NeuroMetrix, Inc.
Form 424B4
July 22, 2004

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Filed Pursuant to Rule 424(b)(4)
Registration No. 333-115440

3,000,000 Shares

NEUROMETRIX, INC.

Common Stock

We are offering 3,000,000 shares of our common stock. We have granted the underwriters the right to purchase up to an additional 450,000 shares to cover over-allotments.

This is our initial public offering and no public market currently exists for our shares. The public offering price is $8.00 per share.

Our common stock has been approved for quotation on the Nasdaq National Market under the symbol "NURO."

Investing in our common stock involves risks. See "Risk Factors" beginning on page 7.

	Per Share	Total
Public Offering Price	$ 8.00	$ 24,000,000
Underwriting Discount	$ 0.56	$ 1,680,000
Proceeds to NeuroMetrix, Inc. (before expenses)	$ 7.44	$ 22,320,000

Neither the Securities and Exchange Commission nor any state securities regulators have approved or disapproved these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The underwriters expect to deliver the shares to purchasers on July 27, 2004.

PUNK, ZIEGEL & COMPANY WR HAMBRECHT + CO

The date of this prospectus is July 22, 2004.

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You should rely only on the information contained in this prospectus. We have not, and the underwriters have not, authorized anyone to provide you with information that is different. This prospectus is not an offer to sell, nor is it seeking an offer to buy, these securities in any jurisdiction where the offer or sale of these securities is not permitted. You should assume that the information contained in this prospectus is accurate as of the date on the front of this prospectus only. Our business, financial condition, results of operations and prospects may have changed since that date.

Our estimates of market share and market size in this prospectus are based on, in certain cases, public disclosure, industry and trade publications and reports prepared by third parties, which we believe to be reliable but have not independently verified.

PROSPECTUS SUMMARY

This summary only highlights the more detailed information appearing elsewhere in this prospectus. As this is a summary, it does not contain all of the information that you should consider in making an investment decision. You should read this entire prospectus carefully, including the information under "Risk Factors" and our financial statements and the related notes included elsewhere in this prospectus, before you decide to invest in our common stock. In this prospectus, unless the context requires otherwise, "NEUROMetrix," "we," "us," "our" and "our company" refer to NeuroMetrix, Inc., a Delaware corporation, and its predecessor entities for the applicable periods, considered as a single enterprise.

Our Business

NEUROMetrix is a medical device company that designs, develops and sells proprietary products used to diagnose neuropathies. Neuropathies are diseases of the peripheral nerves and parts of the spine that frequently are caused by or associated with diabetes, low back pain and carpal tunnel syndrome, as well as other clinical disorders. We believe that our neuropathy diagnostic system, the NC-stat System, is unique in its ability to provide primary care and specialist physicians with objective information that aids in the rapid and accurate diagnosis of neuropathies at the point of service, that is, in the physician's office at the time the patient is examined. Diagnostic procedures performed with the NC-stat System can generate revenue for the physician and save money for the patient and third-party payer. We believe that the benefits of the NC-stat System will lead to its adoption by a significant number of primary care and specialist physicians, who historically have not had the ability to diagnose these neuropathies at the point of service. This in turn should result in more frequent testing of patients at risk for neuropathies and earlier diagnoses of neuropathies, resulting in improved clinical and economic outcomes in many cases. The NC-stat System has been on the market since May 1999 and is presently used in over 1,800 physician's offices, clinics and other health care facilities in the United States. We hold issued utility patents covering a number of important aspects of our NC-stat System. In 2003, we more than doubled our revenues from the prior year, generating $9.2 million in revenues. In the first quarter of 2004, we generated total revenues of $3.0 million, compared to $1.6 million in the first quarter of 2003. Our gross margin percentage in the first quarter of 2004 was 72.7%, and 89.0% of our revenues were attributable to sales of the disposable biosensors that physicians use to perform tests with the NC-stat System. We incurred net losses of approximately $4.8 million in 2002 and $3.7 million in 2003. In the first quarter of 2004, we incurred a net loss of $780,000. Since our inception, more than 230,000 patients have been tested with the NC-stat System.

Our Opportunity

The sensitivity of the nervous system to metabolic and mechanical damage, compounded by its limited regenerative ability, creates a robust market opportunity for a medical device that can assist in point-of-service diagnoses of neuropathies in a manner that is cost-effective for the patient and third-party payer. We estimate that there are approximately two million traditional nerve conduction study and needle electromyography, or NCS/nEMG, procedures currently performed each year in the United States. We believe that use of traditional NCS/nEMG procedures is limited by: (1) the need to obtain a referral to a neurologist for the procedure and the resulting delay in availability of diagnostic information; (2) the inconvenience and discomfort of these procedures for the patient; and (3) the expense to the patient and third-party payer. We anticipate that the advantages and increased availability of the NC-stat System will significantly increase the overall number of nerve conduction studies performed. Based on our analysis of current data, we estimate that the potential market size for the NC-stat System in the diabetes, low back pain and carpal tunnel syndrome markets in the aggregate could be as great as 9.5 million annual patient tests, or over $1.0 billion annually for our disposable NC-stat biosensors, in the United States. However, market size is difficult to predict, and we cannot assure you that our estimates will prove to be correct. We believe that additional applications of the

NC-stat System, including the clinical assessment of patients with neuropathies caused by or associated with other clinical disorders, could further increase this potential market size. Additionally, although we have not yet quantified the size of the market, we believe a significant international market opportunity exists for the NC-stat System.

Our Solution

We believe that the NC-stat System represents a significant advance in neurological diagnostics and offers an improvement over traditional diagnostic methods by:

- Facilitating performance of nerve conduction studies at the point of service;
- Providing a cost-effective diagnostic tool;
- Requiring minimal capital investment;
- Automating much of the procedure, making it simple to operate; and
- Using a patient-friendly, non-invasive procedure.

These benefits address a number of the limitations of the traditional diagnostic methods for assessing patients with or at risk for neuropathies, because these traditional methods typically:

- Require a referral to a neurologist;
- Are expensive to perform;
- Require the use of costly, highly technical equipment; and
- Are uncomfortable and painful for the patient.

We believe the benefits of the NC-stat System will expand the use of nerve conduction studies to include at-risk individuals who currently may not be tested because of these limitations. Additionally, new treatments for neuropathies that are under development, such as those for diabetic peripheral neuropathy, may create increased demand for nerve conduction studies to identify patients in need of these treatments. We therefore believe a significant opportunity exists to broaden the market for nerve conduction studies. By incorporating nerve conduction studies early in patients' care episodes through the use of the NC-stat System, we expect better long-term clinical and economic outcomes will emerge because of the ability to implement preventive care measures based on accurate early diagnostic results.

Our Strategy

Our goal is to become the leading provider of innovative, proprietary, high margin medical devices that provide comprehensive solutions for the diagnosis and treatment of patients with neuropathies. To achieve this objective, we are pursuing the following business strategies:

- Establish the NC-stat System as a standard of care for nerve conduction studies;
- Expand our sales and marketing efforts;

Focus on primary care physician market;

Continue to strengthen our presence within specific specialty physician markets; and

Continue to introduce new products.

Our Products

We currently market the NC-stat System throughout the United States through a network that consists of 16 regional sales managers and more than 50 independent regional sales agencies employing

a total of more than 250 independent sales representatives. The NC-stat System is comprised of: (1) disposable NC-stat biosensors that are placed on the patient's body; (2) the NC-stat monitor and related components; and (3) the NC-stat docking station, an optional device that enables the physician to transmit data to our onCall Information System. The onCall Information System formulates the data it receives for each test into a detailed report that is sent to the physician via facsimile or e-mail in three to four minutes on average and aids in the physician's diagnosis.

