NEOPROBE CORP
Form 424B3
November 18, 2003

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Registration No. 333-91462

PROSPECTUS SUPPLEMENT
Number 2
to

Prospectus dated June 16, 2003 and Prospectus Supplement
dated August 20, 2003

of

NEOPROBE CORPORATION

11,800,563 SHARES OF COMMON STOCK

This Prospectus Supplement relates to the sale of up to 11,800,563 shares of Neoprobe Corporation common stock (the "Shares"). The Shares are being registered to permit public secondary trading of the shares that are being offered by the selling shareholders named in the prospectus. We are not selling any of the Shares in this offering and therefore will not receive any proceeds from this offering.

This Prospectus Supplement No. 2 includes the attached Quarterly Report on Form 10-QSB (the "Form 10-QSB") of Neoprobe Corporation (the "Company"), for the third quarter ended September 30, 2003, filed by the Company with the Securities and Exchange Commission on November 14, 2003. The exhibits to the Form 10-QSB are not included with this Prospectus Supplement No. 2 and are not incorporated by reference herein. This Prospectus Supplement No. 2 should be read in conjunction with the prospectus supplement dated August 20, 2003.

Our common stock is traded on the Over-the-Counter Bulletin Board under the symbol "NEOP".

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS SUPPLEMENT. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The date of this Prospectus Supplement No. 2 is November 18, 2003.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-QSB

(Mark One)

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15 (D) OF THE

SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED: SEPTEMBER 30, 2003

OR

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15 (D) OF THE EXCHANGE ACT
FOR THE TRANSITION PERIOD FROM _____TO_____

COMMISSION FILE NUMBER: 0-26520

NEOPROBE CORPORATION
(Exact name of small business issuer as specified in its charter)

DELAWARE	31-1080091
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)

425 METRO PLACE NORTH, SUITE 300, DUBLIN, OHIO 43017
(Address of principal executive offices)

614.793.7500
(Issuer's telephone number)

43,952,276 SHARES OF COMMON STOCK, PAR VALUE $.001 PER SHARE
(Number of shares of issuer's common equity outstanding as of the close of business on November 3, 2003)

Transitional Small Business Disclosure Format (check one) Yes [ ] No [X]

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NEOPROBE CORPORATION AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

ASSETS	SEPTEMBER 30, 2003 (UNAUDITED)	DECEMBER 31, 2002
Current assets:		
Cash and cash equivalents	$ 422,561	$ 700,525
Accounts receivable, net	1,133,553	746,107
Inventory	1,166,987	1,191,918
Prepaid expenses and other	266,981	451,537

Total current assets	2,990,082	3,090,087
Property and equipment	2,412,003	2,346,445
Less accumulated depreciation and amortization	2,074,648	1,883,797
	337,355	462,648
Patents and trademarks	3,144,100	3,129,031
Non-compete agreements	584,516	584,516
Acquired technology	237,271	237,271
	3,965,887	3,950,818
Less accumulated amortization	935,065	584,490
	3,030,822	3,366,328
Other assets	214,752	160,778
Total assets	$6,573,011	$7,079,841

CONTINUED

NEOPROBE CORPORATION AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS, CONTINUED

LIABILITIES AND STOCKHOLDERS' EQUITY	SEPTEMBER 30, 2003 (UNAUDITED)	DEC
Current liabilities:		
Note payable to CEO, net of discount	$ 230,948	$
Other notes payable, net of discount	201,256	
Secured liabilities	319,853	
Accrued liabilities and other	519,714	
Accounts payable	551,771	
Deferred revenue, current	1,087,265	
Total current liabilities	2,910,807	

Deferred revenue	81,665	
Contingent consideration for acquisition	--	
Other liabilities	207,092	
Total liabilities	3,199,564	
Commitments and contingencies		
Stockholders' equity:		
Preferred stock; $.001 par value; 5,000,000 shares authorized at September 30, 2003 and December 31, 2002; none issued and outstanding (500,000 shares designated as Series A, $.001 par value, at September 30, 2003 and and December 31, 2002; none outstanding)	--	
Common stock; $.001 par value; 75,000,000 shares authorized; 39,148,426 shares issued and outstanding at September 30, 2003; 36,502,183 shares issued and outstanding at December 31, 2002	39,148	
Additional paid-in capital	125,229,489	1
Accumulated deficit	(121,895,190)	(1
Total stockholders' equity	3,373,447	
Total liabilities and stockholders' equity	$ 6,573,011	$

See accompanying notes to the consolidated financial statements

NEOPROBE CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	THREE MONTHS ENDED SEPTEMBER 30,		
	2003	2002	
Revenues:			
Net sales	$ 927,949	$ 575,138	$
License and other revenue	257,588	344,623	
Total revenues	1,185,537	919,761	
Cost of goods sold	497,458	620,086	

Gross profit	688,079	299,675	
Operating expenses:			
Research and development	508,693	561,330	
Selling, general and administrative	755,104	832,232	
Total operating expenses	1,263,797	1,393,562	
Loss from operations	(575,718)	(1,093,887)	(
Other income (expenses):			
Interest income	19,695	26,092	
Interest expense	(99,520)	(11,734)	
Other	(3,571)	(3,213)	
Total other (expenses) income	(83,396)	11,145	
Net loss	$ (659,114)	$ (1,082,742)	$ (
Net loss per common share:			
Basic	$ (0.02)	$ (0.03)	$
Diluted	$ (0.02)	$ (0.03)	$
Weighted average shares outstanding:			
Basic	38,555,261	36,062,183	3
Diluted	38,555,261	36,062,183	3

See accompanying notes to the consolidated financial statements.

