.

**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™ 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 accountants since 1997.

**Item 8A. Controls and Procedures**

As of December 31, 2005, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chairman of the Board and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e) and Rule 15d-15(e)). Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective at a reasonable level in timely alerting them to material information relating to the Company that is required to be included in the Company's periodic filings with the Securities and Exchange Commission. There have been no changes in the Company's internal controls over financial reporting that occurred during the Company's most recent fiscal quarter that has materially affected or is reasonably likely to materially affect, the Company's internal control over financial reporting.

The Company's management, including the Chairman of the Board and Chief Financial Officer, do not expect that the Company's disclosure controls or internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met due to numerous factors, ranging from errors to conscious acts of an individual, or individuals acting together. In addition, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in a cost-effective control system, misstatements due to error and/or fraud may occur and not be detected.

**Item 8B. Other Information**

Joint Venture dated December 28, 2005

On December 28, 2005, the Company entered into a Memorandum of Understanding with IMAGIN and Quantum Molecular Pharmaceutical, Inc. ("QMP"), a Canadian company and majority-owned subsidiary of IMAGIN. The Memorandum provides that the parties will form a joint venture to be called Quantum Molecular Technologies JV. Initially, the joint venture will be owned 20%, 29% and 51% by the Company, IMAGIN and QMP, respectively. The Company has the right to increase its interest in the joint venture to a maximum of 51% by the issuance to QMP of up to 150 million shares of the Company's common stock. In consideration for the Company's 20% interest in the joint venture, the Company is obligated to loan to the joint venture sufficient funds, in the form of senior debt, to meet the joint venture's capital requirements as determined by the Company. In turn, IMAGIN and QMP have committed to purchase up to $4 million in preferred equity in the Company.

The joint venture will be formed to develop a new generation of PET technologies using concepts and research and development activities conceived and to be implemented by Dr. Irving Weinberg, an exclusive consultant to QMP. The Company will have the right to manufacture and sell any PET products developed by the joint venture in

exchange for royalty payments still to be negotiated.

Dr. Weinberg has been at the forefront of the evolution of PET, tracing his roots back to the UCLA group that created the PET industry. Later, as a practicing radiologist and entrepreneur, Dr. Weinberg designed and built the first breast-specific PET scanner, which was able to detect the earliest form of breast cancer better than any other modality.

Dr. Weinberg's participation is directly attributable to the efforts of J. David Wilson, who at the time of the joint venture and capital commitment between QMT and the Company, was CEO of the Company and Quantum Molecular Pharmaceutical, which is a majority owner of Quantum Molecular Technologies.

There can be no assurance that the joint venture will meet the parties objectives. The issuance of shares of preferred stock and any common stock to IMAGIN and QMP will involve substantial dilution to the Company's current shareholders.

## PART III

### Item 9. Directors, Executive Officers, Promoters and Control Persons; Compliance with Section 16(a) of the Exchange Act

The information regarding directors and executive officers appearing under the headings “Nominees”, “Nominating Committee”, “Directors and Executive Officers”, “Code of Ethics”, “Audit Committee” and “Section 16 (a) Beneficia Ownership Reporting Compliance” of our proxy statement relating to our 2006 Annual Meeting of Stockholders to be held on May 18, 2006 (the “2006 Proxy Statement”) is incorporated into this item by reference.

### Item 10. Executive Compensation

The information appearing under the headings “Compensation of Directors”, “Compensation Committee”, “Compensation Committee Interlocks and Insider Participation”, “Compensation Committee Report of the Board of Directors”, and “Executive Compensation” of our 2006 Proxy Statement is incorporated into this item by reference (except to the extent allowed by Item 402(a)(7) of Regulation S-B).

### Item 11. Security Ownership of Directors, Officers and Certain Beneficial Owners

The information appearing under the heading “Equity Compensation Plan Information” and “Security Ownership of Directors, Officers and Certain Beneficial Owners” of our 2006 Proxy Statement is incorporated into this item by reference.

### Item 12. Certain Relationships and Related Transactions

The information appearing under the heading “Certain Relationships and Related Transactions” of our 2006 Proxy Statement is incorporated into this item by reference.

### Item 13. Exhibits

Exhibits:

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| 3.1 | Articles of Incorporation of the Registrant (incorporated herein by reference to Exhibit 3.1 to the Company’s Registration Statement on Form SB-2 (File No. 33-68722)). |
| 3.2 | By-laws of the Registrant, as amended (incorporated herein by reference to Exhibit 3.2 to the Company’s Registration Statement on Form SB-2 (File No. 33-68722)). |
| 4.1 | Specimen Stock Certificate (incorporated herein by reference to Exhibit 4.1 of the Company’s Annual Report on Form 10-KSB for the year ended December 31, 1994). |
| 4.2 | Statement of Designation Establishing Series A 8% Cumulative Convertible Redeemable Preferred Stock of Positron Corporation, dated February 28, 1996 (incorporated herein by reference to Exhibit 4.3 of the Company’s Annual Report on Form 10-KSB for the year ended December 31, 1995). |

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| 4.3 | Warrant Agreement dated as of June 15, 1999 between Positron Corporation and Gary Brooks (incorporated herein by reference to Exhibit 4.9 to the Company's Registration Statement on Form SB-2 (File No. 333-30316)). |

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| 4.4 | Stock Purchase Warrant dated as of June 15, 1999 issued by Positron Corporation to Gary H. Brooks (incorporated herein by reference to Exhibit 4.10 to the Company's Registration Statement on Form SB-2 (File No. 333-30316)). |
| 4.5 | Warrant Agreement dated as of June 15, 1999 between Positron Corporation and S. Lewis Meyer (incorporated herein by reference to Exhibit 4.11 to the Company's Registration Statement on Form SB-2 (File No. 333-30316)). |
| 4.6 | Stock Purchase Warrant dated as of June 15, 1999 issued by Positron Corporation to S. Lewis Meyer (incorporated herein by reference to Exhibit 4.12 to the Company's Registration Statement on Form SB-2 (File No. 333-30316)). |
| 4.7 | Statement of Designation Establishing Series C Preferred Stock of Positron Corporation dated May 21, 2004 (incorporated by reference to Exhibit 4.1 to the Company's Report on Form 8-K dated May 21, 2004) |
| 4.8 | Statement of Designation Establishing Series D Preferred Stock of Positron Corporation dated May 21, 2004 (incorporated by reference to Exhibit 4.2 to the Company's Report on Form 8-K dated May 21, 2004) |
| 4.9 | Statement of Designation Establishing Series E Preferred Stock of Positron Corporation dated February 28, 2005 (incorporated by reference to Exhibit 4.18 to the Company's Annual Report on Form 10-KSB dated April 19, 2005) |
| 4.10 | Statement of Designation Establishing Series F Preferred Stock of Positron Corporation (incorporated herein by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K dated June 27, 2005). |
| 10.1 | Lease Agreement dated as of July 1, 1991, by and between Lincoln National Pension Insurance Company and Positron Corporation (incorporated herein by reference to Exhibit 10.1 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)). |
| 10.2 | Agreement dated as of March 1, 1993, by and between Positron Corporation and Oxford Instruments (UK) Limited (incorporated herein by reference to Exhibit 10.2 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)). |
| 10.3 | International Distribution Agreement dated as of November 1, 1992, by and between Positron Corporation and Batec International, Inc. (incorporated herein by reference to Exhibit 10.3 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)). |
| 10.4 † | 1994 Incentive and Nonstatutory Option Plan (incorporated herein by reference to Exhibit A to Company's Proxy Statement dated May 2, 1994).† |
| 10.5 | Amended and Restated 1987 Stock Option Plan (incorporated herein by reference to Exhibit 10.5 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)).† |
| 10.6 | Retirement Plan and Trust (incorporated herein by reference to Exhibit 10.6 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)).† |

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| 10.7 | Amended and Restated License Agreement dated as of June 30, 1987, by and among The Clayton Foundation for Research, Positron Corporation, K. Lance Gould, M.D., and Nizar A. Mullani (incorporated herein by reference to Exhibit 10.7 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)). |
| 10.8 | Clarification Agreement to Exhibit 10.7 (incorporated herein by reference to Exhibit 10.8 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)). |
| 10.9 | Royalty Assignment dated as of December 22, 1988, by and between K. Lance Gould and Positron Corporation (incorporated herein by reference to Exhibit 10.10 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)). |
| 10.10 | Royalty Assignment dated as of December 22, 1988, by and between Nizar A. Mullani and Positron Corporation (incorporated herein by reference to Exhibit 10.11 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)). |

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| 10.11 | Royalty Assignment dated as of December 22, 1988, by and between The Clayton Foundation and Positron Corporation (incorporated herein by reference to Exhibit 10.12 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)). |
| 10.12 | Consulting Agreement dated as of January 15, 1993, by and between Positron Corporation and K. Lance Gould, M.D. (incorporated herein by reference to Exhibit 10.24 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)). |
| 10.13 | Consulting Agreement dated February 23, 1995, effective December 15, 1994, by and between Positron Corporation and F. David Rollo, M.D. Ph.D., FACNP. |
| 10.14 | Consulting Agreement dated as of January 15, 1993, by and between Positron Corporation and Nizar A. Mullani (incorporated herein by reference to Exhibit 10.31 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)). |
| 10.15 | Consulting Agreement dated as of November 12, 1993, by and between Positron Corporation and OmniMed Corporation (incorporated herein by reference to Exhibit 10.35 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)). |
| 10.16 | Contract No. 1318 dated as of December 30, 1991, by and between Positron Corporation and The University of Texas Health Science Center at Houston (incorporated herein by reference to Exhibit 10.39 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)). |
| 10.17 | Letter Agreement dated July 30, 1993 between Positron Corporation and Howard Baker (incorporated herein by reference to Exhibit 10.52 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)). |
| 10.18 | Technology Transfer Agreement dated as of September 17, 1990, by and between Positron Corporation and Clayton Foundation for Research (incorporated herein by reference to Exhibit 10.54 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)). |
| 10.19 | Form of Amended and Restated Registration Rights Agreement dated as of November 3, 1993, by and among Positron and the other signatories thereto (1993 Private Placement) (incorporated herein by reference to Exhibit 10.73 to the Company's Registration Statement on Form SB-2 (File No. 33-68722). |
| 10.20 | Registration Rights Agreement dated as of July 31, 1993, by and among Positron and the other signatories thereto (other than the 1993 Private Placement) (incorporated herein by reference to Exhibit 10.74 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)). |
| 10.21 | Software Licenses dated as of March 1, 1993, by and between Positron Corporation and Oxford Instruments (UK) Limited (incorporated herein by reference to Exhibit 10.81 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)). |
| 10.22 | Distribution Agreement dated as of June 1, 1993, by and between Positron Corporation and Elscint, Ltd. (incorporated herein by reference to Exhibit 10.82 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)). |
| 10.23 | |