The NC-stat System can be used by primary care and specialist physicians, including neurologists. The complexity and high capital cost of traditional diagnostic methods have limited their use mainly to neurologists. Because of the benefits and advantages of the NC-stat System outlined above, we believe it will be readily adopted by a wide range of physicians. The NC-stat System enables the physician to make rapid and accurate diagnoses that are cost-effective for the patient and third-party payer.

We also believe that we may be able to adapt and extend our core technology to provide minimally invasive approaches to treating neuropathies. In particular, we believe that many neuropathies can be safely and effectively treated if drugs can be delivered near the disease site without damaging the nerve in the process. We are in the early stages of designing a drug delivery system for the minimally invasive treatment of neuropathies by both primary care and specialist physicians.

Risks Affecting Us

Our business is subject to numerous risks, as discussed more fully in the section entitled "Risk Factors" immediately following this prospectus summary. If physicians or other healthcare providers are unable to obtain sufficient reimbursement from third-party healthcare payers for procedures performed using the NC-stat System, the adoption of the NC-stat System and our future product sales will be severely harmed. We may be unable to expand the market for the NC-stat System, or to successfully sell the NC-stat System to primary care physicians for a variety of reasons, which would limit our ability to increase our revenues. We also may not be able to accurately predict the size of the market for our NC-stat System. From inception through March 31, 2004, we have incurred losses every quarter and, as of March 31, 2004, we had an accumulated deficit of approximately $54.0 million. It is possible that we will never generate sufficient revenues from product sales to achieve profitability.

Our Corporate Information

NEUROMetrix was founded in June 1996 by our President & Chief Executive Officer, Shai N. Gozani, M.D., Ph.D. We originally were incorporated in Massachusetts in 1996, and we reincorporated in Delaware in 2001. Our principal offices are located at 62 Fourth Avenue, Waltham, Massachusetts 02451, and our telephone number is (781) 890-9989. Our website address is www.neurometrix.com. We do not incorporate the information on, or accessible through, our website into this prospectus, and you should not consider it part of this prospectus.

NEUROMetrix®, NC-stat® and onCall are trademarks of ours.

Recent Operating Results

Based on our preliminary internal calculations for the second quarter of 2004, we expect revenues in the second quarter of 2004 to be between $4.1 million and $4.3 million and a net loss for the quarter of between $1.3 million and $1.5 million. We expect our net loss for the second quarter to include non-cash stock-based compensation charges of between $700,000 and $800,000. These results are preliminary and subject to revision based upon our review and the finalization of our financial statements for the second quarter of 2004. We cannot assure you that, upon completion of our review and the finalization of our financial statements for the second quarter of 2004, we will not report materially different financial results than those described above.

The Offering

Common stock offered by NEUROMetrix	3,000,000 shares
Common stock outstanding after this offering	11,568,466 shares
Use of proceeds	We expect to receive net proceeds from this offering of $20.7 million after deducting the underwriting discount and estimated offering expenses payable by us. We intend to use the proceeds to expand our sales and marketing activities, to fund research and development relating to potential new products, to repay outstanding debt obligations of approximately $3.1 million, and for general corporate purposes. See "Use of Proceeds."
Nasdaq National Market symbol	NURO

The number of shares of common stock outstanding after this offering is based on 8,568,466 shares outstanding as of June 21, 2004 and excludes:

- 1,012,426 shares of common stock issuable upon the exercise of outstanding stock options as of June 21, 2004 at a weighted average exercise price per share of $4.14;
- 100,000 shares of common stock issuable upon the exercise of an outstanding warrant as of June 21, 2004 at an exercise price per share of $6.00;
- 825,000 shares of common stock to be reserved for future issuance upon the exercise of options available for future grant under our 2004 Stock Option and Incentive Plan; and
- 375,000 shares of common stock to be reserved for future issuance under our 2004 Employee Stock Purchase Plan.

Unless otherwise indicated, the information in this prospectus assumes that the underwriters will not exercise the over-allotment option granted to them by us, and has been adjusted to reflect:

- the filing of our Second Amended and Restated Certificate of Incorporation and the adoption of our Second Amended and Restated By-Laws effective as of July 15, 2004;
- a one-for-four reverse stock split of our common stock effective as of July 15, 2004;
- conversion of all of our outstanding shares of preferred stock into 7,488,758 shares of common stock upon the closing of this offering;
- automatic conversion of the existing warrant to purchase 400,000 shares of Series E-1 preferred stock into a warrant to purchase 100,000 shares of common stock upon the closing of this offering; and
- the filing of our Third Amended and Restated Certificate of Incorporation following the closing of this offering, which is a technical filing made solely to reflect the conversion of all of our outstanding shares of preferred stock into shares of common stock upon the closing of the offering.

Summary Financial Data

The following summary financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Selected Financial Data" and our financial statements and related notes included elsewhere in this prospectus. The summary financial data for the years ended December 31, 2001, 2002 and 2003, and as of December 31, 2002 and 2003, are derived from our audited financial statements included elsewhere in this prospectus. The summary financial data for the three months ended March 31, 2003 and 2004 have been derived from our unaudited financial statements included elsewhere in this prospectus.

	Year Ended December 31,			Three Months Ended March 31,	
	2001	2002	2003	2003	2004
				(Unaudited)	
	(in thousands, except share and per share data)				
Statement of Operations Data:					
Revenues:					
Diagnostic device	$ 782	$ 723	$ 1,303	$ 287	$ 334
Biosensor	2,682	3,502	7,865	1,334	2,696
Total revenues	3,464	4,225	9,168	1,621	3,030
Cost of revenues	1,424	1,370	2,707	477	827
Gross margin	2,040	2,855	6,461	1,144	2,203
Operating expenses:					
Research and development (1)	2,561	2,146	2,397	541	650
Sales and marketing (1)	5,304	2,870	4,768	1,041	1,335
General and administrative (1)	3,228	2,673	2,850	597	855
Total operating expenses	11,093	7,689	10,015	2,185	2,840
Loss from operations	(9,053)	(4,834)	(3,554)	(1,041)	(637)
Interest income (expense), net	336	41	(113)		(143)
Net loss	(8,717)	(4,793)	(3,667)	(1,041)	(780)
Accretion of dividend on redeemable convertible preferred stock	(1,757)	(1,893)	(2,009)	(502)	(534)
Deemed dividend on redeemable convertible preferred stock		(6,873)			(788)
Beneficial conversion feature associated with redeemable convertible preferred stock					(7,051)
Net loss attributable to common stockholders	$ (10,474)	$ (13,559)	$ (5,676)	$ (1,543)	$ (9,153)
Net loss per common share:					
Basic and diluted	$ (10.47)	$ (13.17)	$ (5.46)	$ (1.49)	$ (8.78)
Weighted average basic and diluted common shares outstanding	1,000,323	1,029,210	1,038,817	1,037,007	1,042,990
			$ (0.54)		$ (1.01)

	Year Ended December 31,			Three Months Ended March 31,	
Pro forma basic and diluted net loss per common share (2)					
Shares used in computing pro forma basic and diluted net loss per common share			6,764,884		8,531,748

(1) Non-cash stock-based compensation expense included in these amounts are as follows:

Research and development	$ 8	$ 7	$ 35	$ 4	$ 16
Sales and marketing	15	6	37	7	17
General and administrative	33	37	24	3	12
Total non-cash stock-based compensation	$ 56	$ 50	$ 96	$ 14	$ 45

(2) Pro forma basic and diluted net loss per common share is calculated assuming the conversion of all then-outstanding shares of redeemable convertible preferred stock into shares of common stock.