NEOPROBE CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	NINE MONTHS ENDED SEPTEMBER 30,	
	2003	2002
Cash flows from operating activities:		
Net loss	$(1,217,054)	$(2,799,027
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	555,388	740,749

Amortization of debt discount and offering costs	61,818	--
Change in operating assets and liabilities:		
Accounts receivable	(387,446)	155,971
Inventory	10,474	140,017
Accrued and other liabilities	138,036	(203,260
Accounts payable	119,631	(325,625
Deferred revenue	(468,555)	(466,683
Other assets and liabilities	160,733	174,707
Other	107,599	45,678
Net cash used in operating activities	(919,376)	(2,537,473
Cash flows from investing activities:		
Purchases of available-for-sale securities	--	(2,491,361
Sales of available-for-sale securities	--	200,000
Maturities of available-for-sale securities	--	805,000
Purchases of property and equipment	(63,195)	(240,638
Patent and trademark costs	(20,783)	(19,336
Subsidiary acquisition costs	--	(24,028
Net cash used in investing activities	(83,978)	(1,770,363
Cash flows from financing activities:		
Proceeds from issuance of common stock	138,430	--
Payment of common stock offering costs	(7,972)	(47,456
Proceeds from line of credit	--	2,000,000
Proceeds from notes payable, net of offering costs	458,334	--
Payment of notes payable	(172,381)	(161,865
Proceeds from secured financing	319,813	--
Payments under capital lease	(10,834)	(9,529
Net cash provided by financing activities	725,390	1,781,150
Net decrease in cash and cash equivalents	(277,964)	(2,526,686
Cash and cash equivalents, beginning of period	700,525	4,287,101
Cash and cash equivalents, end of period	$ 422,561	$ 1,760,415

See accompanying notes to the consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The information as of September 30, 2003 and 2002 and for the periods then

ended is unaudited, but includes all adjustments (which consist only of normal recurring adjustments) that the management of Neoprobe Corporation (Neoprobe or we) believes to be necessary for the fair presentation of results for the periods presented. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the U.S. Securities and Exchange Commission. The results for the interim period are not necessarily indicative of results to be expected for the year. The financial statements should be read in conjunction with Neoprobe's audited financial statements for the year ended December 31, 2002, which were included as part of our Annual Report on Form 10-KSB. Certain 2002 amounts have been reclassified to conform to the 2003 presentation.

Our consolidated financial statements include the accounts of Neoprobe and our wholly-owned subsidiary, Cardiosonix Ltd. (Cardiosonix). All significant intercompany accounts were eliminated in consolidation.

2. COMPREHENSIVE INCOME (LOSS)

We had no accumulated other comprehensive income (loss) activity during the three-month and nine-month periods ended September 30, 2003.

Due to our net operating loss position, there are no income tax effects on comprehensive income (loss) components for the three-month and nine-month periods ended September 30, 2002.

	THREE MONTHS ENDED SEPTEMBER 30, 2002	NINE MONTHS ENDED SEPTEMBER 30,
Net loss	$ (1,082,742)	$ (2,799,02
Unrealized gains on securities	3,926	17,38
Other comprehensive loss	$ (1,078,816)	$ (2,781,64

3. EARNINGS PER SHARE

Basic earnings (loss) per share is calculated using the weighted average number of common shares outstanding during the periods. Diluted earnings (loss) per share is calculated using the weighted average number of common shares outstanding during the periods, adjusted for the effects of convertible securities, options and warrants, if dilutive.

	THREE MONTHS ENDED SEPTEMBER 30, 2003		THRE SEPT
	BASIC EARNINGS PER SHARE	DILUTED EARNINGS PER SHARE	BASIC EARNINGS PER SHARE
Outstanding shares	39,148,426	39,148,426	36,502,183
Effect of weighting changes			

in outstanding shares	(463,165)	(463,165)	--
Contingently issuable shares	(130,000)	(130,000)	(440,000
Adjusted shares	38,555,261	38,555,261	36,062,183

	NINE MONTHS ENDED SEPTEMBER 30, 2003		NINE SEPT
	BASIC EARNINGS PER SHARE	DILUTED EARNINGS PER SHARE	BASIC EARNINGS PER SHARE
Outstanding shares	39,148,426	39,148,426	36,502,183
Effect of weighting changes in outstanding shares	(563,980)	(563,980)	(30,352
Contingently issuable shares	(130,000)	(130,000)	(440,000
Adjusted shares	38,454,446	38,454,446	36,031,831

There is no difference in basic and diluted loss per share related to the three-month and nine-month periods ended September 30, 2003 and 2002. The net loss per common share for these periods excludes the number of common shares issuable upon exercise of outstanding stock options and warrants into our common stock since such inclusion would be anti-dilutive.

4. ACCOUNTS RECEIVABLE

During the third quarter of 2003, we entered into an accounts receivable financing facility under which certain of our U.S. accounts receivable are factored at an advance rate of 80% and with recourse to a third party financing company. We account for the sales of receivables in accordance with the requirements of Statement of Financial Accounting Standards (SFAS) No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities. Due to the financing company's ability to require us to repurchase accounts sold to them in the event the account is deemed uncollectible under the terms of the facility, we have classified the amount advanced to us by the financing company as secured liabilities in the balance sheet. At September 30, 2003 a total of $400,000 in U.S. trade receivables had been factored and remained outstanding under this facility. The agreement for the sale of accounts receivable provides for the continuation of the program on a revolving basis and will expire under its current terms during December 2003. As collections reduce previously sold receivables, we may replenish these with new receivables. The risk we bear from bad debt losses on U.S. trade receivables sold is retained by us since we hold a retained interest in the sold receivables. We have addressed this risk in our allowance for doubtful accounts. However, we do not believe we will incur any financial loss for receivables sold under this facility. Net discounts recognized on sales of receivables are

calculated at one percentage point per fifteen day period the factored invoices are outstanding with the financing company and are included in interest expense in the consolidated statements of operations. Such discounts totaled $2,500 for the three months ended September 30, 2003.