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| | First Amendment to Amended and Restated Registration Rights Agreement, dated as of November 19, 1993, by and among Positron Corporation and the other signatories thereto (incorporated herein by reference to Exhibit 10.91 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)). |
| 10.24 | Agreement made and entered into as of October 31, 1993, by and between Positron Corporation and Nizar A. Mullani (incorporated herein by reference to Exhibit 10.97 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)). |
| 10.25 | Agreement made and entered into as of October 31, 1993, by and between Positron Corporation and K. Lance Gould (incorporated herein by reference to Exhibit 10.98 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)). |
| 10.26 | Agreement made and entered into as of November 15, 1993, by and between Positron Corporation and Nizar A. Mullani (incorporated herein by reference to Exhibit 10.100 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)). |

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| 10.27 | Agreement made and entered into as of November 15, 1993, by and between Positron Corporation and K. Lance Gould (incorporated herein by reference to Exhibit 10.101 to the Company's Registration Statement on Form SB-2 (File No. 33-68722)). |
| 10.28 | First Amendment made and entered as of January 25, 1994, by and between Emory University d/b/a Crawford Long Hospital and Positron Corporation (incorporated herein by reference to Exhibit 10.102 of the Company's Annual Report on Form 10-KSB for the year ended December 31, 1993). |
| 10.29 | Acquisition Agreement between General Electric Company and Positron Corporation dated July 15, 1996 (incorporated by reference to Exhibit 10.56 to the Company's Report on Form 10-KSB for the year ended December 31, 1996). |
| 10.30 | Sales and Marketing Agreement With Beijing Chang Feng Medical (incorporated by reference to Exhibit 10.58 to the Company's Report on Form 10-KSB/A for the year ended December 31, 1996). |
| 10.31 | Stock Purchase Agreement between Positron Corporation and Imatron, Inc. (incorporated hereby by reference to Annex A to the Company's Proxy Statement dated December 18, 1998). |
| 10.32 | Agreement and Release dated as of November 30, 1999 by and among Positron Corporation, K. Lance Gould and University of Texas Medical Center (incorporated herein by reference to Exhibit 10.62 to the Company's Registration Statement on Form SB-2 (File No. 333-30316)). |
| 10.33 | 1999 Stock Option Plan (incorporated herein by reference to Exhibit 10.63 to the Company's Registration Statement on Form SB-2 (File No. 333-30316)).† |
| 10.34 | 1999 Non-Employee Directors' Stock Option Plan (incorporated herein by reference to Exhibit 10.64 to the Company's Registration Statement on Form SB-2 (File No. 333-30316)).† |
| 10.35 | 1999 Stock Bonus Incentive Plan (incorporated herein by reference to Exhibit 10.65 to the Company's Registration Statement on Form SB-2 (File No. 333-30316)).† |
| 10.36 | 1999 Employee Stock Purchase Plan (incorporated herein by reference to Exhibit 10.66 to the Company's Registration Statement on Form SB-2 (File No. 333-30316)).† |
| 10.37 | Stock Purchase Warrant dated September 1, 1999 issued by Positron to S. Okamura and Associates, Inc. (incorporated herein by reference to Exhibit 10.67 to the Company's Registration Statement on Form SB-2 (File No. 333-30316)). |
| 10.38 | Stock Purchase Warrant dated August 18, 1999 issued by Positron to Morris Holdings Ltd. (incorporated herein by reference to Exhibit 10.68 to the Company's Registration Statement on Form SB-2 (File No. 333-30316)). |
| 10.39 | Stock Purchase Warrant dated January 20, 2000 issued by Positron to Vistula Finance Limited (incorporated herein by reference to Exhibit 10.69 to the Company's Registration Statement on Form SB-2 (File No. 333-30316)). |
| 10.40 | Loan Agreement with Imatron Inc dated June 29, 2001 (incorporation herein by reference to the Company's Report on Form 8-K dated July 12, 2001) |

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| 10.41 | Technology Purchase Agreement, dated as of June 29, 2003, by and between General Electric Company and Positron Corporation (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on July 14, 2003) |
| 10.42 | Software License Agreement, dated as of June 29, 2003, by and between General Electric Company and Positron Corporation (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on July 14, 2003) |
| 10.43 | Agreement for Services, dated as of June 29, 2003, by and between General Electric Company and Positron Corporation (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on July 14, 2003) |
| 10.44 | Note Purchase Agreement dated May 21, 2004 between Positron and IMAGIN Diagnostic Centres, Inc. (incorporated by reference to Exhibit 10.1 to the Company's Report on Form 8-K dated May 21, 2004) |

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| 10.45 | Secured Convertible Promissory Note dated May 21, 2004 in the principal amount of $400,000 (incorporated by reference to Exhibit 10.2 to the Company's Report on Form 8-K dated May 21, 2004) |
| 10.46 | Form Secured Convertible Promissory Note in the principal amount of $300,000 (incorporated by reference to Exhibit 10.3 to the Company's Report on Form 8-K dated May 21, 2004) |
| 10.47 | Security Agreement dated May 21, 2004 between Positron and IMAGIN Diagnostic Centres, Inc. (entered into in connection with Note Purchase Agreement) (incorporated by reference to Exhibit 10.4 to the Company's Report on Form 8-K dated May 21, 2004) |
| 10.48 | Loan Agreement dated May 21, 2004 between Positron and IMAGIN Diagnostic Centres, Inc. (incorporated by reference to Exhibit 10.5 to the Company's Report on Form 8-K dated May 21, 2004) |
| 10.49 | Security Agreement dated May 21, 2004 between Positron and IMAGIN Diagnostic Centres, Inc. (entered into in connection with Loan Agreement) (incorporated by reference to Exhibit 10.7 to the Company's Report on Form 8-K dated May 21, 2004) |
| 10.50 | Voting Agreement dated May 21, 2004 between Positron and IMAGIN Diagnostic Centres, Inc. (incorporated by reference to Exhibit 10.8 to the Company's Report on Form 8-K dated May 21, 2004) |
| 10.51 | Registration Rights Agreement dated May 21, 2004 between Positron and IMAGIN Diagnostic Centres, Inc. (incorporated by reference to Exhibit 10.9 to the Company's Report on Form 8-K dated May 21, 2004) |
| 10.52 | Note Purchase Agreement dated February 28, 2005 between Positron and Solaris Opportunity Fund, L.P. (incorporated by reference to Exhibit 10.83 to the Company's Annual Report on Form 10-KSB/A for the fiscal year ended December 31, 2005) |
| 10.53 | Secured Convertible Promissory Note dated March 7, 2005 in the principal amount of $200,000 in favor of Solaris Opportunity Fund, L.P. (incorporated by reference to Exhibit 10.84 to the Company's Annual Report on Form 10-KSB/A for the fiscal year ended December 31, 2005) |
| 10.54 | Security Agreement dated February 28, 2005 between Positron and Solaris Opportunity Fund, L.P. (incorporated by reference to Exhibit 10.85 to the Company's Annual Report on Form 10-KSB/A for the fiscal year ended December 31, 2005) |
| 10.55 | Registration Rights Agreement dated February 28, 2005 between Positron and Solaris Opportunity Fund, L.P. (incorporated by reference to Exhibit 10.86 to the Company's Annual Report on Form 10-KSB/A for the fiscal year ended December 31, 2005) |
| 10.56 | Warrant Purchase Agreement by and among Positron Corporation, Carlos Sao Paulo, Sofia Salema Garcao, Maria Madalena Pimental and José Maria Salema Garção dated May 12, 2005 (incorporated by reference to Exhibit 10.1 to the Company's Report on Form 8-K dated May 12, 2005) |
| 10.57 | Note Purchase Agreement dated June 27, 2005 between Positron and Solaris Opportunity Fund, L.P. (incorporated by reference to Exhibit 10.1 to the Company's Report on Form 8-K dated June 27, 2005) |
| 10.58 | |

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| | Form Secured Convertible Promissory Note (incorporated by reference to Exhibit 10.2 to the Company's Report on Form 8-K dated June 27, 2005) |
| 10.59 | Security Agreement dated June 27, 2005 between Positron and Solaris Opportunity Fund, L.P. (incorporated by reference to Exhibit 10.3 to the Company's Report on Form 8-K dated June 27, 2005) |
| 10.60 | Registration Rights Agreement dated June 27, 2005 between Positron and Solaris Opportunity Fund, L.P. (incorporated by reference to Exhibit 10.4 to the Company's Report on Form 8-K dated June 27, 2005) |

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| 10.61 | Note Purchase Agreement dated August 8, 2005 between Positron and IMAGIN Diagnostic Centres, Inc. (incorporated by reference to Exhibit 10.1 to the Company's Report on Form 8-K dated August 8, 2005) |
| 10.62 | Form Secured Convertible Promissory Note (incorporated by reference to Exhibit 10.2 to the Company's Report on Form 8-K dated August 8, 2005) |
| 10.63 | Registration Rights Agreement dated August 8, 2005 between Positron and IMAGIN Diagnostic Centres, Inc. (incorporated by reference to Exhibit 10.3 to the Company's Report on Form 8-K dated August 8, 2005) |
| 10.64 | Agreement between Gary H. Brooks and Positron Corporation dated September 29, 2005 (incorporated by reference to Exhibit 10.1 of the Company's Report on Form 8-K dated September 29, 2005) |
| 10.65 | Note Purchase Agreement dated October 31, 2005 between Positron and IMAGIN Diagnostic Centres, Inc. (incorporated by reference to Exhibit 10.1 of the Company's Report on Form 8-K dated October 31, 2005) |
| 10.66 | Form Secured Convertible Promissory Note (incorporated by reference to Exhibit 10.2 of the Company's Report on Form 8-K dated October 31, 2005) |
| 10.67 | Registration Rights Agreement dated October 31, 2005 between Positron and IMAGIN Diagnostic Centres, Inc. (incorporated by reference to Exhibit 10.3 of the Company's Report on Form 8-K dated October 31, 2005) |
| 10.68 | Joint Venture Contract dated July 30, 2005 between Positron Corporation and Neusoft Medical Systems Co., Ltd. (incorporated by reference to Exhibit 10.1 of the Company's Quarterly Report on Form 10-QSB for the quarter ended September 30, 2005) |
| 10.69 | Technologies Contribution Agreement dated July 30, 2005 between Positron Corporation and Neusoft Positron Medical Systems Co., Ltd. (incorporated by reference to Exhibit 10.2 of the Company's Quarterly Report on Form 10-QSB for the quarter ended September 30, 2005) |
| 10.70 | Software Sub-License Agreement dated September 6, 2005 between Positron Corporation and Neusoft Positron Medical Systems Co., Ltd. (incorporated by reference to Exhibit 10.3 of the Company's Quarterly Report on Form 10-QSB for the quarter ended September 30, 2005) |
| 10.71 | Trademark License Agreement dated July 30, 2005 between Positron Corporation and Neusoft Positron Medical Systems Co., Ltd. (incorporated by reference to Exhibit 10.4 of the Company's Quarterly Report on Form 10-QSB for the quarter ended September 30, 2005) |
| 10.72 | Corporate Name License Agreement dated July 30, 2005 between Positron Corporation and Neusoft Positron Medical Systems Co., Ltd. (incorporated by reference to Exhibit 10.5 of the Company's Quarterly Report on Form 10-QSB for the quarter ended September 30, 2005) |
| 10.73 | Employment Agreement dated December 27, 2005 between Positron Corporation and Joseph G. Oliverio (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed on March 9, 2006)† |