	As of March 31, 2004	
	Actual	As Adjusted (1)
	(in thousands)	
Balance sheet data:		
Cash and cash equivalents	$ 10,900	$ 31,620
Working capital	12,179	32,899
Total assets	17,079	37,779
Long-term debt and other long-term liabilities	1,933	1,933
Warrants for redeemable convertible preferred stock	450	
Redeemable convertible preferred stock	66,623	
Total stockholders' (deficit) equity	(54,611)	33,182

(1) The as adjusted balance sheet data as of March 31, 2004 gives effect to (a) the conversion of all of our outstanding shares of redeemable convertible preferred stock into an aggregate of 7,488,758 shares of common stock upon the closing of this offering, (b) the automatic conversion of the existing warrant to purchase 400,000 shares of Series E-1 preferred stock into a warrant to purchase 100,000 shares of common stock upon the closing of this offering, and (c) the receipt of net proceeds of $20.7 million from the sale of 3,000,000 shares of common stock offered by this prospectus after deducting the underwriting discount and estimated offering expenses payable by us.

RISK FACTORS

An investment in our common stock involves a high degree of risk. Accordingly, you should carefully consider the following risks and all other information contained in this prospectus before purchasing our common stock. If any of the following risks occurs, our business, prospects, reputation, results of operations or financial condition could be harmed. In that case, the trading price of our common stock could decline, and you could lose all or part of your investment. This prospectus also contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of specific factors, including the risks described below and elsewhere in this prospectus.

Risks Relating to Our Business

We have incurred significant operating losses since inception and cannot assure you that we will achieve profitability.

Since our inception in 1996, we have incurred losses every quarter. We began commercial sales of our products in May 1999 and we have yet to demonstrate that we can generate sufficient sales of our products to become profitable. The extent of our future operating losses and the timing of profitability are highly uncertain, and we may never achieve or sustain profitability. We have incurred significant net losses since our inception, including net losses of approximately $8.7 million in 2001, $4.8 million in 2002, $3.7 million in 2003 and $780,000 for the three months ended March 31, 2004. At March 31, 2004, we had an accumulated deficit of approximately $54.0 million. It is possible that we will never generate sufficient revenues from product sales to achieve profitability.

If physicians or other healthcare providers are unable to obtain sufficient reimbursement from third-party healthcare payers for procedures performed using the NC-stat System, the adoption of the NC-stat System and our future product sales will be severely harmed.

Widespread adoption of the NC-stat System by the medical community is unlikely to occur if physicians do not receive sufficient reimbursement from third-party payers for performing nerve conduction studies using the NC-stat System. If physicians are unable to obtain adequate reimbursement for procedures performed using the NC-stat System, we may be unable to sell the NC-stat System and our business would suffer significantly. Additionally, even if these procedures are reimbursed by third-party payers, adverse changes in payers' policies toward reimbursement for the procedures would harm our ability to market and sell the NC-stat System. Third-party payers include those governmental programs such as Medicare and Medicaid, workers' compensation programs, private health insurers and other organizations. These third-party payers may deny coverage if they determine that a procedure was not reasonable or necessary, for example, if its use was not considered medically appropriate, or was experimental, or was performed for an unapproved indication. In addition, some health care systems are moving towards managed care arrangements in which they contract to provide comprehensive healthcare for a fixed cost per person, irrespective of the amount of care actually provided. These providers, in an effort to control healthcare costs, are increasingly challenging the prices charged for medical products and services and, in some instances, have pressured medical suppliers to lower their prices. If we are pressured to lower our prices, our revenues may decline and our profitability could be harmed. The Center for Medicare and Medicaid Services, or CMS, guidelines set the reimbursement rates for procedures covered by Medicare. Future regulatory action by CMS or other governmental agencies or negative clinical results may diminish reimbursement payments to physicians for performing procedures using the NC-stat System. Medicaid reimbursement differs from state to state, and some state Medicaid programs may not reimburse physicians for performing procedures using the NC-stat System in an adequate amount, if at all. Additionally, some private payers do not follow the CMS and Medicaid guidelines and may reimburse for only a portion of

these procedures or not at all. We are unable to predict what changes will be made in the reimbursement methods used by private or governmental third-party payers.

We may be unable to expand the market for the NC-stat System, which would limit our ability to increase our revenues.

We believe that the drawbacks of traditional nerve conduction studies, including those related to the referral process, and the limited treatment options for diabetic peripheral neuropathy, or DPN, have limited the number of nerve conduction studies that are performed. For our future growth, we are relying, in part, on increased use of nerve conduction studies. A number of factors could limit the increased use of nerve conduction studies and the NC-stat System, including:

- third-party payers challenging, or the threat of third-party payers challenging, the necessity of increased levels of nerve conduction studies;
- third-party payers reducing or eliminating reimbursement for procedures performed by physicians using the NC-stat System;
- unfavorable experiences by physicians using the NC-stat System;
- physicians' reluctance to alter their existing practices; and
- the failure of other companies' existing drug development programs to produce an effective treatment for DPN, which may limit the perceived need and the actual use of the NC-stat System in connection with this disease, and thereby limit or delay our growth in the DPN market, which we have estimated to be our largest potential market for our NC-stat System.

If we are unable to expand the market for the NC-stat System, our ability to increase our revenues will be limited and our business prospects will be adversely affected.

We may not be able to accurately predict the size of the market for our NC-stat System.

We may not be able to accurately predict the size of the market for products used to diagnose neuropathies, such as our NC-stat System. Neuropathies traditionally have been diagnosed by an NCS/nEMG procedure, performed by a neurologist or physician in a related specialty. We estimate that there are approximately two million traditional NCS/nEMG procedures performed each year in the United States; however, we anticipate that the advantages and increased availability of the NC-stat System will significantly increase the number of nerve conduction studies performed. Based on our analysis of current data, we estimate that the potential market size for the NC-stat System in the diabetes, low back pain and carpal tunnel syndrome markets in the aggregate could be as great as 9.5 million annual patient tests. This represents a more than four-fold increase in the size of the market for nerve conduction studies and is based upon a number of assumptions and estimates, which themselves may not be accurate. For example, we have assumed that all initial office visits for low back pain may represent an opportunity for use of the NC-stat System, and we have estimated that an annual testing rate of 50% for all individuals diagnosed with diabetes represents the potential addressable market in diabetes. Market size is difficult to predict, and we cannot assure you that our assumptions or estimates will prove to be correct. The industry and market data in this prospectus, including the industry data on which we base our assumptions and estimates of future market size, may be inaccurate or incomplete, and we have not independently verified those data. If our estimate of the size of the market for our NC-stat System is incorrect, our potential revenue growth may be limited.

If we are unable to successfully sell the NC-stat System to primary care physicians, our ability to increase our revenues will be limited.

We are focusing our sales and marketing efforts for the NC-stat System on primary care physicians. As these physicians traditionally have not been targeted by companies selling equipment used to

perform nerve conduction studies, we may face difficulties in selling our products to them. Particularly, we may be unable to convince these physicians that the NC-stat System provides an effective alternative or useful supplement to existing testing methods. In addition, these physicians may be reluctant to make the capital investment to purchase the NC-stat System and alter their existing practices. If we are unable to successfully sell the NC-stat System to primary care physicians, our ability to increase our revenues will be severely limited.

We are dependent on two single source manufacturers to produce all of our current products, and any change in our relationship with either of these manufacturers could prevent us from delivering products to our customers in a timely manner and may adversely impact our future revenues or costs.