5. INVENTORY

The components of net inventory are as follows:

	SEPTEMBER 30, 2003 (UNAUDITED)	DECEMBER 31, 2002
Materials and component parts	$ 677,450	$ 760,540
Work in process	-	59,888
Finished goods	489,537	371,490
	$ 1,166,987	$ 1,191,918

6. INTANGIBLE ASSETS

The major classes of intangible assets are as follows:

	SEPTEMBER 30, 2003 (UNAUDITED)		DECEMBER 31,	
	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	GROSS CARRYING AMOUNT	A AM
Patents and trademarks	$3,144,100	$ 615,408	$3,129,031	$
Non-compete agreements	584,516	259,357	584,516	
Acquired technology	237,271	60,300	237,271	
Total	$3,965,887	$ 935,065	$3,950,818	$

The estimated future amortization expenses for the next five fiscal years are as follows:

	ESTIMATED AMORTIZATION EXPENSE

For the year ended 12/31/2004	$ 420,072
For the year ended 12/31/2005	416,432
For the year ended 12/31/2006	262,108
For the year ended 12/31/2007	230,928
For the year ended 12/31/2008	203,150

7. DEBT FINANCING

During April 2003, we completed a loan agreement with our President and CEO, David Bupp. Under the terms of the agreement, Mr. Bupp advanced us $250,000. Interest accrues on the note at 8.5% per annum, payable monthly, and repayment of the note is due on June 30, 2004. In consideration for the loan, we issued Mr. Bupp 375,000 warrants to purchase our common stock at an exercise price of $0.13 per share. The warrants were recorded at their estimated relative fair value of $32,000 along with a corresponding discount to the face amount of the note. The discount is being amortized into interest expense over the 15-month term of the note.

Also during April 2003, we completed a convertible loan agreement with an outside investor for an additional $250,000. Under the terms of the agreement, interest accrues on the note at 9.5% per annum, payable monthly, and repayment of the note is due on June 30, 2004. In consideration for the loan, we issued the investor 500,000 warrants to purchase our common stock at an exercise price of $0.13 per share. Also, the outside investor's note is convertible, at the option of the investor, into our common stock beginning on July 1, 2003. Half of the principal is convertible into common stock at a 15% discount to the 20-day average market price preceding the conversion, but in no case greater than a $0.20 ceiling conversion price or less than a $0.10 floor conversion price. The remaining half of the principal is also convertible at a 15% discount to a 20-day average market price preceding the conversion, subject only to the $0.10 floor conversion price. The warrants were recorded at their estimated relative fair value of $41,000 along with a corresponding discount to the face amount of the note. In addition, the beneficial conversion feature of the note was recorded at its estimated fair value of $41,000 along with an additional corresponding discount to the face value of the note. The discounts are being amortized into interest expense over the 15-month term of the note.

8. PRODUCT WARRANTY

We generally warrant our gamma detection products against defects in design, materials, and workmanship for a period of one year from the date of sale to the end customer. Our accrual for warranty expenses is adjusted periodically to reflect actual experience. The primary marketing partner of our gamma detection devices, Ethicon Endo-Surgery, Inc. (EES), a Johnson and Johnson company, also reimburses us for a portion of warranty expense incurred based on end customer sales they make during a given fiscal year. We generally warrant our blood flow products, with the exception of ultrasound probes, for one year from the date of sale to the end customer.

The activity in the warranty reserve account for the three-month and nine-month periods ended September 30, 2003 and 2002 are as follows:

	THREE MONTHS ENDED	NINE

	SEPTEMBER 30,		S
	2003	2002	2003
Warranty reserve at beginning of period	$ 58,000	$ 70,000	$ 35,000
Provision for warranty claims and changes in reserve for warranties	(4,914)	(8,669)	31,615
Costs charged against the reserve, net	(86)	(21,331)	(13,615
Warranty reserve at end of period	$ 53,000	$ 40,000	$ 53,000

9. EQUITY

A. STOCK OPTIONS AND RESTRICTED STOCK. During the first nine months of 2003, the Board of Directors granted options to employees and certain non-employee directors to purchase 780,000 shares of common stock, exercisable at an average price of $0.15 per share, vesting over three years. As of September 30, 2003, we have 2.8 million options outstanding under three stock option plans. Of the outstanding options, 1.4 million options have vested as of September 30, 2003, at an average exercise price of $0.71 per share.

The following table illustrates the effect on net loss and net loss per share if compensation cost for our stock-based compensation plans had been determined based on the fair value at the grant dates for awards under those plans consistent with SFAS No. 123, Accounting for Stock-Based Compensation:

	THREE MONTHS ENDED SEPTEMBER 30,	
	2003	2002
Net loss, as reported	$ (659,114)	$(1,082,742)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	(39,997)	(63,750)
Pro forma net loss	$ (699,111)	$(1,146,492)
Net loss per common share:		
As reported (basic and diluted)	$ (0.02)	$ (0.03)
Pro forma (basic and diluted)	$ (0.02)	$ (0.03)

	NINE MONTHS ENDED SEPTEMBER 30,	
	2003	2002
Net loss, as reported	$(1,217,054)	$(2,799,027)
Add: Total stock-based employee compensation expense included in reported net loss	39,990	--
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	(164,970)	(215,972)
Pro forma net loss	$(1,342,034)	$(3,014,999)
Net loss per common share:		
As reported (basic and diluted)	$ (0.03)	$ (0.08)
Pro forma (basic and diluted)	$ (0.03)	$ (0.08)

During the first quarter of 2003, we vested 310,000 shares of previously restricted stock related to new or amended employment agreements of three of our officers. We recognized $39,990 of compensation expense related to this in the first quarter of 2003.