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| 10.74 | Joseph G. Oliverio Stock Option Agreement (incorporated by reference to Exhibit 10.2 of the Company's Current Report on Form 8-K filed on March 9, 2006)† |
| 10.75 | Joseph G. Oliverio Notice of Grant of Stock Option (incorporated by reference to Exhibit 10.3 of the Company's Current Report on Form 8-K filed on March 9, 2006)† |
| 10.76 | Amended and Restated 2005 Stock Incentive Plan (incorporated by reference to Exhibit 10.4 of the Company's Current Report on Form 8-K filed on March 9, 2006)† |
| 10.77 | 2005 Stock Incentive Plan - Form Notice of Grant of Stock Option (incorporated by reference to Exhibit 10.5 of the Company's Current Report on Form 8-K filed on March 9, 2006)† |
| 10.78 | 2005 Stock Incentive Plan - Form Stock Option Agreement (incorporated by reference to Exhibit 10.6 of the Company's Current Report on Form 8-K filed on March 9, 2006)† |
| 10.79* | Memorandum of Understanding between Quantum Molecular Pharmacutical, Inc., Imagin Diagnostic Centres, Inc. and Positron Corporation dated December 28, 2005. |
| 14.1 | Code of Business Conduct and Ethics (incorporated by reference to Exhibit 14.1 to the Company's Report on Annual Form 10-KSB dated March 30, 2005) |

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| 31.1* | Chairman of the Board Certification of Periodic Financial Report Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2* | Chief Financial Officer Certification of Periodic Financial Report Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1# | Chairman of the Board Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2# | Chief Financial Officer Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002 |
| † | Management contract or compensatory plan or arrangement identified pursuant to Item 13(a). |
| * | Filed herewith |
| # | Furnished herewith |

**Item 14. Principal Accountant Fees and Services**

The information appearing under the heading “Fees to Independent Auditors for Fiscal 2005 and 2004” of our 2006 Proxy Statement is incorporated into this item by reference.

**SIGNATURES**

In accordance with Section 13 or 15(d) of the Exchange Act, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

POSITRON CORPORATION

Date: March 30, 2006

By: /s/ Patrick G. Rooney
Patrick G. Rooney
Chairman of the Board

**POWER OF ATTORNEY**

Each person whose signature appears below hereby constitutes and appoints Patrick G. Rooney, his attorney-in-fact, with the power of substitution, for him in any and all capacities, to sign any amendments to this Report on Form 10-KSB, and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting to said attorney-in-fact, or his substitute or substitutes, the power and authority to perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorney-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

/s/ Patrick G. Rooney
Patrick G. Rooney
Chairman of the Board
(principal executive officer)

March 30, 2006

/s/ Corey N. Conn
Corey N. Conn
Chief Financial Officer
(principal accounting officer)

March 30, 2006

/s/ Sachio Okamura
Sachio Okamura
Director

March 30, 2006

/s/ Dr. Anthony C. Nicholls
Dr. Anthony c. Nicholls
Director

March 30, 2006

**POSITRON CORPORATION**

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**FINANCIAL STATEMENTS**
**WITH REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**
**for the years ended December 31, 2005 and 2004**

**FINANCIAL STATEMENTS**
**TABLE OF CONTENTS**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Stockholders
Positron Corporation

We have audited the accompanying balance sheet of Positron Corporation as of December 31, 2005 and the related statements of operations, stockholders' deficit and cash flows for each of the two years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Positron Corporation as of December 31, 2005, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 2 to the financial statements, the Company has suffered recurring losses from operations and low inventory turnover. These factors raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Ham, Langston & Brezina, L.L.P.

Houston, Texas
March 30, 2006

**POSITRON CORPORATION**
**BALANCE SHEET**
**December 31, 2005**
**(In thousands, except share data)**

| | | |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $ | 209 |
| Inventories | | 202 |
| Prepaid expenses | | 66 |
| Other current assets | | 21 |
| Total current assets | | 498 |
| Investment in Joint Venture | | 230 |
| Property and equipment, net | | 120 |
| Other assets | | 57 |
| Total assets | $ | 905 |
| LIABILITIES AND STOCKHOLDERS' DEFICIT | | |
| Current liabilities: | | |
| Accounts payable, trade and accrued liabilities | $ | 1,694 |
| Customer deposits | | 15 |
| Unearned revenue | | 66 |
| Deposits for Unissued Series G Preferred Stock | | 195 |
| Convertible notes payable to affiliated entity, less discount of $6 | | 627 |
| Total current liabilities | | 2,597 |
| Convertible notes payable to affiliated entities, less discount of $884 | | 1,216 |
| Stockholders' deficit: | | |
| Series A Preferred Stock: $1.00 par value; 8% cumulative, convertible, redeemable;5,450,000 shares authorized; 464,319 shares issued and outstanding. | | 464 |
| Series C Preferred Stock: $1.00 par value; 6% cumulative, convertible, redeemable; 840,000 shares authorized; 770,000 shares issued and outstanding | | 770 |
| Common stock: $0.01 par value; 100,000,000 shares authorized;77,835,202 shares issued and 77,775,046 shares outstanding. | | 778 |
| Additional paid-in capital | | 57,364 |
| Subscription receivable | | (30) |
| Accumulated deficit | | (62,239) |
| Treasury Stock: 60,156 shares at cost | | (15) |

| | | |
|---|---|---|
| Total stockholders' deficit | | (2,908) |
| Total liabilities and stockholders' deficit | $ | 905 |

See notes to financial statements

**POSITRON CORPORATION**
**STATEMENTS OF OPERATIONS**
**(In thousands, except per share data)**

| | Year Ended December 31, 2005 | 2004 |
|---|---|---|
| Revenue: | | |
| System sales | $ -- | $ 1,150 |
| System upgrades | 37 | 691 |
| Service and components | 725 | 939 |
| Total revenue | 762 | 2,780 |
| Costs of revenues: | | |
| System sales | 350 | 1,178 |
| System upgrades | 11 | 284 |
| Service, warranty and components | 271 | 321 |
| Write-off of inventory and field service parts | 656 | -- |
| Total costs of revenues | 1,288 | 1,783 |
| Gross (loss) profit | (526) | 997 |
| Selling, general and administrative | 2,139 | 1,735 |
| Research and development | 446 | 401 |
| Stock based compensation | (59) | 363 |
| Loss from operations | (3,052) | (1,502) |
| Other income (expenses): | | |
| Interest expense | (985) | (157) |
| Interest income | 1 | 1 |
| Equity in losses of joint venture | (20) | -- |
| Royalty on sale of software license | 250 | -- |
| Total other income(expense) | (754) | (156) |
| Net loss | $ (3,806) | $ (1,658) |
| Basic and diluted loss per common share | $ (0.06) | $ (0.03) |
| Basic and diluted weighted average shares outstanding | 65,044 | 53,186 |

See notes to financial statements

**POSITRON CORPORATION**
**STATEMENTS OF STOCKHOLDERS' DEFICIT**
**for the years ended December 31, 2005 and 2004**
**(In thousands, except share data)**

| | Series A Preferred Stock | | Series C Preferred Stock | | Common Stock | | Additional Paid-In Capital | Subscription Receivable | Accumulated Deficit | Treasury Stock | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | Shares | Amount | | | | | |
| Balance at December 31, 2003 | 510,219 | $ 510 | - | $ - | 53,245,959 | $ 532 | $ 55,184 | $ (30) | $ (56,775) | $ (15) | $ (594) |
| Net loss | - | - | - | - | - | - | - | - | (1,658) | - | (1,658) |
| Compensation related to repricing of warrants and options | - | - | - | - | - | - | 363 | - | - | - | 363 |
| Balance at December 31, 2004 | 510,219 | 510 | - | - | 53,245,959 | 532 | 55,547 | (30) | (58,433) | (15) | (1,889) |
| Net loss | - | - | - | - | - | - | - | - | (3,806) | - | (3,806) |
| Compensation related to repricing of warrants and options | - | - | - | - | - | - | (95) | - | - | - | (95) |
| Compensation related to issuance of options | - | - | - | - | - | - | 20 | - | - | - | 20 |
| Conversion of debt to equity | - | - | 770,000 | 770 | 24,250,000 | 243 | 344 | - | - | - | 1,357 |
| Conversion of preferred stock into common stock | (45,900) | (46) | - | - | 139,243 | 1 | 45 | - | - | - | - |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Issuance of common stock for services | - | - | - | - | 200,000 | 2 | 14 | - | - | - | 16 |
| Beneficial conversion feature of convertible debt | - | - | - | - | - | - | 1,425 | - | - | - | 1,425 |
| Loan discount | - | - | - | - | - | - | 64 | - | - | - | 64 |
| Balance at December 31,2005 | 464,319 | $ 464 | 770,000 | $ 770 | 77,835,202 | $ 778 | $ 57,364 | $ (30) | $ (62,239) | $ (15) | $ (2,908) |

**POSITRON CORPORATION**
**STATEMENTS OF CASH FLOWS**
**(In thousands)**

| | Year Ended December 31, 2005 | 2004 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net loss | $ (3,806) | $ (1,658) |
| Adjustments to reconcile net loss to net cash used in operating activities | | |
| Compensation related to repricing of warrants and options | (95) | 363 |
| Compensation related to issuance of options | 20 | -- |
| Depreciation expense | 71 | 86 |
| Write-off of inventory and field service parts | 656 | -- |
| Issuance of common stock for services | 16 | -- |
| Equity in losses of joint venture | 20 | -- |
| Amortization of loan costs, debt discount and beneficial conversion feature | 691 | 92 |
| Changes in operating assets and liabilities: | | |
| Decrease in accounts receivable | -- | 3 |
| (Increase) decrease in inventories | (103) | 325 |
| (Increase) decrease in prepaid expenses | (4) | 113 |
| Decrease (increase) in other current assets | 7 | (16) |
| Decrease in field service parts | 36 | -- |
| Increase(decrease) in accounts payable and accrued liabilities | 371 | (505) |
| Decrease in customer deposits | (1) | (154) |
| (Decrease) increase in unearned revenue | (87) | 58 |
| Net cash used in operating activities | (2,208) | (1,293) |
| Cash flows from investing activities: | | |
| Investment in joint venture | (250) | -- |
| Capital expenditures | (35) | (20) |
| Net cash used in investing activities | (285) | (20) |
| Cash flows from financing activities: | | |
| Proceeds from notes payable to affiliated entities | 2,375 | 1,550 |
| Deferred loan costs | -- | (100) |
| Repayment of capital lease obligation | -- | (9) |
| Proceeds from deposit for unissued preferred stock | 194 | -- |
| Net cash provided by financing activities | 2,569 | 1,441 |
| Net increase in cash and cash equivalents | 76 | 128 |
| Cash and cash equivalents, beginning of year | 133 | 5 |

| | | | | |
|---|---|---|---|---|
| Cash and cash equivalents, end of year | $ | 209 | $ | 133 |