We rely on two third-party manufacturers to manufacture all of our current products. In the event that either of our manufacturers ceases to manufacture sufficient quantities of our products in a timely manner and on terms acceptable to us, we would be forced to locate an alternate manufacturer. Additionally, if either of our manufacturers experiences a failure in its production process, is unable to obtain sufficient quantities of the components necessary to manufacture our products or otherwise fails to meet our quality requirements, we may be forced to delay the manufacture and sale of our products or locate an alternative manufacturer. We may be unable to locate suitable alternative manufacturers for our products, particularly our NC-stat biosensors, for which the manufacturing process is relatively specialized, on terms acceptable to us, or at all. Currently, we rely on a single manufacturer, Polyflex Circuits, Inc., a wholly owned subsidiary of Parlex Corporation, for the manufacture of the NC-stat biosensors, and a single manufacturer, Advanced Electronics, Inc., or AEI, for the manufacture of our NC-stat monitors and docking stations. We order all of our products from Polyflex on a purchase order basis. Because we do not have a supply agreement in place with Polyflex, Polyflex may cease manufacturing our products or increase the price it charges us for our products at any time. We do have a one-year, automatically renewable contract manufacturing agreement with AEI. However, under the agreement, either party may elect not to renew the agreement upon 90 days' prior written notice prior to the end of the current term. Accordingly, AEI could cease manufacturing NC-stat monitors and docking stations for us when the current term of the agreement expires in November 2004. We have not experienced any significant problems in the past with the quality or quantity of products delivered by either AEI or Polyflex. We do occasionally experience transient inventory shortages, typically lasting less than one month, on new products during the initial production ramp-up phase. If any of the changes in our relationships with these manufacturers as described above occurs, our ability to supply our customers will be severely limited until we are able to engage an alternate manufacturer or, if applicable, resolve any quality issues with our existing manufacturer. This situation could prevent us from delivering products to our customers in a timely manner, lead to decreased sales or increased costs, or harm our reputation with our customers.

If our manufacturers are unable to supply us with an adequate supply of products as we expand our markets, we could lose customers, our growth could be limited and our business could be harmed.

In order for us successfully to expand our business within the United States and internationally, our contract manufacturers must be able to provide us with the products that comprise the NC-stat System in substantial quantities, in compliance with regulatory requirements, in accordance with agreed upon specifications, at acceptable cost and on a timely basis. Our anticipated growth may strain the ability of our manufacturers to deliver an increasingly large supply of products and obtain materials and components in sufficient quantities. Manufacturers often experience difficulties in scaling up production, including problems with production yields and quality control and assurance. If we are unable to obtain sufficient quantities of high quality products to meet customer demand on a timely basis, we could lose customers, our growth may be limited and our business could be harmed.

We currently rely entirely on sales of the products that comprise the NC-stat System to generate revenues, and any factors that negatively impact our sales of these products could significantly reduce our ability to generate revenues.

We introduced the NC-stat System to the market in May 1999. We derive all of our revenues from sales of the products that comprise the NC-stat System, and we expect that sales of these products will continue to constitute the substantial majority of our sales for the foreseeable future. Accordingly, our ability to generate revenues is entirely reliant on our ability to market and sell the products that comprise the NC-stat System, particularly the higher-margin disposable biosensors, sales of which accounted for approximately 85.8% and 82.9% of our total revenues in 2003 and 2002, respectively. Our sales of these products may be negatively impacted by many factors, including:

- changes in reimbursement rates or policies relating to our products by third-party payers;
- the failure of the market to accept our products;
- manufacturing problems;
- claims that our products infringe on patent rights or other intellectual property rights owned by other parties;
- adverse regulatory or legal actions relating to our products;
- competitive pricing and related factors; and
- results of clinical studies relating to our products or our competitors' products.

If any of these events occurs, our ability to generate revenues could be significantly reduced.

The patent rights we rely upon to protect the intellectual property underlying our products may not be adequate, which could enable third parties to use our technology and would harm our ability to compete in the market.

Our success will depend in part on our ability to develop or acquire commercially valuable patent rights and to protect these rights adequately. Our patent position is generally uncertain and involves complex legal and factual questions. The risks and uncertainties that we face with respect to our patents and other related rights include the following:

- the pending patent applications we have filed or to which we have exclusive rights may not result in issued patents or may take longer than we expect to result in issued patents;
- the claims of any patents that are issued may not provide meaningful protection;
- we may not be able to develop additional proprietary technologies that are patentable;
- other parties may challenge patents, patent claims or patent applications licensed or issued to us; and
- other companies may design around technologies we have patented, licensed or developed.

We also may not be able to protect our patent rights effectively in some foreign countries. For a variety of reasons, we may decide not to file for patent protection. Our patent rights underlying our products may not be adequate, and our competitors or customers may design around our proprietary technologies or independently develop similar or alternative technologies or products that are equal or superior to our technology

and products without infringing on any of our patent rights. In addition, the patents licensed or issued to us may not provide a competitive advantage. If any of these events were to occur, our ability to compete in the market would be harmed.

Other rights and measures we have taken to protect our intellectual property may not be adequate, which would harm our ability to compete in the market.

In addition to patents, we rely on a combination of trade secrets, copyright and trademark laws, confidentiality, nondisclosure and assignment of invention agreements and other contractual provisions and technical measures to protect our intellectual property rights. In particular, we have sought no patent protection for the technology and algorithms we use in our onCall Information System, and we rely on trade secrets to protect this information. While we currently require employees, consultants and other third parties to enter into confidentiality, non-disclosure or assignment of invention agreements or a combination thereof where appropriate, any of the following could still occur:

- the agreements may be breached;
- we may have inadequate remedies for any breach;
- trade secrets and other proprietary information could be disclosed to our competitors; or
- others may independently develop substantially equivalent proprietary information and techniques or otherwise gain access to our trade secrets or disclose such technologies.

If, for any of the above reasons, our intellectual property is disclosed or misappropriated, it would harm our ability to protect our rights and our competitive position.

We may need to initiate lawsuits to protect or enforce our patents and other intellectual property rights, which could be expensive and, if we lose, could cause us to lose some of our intellectual property rights, which would harm our ability to compete in the market.

We rely on patents to protect a portion of our intellectual property and our competitive position. Patent law relating to the scope of claims in the technology fields in which we operate is still evolving and, consequently, patent positions in the medical device industry are generally uncertain. In order to protect or enforce our patent rights, we may initiate patent litigation against third parties, such as infringement suits or interference proceedings. Litigation may be necessary to:

- assert claims of infringement;
- enforce our patents;
- protect our trade secrets or know-how; or
- determine the enforceability, scope and validity of the proprietary rights of others.

Any lawsuits that we initiate could be expensive, take significant time and divert management's attention from other business concerns. Litigation also puts our patents at risk of being invalidated or interpreted narrowly and our patent applications at risk of not issuing. Additionally, we may provoke third parties to assert claims against us. We may not prevail in any lawsuits that we initiate and the damages or other remedies awarded, if any, may not be commercially valuable. The occurrence of any of these events could harm our business, our ability to compete in the market or our reputation.

Claims that our products infringe on the proprietary rights of others could adversely affect our ability to sell our products and increase our costs.

Substantial litigation over intellectual property rights exists in the medical device industry. We expect that our products could be increasingly subject to third-party infringement claims as the number of competitors grows and the functionality of products and technology in different industry segments overlap. Third parties may currently have, or may eventually be issued, patents on which our products or technologies may infringe. Any of these third parties might make a claim of infringement against us. Any litigation regardless of its impact

would likely result in the expenditure of significant financial resources and the diversion of management's time and resources. In addition, litigation in which we are accused of infringement may cause negative publicity, adversely impact prospective customers, cause

product shipment delays or require us to develop non-infringing technology, make substantial payments to third parties, or enter into royalty or license agreements, which may not be available on acceptable terms, or at all. If a successful claim of infringement were made against us and we could not develop non-infringing technology or license the infringed or similar technology on a timely and cost-effective basis, our revenues may decrease substantially and we could be exposed to significant liability.