B. SALES OF COMMON STOCK. In November of 2001, we entered into a common stock purchase agreement with Fusion Capital Fund II, LLC (Fusion) under which we may require Fusion to purchase common stock up to a daily base amount of $12,500, subject to the sale and floor pricing terms outlined in the agreement. During the third quarter, we sold Fusion a total of 453,869 shares of common stock and realized proceeds of $138,000. In addition, we issued Fusion another 6,221 shares of common stock for commitment fees due to Fusion related to the sales of our common stock to them during the third quarter.

10. SEGMENT AND SUBSIDIARY INFORMATION

We own or have rights to intellectual property involving two primary types of medical device products, including gamma detection instruments currently used primarily in the application of intraoperative lymphatic mapping (ILM), and blood flow measurement devices.

The information in the following table is derived directly from each segment's internal financial reporting used for corporate management purposes. Selling, general and administrative costs and other income, including amortization, interest and other costs that relate primarily to corporate activity, are not currently allocated to the operating segments for financial reporting purposes.

($ AMOUNTS IN THOUSANDS)	GAMMA	BLOOD

THREE MONTHS ENDED SEPTEMBER 30, 2003	DETECTION	FLOW	UNALLOCATED
Net sales:			
United States(1)	$ 900	$ --	$ --
International	4	24	--
License and other revenue	258	--	--
Research and development expenses	199	310	--
Selling, general and administrative expenses	--	--	755
Income (loss) from operations(2)	476	(297)	(755)
Other income	--	--	(83)
THREE MONTHS ENDED SEPTEMBER 30, 2002			
Net sales:			
United States(1)	$ 573	$ --	$ --
International	2	--	--
License and other revenue	345	--	--
Research and development expenses	248	313	--
Selling, general and administrative expenses	--	--	832
Income (loss) from operations(2)	51	(313)	(832)
Other income	--	--	11

($ AMOUNTS IN THOUSANDS) NINE MONTHS ENDED SEPTEMBER 30, 2003	GAMMA DETECTION	BLOOD FLOW	UNALLOCATED
Net sales:			
United States(1)	$ 3,636	$ --	$ --
International	8	225	--
License and other revenue	746	--	--
Research and development expenses	469	896	--
Selling, general and administrative expenses	--	--	2,231
Income (loss) from operations(2)	1,892	(755)	(2,231)
Other income	--	--	(123)
NINE MONTHS ENDED SEPTEMBER 30, 2002			
Net sales:			
United States(1)	$ 2,154	$ --	$ --
International	62	--	--
License and other revenue	1,029	--	--
Research and development expenses	744	1,055	--
Selling, general and administrative Expenses	--	--	2,407
Income (loss) from operations(2)	637	(1,055)	(2,407)
Other income	--	--	26

(1) All sales to EES are made in the United States. EES distributes the product globally through its international affiliates.

(2) Income (loss) from operations does not reflect the allocation of selling, general and administrative costs to the operating segments.

11. SUBSEQUENT EVENTS

Subsequent to September 30, 2003, we executed common stock purchase agreements with third parties for the purchase of 12.2 million shares of our common stock at a price of $0.23 per share for net proceeds of $2.5 million. In addition, we agreed to issue the purchasers warrants to purchase 6.1 million shares of common stock at an exercise price of $0.28 per share and agreed to issue the placement agents warrants to purchase 1.6 million shares of our common stock at similar terms. All warrants to be issued in connection with the transaction expire five years from the date of issuance.

12. NEW ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 143, Accounting for Asset Retirement Obligations. SFAS 143 requires us to record the fair value of an asset retirement obligation as a liability in the period in which we incur a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development, and/or normal use of the assets. We are also required to record a corresponding asset that is depreciated over the life of the asset. Subsequent to the initial measurement of the asset retirement obligation, the obligation will be adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. We adopted SFAS 143 on January 1, 2003. The adoption of SFAS 143 did not have a material effect on our financial statements.

In July 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. SFAS 146 requires us to disclose information about our exit and disposal activities, the related costs, and changes in those costs in the notes to the interim and annual financial statements that include the period in which an exit or disposal activity is initiated. SFAS 146 requires us to disclose, for each reportable segment, the exit or disposal activity costs incurred in the period and the cumulative amount incurred, net of any changes in the liability, with an explanation of the reasons for the changes. SFAS 146 also requires us to disclose the total amount of costs expected to be incurred in connection with the exit or disposal activity. The new requirements are effective prospectively for exit and disposal activities initiated after December 31, 2002. The adoption of SFAS 146 did not have a material impact on our financial statements.