See notes to financial statements

## NOTES TO FINANCIAL STATEMENTS

### 1. Description of Business and Summary of Significant Accounting Policies

**Description of Business**

Positron Corporation (the "Company") was incorporated on December 20, 1983 in the state of Texas and commenced commercial operations during 1986. The Company designs, manufactures, markets and services its POSICAM™ system advanced medical imaging devices, utilizing positron emission tomography ("PET") technology and has the ability to participate in manufacturing through its joint venture with Neusoft Medical Systems Co., Ltd. These systems utilize the Company's patented and proprietary technology, an imaging technique which assesses the biochemistry, cellular metabolism and physiology of organs and tissues, as well as producing anatomical and structural images. Targeted markets include medical facilities and diagnostic centers located throughout the world. POSICAM™ systems are used by physicians as diagnostic and treatment evaluation tools in the areas of cardiology, neurology and oncology. The Company faces competition principally from three other companies which specialize in advanced medical imaging equipment.

**Cash Equivalents and Short-term Investments**

For the purposes of reporting cash flows, the Company considers highly liquid, temporary cash investments with an original maturity period of three months or less to be cash equivalents. Short-term investments include certificates of deposits, commercial paper and other highly liquid investments that do not meet the criteria of cash equivalents. Cash equivalents and short-term investments are stated at cost plus accrued interest which approximates fair value.

**Concentrations of Credit Risk**

Cash and accounts receivables are the primary financial instruments that subject the Company to concentrations of credit risk. The Company maintains its cash in banks or other financial institutions selected based upon management's assessment of the bank's financial stability. Cash balances periodically exceed the $100,000 federal depository insurance limit.

Accounts receivable arise primarily from transactions with customers in the medical industry located throughout the world, but concentrated in the United States and Japan. The Company provides a reserve for accounts where collectibility is uncertain. Collateral is generally not required for credit granted.

**Inventory**

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out (FIFO) method of inventory valuation.

**Property and Equipment**

Property and equipment are recorded at cost and depreciated for financial statement purposes using the straight-line method over estimated useful lives of three to seven years. Gains or losses on dispositions are included in the statement of operations in the period incurred. Maintenance and repairs are charged to expense as incurred.

**Impairment of Long-Lived Assets**

Periodically, the Company evaluates the carrying value of its plant and equipment, and long-lived assets, which includes patents and other intangible assets, by comparing the anticipated future net cash flows associated with those assets to the related net book value. If an impairment is indicated as a result of such reviews, the Company would remove the impairment based on the fair market value of the assets, using techniques such as projected future discounted cash flows or third party valuations.

**Revenue Recognition**

Revenues from POSICAM™ system contracts are recognized when all significant costs have been incurred and the system has been shipped to the customer. Revenues from maintenance contracts are recognized over the term of the contract. Service revenues are recognized upon performance of the services.

**Advertising**

Indirect-response advertising costs are charged to operations the first time the advertising takes place. The cost of direct-response advertising is not significant. Advertising expenses for 2005 and 2004 were $128,000 and $78,000, respectively.

**Research and Development Expenses**

All costs related to research and development are charged to expense as incurred.

**Stock Based Compensation**

The Company has elected to apply the disclosure only provisions of Statement of Financial Accounting No. 123, Accounting for Stock-Based Compensation ("SFAS 123") which, if fully adopted by the Company, would change the method the Company applies in recognizing the cost of the Plan. Adoption of the cost recognition provisions of SFAS 123 is optional and the Company has decided not to elect those provisions. As a result, the Company continues to apply Accounting Principles Board Opinion No. 25 ("APB 25") and related interpretations in accounting for the measurement and recognition of the Plan's cost.

Under SFAS 123, compensation cost is measured at the grant date based on the fair value of the awards and is recognized over the service period, which is usually the vesting period. The fair value of options granted during 2005 and 2004 was estimated on the date of grant using the Black Scholes option-pricing model with the following assumptions used to calculate fair value: (i) average dividend yield of 0.0%; (ii) expected volatility of 133.2% and 242.0%, respectively; (iii) expected life of five (5) and two (2) years; and (iv) estimated risk-free interest rate of 4.5% and 3.3%, respectively.

| | 2005 | 2004 |
|---|---|---|
| Net loss as reported | $ (3,806) | $ (1,658) |
| Add: Stock-based employee compensationexpense included in reported net loss | (59) | 363 |
| Deduct: Stock-based employee compensationexpense determined under fair value basedmethod for all awards | (110) | (400) |
| Pro-Forma net loss | $ (3,975) | $ (1,695) |
| Loss per share | | |
| Basic and diluted as reported | $ (0.06) | $ (0.03) |

| | | |
|---|---|---|
| Basic and diluted pro-forma | $ (0.06) | $ (0.03) |

**Warranty Costs**

The Company accrues for the cost of product warranty on POSICAM™ systems at the time of shipment. Warranty periods generally range up to a maximum of one year but may extend for longer periods. Actual results could differ from the amounts estimated.

**Loss Per Common Share**

Basic loss per share is calculated by dividing net income by the weighted average common shares outstanding during the period. Diluted loss per share is calculated by dividing net income by the weighted average number of common shares used in the basic loss per share calculation plus the number of common shares that would be issued assuming conversion of all potentially dilutive securities outstanding, less common shares which could have been repurchased by the Company with the related proceeds.

**Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Fair Value of Financial Instruments**

The Company includes fair value information in the notes to the financial statements when the fair value of its financial instruments is different from the book value. When the book value approximates fair value, no additional disclosure is made.

**New Accounting Pronouncements**

In December 2004, the Financial Accounting Standards Board (“the FASB”) issued (“SFAS”) No. 123(R), *Share-Based Payment.* SFAS 123(R) requires compensation costs related to share-based payment transactions to be recognized in the financial statements. With limited exceptions, the amount of compensation cost is to be measured based on the grant-date fair value of the equity or liability instruments issued. In addition, liability awards are to be remeasured each reporting period. Compensation cost will be recognized over the period that an employee provides service in exchange for the award. SFAS 123(R) is a revision of SFAS 123, *Accounting for Stock-Based Compensation*, as amended by SFAS 148, *Accounting for Stock-Based Compensation-Transition and Disclosure* and supersedes APB NO. 25, *Accounting for Stock Issued to Employees*. SFAS 123(R) is effective for private companies as of the beginning of the first annual reporting period that begins after December 15, 2005. The Company adopted SFAS 123R effective January 1, 2006, using the modified prospective method. This method applies the fair value based method to new awards and to awards modified, repurchased or cancelled after the required effective date. Also, compensation cost for the portion of awards for which the requisite service has not been rendered that are outstanding as of the required effective date shall be recognized as the service is rendered on or after the required effective date. Any options issued subsequent to January 1, 2006 will be accounted for under SFAS 123R..

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs*. The new Statement amends ARB No. 43, Chapter 4, *Inventory Pricing*, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. This Statement requires that those items be recognized as current period charges and requires that allocation of fixed production overhead to the cost of conversion be based on the normal capacity of the production facilities. This Statement is effective for fiscal years beginning after June 15, 2005. The adoption of this statement is not expected to have a material impact on the Company's financial position or results of operations.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets - An Amendment of APB Opinion No. 29*. SFAS No. 153 amends APB Opinion No. 29 to eliminate the exception for exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have

commercial substance. SFAS No. 153 is to be applied prospectively for nonmonetary exchanges occurring in fiscal periods beginning after June 15, 2005. The Company's adoption of SFAS No. 153 is not expected to have a material impact on its financial position or results of operations.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections—a replacement of APB Opinion No. 20 and FASB Statement No. 3.* This Statement replaces APB Opinion No.20, *Accounting Changes*, and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*, and changes the requirements for the accounting for and reporting of a change in accounting principle. This Statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. This Statement is effective for fiscal years beginning after December 15, 2005. The adoption of this statement is not expected to have a material impact on the Company's financial position or results of operations.

**2. Going Concern Consideration**

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, 2005, the Company had an accumulated deficit of $62,239,000 and a stockholders' deficit of $2,908,000. 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.

The Company utilized proceeds of $2,375,000 from notes payable to affiliated entities to fund its 2005 operating activities. The Company had cash and cash equivalents of $209,000 at December 31, 2005. At the same date, the Company had accounts payable and accrued liabilities of $1,694,000. In addition, debt service and working capital requirements for the upcoming year may reach beyond current cash balances. The Company plans to continue to raise funds as required through equity and debt financings to sustain business operations. These factors raise substantial doubt about the Company's ability to continue as a going concern.

There can be no assurance that the Company will be successful in implementing its business plan and ultimately achieving operational profitability. The Company's long-term viability as a going concern is dependent on its ability to 1) achieve adequate profitability and cash flows from operations to sustain its operations, 2) control costs and expand revenues from existing or new business and 3) meet current commitments and fund the continuation of its business operation in the near future.

**3. Inventories**

Inventories at December 31, 2005 consisted of the following (in thousands):

| | | |
|---|---|---|
| Raw materials | $ | 235 |
| Work in progress | | 17 |
| Subtotal | | 252 |
| Less reserve for obsolescence | | (50) |
| Total | $ | 202 |

The Company expensed $522,000 of excess inventory as it ceased manufacturing activities at its Houston facility in 2005.

**4. Investment in Joint Venture**

The Company recently entered into a joint venture with a Chinese company for the production of its PET scanners. On June 30, 2005 the Company entered into a Joint Venture Contract with Neusoft Medical Systems Co., Inc. of Shenyang, Lianoning Province, People's Republic of China ("Neusoft"). Pursuant to the Joint Venture Contract the parties formed a jointly-owned company, Neusoft Positron Medical Systems Co., Ltd. (the "JV Company"), to engage in the manufacturing of PET and CT/PET medical imaging equipment. The JV Company received its business license and was organized in September 2005.