We are subject to extensive regulation by the U.S. Food and Drug Administration, which could restrict the sales and marketing of the NC-stat System and could cause us to incur significant costs.

We sell medical devices that are subject to extensive regulation in the United States by the Food and Drug Administration, or FDA, for manufacturing, labeling, sale, promotion, distribution and shipping. Before a new medical device, or a new use of or claim for an existing product, can be marketed in the United States, it must first receive either 510(k) clearance, grant of a *de novo* classification or pre-marketing approval from the FDA, unless an exemption applies. We may be required to obtain a new 510(k) clearance or *de novo* classification or pre-market approval for significant post-market modifications to our products. Each of these processes can be expensive and lengthy. The FDA's process for obtaining 510(k) clearance usually takes from three to 12 months, but it can last longer. The process for obtaining *de novo* classification involves a level of scrutiny similar to the 510(k) clearance process. The process for obtaining pre-market approval is much more costly and uncertain and it generally takes from one to three years, or longer, from the time the application is filed with the FDA.

Medical devices may be marketed only for the indications for which they are approved or cleared. We have obtained 510(k) clearance for the current clinical applications for which we market our products. However, our clearances can be revoked if safety or effectiveness problems develop. Further, we may not be able to obtain additional 510(k) clearances or premarket approvals for new products or for modifications to, or additional indications for, our existing products in a timely fashion, or at all. Delays in obtaining future clearances would adversely affect our ability to introduce new or enhanced products in a timely manner which in turn would harm our revenue and future profitability. We have made modifications to our devices in the past and may make additional modifications in the future that we believe do not or will not require additional clearances or approvals. If the FDA disagrees, and requires new clearances or approvals for the modifications, we may be required to recall and to stop marketing the modified devices. We also are subject to numerous post-marketing regulatory requirements, including quality system regulations, which relate to the manufacturing of our products, labeling regulations and medical device reporting regulations. Our failure or either contract manufacturer's failure to comply with applicable regulatory requirements could result in enforcement action by the FDA, which may include any of the following sanctions:

- warning letters, fines, injunctions, consent decrees and civil penalties;
- requiring repair, replacement, refunds, recall or seizure of our products;
- imposing operating restrictions, suspension or shutdown of production;
- refusing our requests for 510(k) clearance or pre-market approval of new products, new intended uses, or modifications to existing products;
- withdrawing 510(k) clearance or pre-market approvals that have already been granted; and
- criminal prosecution.

If any of these events were to occur, they could harm our reputation, our ability to generate revenues and our profitability.

If we or our contract manufacturers fail to comply with the FDA's quality system regulations, the manufacturing and distribution of our products could be interrupted, and our product sales and operating results could suffer.

We and our contract manufacturers are required to comply with the FDA's quality system regulations, which is a complex regulatory scheme that covers the procedures and documentation of the design, testing, production, control, quality assurance, labeling, packaging, sterilization, storage and shipping of our devices. The FDA enforces its quality system regulations through periodic unannounced inspections. We cannot assure you that our facilities or our contract manufacturers' facilities would pass any future quality system inspection. If our or any of our contract manufacturers' facilities fails a quality system inspection, the manufacturing or distribution of our products could be interrupted and our operations disrupted. Failure to take adequate and timely corrective action in response to an adverse quality system inspection could force a suspension or shutdown of our packaging and labeling operations, the manufacturing operations of our contract manufacturers or a recall of our products. If any of these events occurs, we may not be able to provide our customers with the quantity of products they require on a timely basis, our reputation could be harmed, and we could lose customers and suffer reduced revenues and increased costs.

Our products are subject to recalls even after receiving FDA clearance or approval, which would harm our reputation, business and financial results.

We are subject to the medical device reporting regulations, which require us to report to the FDA if our products cause or contribute to a death or serious injury, or malfunction in a way that would likely cause or contribute to a death or serious injury. The FDA and similar governmental bodies in other countries have the authority to require the recall of our products if we or our contract manufacturers fail to comply with relevant regulations pertaining to manufacturing practices, labeling, advertising or promotional activities, or if new information is obtained concerning the safety or efficacy of our products. A government-mandated or voluntary recall by us could occur as a result of manufacturing defects, labeling deficiencies, packaging defects or other failures to comply with applicable regulations. Any recall would divert management attention and financial resources and harm our reputation with customers. A recall involving the NC-stat System would be particularly harmful to our business and financial results because the products that comprise the NC-stat System are currently our only products.

We are subject to federal and state laws prohibiting "kickbacks" and false or fraudulent claims, which, if violated, could subject us to substantial penalties. Additionally, any challenge to or investigation into our practices under these laws could cause adverse publicity and be costly to respond to, and thus could harm our business.

A federal law commonly known as the Medicare/Medicaid anti-kickback law, and several similar state laws, prohibit payments that are intended to induce physicians or others either to refer patients or to acquire or arrange for or recommend the acquisition of healthcare products or services. These laws constrain our sales, marketing and other promotional activities by limiting the kinds of financial arrangements, including sales programs, we may have with hospitals, physicians or other potential purchasers of medical devices. Other federal and state laws generally prohibit individuals or entities from knowingly presenting, or causing to be presented, claims for payment from Medicare, Medicaid or other third-party payers that are false or fraudulent, or for items or services that were not provided as claimed. Because we may provide some coding and billing information to purchasers of our products, and because we cannot assure that the government will regard any billing errors that may be made as inadvertent, these laws are potentially applicable to us. Anti-kickback and false claims laws prescribe civil and criminal penalties for noncompliance, which can be substantial. Even an unsuccessful

challenge or investigation into our practices could cause adverse publicity, and be costly to respond to, and thus could harm our business and results of operations.

If we are found to have violated laws protecting the confidentiality of patient health information, we could be subject to civil or criminal penalties, which could increase our liabilities and harm our reputation or our business.

There are a number of federal and state laws protecting the confidentiality of certain patient health information, including patient records, and restricting the use and disclosure of that protected information. In particular, the U.S. Department of Health and Human Services promulgated patient privacy rules under the Health Insurance Portability and Accountability Act of 1996, or HIPAA. These privacy rules protect medical records and other personal health information by limiting their use and disclosure, giving individuals the right to access, amend and seek accounting of their own health information and limiting most use and disclosures of health information to the minimum amount reasonably necessary to accomplish the intended purpose. Although we do not believe that we are subject to the HIPAA rules because we receive patient data in our onCall Information System on an anonymous basis, the exact scope of these rules has not been clearly established. If we are found to be in violation of the privacy rules under HIPAA, we could be subject to civil or criminal penalties, which could increase our liabilities and harm our reputation or our business.

The use of the NC-stat System could result in product liability claims that could be expensive, damage our reputation and harm our business.

Our business exposes us to an inherent risk of potential product liability claims related to the manufacturing, marketing and sale of medical devices. The medical device industry historically has been litigious, and we face financial exposure to product liability claims if the use of our products were to cause or contribute to injury or death. In particular, the NC-stat System may be susceptible to claims of injury because it involves the electric stimulation of a patient's nerves. Although we maintain product liability insurance for our products, the coverage limits of these policies may not be adequate to cover future claims. As sales of our products increase, we may be unable to maintain sufficient product liability insurance on acceptable terms or at reasonable costs, and this insurance may not provide us with adequate coverage against potential liabilities. A successful claim brought against us in excess of, or outside of, our insurance coverage could have a material adverse effect on our financial condition and results of operations. A product liability claim, regardless of its merit or eventual outcome, could result in substantial costs to us, a substantial diversion of management attention and adverse publicity. A product liability claim could also harm our reputation and result in a decline in revenues and an increase in expenses.