In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others, an interpretation of FASB Statement Nos. 5, 57 and 107 and a rescission of FASB Interpretation No. 34. This Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. The Interpretation also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The initial recognition and measurement provisions of the Interpretation are applicable to guarantees issued or modified after December 31, 2002, and did not have a material effect on our financial statements. The disclosure requirements are effective for financial statements of interim and annual periods ending after December 15, 2002.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity. The Statement requires issuers to classify as liabilities (or assets in some circumstances) three classes of freestanding financial instruments that embody obligations for the issuer. Generally, the Statement is effective for financial instruments entered into or modified after May 31, 2003 and is otherwise effective at the beginning of the first interim period beginning after June 15, 2003. We adopted the provisions of the Statement on July 1, 2003. The adoption of SFAS No. 150 did not have a material effect on our financial statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

Revenue for the first nine months of 2003 increased $1.4 million or 42% to $4.6 million from $3.2 million for the same period in 2002. Major expense categories as a percentage of net sales decreased in the first nine months of 2003 as compared to the same period in 2002, due primarily to the increase in net sales coupled with a lower overall cost structure for our gamma business. Research and development expenses, as a percentage of net sales, decreased to 35% during the first nine months of 2003 from 81% during the same period in 2002. Selling, general and administrative expenses, as a percentage of net sales, decreased to 58% during the first nine months of 2003 from 109% during the same period in 2002. Controlling our costs remains a high priority for us as we endeavor to return to profitability. We expect these major expense categories, as a percentage of net sales, to continue to be lower overall for 2003 as compared to 2002 consistent with results year-to-date; however, this decrease will depend on our success in achieving additional commercial sales of our blood flow products and continuing positive trends for our gamma detection products.

Three Months Ended September 30, 2003 and 2002

Net Sales and Margins. Net sales increased $353,000, or 61%, to $928,000 during the third quarter of 2003 from $575,000 during the same period in 2002. Gross margins on net sales increased to 46% of net sales for the third quarter of 2003 compared to a negative gross margin of 8% of net sales for the same period in 2002. During the third quarter of 2002, we recorded an inventory impairment charge of $214,000 related to our BlueTip(R) probe product. This charge adversely affected our gross margins for the quarter by 37 percentage points.

Approximately $329,000 of the increase in net sales was the result of increased revenue related to our gamma detection products with the remaining $24,000 generated from our blood flow products. We had no revenues from blood flow products during the same period in 2002. Of the increased revenue from gamma detection products, approximately 33% was due to increased prices realized on our neo2000(R) control unit and 14mm probes, with approximately 54% due to increased sales volumes of these products. The remaining 13% was due to various changes in other products and product mix. The price at which we sell our gamma detection products to EES is based on a percentage of the global average sales price (ASP) received by EES on sales of Neoprobe products to end customers, subject to a minimum floor price. During the third quarter of 2002, we recorded revenue at the floor sales prices per the distribution agreement due to

perceived weakness in the global ASP. However, beginning in the third quarter of 2002 we began to note a strengthening in global ASP. This trend in ASP, coupled with the favorable effects of the Euro exchange rate on our sales prices to EES, has continued through the third quarter of 2003 such that management believed it was more appropriate to record revenue for the third quarter of 2003 at the estimated 2003 sales price calculated consistently with prior periods per the terms of the distribution agreement. The increase in gross margins was primarily due to the higher recorded revenue per gamma detection system combined with lower capitalized internal manufacturing costs as a result of headcount reductions that contributed to lower average costs.

License and Other Revenue. License and other revenue in the third quarters of 2003 and 2002 included $200,000 from the pro-rata recognition of license fees related to the distribution agreement with EES and $58,000 and $145,000, respectively, from the reimbursement by EES of certain product development costs.

Research and Development Expenses. Research and development expenses decreased $53,000, or 9%, to $509,000 during the third quarter of 2003 from $561,000 during the same period in 2002. The decrease was primarily due to lower compensation costs resulting from headcount reductions of gamma product line personnel in the third and fourth quarters of 2002. The third quarter of 2003 also included $25,000 of license fees related to the Lymphoseek(TM) targeting agent.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased $77,000, or 9%, to $755,000 during the third quarter of 2003 from $832,000 during the same period in

2002. The decrease was primarily due to $80,000 in impairment expense related to production equipment and intellectual property that we did not believe had ongoing value to our business recorded in the third quarter of 2002 and lower compensation costs resulting from headcount reductions of gamma product $64,000 in line personnel in the third and fourth quarters of 2002, offset by increases in certain overhead costs such as professional services and bad debts and increased selling, general and administrative expenses incurred in the operation and support of Cardiosonix.

Other Income (Expenses). Other income decreased $95,000 resulting in other expenses of $83,000 during the third quarter of 2003 compared to other income of $11,000 during the same period in 2002. Other expenses during the third quarter of 2003 consisted primarily of interest expense, amortized discount on our notes payable and interest expense related to the financing of our accounts receivable. Other income during the third quarter of 2002 consisted primarily of interest income. Our interest income decreased because we maintained a lower balance of cash and investments during the third quarter of 2003 as compared to the same period in 2002.

Nine Months Ended September 30, 2003 and 2002

Net Sales and Margins. Net sales increased $1.7 million, or 75%, to $3.9 million during the first nine months of 2003 from $2.2 million during the same period in 2002. Gross margins on net sales increased to 45% of net sales for the first nine months of 2003 compared to 16% of net sales for the same period in 2002. During the third quarter of 2002, we recorded an inventory impairment charge of $214,000 related to our BlueTip probe product. This charge adversely affected our gross margins for the nine months ended September 30, 2002 by 29 percentage points.