The Company and Neusoft are active in researching, developing, manufacturing, marketing and/or selling Positron Emission Tomography ("PET") technology and both parties seek to mutually benefit from each other's strengths, and intend to cooperate in the research, development and manufacturing of PET technology. The purpose and scope of the JV Company's business is to research, develop and manufacture Positron Emission Tomography systems (PET), and an integrated X-ray Computed Tomography system (CT) and PET system (PET/CT), and to otherwise provide

relevant technical consultation and services.

The parties to the joint venture contributed an aggregate of US $2,000,000 in capital contributions. Neusoft's aggregate contribution to the capital of the JV Company is 67.5% of the total registered capital of the Company, or US$ 1,350,000, and was made in cash. The Company's aggregate contribution to the capital of the JV Company is 32.5% of the total registered capital of the Company, or US$ 650,000, of which US$ 250,000 was made in cash, and US$ 400,000 was made in the form of a technology license. Positron has transferred to the JV Company certain of its PET technology, while Neusoft made available to the JV Company certain CT technology for the development and production of an integrated PET/CT system. The parties will share the profits, losses and risks of the JV Company in proportion to and, in the event of losses, to the extent of their respective contributions to the registered capital of the JV Company.

CONDENSED FINANCIAL STATEMENTS FOR THE JV COMPANY TO FOLLOW.

**NEUSOFT POSITRON MEDICAL SYSTEMS CO., LTD.**
**CONDENSED BALANCE SHEET**
**DECEMBER 31, 2005**
(in thousands)

| | | |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $ | 1,295 |
| Other current assets | | 4 |
| Total current assets | | 1,299 |
| Intangibles and other assets | | 646 |
| Total assets | $ | 1,945 |
| LIABILITIES AND CAPITAL | | |
| Current liabilities: | | |
| Other current liabilities | $ | 3 |
| Total current liabilities | | 3 |
| Capital | | 1,942 |
| Total liabilities and capital | $ | 1,945 |

**NEUSOFT POSITRON MEDICAL SYSTEMS CO., LTD.**
**CONDENSED STATEMENT OF OPERATIONS**
**INCEPTION THROUGH DECEMBER 31, 2005**
(in thousands)

| | | |
|---|---|---|
| Revenue | $ | -- |
| Expense | | |
| General and administrative expense | | 61 |
| Total expense | | 61 |
| Undistributed loss | $ | ( 61) |

**5. Property and Equipment**

Property and equipment at December 31, 2005 consisted of the following (in thousands):

| | | |
|---|---|---|
| Furniture and fixtures | $ | 161 |
| Computers and peripherals | | 318 |
| Machinery and equipment | | 134 |
| Subtotal | | 613 |
| Less accumulated depreciation | | (493) |
| Total | $ | 120 |

**6. Other Assets**

Other assets at December 31, 2005 consisted of the following (in thousands):

| | | |
|---|---|---|
| Field service parts and supplies | $ | 45 |
| Deferred loan costs | | 12 |
| Total | $ | 57 |

The Company expensed $134,000 of excess field service parts and supplies in 2005.

**7. Accounts Payable and Accrued Liabilities**

Accounts payable and accrued liabilities at December 31, 2005 consisted of the following (in thousands):

| | | |
|---|---|---|
| Trade accounts payable | $ | 441 |
| Accrued royalties | | 352 |
| Accrued interest | | 260 |
| Sales taxes payable | | 236 |
| Accrued compensation | | 159 |
| Accrued property taxes | | 113 |
| Accrued professional fees | | 80 |
| Insurance premiums payable | | 43 |
| Accrued warranty costs | | 10 |
| Total | $ | 1,694 |

Accrued compensation includes severance payments payable to the Company's former Chief Executive Officer, Gary H. Brooks. Mr. Brooks resigned effective September 29, 2005. In connection with his resignation, the Company agreed to make severance payments to Mr. Brooks of $18,583.33 per month for a period of six months, and to extend the expiration date of options held by Mr. Brooks through September 30, 2006, and warrants held by Mr. Brooks until the later of (i) October 31, 2007 for 7,000,000 warrants and June 2009 for 500,000 warrants, and (ii) the date on which a registration statement filed with the Securities Exchange Commission permitting a sale of the shares underlying such warrants shall have become effective and shall have remained effective for a period of six months.

**8. Convertible Notes Payable to Affiliated Entities**

Notes payable to affiliated entities at December 31, 2005 consisted of the following (in thousands):

| | | |
|---|---|---|
| IMAGIN Diagnostic Centres, Inc., less discount of $610 | $ | 1,723 |
| Solaris Opportunity Fund, L.P., less discount of $280 | | 120 |
| Total | $ | 1,843 |

**IMAGIN Diagnostic Centres, Inc.**

*Financing Agreements dated May 21, 2004*

On May 26, 2004 and June 17, 2004, the Company sold two separate secured convertible promissory notes under a Note Purchase Agreement dated May 21, 2004, to IMAGIN Diagnostic Centres, Inc. ("IMAGIN") in the principal amounts of $400,000 and $300,000, respectively. Interest is charged on the outstanding principal at the rate of ten percent (10%) per annum and is payable annually to the extent of positive cash flow on the anniversary dates of these notes. The principal and any unpaid interest must be paid on the earlier to occur of May 21, 2006 or when declared due and payable by IMAGIN upon occurrence of an event of default. The notes are initially convertible into new shares of Series C Preferred Stock that, in turn are convertible into an aggregate of 35,000,000 shares of the Company's common stock. These notes are collateralized by all of the assets of the Company. Principal of $700,000 has been advanced related to these notes. An additional $70,000 in accrued interest on these notes was converted to loan principal on May 21, 2005. On October 21, 2005, IMAGIN converted loan principal of $770,000 on promissory notes into 770,000 shares of Series C Preferred Stock. Full convertibility of the shares of Series C Preferred Stock into common stock will require an amendment to the Company's Articles of Incorporation, which must be approved by the shareholders.

In a second stage of the financing IMAGIN agreed to purchase additional secured convertible promissory notes in the aggregate principal amount of $1,300,000. These notes were to be purchased over a six and a half month period, commencing July 15, 2004. These notes are due and payable on May 21, 2006. These notes are initially convertible into new shares of Series D Preferred Stock that, in turn is convertible into an aggregate of 52,000,000 shares of the Company's common stock. As of June 30, 2005, principal of $1,208,500 had been advanced related to these notes. On June 30, 2005, IMAGIN converted $575,000 of these promissory notes into shares of Series D Preferred Stock that, in turn were converted into 23,000,000 shares of the Company's common stock. This conversion reduced the principal owed under these promissory notes from $1,208,500 to $633,500. Full convertibility of the shares of Series D Preferred Stock into common stock will require an amendment to the Company's Articles of Incorporation, which must be approved by the shareholders.

The agreements with IMAGIN provided for a $200,000 transaction fee payable to IMAGIN upon completion of the financing. Under terms of these agreements, this fee obligation was to be reduced by an amount equal to $0.02 multiplied by the number of warrants issued to IMAGIN. The agreements with IMAGIN also provided for the issuance of new warrants for the purchase of 4,575,000 shares of common stock, which resulted in a $91,500 decrease in this fee obligation to $108,500. This fee obligation is included in the principal of the notes payable to IMAGIN at December 31, 2005. The Company allocated the proceeds received from this convertible debt with detachable warrants using the relative fair value of the individual elements at the time of issuance. The notes payable to IMAGIN contain an unamortized discount balance of approximately $6,000 at December 31, 2005. The discount of the debt is to be amortized over the term of the notes payable.

Patrick G. Rooney, Chairman of the Board of the Company is the son of Patrick Rooney, Director of Corporate Development of IMAGIN Diagnostic Centres, Inc. Patrick G. Rooney was appointed to the Board of Directors of the Company.

As a result of these financing agreements, several agreements were also reached involving option and warrants contracts for the purchase of common stock of the Company.

- The Company agreed to exchange 917,068 outstanding options currently held by its employees for new options that are exercisable for the purchase of common stock at a price of $0.02 per share. The new options issued to the employees are subject to four year vesting in equal monthly installments. This re-pricing will require the Company to apply the variable accounting rules established in Interpretation No. 44 of the Financial Accounting Standards Board ("FIN 44") to these options and record changes in compensation based upon movements in the stock price. The Company recognized $13,000 and $10,100 in compensation related to the re-pricing of options in 2004 and 2005, respectively, in accordance with the variable accounting rules established in FIN 44. The market value of the Company's common stock increased to $0.09 per share at December 31, 2005, resulting in an intrinsic value of $0.07 per share.
- The Company agreed to re-price the outstanding warrants currently held by its President & CEO for the purchase of 3,500,000 shares of common stock at $0.02 per share. The Company recognized $350,000 in compensation expense in 2004 and reversed $105,000 in compensation expense in 2005, in accordance with the variable accounting rules established in FIN 44. The market value of the Company's common stock increased to $0.09 per share at December 31, 2005, resulting in an intrinsic value of $0.07 per share. The Company will record changes in compensation based upon movements in the stock price.
- The Company agreed to issue a new warrant to its President & CEO for the purchase of 4,000,000 shares of common stock at $0.02 per share.
- The Company agreed to re-price outstanding warrants for the purchase of 9,150,000 shares of common stock. These warrants have been surrendered and new warrants will be issued to the same third party holders for the purchase of 4,575,000 shares of common stock at $0.02 per share. New warrants for the purchase of 4,575,000 shares of

common stock at $0.02 per share (the remaining half of the surrendered warrants) will also be issued to IMAGIN.

***Financing Agreements dated August 8, 2005***

On August 8, 2005, the Company sold to IMAGIN 10% secured convertible promissory notes under a Note Purchase Agreement, dated the same date, in the aggregate principal amount of $400,000. As of December 31, 2005, IMAGIN has purchased $400,000 of these notes. These notes are due and payable on August 7, 2008. These notes are convertible into an aggregate of 20,000,000 shares of the Company's common stock. Full convertibility of the notes into shares of common stock will require an amendment to the Company's Articles of Incorporation, which must be approved by the shareholders.

In accordance with generally accepted accounting principals in the event the conversion price is less than the Company's stock price at the date of the agreement, the difference is considered to be a beneficial conversion feature and is amortized over the period from the date of issuance to the stated maturity date. The fair value of the common stock at the commitment date of $1,200,000 less the $400,000 in loan proceeds, results in intrinsic value of $800,000 for the beneficial conversion feature. However, the beneficial conversion feature is limited to the $400,000 proceeds of the debt. Due to the fact that there were not enough common shares available to facilitate the conversion of the debt into common stock on August 8, 2005, no beneficial conversion feature was recorded for this transaction.

Pursuant to the terms of the agreements, the Company granted to IMAGIN a security interest in all of its assets to secure payment of the convertible promissory notes. The security interest is subordinate to the security interest previously granted in the same collateral to IMAGIN and Solaris Opportunity Fund, L.P. ("Solaris").