Our products are complex in design, and defects may not be discovered prior to shipment to customers, which could result in warranty obligations or product liability claims, reducing our revenues and increasing our costs and liabilities.

We depend upon third parties for the manufacture of our products. Our products, particularly our NC-stat biosensors, require a significant degree of technical expertise to produce. If our manufacturers fail to produce our products to specification, or if the manufacturers use defective materials or workmanship in the manufacturing process, the reliability and performance of our products will be compromised.

If our products contain defects that cannot be repaired quickly, easily and inexpensively, we may experience:

- loss of customer orders and delay in order fulfillment;
- damage to our brand reputation;

increased cost of our warranty program due to product repair or replacement;

inability to attract new customers;

diversion of resources from our manufacturing and research and development departments into our service department; and

legal action.

The occurrence of any one or more of the foregoing could harm our reputation and materially reduce our revenues and increase our costs and liabilities.

If we lose any of our officers or key employees, our management and technical expertise could be weakened significantly.

Our success largely depends on the skills, experience and efforts of our officers, including Shai N. Gozani, M.D., Ph.D., our founder and President and Chief Executive Officer; Gary L. Gregory, our Chief Operating Officer; Guy Daniello, our Senior Vice President of Information Technology; Michael Williams, Ph.D., our Senior Vice President of Engineering; Nicholas J. Alessi, Director of Finance and Treasurer; and our other key employees. We maintain a $5.0 million key person life insurance policy on Dr. Gozani, but do not maintain key person life insurance policies covering any of our other employees. The loss of any of our officers or key employees could weaken our management and technical expertise significantly and harm our business.

If we are unable to recruit, hire and retain skilled and experienced personnel, our ability to manage and expand our business will be harmed, which would impair our future revenues and profitability.

We are a small company with only 57 employees, and our ability to retain our skilled labor force and our success in attracting and hiring new skilled employees will be a critical factor in determining our future performance. We may not be able to meet our future hiring needs or retain existing personnel. We will face challenges and risks in hiring, training, managing and retaining engineering and sales and marketing employees, as well as independent regional sales agencies and sales representatives, most of whom are geographically dispersed and must be trained in the use and benefits of our products. Failure to attract and retain personnel, particularly technical and sales and marketing personnel, would materially harm our ability to compete effectively and grow our business.

If we do not effectively manage our growth, our business resources may become strained, we may not be able to deliver the NC-stat System in a timely manner and our results of operations may be adversely affected.

We expect to increase our sales force and our total headcount significantly subsequent to this offering. This growth, as well as any other growth that we may experience in the future, will provide challenges to our organization and may strain our management and operations. We may misjudge the amount of time or resources that will be required to effectively manage any anticipated or unanticipated growth in our business or we may not be able to attract, hire and retain sufficient personnel to meet our needs. If we cannot scale our business appropriately, maintain control over expenses or otherwise adapt to anticipated and unanticipated growth, our business resources may become strained, we may not be able to deliver the NC-stat System in a timely manner and our results of operations may be adversely affected.

If we are unable to successfully expand, develop and retain our sales force, our revenues may decline, our future revenue growth may be limited and our expenses may increase.

We presently employ 16 regional sales managers who lead more than 50 independent regional sales agencies employing a total of more than 250 sales representatives. We are highly dependent on our

regional sales managers to generate our revenues. We currently intend to increase our existing sales force significantly using part of the net proceeds from this offering. Our ability to build and develop a strong sales force will be affected by a number of factors, including:

- our ability to attract, integrate and motivate sales personnel;
- our ability to effectively train our sales force;
- the ability of our sales force to sell an increased number of products;
- the length of time it takes new sales personnel to become productive;
- the competition we face from other companies in hiring and retaining sales personnel;
- our ability to effectively manage a multi-location sales organization;
- our ability to enter into agreements with prospective members of our sales force on commercially reasonable terms; and
- our ability to get our independent sales agencies, who may sell products of multiple companies, to commit the necessary resources to effectively market and sell our products.

If we are unable to successfully build, develop and retain a strong sales force, our revenues may decline, our revenue growth may be limited and our expenses may increase.

Failure to develop products other than the NC-stat System and enhance the NC-stat System could have an adverse effect on our business prospects.

All of our current revenues are derived from selling the NC-stat System. Our future business and financial success will depend, in part, on our ability to continue to introduce new products and upgraded products into the marketplace. Developing new products and upgrades to existing and future products imposes burdens on our research and development department and our management. This process is costly, and we cannot assure you that we will be able to successfully develop new products or enhance the NC-stat System or any future products. In addition, as we develop the market for point-of-service nerve conduction studies, future competitors may develop desirable product features earlier than we do, which could make our competitors' products less expensive or more effective than our products and could render our products obsolete or unmarketable. If our product development efforts are unsuccessful, we will have incurred significant costs without recognizing the expected benefits and our business prospects may suffer.

We currently compete, and may in the future need to compete, against other medical device companies with greater resources, more established distribution channels and other competitive advantages, and the success of these competitors may harm our ability to generate revenues.

We currently do, and in the future may need to, compete directly and indirectly with a number of other companies that enjoy significant competitive advantages over us. Currently, in the point-of-service market, we indirectly compete with companies that sell traditional NCS/nEMG equipment. In this market, these companies are indirect competitors because the equipment they sell traditionally has been used by neurologists, who rely upon and seek to obtain referrals from primary care physicians to perform the same types of tests that may be performed by primary care physicians using the NC-stat System. Additionally, in selling the NC-stat System to neurologists, which is not a market we historically have focused on, we compete directly with the companies that sell traditional NCS/nEMG equipment. There are a number of companies that sell traditional NCS/nEMG equipment including the Nicolet Biomedical division of Viasys Healthcare Inc., the Functional Diagnostics division of Medtronic, Inc., Oxford Instruments, Plc., and Cadwell Laboratories, Inc. Additionally, we are aware of one company, Neumed Inc., that markets a nerve conduction study system to the point-of-service market. Of these

companies, Viasys Healthcare, Medtronic and Oxford Instruments, in particular, enjoy significant competitive advantages, including:

- greater resources for product development, sales and marketing
- more established distribution networks;
- greater name recognition;
- more established relationships with health care professionals, customers and third-party payers; and
- additional lines of products and the ability to offer rebates or bundle products to offer discounts or incentives.

Other than Neumed, we do not know if these companies or others are engaged in research and development efforts to develop products to perform point-of-service nerve conduction studies that would be directly competitive with the NC-stat System. As we develop the market for point-of-service nerve conduction studies, we may be faced with competition from these companies or others that decide and are able to enter this market. Some or all of our future competitors in the point-of-service market may enjoy competitive advantages such as those described above. If we are unable to compete effectively against existing and future competitors, our sales will decline and our business will be harmed.

We are dependent upon the computer and communications infrastructure employed and utilized by our onCall Information System, and any failures or disruptions in this infrastructure could impact our revenues and profit margins or harm our reputation.