Approximately $1.4 million of the increase in net sales was the result of increased revenue related to our gamma detection products with the remaining $225,000 generated from our blood flow products. We had no revenues from blood flow products during the same period in 2002. Of the increased revenue from gamma detection products, approximately 35% was due to increased prices realized on our neo2000 control unit and 14mm probes, with approximately 49% due to increased sales volumes of these products. The remaining 16% was due to various changes in other products and product mix. The price at which we sell our gamma detection products to EES is based on a percentage of the global ASP received by EES on sales of Neoprobe products to end customers, subject to a minimum floor price. During the first nine months of 2002, we recorded revenue at the floor sales prices per the distribution agreement due to perceived weakness in the global ASP. However, beginning in the third quarter of 2002, we began to note a strengthening in global ASP. This trend in ASP, coupled with the favorable effects of the Euro exchange rate on our sales prices to EES, has continued through the first nine months of 2003 such that management believed it was more appropriate to record revenue for the first nine months of 2003 at the estimated 2003 sales price calculated consistently with prior periods per the terms of the distribution agreement. The increase in gross margins was primarily due to the higher recorded revenue per gamma detection system combined with lower capitalized internal manufacturing costs as a result of headcount reductions that contributed to lower average costs.

License and Other Revenue. License and other revenue in the first nine months of 2003 and 2002 included $600,000 from the pro-rata recognition of license fees related to the distribution agreement with EES and $146,000 and $429,000, respectively, from the reimbursement by EES of certain product development costs.

Research and Development Expenses. Research and development expenses decreased $433,000, or 24%, to $1.4 million during the first nine months of 2003 from $1.8 million during the same period in 2002. The decrease was primarily due to lower compensation costs resulting from headcount reductions of gamma product line personnel in the third and fourth quarters of 2002, coupled with decreased use of external design consultants and decreased prototype expenses related to the blood flow product line. The first nine months of 2003 and 2002 also included $25,000 and $50,000, respectively, of license fees related to the Lymphoseek targeting agent.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased $177,000, or 7%, to $2.2 million during the first nine months of 2003 from $2.4 million during the same

period in 2002. The decrease was primarily due to $193,000 in lower compensation costs resulting from headcount reductions of gamma product line personnel in the third and fourth quarters of 2002, offset by increases in certain overhead costs such as bad debts and insurance and increased selling, general and administrative expenses incurred in the operation and support of Cardiosonix. Selling, general and administrative expenses in the first nine months of 2003 and 2002 included $30,000 and $125,000, respectively, in impairment expense related to production equipment and intellectual property that we did not believe had ongoing value to our business. Selling, general and administrative expenses in the first nine months of 2002 also included $79,000 for the transfer of manufacturing of certain components of the neo2000 gamma detection system to a new contract manufacturer.

Other Income (Expenses). Other income decreased $150,000 resulting in other

expenses of $123,000 during the first nine months of 2003 compared to other income of $26,000 during the same period in 2002. Other expenses during the first nine months of 2003 consisted primarily of interest expense, amortized discount on our notes payable and interest expense related to the financing of our accounts receivable. Other income during the first nine months of 2002 consisted primarily of interest income. Our interest income decreased because we maintained a lower balance of cash and investments during the first nine months of 2003 as compared to the same period in 2002.

LIQUIDITY AND CAPITAL RESOURCES

Operating Activities. Cash used in operations decreased $1.6 million to $919,000 during the first nine months of 2003 from $2.5 million during the same period in 2002. Working capital decreased $1.1 million to $79,000 at September 30, 2003 as compared to $1.1 million at December 31, 2002. The current ratio decreased to 1:1.0 at September 30, 2003 from 1:1.6 at December 31, 2002. The decrease in working capital was primarily related to cash used to fund blood flow development activities offset slightly by net changes in other working capital components.

Cash balances decreased to $423,000 at September 30, 2003 from $701,000 at December 31, 2002, primarily due to the requirements of supporting the operations of Cardiosonix, offset by the cash generated from the sale of accounts receivable, debt financing arrangements, sales of common stock and the increased net sales experienced during the first nine months of 2003.

Accounts receivable increased to $1.1 million at September 30, 2003 from $746,000 at December 31, 2002 due primarily to greater sales in September 2003 than December 2002. During the third quarter of 2003, we entered into an accounts receivable financing facility under which certain of our U.S. accounts receivable are factored at an advance rate of 80% and with recourse to a third party financing company. At September 30, 2003 U.S. trade receivables of $400,000 had been factored and remained outstanding under this facility. As such, the accounts receivable balance we have disclosed at September 30, 2003 includes the $400,000 in factored accounts receivable. The agreement for the sale of accounts receivable provides for the continuation of the program on a revolving basis and will expire under its current terms until December 2003. As collections reduce previously sold receivables, we may replenish these with new receivables. However, as the financing arrangement is being accounted for as a secured financing, it does not affect the overall level of accounts receivable disclosed on our balance sheet. As such, we expect overall receivable levels will continue to fluctuate in 2003 depending on the timing of purchases and payments by EES. However, on average, we expect accounts receivable balances will start to increase commensurate with anticipated increases in sales of blood flow products to our distributors, many of whom are foreign-domiciled entities who typically pay at a slower rate than domestic companies. Such increases, if any, will require the increased use of our cash resources over time.

Inventory levels remained constant at $1.2 million at September 30, 2003 and December 31, 2002. Over the first nine months of 2003, finished goods of gamma detection products have decreased due to greater than originally anticipated demand from EES during the first three quarters of 2003. Gamma-related raw materials have continued to decrease due to usage of certain long-lead gamma detection device components that were built up in prior periods to take advantage of quantity price breaks. These decreases were offset by the build-up of raw material and finished goods inventory related to our blood flow products as we continue market launch preparations. We expect inventory levels to increase slightly during the remainder of 2003.