***Financing Agreements dated October 31, 2005***

On October 31, 2005, the Company sold to IMAGIN 10% secured convertible promissory notes under a Note Purchase Agreement, dated the same date, in the aggregate principal amount of $400,000. As of December 31, 2005, IMAGIN has purchased $300,000 of these notes. These notes are due and payable on October 31, 2008. These notes are convertible into an aggregate of 20,000,000 shares of the Company's common stock. Full convertibility of the notes into shares of common stock will require an amendment to the Company's Articles of Incorporation which must be approved by the shareholders.

In accordance with generally accepted accounting principals in the event the conversion price is less than the Company's stock price at the date of the agreement, the difference is considered to be a beneficial conversion feature and is amortized over the period from the date of issuance to the stated maturity date. The fair value of the common stock at the commitment date of $1,800,000 less the $300,000 in loan proceeds, results in intrinsic value of $1,500,000 for the beneficial conversion feature. However, the beneficial conversion feature is limited to the $300,000 of the debt. Due to the fact that there were not enough common shares available to facilitate the conversion of the debt into common stock on October 31, 2005, no beneficial conversion feature was recorded for this transaction.

Pursuant to the terms of the agreements, the Company granted to IMAGIN a security interest in all of its assets to secure payment of the convertible promissory notes. The security interest is subordinate to the security interest previously granted in the same collateral to IMAGIN and Solaris Opportunity Fund, L.P.

**Solaris Opportunity Fund, L.P.**

*Financing Agreements dated February 28, 2005*

On February 28, 2005, the Company entered into a series of agreements with Solaris pursuant to which Solaris agreed to purchase an aggregate of $1,000,000 face amount of the Company's 10% secured convertible promissory notes. As of December 31, 2005, Solaris has purchased $1,000,000 of these notes. These notes are due and payable on March 6, 2007. The notes are initially convertible into new shares of Series E Preferred Stock that, in turn are convertible into an aggregate of 22,000,000 shares of the Company's common stock. As of December 31, 2005, full convertibility of the shares of Series E Preferred Stock into common stock will require an amendment to the Company's Articles of Incorporation, which must be approved by the shareholders.

In accordance with generally accepted accounting principles in the event the conversion price is less than the Company's stock price at the date of the agreement, the difference is considered to be a beneficial conversion feature and is amortized over the period from the date of issuance to the stated maturity date. On February 28, 2005, enough common shares were available to facilitate the conversion of substantially all of the debt into common stock. The fair value of the related Series E Preferred Stock at the commitment date of $2,200,000 less the $1,000,000 in loan proceeds, results in an intrinsic value of $1,200,000 for the beneficial conversion feature. However, the beneficial conversion feature is limited to the $1,000,000 proceeds of the debt. The balance of the unamortized discount was approximately $604,000 at December 31, 2005.

Pursuant to the terms of the agreements, the Company granted to Solaris a security interest in all of its assets to secure payment of the convertible promissory notes. The security interest is subordinate to the security interest previously granted in the same collateral to IMAGIN.

We have been advised by Solaris that it has since sold the $1,000,000 principal amount of these notes to IMAGIN.

*Financing Agreements dated June 27, 2005*

On June 27, 2005, the Company entered into a series of agreements with Solaris pursuant to which Solaris agreed to purchase an aggregate of $400,000 face amount of the Company's 10% secured convertible promissory notes. As of December 31, 2005, Solaris has purchased $400,000 of these notes. These notes are due and payable on March 6, 2007. The notes are initially convertible into new shares of Series F Preferred Stock that, in turn are convertible into an aggregate of 20,000,000 shares of the Company's common stock. As of December 31, 2005, full convertibility of the shares of Series F Preferred Stock into common stock will require an amendment to the Company's Articles of Incorporation, which must be approved by the shareholders.

In accordance with generally accepted accounting principles in the event the conversion price is less than the Company's stock price at the date of the agreement, the difference is considered to be a beneficial conversion feature and is amortized over the period from the date of issuance to the stated maturity date. On June 27, 2005, enough common shares were available to facilitate the conversion of all of the debt into common stock. The fair value of the related Series F Preferred Stock at the commitment date of $1,600,000 less the $400,000 in loan proceeds, results in an intrinsic value of $1,200,000 for the beneficial conversion feature. However, the beneficial conversion feature is limited to the $400,000 proceeds of the debt. The balance of the unamortized discount was approximately $280,000 at December 31, 2005.

Pursuant to the terms of the agreements, the Company granted to Solaris a security interest in all of its assets to secure payment of the convertible promissory notes. The security interest is subordinate to the security interest previously granted in the same collateral to IMAGIN and Solaris.

Patrick G. Rooney, Chairman of the Board of the Company, is the managing director of the manager of Solaris.

## 9. Options and Warrants

### Options

Effective June 3, 1994, the shareholders of the Company approved the 1994 Incentive and Nonstatutory Option Plan (the "1994 Plan"). The 1994 Plan as amended, provides for the issuance of an aggregate of 601,833 common stock options to key employees, directors, and certain consultants and advisors of the Company. The 1994 Plan also provides that the exercise price of Incentive Options shall not be less than the fair market value of the shares on the date of the grant. The exercise price per share of Nonstatutory options shall not be less than the par value of the common stock or 50% of the fair market value of the common stock on the date of grant. The 1994 Plan is administered by the Compensation Committee of the Board of Directors. The committee has the authority to determine the individuals to whom awards will be made, the amount of the awards, and all other terms and conditions of the awards.

The 1994 Plan also provides that each non-employee director automatically receives options to purchase 10,500 shares of common stock at the date such individual becomes a non-employee director. Each non-employee director who is a director on the first business day following each Annual Shareholder Meeting also receives an option to purchase a number of shares of common stock having a value of $15,000 as determined by the fair market value of the common stock at the date of grant. The terms of the 1994 Plan regarding issuances to non-employee directors were suspended during the years ended December 31, 1999 and 1998. All 1994 Plan options expire within ten years of the date of the grant.

Effective June 15, 1999, the shareholders of the Company adopted the 1999 Stock Option Plan (the "1999 Plan") and terminated the 1994 Stock Option Plan, effective October 6, 1999. The 1994 Plan provided for the grant of options to officers, directors, key employees and consultants of the Company. The 1999 Plan provides for the grant of options to officers, employees (including employee directors) and consultants. The 1999 Plan is administered by the Board of Directors. The administrator is authorized to determine the terms of each option granted under the plan, including the number of shares, exercise price, term and exercisability. Options granted under the plan may be incentive stock options or nonqualified stock options. The exercise price of incentive stock options may not be less than 100% of the fair market value of the common stock as of the date of grant (110% of the fair market value in the case an optionee owns more than 10% of the total combined voting power of all classes of Positron capital stock). Options may not be exercised more than ten years after the date of grant (five years in the case of 10% stockholders). As of December 31, 2005, a total of 5,467,500 stock options have been awarded under the 1999 Plan.

**Non-Employee Directors' Stock Option Plan**

Effective October 6, 1999, the shareholders of the Company approved the 1999 Non-Employee Directors' Stock Option Plan (the "Directors' Plan") which provides for the automatic grant of an option to purchase 25,000 shares of common stock to non-employee directors upon their election or appointment to the Board, and subsequent annual grants also in the amount of 25,000 shares of common stock. The exercise price of the options is 85% of the fair market value of the common stock on the date of grant. The Directors' Plan is administered by the Board. Options granted under the Directors' Plan become exercisable in one of two ways: either in four equal annual installments, commencing on the first anniversary of the date of grant, or immediately but subject to the Company's right to repurchase, which repurchase right lapses in four equal annual installments, commencing on the first anniversary of the date of grant. To the extent that an option is not exercisable on the date that a director ceases to be a director of the Company, the unexercisable portion terminates. Options covering 500,000 shares of common stock have been granted under the Directors' Plan at December 31, 2005.

**1999 Stock Bonus Incentive Plan**

In October 1999 the Board adopted an Employee Stock Bonus Incentive Plan (the "Stock Bonus Plan"), effective November 1, 1999. The Stock Bonus Plan provides for the grant of bonus shares to any Positron employee or consultant to recognize exceptional service and performance beyond the service recognized by the employee's salary or consultant's fee. The Board has authorized up to an aggregate of 1,000,000 shares of common stock for issuance as bonus awards under the Stock Bonus Plan. The Stock Bonus Plan is currently administered by the Board. Each grant of bonus shares is in an amount determined by the Board, up to a maximum of the participant's salary. The shares become exercisable according to a schedule to be established by the Board at the time of grant. A total of 316,000 shares have been issued under the Stock Bonus Plan at December 31, 2005.

**1999 Employee Stock Purchase Plan**

The shareholders of the Company approved the 1999 Employee Stock Purchase Plan (the "Purchase Plan") in October 1999. A total of 500,000 shares of common stock have been reserved for issuance under the Purchase Plan, none of which has yet been issued. The Purchase Plan permits eligible employees to purchase common stock at a discount through payroll deductions during offering periods of up to 27 months. Offering periods generally will begin on the first trading day of a calendar quarter. The initial offering period began on January 1, 2000. The price at which stock is purchased under the Purchase Plan will be equal to 85% of the fair market value of common stock on the first or last day of the offering period, whichever is lower. No shares have been issued under the Purchase Plan at December 31, 2005.

**Amended and Restated 2005 Stock Incentive Plan**

Positron's Board administers the Amended and Restated 2005 Stock Incentive Plan ("2005 Plan"), which was adopted by the Board effective November 18, 2005. The 2005 Plan provides for the grant of options and stock to directors, officers, employees and consultants. The administrator is authorized to determine the terms of each award granted under the plan, including the number of shares, exercise price, term and exercisability. Options granted under the plan may be incentive stock options or nonqualified stock options. The exercise price of incentive stock options may not be less than 100% of the fair market value of the Common Stock as of the date of grant (110% of the fair market value in the case of an optionee who owns more than 10% of the total combined voting power of all classes of the Company's capital stock). Options may not be exercised more than ten years after the date of grant (five years in the case of 10% shareholders). Upon termination of employment for any reason other than death or disability, each option may be exercised for a period of 90 days, to the extent it is exercisable on the date of termination. In the case of a termination

due to death or disability, an option will remain exercisable for a period of one year, to the extent it is exercisable on the date of termination. The Board has directed the officers of the Company to submit the 2005 Plan for approval by the stockholders of the Company at its next annual meeting. A total of 40,000,000 shares of Common Stock have been authorized for issuance under the 2005 Plan. As of December 31, 2005, a total of 7,500,000 options have been granted under the 2005 Plan, none of which have been exercised, and of which 5,500,000 are subject to vesting and 2,000,000 are fully vested.