We are dependent upon the computer and communications infrastructure employed and utilized by our onCall Information System. Our computer and communications infrastructure consists of standard hardware, off-the-shelf system software components, database servers, proprietary application servers, a modem bank and desktop applications. Our future success in selling the NC-stat System will depend, in part, upon the maintenance and growth of this infrastructure. Any failures or outages of this infrastructure as a result of a computer virus, intentional disruption of our systems by a third party, manufacturing failure, telephone system failure, fire, storm, flood, power loss or other similar events, could prevent or delay the operation of our onCall Information System, which could result in increased costs to eliminate these problems and address related security concerns and harm our reputation with our customers. In addition, if our infrastructure fails to accommodate growth in customer transactions, customer satisfaction could be impaired, we could lose customers, our ability to add customers could be impaired or our costs could be increased, any of which would harm our business.

If future clinical studies or other articles are published, or physician associations or other organizations announce positions, that are unfavorable to the NC-stat System, our sales efforts and revenues may be negatively affected.

Future clinical studies or other articles regarding our existing products or any competing products may be published that either support a claim, or are perceived to support a claim, that a competitor's product is more accurate or effective than our products or that our products are not as accurate or effective as we claim or previous clinical studies have concluded. Additionally, physician associations or other organizations that may be viewed as authoritative could endorse products or methods that compete with the NC-stat System or otherwise announce positions that are unfavorable to the NC-stat System. Any of these events may negatively affect our sales efforts and result in decreased revenues.

Our future capital needs are uncertain and we may need to raise additional funds in the future, and these funds may not be available on acceptable terms or at all.

We believe that our current cash and cash equivalents, including the proceeds from this offering, together with our short-term investments and the cash to be generated from expected product sales, will be sufficient to meet our projected operating requirements for at least the next 24 months. However, we may seek additional funds from public and private stock offerings, borrowings under credit lines or other sources. Our capital requirements will depend on many factors, including:

- the revenues generated by sales of the NC-stat System and any other products that we develop;
- the costs associated with expanding our sales and marketing efforts;
- the expenses we incur in manufacturing and selling our products;
- the costs of developing new products or technologies and enhancements to existing products;
- the cost of obtaining and maintaining FDA approval or clearance of our products and products in development;
- costs associated with any expansion;
- the costs associated with capital expenditures; and
- the number and timing of any acquisitions or other strategic transactions.

As a result of these factors, we may need to raise additional funds, and these funds may not be available on favorable terms, or at all. Furthermore, if we issue equity or debt securities to raise additional funds, our existing stockholders may experience dilution, and the new equity or debt securities may have rights, preferences and privileges senior to those of our existing stockholders. In addition, if we raise additional funds through collaboration, licensing or other similar arrangements, it may be necessary to relinquish valuable rights to our potential products or proprietary technologies, or grant licenses on terms that are not favorable to us. If we cannot raise funds on acceptable terms, we may not be able to develop or enhance our products, execute our business plan, take advantage of future opportunities, or respond to competitive pressures or unanticipated customer requirements. If any of these events occurs, our ability to achieve our development and commercialization goals would be adversely affected.

If we choose to acquire or invest in new businesses, products or technologies, instead of developing them ourselves, these acquisitions or investments could disrupt our business and could result in the use of significant amounts of equity, cash or a combination of both.

From time to time we may seek to acquire or invest in businesses, products or technologies, instead of developing them ourselves. Acquisitions and investments involve numerous risks, including:

- the inability to complete the acquisition or investment;
- disruption of our ongoing businesses and diversion of management attention;
- difficulties in integrating the acquired entities, products or technologies;

difficulties in operating the acquired business profitably;

the inability to achieve anticipated synergies, cost savings or growth;

potential loss of key employees, particularly those of the acquired business;

difficulties in transitioning and maintaining key customer, distributor and supplier relationships;

- risks associated with entering markets in which we have no or limited prior experience; and
- unanticipated costs.

In addition, any future acquisitions or investments may result in one or more of the following:

- issuances of dilutive equity securities, which may be sold at a discount to market price;
- the use of significant amounts of cash;
- the incurrence of debt;
- the assumption of significant liabilities;
- increased operating costs or reduced earnings;
- financing obtained on unfavorable terms;
- large one-time expenses; and
- the creation of certain intangible assets, including goodwill, the write-down of which may result in significant charges to earnings.

Any of these factors could materially harm our stock price, our business or our operating results.

If we expand, or attempt to expand, into foreign markets, we will be affected by new business risks that may adversely impact our financial condition or results of operations.

If we expand, or attempt to expand, into foreign markets, we will be subject to new business risks, including:

- failure to fulfill foreign regulatory requirements to market the NC-stat System or other future products;
- availability of, and changes in, reimbursement within prevailing foreign health care payment systems;
- adapting to the differing business practices and laws in foreign countries;
- difficulties in managing foreign relationships and operations, including any relationships that we establish with foreign distributors or sales or marketing agents;
- limited protection for intellectual property rights in some countries;
- difficulty in collecting accounts receivable and longer collection periods;

costs of enforcing contractual obligations in foreign jurisdictions;

recessions in economies outside of the United States;

political instability and unexpected changes in diplomatic and trade relationships;

currency exchange rate fluctuations; and

potentially adverse tax consequences.

If we are successful in introducing our products into foreign markets, we will be affected by these additional business risks, which may adversely impact our financial condition or results of operations. In addition, expansion into foreign markets imposes additional burdens on our executive and administrative personnel, research and sales departments, and general managerial resources. Our efforts to introduce our products into foreign markets may not be successful, in which case we may have expended significant resources without realizing the expected benefit. Ultimately, the investment required for expansion into foreign markets could exceed the revenues generated from this expansion.

Our operating results may fluctuate due to various factors and, as a result, period-to-period comparisons of our results of operations will not necessarily be meaningful.

Factors relating to our business make our future operating results uncertain and may cause them to fluctuate from period to period. These factors include:

- changes in the availability of third-party reimbursement in the United States or other countries;
- the timing of new product announcements and introductions by us or our competitors;
- market acceptance of new or enhanced versions of our products;
- changes in manufacturing costs or other expenses;
- competitive pricing pressures;
- the gain or loss of significant distribution outlets or customers;
- increased research and development expenses;
- the timing of any future acquisitions; or
- general economic conditions.

Because our operating results may fluctuate from quarter to quarter, it may be difficult for us or our investors to predict our future performance by viewing our historical operating results.

Risks Related to this Offering

Our principal stockholders have significant voting power and may take actions that may not be in the best interests of our other stockholders.

After this offering, our officers, directors and principal stockholders will together control approximately 71.4% of our outstanding common stock or 68.7% if the over-allotment option is exercised in full. If some or all of these stockholders act together, they will be able to control our management and affairs in all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions. This concentration of ownership may have the effect of delaying or preventing a change in control and might adversely affect the market price of our common stock. In addition, this significant concentration of share ownership may adversely affect the trading price of our common stock because investors often perceive disadvantages to owning stock in companies with controlling stockholders.

The sale or expected sale of a substantial number of shares of our common stock may cause the price of our common stock to decline.