We estimate that the additional costs to complete planned development activities, respond to initial customer feedback, and support initial marketing efforts for our blood flow products for the year ended December 31, 2003 will approach $2.0 million. We expect the development efforts will continue in 2004 as we respond to additional customer feedback and as we continue to refine the blood flow products.

Investing Activities. Cash used in investing activities decreased to $84,000 during the first nine months of 2003 from $1.8 million during the same period in 2002. During February and March 2002, we invested in $2.5 million of available-for-sale securities. Capital expenditures during the first nine months of 2003 were primarily purchases of production tools and equipment related to the manufacture of our Quantix line of blood flow measurement equipment. Capital expenditures during the first nine months of 2002 were split between purchases of production tools and equipment and technology infrastructure. Capital needs for 2003 are expected to remain below 2002 as we have deferred the more significant expenditures originally anticipated related to blood flow product production until 2004 following the transfer of primary manufacturing activities for the blood flow products to a contract manufacturer.

Financing Activities. Financing activities provided $725,000 in cash in the first nine months of 2003 versus $1.8 million during the same period in 2002. Proceeds from sales of accounts receivable were $320,000 during the first nine months of 2003. Payments of notes payable were $11,000 higher during the first nine months of 2003 as compared to the same period in 2002 due to the increased cost of financed insurance.

On November 19, 2001, we entered into a common stock purchase agreement with an investment fund, Fusion Capital Fund II, LLC (Fusion) for the issuance and purchase of our common stock. Under the stock purchase agreement, Fusion committed to purchase up to $10 million of our common stock over a forty-month period that commenced in May 2002. A registration statement registering for resale up to 5 million shares of our common stock became effective on April 15, 2002. Under the terms of the agreement, we can request daily drawdowns, subject to a daily base amount currently set at $12,500. The number of shares we are to issue to Fusion in return for that money will be based on the lower of (a) the closing sale price for our common stock on the day of the draw request or (b) the average of the three lowest closing sales prices for our common stock during a twelve day period prior to the draw request. However, no shares may be sold to Fusion at lower than a floor price currently set at $0.30, which may be reduced by us, but in no case below $0.20 without Fusion's prior consent. Upon execution of the common stock purchase agreement, we issued 449,438 shares of our common stock to Fusion as a commitment fee. During the third quarter of 2003, we sold Fusion a total of 453,869 shares of common stock and realized proceeds of $138,000. In addition, we issued Fusion another 6,221 shares of common stock for commitment fees due to Fusion related to the sales of our common stock to them during the quarter.

During April 2003, we completed a bridge loan agreement with our President and CEO, David Bupp. Under the terms of the agreement, Mr. Bupp advanced us $250,000. Interest accrues on the note at 8.5% per annum, payable monthly, and the note is due on June 30, 2004. In consideration for the loan, we issued Mr. Bupp 375,000 warrants to purchase our common stock at an exercise price of $0.13 per share.

During April 2003, we also completed a convertible bridge loan agreement with an outside investor for an additional $250,000. Under the terms of the agreement, interest accrues on the note at 9.5% per annum, payable monthly, and the note is due on June 30, 2004. In consideration for the loan, we issued the investor 500,000 warrants to purchase our common stock at an exercise price of $0.13 per share. The outside investor's note is also convertible, at the option of the

investor, into our common stock beginning on July 1, 2003. Half of the principal is convertible into common stock at a 15% discount to the 20-day average market price preceding the conversion, but in no case greater than a $0.20 ceiling conversion price or less than a $0.10 floor conversion price. The remaining half of the principal is also convertible at a 15% discount to a 20-day average market price preceding the conversion, subject only to the $0.10 floor conversion price.

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During the second quarter of 2003, we engaged the services of an investment banking firm to assist us in raising capital. In exchange for their services, we agreed to pay the firm a monthly retainer of $10,000, half payable in cash and half payable in common stock, and we agreed to pay them a percentage of the funds received, if any, as a success fee, on funds received from parties they introduced us to. We terminated the agreement with the investment banking firm effective September 23, 2003, and agreed to issue them 150,943 shares and warrants to purchase 78,261 shares of common stock in full satisfaction of our obligation under the agreement and in exchange for their assistance in arranging the accounts receivable funding source. We will owe this firm a potential success fee for a period of time if we complete an investment transaction with any of the potential investors who were introduced to us by the firm.

To date in the fourth quarter of 2003, we have executed common stock purchase agreements with third parties introduced to us by a different investment banking firm for the purchase of 12.2 million shares of our common stock at a price of $0.23 per share for net proceeds of $2.5 million. In addition, we agreed to issue the purchasers warrants to purchase 6.1 million shares of common stock at an exercise price of $0.28 per share and agreed to issue the placement agents warrants to purchase 1.6 million shares of our common stock at similar terms. All warrants to be issued in connection with the transaction expire five years from the date of issuance.

Our future liquidity and capital requirements will depend on a number of factors, including our ability to raise additional capital in a timely manner through additional investment, expanded market acceptance of our current products, our ability to complete the commercialization of new products such as our blood flow product line, our ability to monetize our investment in non-core technologies, our ability to obtain milestone or development funds from potential development and distribution partners, regulatory actions by the U.S. FDA and other international regulatory bodies, and intellectual property protection.