A summary of stock option activity is as follows:

| | Shares Issuable Under Outstanding Options | Price Range or Weighted Average Exercise Price |
|---|---|---|
| Balance at December 31, 2003 | 2,304,588 | $ 0.32 |
| Granted | 100,000 | $ 0.03 - $0.12 |
| Forfeited | (682,316) | $ 0.02 - $4.13 |
| Balance at December 31, 2004 | 1,722,272 | $ 0.12 |
| Granted | 7,625,000 | $ 0.04 - $0.10 |
| Forfeited | (597,272) | $ 0.01 - $2.63 |
| Balance at December 31, 2005 | 8,750,000 | $ 0.05 |

In conjunction with the IMAGIN transaction in 2004 (see Note 12), the Company agreed to exchange 917,068 outstanding options currently held by its employees for new options that are exercisable for the purchase of common stock at a price of $0.02 per share.

The shares exercisable for vested options and the corresponding weighted average exercise price was 3,050,625 shares and $0.05 per share at December 31, 2005.

Following is a summary of stock options outstanding at December 31, 2005.

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Price | Shares | Weighted Average Remaining Term (in Years) | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price |
| $0.020 | 100,000 | 3.80 | $ 0.02 | 39,583 | $ 0.02 |
| $0.020 | 75,000 | 4.63 | $ 0.02 | 29,688 | $ 0.02 |
| $0.050 | 7,500,000 | 5.00 | $ 0.05 | 2,000,000 | $ 0.05 |
| $0.111 | 25,000 | 5.25 | $ 0.11 | 25,000 | $ 0.11 |
| $0.077 | 25,000 | 6.00 | $ 0.08 | 25,000 | $ 0.08 |
| $0.010 - $0.050 | 850,000 | 7.39 | $ 0.04 | 756,354 | $ 0.05 |
| $0.034 - $0.119 | 75,000 | 8.25 | $ 0.09 | 75,000 | $ 0.09 |
| $0.102 | 75,000 | 9.00 | $ 0.10 | 75,000 | $ 0.10 |
| $0.043 | 25,000 | 9.67 | $ 0.04 | 25,000 | $ 0.04 |

| | | | | | |
|---|---|---|---|---|---|
| Balance at 12/31/2005 | 8,750,000 | $ | 0.05 | 3,050,625 | $ 0.05 |
| Balance at 12/31/2004 | 1,722,272 | $ | 0.12 | 960,122 | $ 0.20 |

The Company recognized $13,000 and $10,100 in compensation related to the re-pricing of options in 2004 and 2005, respectively (see Note 13).

**Warrants**

In 2004, the Company agreed to issue new warrants and re-price various outstanding warrants in conjunction with the IMAGIN transaction (see Note 12).

A summary of warrant activity is as follows:

| | Number of Shares | Exercise Price | Weighted Average Exercise Price |
|---|---|---|---|
| Balance at December 31, 2003 | 25,120,000 | $ 0.05 - $2.40 | $ 0.23 |
| New warrants issued in connection with IMAGIN transaction | 8,575,000 | $ 0.02 | $ 0.02 |
| Expired | (15,545,000) | $ 0.05 - $0.30 | $ 0.23 |
| Balance at December 31, 2004 and 2005 | 18,150,000 | | |

All outstanding warrants are currently exercisable. A summary of outstanding stock warrants at December 31, 2005 follows:

| Number of Common Stock Equivalents | Expiration Date | Remaining Contractual Life (Years) | Exercise Price |
|---|---|---|---|
| 3,825,000 | August 2005 | 0.7 | $ 0.02 |
| 250,000 | January 2007 | 2.1 | $ 2.40 |
| 500,000 | October 2007 | 2.8 | $ 0.02 |
| 1,250,000 | March 2008 | 3.3 | $ 0.25 |
| 3,750,000 | June 2009 | 4.5 | $ 0.02 |
| 8,575,000 | May 2010 | 5.4 | $ 0.02 |
| 18,150,000 | | | |

The Company recognized $350,000 in compensation expense in 2004 and reversed $105,000 in compensation expense in 2005, related to the re-pricing of warrants (see Note 13).

**10. Preferred Stock**

The Company's Articles of Incorporation authorize the Board of Directors to issue 10,000,000 shares of preferred stock from time to time in one or more series. The Board of Directors is authorized to determine, prior to issuing any such series of preferred stock and without any vote or action by the shareholders, the rights, preferences, privileges and restrictions of the shares of such series, including dividend rights, voting rights, terms of redemption, the provisions of any purchase, retirement or sinking fund to be provided for the shares of any series, conversion and exchange rights, the preferences upon any distribution of the assets of the Company, including in the event of voluntary or involuntary liquidation, dissolution or winding up of the Company, and the preferences and relative rights among each series of preferred stock. At December 31, 2005, the Company had two classes of preferred stock outstanding, which are the Series A 8% Cumulative Convertible Redeemable Preferred Stock and Series C 6% Cumulative Convertible Redeemable Preferred Stock.

**Series A Preferred Stock**

In February, March and May of 1996, the Company issued 3,075,318 shares of Series A 8% Cumulative Convertible Redeemable Preferred Stock $1.00 par value ("Series A Preferred Stock") and Redeemable common stock Purchase Warrants to purchase 1,537,696 shares of the Company's Common Stock. The net proceeds of the private placement were approximately $2,972,000. Subject to adjustment based on issuance of shares at less than fair market value, each

share of the Series A Preferred Stock was initially convertible into one share of common stock. Each Redeemable common stock Purchase Warrant is exercisable at a price of $2.00 per share of common stock. Eight percent (8%) dividends on the Series A Preferred Stock may be paid in cash or in Series A Preferred Stock at the discretion of the Company. The Series A Preferred Stock is senior to the Company's common stock in liquidation. Holders of the Series A Preferred stock may vote on an as if converted basis on any matter requiring shareholder vote. While the Series A Preferred Stock is outstanding or any dividends thereon remain unpaid, no common stock dividends may be paid or declared by the Company. The Series A Preferred Stock may be redeemed in whole or in part, at the option of the Company, at any time subsequent to March 1998 at a price of $1.46 per share plus any undeclared and/or unpaid dividends to the date of redemption. Redemption requires at least 30 days advanced notice and notice may only be given if the Company's common stock has closed above $2.00 per share for the twenty consecutive trading days prior to the notice.

As of December 31, 2005 and 2004, stated dividends that are undeclared and unpaid on the Series A Preferred Stock total $448,000 and $399,000. The Company anticipates that such dividends, if and when declared, will be paid in shares of Series A Preferred Stock.

**Series C Preferred Stock**

The Company has designated 840,000 shares out of its 10,000,000 shares of authorized preferred stock as Series C 6% Cumulative Convertible Redeemable Preferred Stock $1.00 par value ("Series C Preferred Stock"). Each share of the Series C Preferred Stock is convertible into 50 shares of Common Stock. Six percent dividends accrue on the Series C Preferred Stock and may be paid in cash or in Common Stock depending on the Company's operating cash flow. The Series C Preferred Stock is senior to the Company's Common Stock and junior in priority to the Company's Series A Preferred Stock in liquidation. Holders of the Series C Preferred Stock are entitled to 130 votes per share on any matter requiring shareholder vote. While the Series C Preferred Stock is outstanding or any dividends thereon remain unpaid, no Common Stock dividends may be paid or declared by the Company. The Series C Preferred Stock may be redeemed in whole or in part, at the option of the Company, at any time at a price of $1.00 per share plus any undeclared and/or unpaid dividends to the date of redemption.

On October 21, 2005, IMAGIN converted loan principal of $770,000 on promissory notes into 770,000 shares of Series C Preferred Stock $1.00 par value in a noncash transaction. Full convertibility of the shares of Series C Preferred Stock into common stock will require an amendment to the Company’s Articles of Incorporation, which must be approved by the shareholders.

As of December 31, 2005, stated dividends that are undeclared and unpaid on Series C Preferred Stock total $46,000. The Company anticipates that such dividends, if and when declared, will be paid in shares of Common Stock.

**Series D Preferred Stock**

The Company has designated 1,560,000 shares out of its 10,000,000 shares of authorized preferred stock as 6% Cumulative Convertible Redeemable Series D Preferred Stock $1.00 par value. Each share of the Series D Preferred Stock is convertible into 40 shares of Common Stock. Six percent dividends accrue on the Series D Preferred Stock and may be paid in cash or in Common Stock depending on the Company's operating cash flow. The Series D Preferred Stock is senior to the Company's Common Stock and junior in priority to the Company's Series A and C Preferred Stock in liquidation. Except as required by law and in the case of various actions affecting the rights of the Series D Preferred Stock, holders of the Series D Preferred Stock are not entitled to vote on matters requiring shareholder vote. While the Series D Preferred Stock is outstanding or any dividends thereon remain unpaid, no Common Stock dividends may be paid or declared by the Company. The Series D Preferred Stock may be redeemed in whole or in part, at the option of the Company, at any time at a price of $1.00 per share plus any undeclared and/or unpaid dividends to the date of redemption. Currently no shares of Series D Preferred Stock are outstanding. However, the Company has issued 10% secured convertible promissory notes in the principal amount of $696,850, which remain outstanding and are convertible into 696,850 shares of Series D Preferred Stock.

**Series E Preferred Stock**

The Company has designated 1,200,000 shares out of its 10,000,000 shares of authorized preferred stock as 6% Cumulative Convertible Redeemable Series E Preferred Stock $1.00 par value. Each share of the Series E Preferred Stock is convertible into 22 shares of Common Stock. Six percent dividends accrue on the Series E Preferred Stock and may be paid in cash or in Common Stock depending on the Company's operating cash flow. The Series E Preferred Stock is senior to the Company's Common Stock and junior in priority to the Company's Series A, C and D

Preferred Stock in liquidation. Except as required by law and in the case of various actions affecting the rights of the Series E Preferred Stock, holders of the Series E Preferred Stock are not entitled to vote on matters requiring shareholder vote. While the Series E Preferred Stock is outstanding or any dividends thereon remain unpaid, no Common Stock dividends may be paid or declared by the Company. The Series E Preferred Stock may be redeemed in whole or in part, at the option of the Company, at any time at a price of $1.00 per share plus any undeclared and/or unpaid dividends to the date of redemption. Currently no shares of Series E Preferred Stock are outstanding. However, the Company has issued 10% secured convertible promissory notes in the principal amount of $1,000,000, which are convertible into 1,000,000 shares of Series E Preferred Stock.

**Series F Preferred Stock**

The Company has designated 600,000 shares out of its 10,000,000 shares of authorized preferred stock as Series F Preferred Stock $1.00 par value. Each share of the Series F Preferred Stock is convertible into 50 shares of Common Stock. Six percent dividends accrue on the Series F Preferred Stock and may be paid in cash or in Common Stock depending on the Company's operating cash flow. The Series F Preferred Stock is senior to the Company's Common Stock and junior in priority to the Company's Series A, C, D and E Preferred Stock in liquidation. Except as required by law and in the case of various actions affecting the rights of the Series F Preferred Stock, holders of the Series F Preferred Stock are not entitled to vote on matters requiring shareholder vote. While the Series F Preferred Stock is outstanding or any dividends thereon remain unpaid, no Common Stock dividends may be paid or declared by the Company. The Series F Preferred Stock may be redeemed in whole or in part, at the option of the Company, at any time at a price of $1.00 per share plus any undeclared and/or unpaid dividends to the date of redemption. Currently no shares of Series F Preferred Stock are outstanding. However, the Company has issued 10% secured convertible promissory notes in the principal amount of $400,000, which are convertible into 400,000 shares of Series F Preferred Stock.

**Series G Preferred Stock**

The Company has received subscription deposits in the amount of $195,000 for shares of a new series of preferred stock to be designated Series G Preferred Stock. However, the Company has not yet designated a new series of preferred stock or issued any shares thereof. The Company anticipates designating the new series effective upon the filing of a Statement of Designation with the Texas Secretary of State in the second quarter of 2006. The Company also anticipates that the new series will be junior in priority to the Series F Preferred Stock.

## 11. Income Taxes

The Company has incurred losses since its inception and, therefore, has not been subject to federal income taxes. As of December 31, 2005, the Company had net operating loss (“NOL”) carryforwards for income tax purposes of approximately $15,000,000, which expire in 2006 through 2025. 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.

The composition of deferred tax assets and the related tax effects at December 31, 2005 are as follows (in thousands):

| | | |
|---|---|---|
| Deferred tax assets: | | |
| Net operating losses | $ | 4,980 |
| Accrued liabilities and reserves | | 251 |
| Inventory basis difference | | 95 |
| | | 5,326 |
| Valuation allowance | | ( 5,326) |
| Total deferred tax assets | $ | -- |

The difference between the income tax benefit in the accompanying statement of operations and the amount that would result if the U.S. Federal statutory rate of 34% were applied to pre-tax loss is as follows (amounts in thousands):

| | 2005 | | 2004 | |
|---|---|---|---|---|
| | Amount | % | Amount | % |
| Benefit for income tax at federal statutory rate | $ 1,294 | 34.0 | $ 564 | 34.0 |
| Interest not deductible for tax purposes | (325) | (8.5) | (32) | (2.0) |
| Change in valuation allowance | (969) | (25.5) | (532) | (32.0) |
| | $ -- | -- | $ -- | -- |

**12. 401(k) Plan**

The Positron Corporation 401(k) Plan and Trust (the "Plan") covers all of the Company's employees who are United States citizens, at least 21 years of age and have completed at least one quarter of service with the Company. Pursuant to the Plan, employees may elect to reduce their current compensation by up to the statutorily prescribed annual limit and have the amount of such reduction contributed to the Plan. The Plan provides for the Company to make contributions in an amount equal to 25 percent of the participant's deferral contributions, up to 6 percent of the employee's compensation, as defined in the Plan agreement. The Company made no contributions in 2004 and 2005. The Board of Directors of the Company may authorize additional discretionary contributions; however, no additional Company contributions have been made as of December 31, 2005.

**13. Related Party Transactions**

**Joint Venture dated December 28, 2005**

On December 28, 2005, the Company entered into a Memorandum of Understanding with IMAGIN and Quantum Molecular Pharmaceutical, Inc. ("QMP"), a Canadian company and majority-owned subsidiary of IMAGIN. The Memorandum provides that the parties will form a joint venture to be called Quantum Molecular Technologies JV. Initially, the joint venture will be owned 20%, 29% and 51% by the Company, IMAGIN and QMP, respectively. The Company has the right to increase its interest in the joint venture to a maximum of 51% by the issuance to QMP of up to 150 million shares of the Company's common stock. In consideration for the Company's 20% interest in the joint venture, the Company is obligated to loan to the joint venture sufficient funds, in the form of senior debt, to meet the joint venture's capital requirements as determined by the Company. In turn, IMAGIN and QMP have committed to purchase up to $4 million in preferred equity in the Company.

The joint venture will be formed to develop a new generation of PET technologies using concepts and research and development activities conceived and to be implemented by Dr. Irving Weinberg, an exclusive consultant to QMP. The Company will have the right to manufacture and sell any PET products developed by the joint venture in exchange for royalty payments still to be negotiated.

Dr. Weinberg has been at the forefront of the evolution of PET, tracing his roots back to the UCLA group that created the PET industry. Later, as a practicing radiologist and entrepreneur, Dr. Weinberg designed and built the first breast-specific PET scanner, which was able to detect the earliest form of breast cancer better than any other modality.

Dr. Weinberg's participation is directly attributable to the efforts of J. David Wilson, who at the time of the joint venture and capital commitment between QMT and the Company, was CEO of the Company and Quantum Molecular Pharmaceutical, which is a majority owner of Quantum Molecular Technologies.

There can be no assurance that the joint venture will meet the parties objectives. The issuance of shares of preferred stock and any common stock to IMAGIN and QMP will involve substantial dilution to the Company's current shareholders.

**Key Employee Incentive Compensation**

The Company has an incentive compensation plan for certain key employees and its Chairman. The incentive compensation plan provides for annual bonus payments based upon achievement of certain corporate objectives as determined by the Company's compensation committee, subject to the approval of the board of directors. During 2005 the Company did not pay any bonus pursuant to the incentive compensation plan.

**14. Commitments and Contingencies**

Employment Agreement

Effective December 27, 2005, the Company entered into an employment agreement with Joseph G. Oliverio, President of the Company. Under the Agreement, Mr. Oliverio receives an initial base salary of $100,000 per annum which increases to $150,000 per annum on March 1, 2006. Mr. Oliverio also received an option grant exercisable for 7,500,000 shares of Common Stock at an exercise price of $0.05 per share. On the date of grant of the option 2,000,000 shares vested, with an additional 2,000,000 shares vesting on December 27, 2006 and the remainder on December 27, 2007. Mr. Oliverio is entitled to six months severance upon a termination "without cause".

**Royalty Agreements**

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 up to 4.0% in the aggregate of gross revenues from sales, uses, leases, licensing or rentals of the relevant technology. Royalty obligations amounting to approximately $352,000 were included in liabilities at December 31, 2005.

**Lease Agreements**

Prior to 1998, the Company leased its office and manufacturing facility and certain office equipment under leases with unexpired terms ranging from one to four years. In March 1998, the Company, under severe cash flow constraints, was forced to leave its long-term office and manufacturing facility lease space and move its operations to a facility with significantly reduced space and a more affordable lease payment. Although the Company entered into an agreement with the landlord regarding vacating the space, a dispute subsequently arose with the landlord as to interpretation of that agreement. The landlord has filed suit against the Company claiming that the Company owes approximately $150,000, plus attorney’s fees, to the landlord under the terms of the agreement. A subsequent analysis of the transactions under the lease has resulted in the reduction of the lease obligation alleged by 10P10, L.P. to approximately $97,000. In October 2004, the Company finalized a Compromise & Settlement Agreement with 10P10, L.P. In accordance with the terms of this agreement, the Company paid $42,776 in 2004 in full and final settlement of all remaining claims. Operating expenses were reduced by approximately $54,000 in 2004 as a result of credits and charges associated with the abandoned lease.

The Company operates in leased facilities under an operating lease, the term of which expired in March 2004. The rental rate for the facility was $6,744 per month through April 30, 2001 and the monthly rate increased to $7,171 for the period from May 1, 2001 through October 31, 2003. The Company reduced its space under lease and lowered the monthly rent to $4,671 for the period from November 1, 2003 through March 31, 2004. This facility lease continues on a month-to-month basis after March 31, 2004 at the $4,671 monthly rental rate. The cost of leasing the Company's operating facility amounted to approximately $56,000 in 2005 and 2004.

**Litigation**

From time to time the Company may be involved in various legal actions in the normal course of business for which the Company maintains insurance. The Company is currently not aware of any material litigation affecting the Company.

**15. Loss Per Share**

The following information details the computation of basic and diluted loss per share:

| | Year Ended December 31, (In thousands, except for per share data) | |
|---|---|---|
| | 2005 | 2004 |
| Numerator: | | |
| Basic and diluted net loss: | $ (3,806) | $ (1,658) |
| | | |
| Denominator: | | |
| Denominator for basic earnings per share-weightedaverage shares | 65,044 | 53,186 |
| Effect of dilutive securities Convertible Series A Preferred Stock | -- | -- |
| Stock Warrants | -- | -- |
| Stock Options | -- | -- |
| Denominator for diluted earnings per share-adjusted weighted Average shares and assumed conversions | 65,044 | 53,186 |
| | | |
| Basic and diluted loss per common share | $ (0.06) | $ (0.03) |

All common stock equivalents in the years ended December 31, 2005 and 2004 were excluded from the above calculation as their effect was anti-dilutive.

**16. Segment Information and Major Customers**

The Company believes that all of its material operations are conducted in the servicing and sales of medical imaging devices and it currently reports as a single segment.

During the years ended December 31, 2005 and 2004 the Company had a limited number of customers as follows:

| | 2005 | 2004 |
|---|---|---|
| Number of customers | 8 | 13 |
| Customers accounting for more than 10% of revenues | 5 | 2 |
| Percent of revenues derived from largest customer | 28% | 45% |
| Percent of revenues derived from second largest customer | 15% | 20% |

**17. Supplemental Cash Flow Data**

| | 2005 | 2004 |
|---|---|---|
| Supplemental disclosure of cash flow information (in thousands): | | |
| Cash paid for interest | $ -- | $ -- |
| Cash paid for income taxes | $ -- | $ -- |

**18. Subsequent Events**

**Transaction with IMAGIN Disgnostic Centres, Inc.**

In January, 2006, the Company received the final $100,000 installment of funds from the October 31, 2005 sale of $400,000 worth of 10% convertible promissory notes to IMAGIN Diagnostic Centres, Inc.

**Deposits For Series G Preferred Stock**

In the period from January 1, 2006 through March 24, 2006, the Company received $592,900 in deposits from investors for Series G Preferred Stock.

**Reverse Stock Split**

On March 10, 2006, the Company postponed indefinitely the 100-to-1 reverse stock split on the Common Stock. The stock split was approved by the Company's shareholders on October 21, 2005 and was to be effective upon the filing of amended and restated articles of incorporation which were approved by the Company's shareholders. The timing of the reverse split had been left to the discretion of the Board.

**EXHIBITS**

10.79 Memorandum of Understanding between Quantum Molecular Pharmaceuticals, Inc., Imagin Diagnostic Centres, Inc. and Positron Corporation dated December 28, 2005*

31.1 Chairman of the Board Certification of Periodic Financial Report Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*

31.2 Chief Financial Officer Certification of Periodic Financial Report Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*

32.1 Chairman of the Board Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002#

32.2 Chief Financial Officer Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002#

| | |
|---|---|
| * | Filed herewith |
| # | Furnished herewith |