Throughout 2002 and the first three quarters of 2003, we made modifications to our operating plan and reduced or delayed planned development and market-support expenditures due primarily to our delayed ability to secure additional sources of financing. We believe our inability to raise financing did not significantly impact our ability to meet the operational milestones we had set for the first half of 2003; however, we believe the effects of the delay in raising financing, coupled with the delay in receiving 510(k) marketing clearance for the Quantix/OR until September 2003, began to hamper our marketing and commercialization efforts for blood flow products during the third quarter. Planned resources to support marketing and post-launch development activities were delayed until the completion of the recent financing activities. We are now in the process of re-assessing the timing of our goals and objectives for the remainder of 2003 and for calendar year 2004 but believe we now have adequate capital to assure that we can properly support our business goals and objectives over that period. Our near-term priorities are the thought leader evaluation and launch of the Quantix products in the U.S. and the continued support of such activities ongoing in other markets. In addition, we are considering ways to re-invigorate development of other products in our pipeline. We cannot assure

you that we will be able to achieve significant product revenues from our current or potential new products. We also cannot assure you that we will achieve profitability again in 2004.

CRITICAL ACCOUNTING POLICIES

Revenue Recognition Related to Net Sales. We currently generate revenue primarily from sales of our gamma detection products; however, sales of blood flow products constituted approximately 6% of total revenues for the first nine months of 2003 and are expected to increase in the future. We generally recognize sales revenue related to sales of our products when the products are shipped and the earnings process has been completed. Our customers have no right to return products purchased in the ordinary course of business. However, in cases where product is shipped but the earnings process is not yet completed, revenue is deferred until it has been determined that the earnings process has been completed. We also generate revenue from the service and repair of out-of-warranty products. Fees charged for service and repair on products not covered by an extended service agreement are recognized on completion of the service process when the serviced or repaired product has been returned to the customer. Fees charged for service or repair of products covered by an extended

warranty agreement are deferred and recognized as revenue ratably over the life of the extended service agreement. The prices we charge our primary customer, EES, related to sales of products are subject to retroactive annual adjustment based on a fixed percentage of the actual sales prices achieved by EES on sales to end customers made during each fiscal year. To the extent that we can reasonably estimate the end-customer prices received by EES, we record sales to EES based upon these estimates. If we are unable to reasonably estimate end customer sales prices related to certain products sold to EES, we record revenue related to these product sales at the minimum (i.e., floor) price provided for under our distribution agreement with EES. During the first nine months of 2002, we recorded revenue at the floor sales prices per the distribution agreement due to perceived weakness in the global ASP. However, during the second half of 2002, we began to note a strengthening in global ASP. This trend in ASP has continued in 2003, to the point that management believed it was more appropriate to record revenue for the first nine months of 2003 at the estimated 2003 sales price calculated consistently with prior periods per the terms of the distribution agreement.

Impairment or Disposal of Long-Lived Assets. We account for long-lived assets in accordance with the provisions of SFAS No. 144. This Statement requires that long-lived assets and certain identifiable intangibles be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net undiscounted cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. As of September 30, 2003, the most significant long-lived assets on our balance sheet relate to assets recorded in connection with the acquisition of Cardiosonix and gamma detection device patents related to ILM. The recoverability of these assets is based on the financial projections and models related to future sales of Cardiosonix' products which have yet to begin and the continuing success of our gamma detection product line. As such, these assets could be subject to significant adjustment should the Cardiosonix technology not be successfully commercialized or the sales amounts in our current projections not be realized.

FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 (the Act) provides a safe harbor for forward-looking statements made by or on behalf of our company. From time to time, our representatives and we may make written or verbal forward-looking statements, including statements contained in this report and other company filings with the SEC and in our reports to stockholders. Statements that relate to other than strictly historical facts, such as statements about our plans and strategies, expectations for future financial performance, new and existing products and technologies, and markets for our products are forward-looking statements within the meaning of the Act. Generally, the words "believe," "expect," "intend," "estimate," "anticipate," "will" and other similar expressions identify forward-looking statements. The forward-looking statements are and will be based on our then-current views and assumptions regarding future events and operating performance, and speak only as of their dates. Investors are cautioned that such statements involve risks and uncertainties that could cause actual results to differ materially from historical or anticipated results due to many factors including, but not limited to, our limited revenues, accumulated deficit, future capital needs, uncertainty of capital funding, dependence on limited product line and exclusive distributor, uncertainty of market acceptance, competition, limited marketing and manufacturing experience, and other risks detailed in our most recent Annual Report on Form 10-KSB and other SEC filings. We undertake no obligation to publicly update or revise any forward-looking statements.

ITEM 3. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and

procedures are effective to provide reasonable assurance that our disclosure controls and procedures will timely alert them to material information required to be included in our periodic SEC reports. It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and we cannot assure you that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

As of the end of the period covered by this report, there has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Securities Exchange Act of 1934, as amended) during the quarter to which this report relates that has materially affected or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(A) EXHIBITS

3.1	Restated Certificate of Incorporation of Neoprobe Corporation, as corrected February 18, 1994 and as amended June 27, 1994, July 25, 1995, June 3, 1996, March 17, 1999, May 9, 2000 and June 13, 2003.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer of Periodic Financial Reports pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.
32.2	Certification of Chief Financial Officer of Periodic Financial Reports pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.

(B) REPORTS ON FORM 8-K

On August 13, 2003, we filed a Current Report on Form 8-K (dated July 31, 2003) with the Securities and Exchange Commission pursuant to Item 12 (under Item 9) in connection with our July 31, 2003, press release announcing our consolidated financial results for the second quarter ended June 30, 2003.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NEOPROBE CORPORATION
Dated: November 14, 2003

By: /s/ DAVID C. BUPP

David C. Bupp
President and Chief Executive Officer
(duly authorized officer; principal executive officer)

By: /s/ BRENT L. LARSON

Brent L. Larson
Vice President, Finance and Chief Financial Officer
(principal financial and accounting officer)