Sales or the expectation of sales of a substantial number of shares of our common stock in the public market following this offering could harm the market price of our common stock. As additional shares of our common stock become available for resale in the public market, the supply of our common stock will increase, which could decrease the price. There will be approximately 6,797,489 additional shares of common stock, excluding shares issuable upon exercise of outstanding options and an outstanding warrant, eligible for sale beginning 180 days after the effective date of this prospectus upon the expiration of lock-up agreements between our stockholders and Punk, Ziegel & Company. These shares could be eligible for sale sooner if these shares are released from these lock-up agreements earlier. Moreover, after this offering, the holders of 7,488,758 shares of our common stock, comprised of shares issued upon conversion of our preferred stock, and the holder of a warrant to purchase 100,000 shares of common stock, will have rights, subject to various conditions and limitations, to require us to file registration statements covering their shares or to include their shares in registration statements that we may file for ourselves or other stockholders. We also intend to register

all common stock that we may issue under our existing Amended and Restated 1998 Equity Incentive Plan and our 2004 Stock Option and Incentive Plan and 2004 Employee Stock Purchase Plan adopted in connection with this offering. Once we register these shares, and in some cases sooner, they can be freely sold in the public market upon issuance, subject to the lock-up agreements described in "Underwriting," if applicable. If any of these holders cause a large number of securities to be sold in the public market, the sales could reduce the trading price of our common stock. These sales also could impede our ability to raise future capital. Please see "Shares Eligible for Future Sale" for a description of sales that may occur in the future.

Our common stock has not been publicly traded, and we expect that the price of our common stock will fluctuate substantially.

Prior to this offering, there has been no public market for shares of our common stock. An active public trading market may not develop following completion of this offering or, if developed, may not be sustained. The price of the shares of common stock sold in this offering will be determined by negotiation between the underwriters and us. This price will not necessarily reflect the market price of our common stock following this offering. The market price of our common stock following this offering will be affected by a number of factors, including:

- changes in the availability of third-party reimbursement in the United States or other countries;
- volume and timing of orders for our products;
- developments in administrative proceedings or litigation related to intellectual property rights;
- issuance of patents to us or our competitors;
- the announcement of new products or product enhancements by us or our competitors;
- the announcement of technological or medical innovations in the treatment or diagnosis of neuropathies;
- changes in governmental regulations or in the status of our regulatory approvals or applications;
- developments in our industry;
- publication of clinical studies relating to our products or a competitor's product;
- quarterly variations in our or our competitors' results of operations;
- changes in earnings estimates or recommendations by securities analysts; and
- general market conditions and other factors, including factors unrelated to our operating performance or the operating performance of our competitors.

New investors will experience immediate and substantial dilution in the net tangible book value of their common stock following this offering.

If you purchase shares of our common stock in this offering, you will incur immediate and substantial dilution of $5.12 per share, because the price you pay would be substantially greater than the net tangible book value per share of common stock that you acquire. This dilution is due in large part to the fact that our existing investors paid substantially less than the initial public offering price for their shares of our capital stock. If the holders of outstanding options or warrants exercise their rights to acquire common stock, you will incur further dilution.

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Our management team may invest or spend the proceeds of this offering in ways with which you may not agree or in ways which may not yield a return.

Our management will have considerable discretion in the application of the net proceeds of this offering. We expect to use some of the net proceeds from this offering to expand our sales and marketing activities, to fund research and development relating to potential new products and to repay outstanding debt obligations of approximately $3.1 million. We cannot specify with certainty how we will use all of the net proceeds of this offering or our existing cash balance. The net proceeds may be used for corporate purposes that do not increase our operating results or market value. Until the net proceeds are used, they may be placed in investments that do not produce income or that lose value.

We will incur increased expenses as a result of recently enacted laws and regulations affecting public companies.

Recently enacted laws and regulations affecting public companies, including the provisions of the Sarbanes-Oxley Act of 2002 and rules adopted by the Securities and Exchange Commission and by the National Association of Securities Dealers, Inc., will result in increased expenses to us. The new rules could make it more difficult or more costly for us to obtain some types of insurance, including directors' and officers' liability insurance, and we may be forced to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. The impact of these events also could make it more difficult for us to attract and retain qualified persons to serve on our board of directors, on our board committees or as executive officers. We will incur increased expenses in order to comply with these new rules, and we may not be able to accurately predict the timing or amount of these expenses.

Anti-takeover provisions in our organizational documents and Delaware law may discourage or prevent a change of control, even if an acquisition would be beneficial to our stockholders, which could affect our stock price adversely and prevent attempts by our stockholders to replace or remove our current management.

Our restated certificate of incorporation and restated bylaws to be in effect upon completion of this offering contain provisions that could delay or prevent a change of control of our company or changes in our board of directors that our stockholders might consider favorable. Some of these provisions:

- authorize the issuance of preferred stock which can be created and issued by the board of directors without prior stockholder approval, with rights senior to those of our common stock;
- provide for a classified board of directors, with each director serving a staggered three-year term;
- prohibit our stockholders from filling board vacancies, calling special stockholder meetings, or taking action by written consent;
- provide for the removal of a director only with cause and by the affirmative vote of the holders of 75% or more of the shares then entitled to vote at an election of our directors; and
- require advance written notice of stockholder proposals and director nominations.

In addition, we are subject to the provisions of Section 203 of the Delaware General Corporation Law, which may prohibit certain business combinations with stockholders owning 15% or more of our outstanding voting stock. These and other provisions in our restated certificate of incorporation, restated bylaws and Delaware law could make it more difficult for stockholders or potential acquirors to obtain control of our board of directors or initiate actions that are opposed by our then-current board of directors, including a merger, tender offer, or proxy contest involving our company. Any delay

or prevention of a change of control transaction or changes in our board of directors could cause the market price of our common stock to decline.

We do not intend to pay cash dividends.

We have never declared or paid cash dividends on our capital stock. We currently intend to retain all available funds and any future earnings for use in the operation and expansion of our business and do not anticipate paying any cash dividends in the foreseeable future. In addition, the terms of any future debt or credit facility may preclude us from paying any dividends. As a result, capital appreciation, if any, of our common stock will be your sole source of potential gain for the foreseeable future.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

The statements contained in this prospectus, including under the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and other sections of this prospectus that are not purely historical, are forward-looking statements including, without limitation, statements regarding our or our management's expectations, hopes, beliefs, intentions or strategies regarding the future. The words "believe," "may," "will," "estimate," "continue," "anticipate," "intend," "expect," "plan" and similar expressions may identify forward-looking statements, but the absence of these words does not mean that a statement is not forward-looking. Forward-looking statements in this prospectus may include, for example, statements about:

- the expected rate and degree of market acceptance of the NC-stat System;
- the expected size and growth of the market for nerve conduction studies and procedures using the NC-stat System;
- our estimates regarding revenues, expenses, capital requirements and needs for additional financing;
- implementation of our business strategies, including the expansion of our sales and marketing efforts;
- our research, development, commercialization and other activities and projected expenditures;
- the advantages of the NC-stat System as compared to other products, and our ability to compete with our competitors;
- our ability to obtain regulatory approvals for any future products;
- our intellectual property position;
- our use of proceeds from this offering;
- our cash needs; and
- our financial performance.

The forward-looking statements contained in this prospectus are based on our current expectations and beliefs concerning future developments and their potential effects on us. There can be no assurance that future developments affecting us will be those that we have anticipated. These forward-looking statements involve a number of risks, uncertainties (some of which are beyond our control) or other assumptions that may cause actual results or performance to be materially different from those expressed or implied by these forward-looking statements. These risks and uncertainties include, but are not limited to, those factors described under the heading "Risk Factors." Should one or

more of these risks or uncertainties materialize, or should any of our assumptions prove incorrect, actual results may vary in material respects from those projected in these forward-looking statements. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required under applicable securities laws.

USE OF PROCEEDS

We estimate that the net proceeds from the sale of 3,000,000 shares of common stock we are offering will be $20.7 million after deducting the underwriting discount and estimated offering expenses payable by us. If the underwriters' over-allotment option is exercised in full, we estimate that we will receive net proceeds of $24.1 million.

We intend to use the proceeds from this offering for:

- the expansion of our sales and marketing activities, including an increase in our direct sales force;
- research and development activities relating to potential new products, including the design of a drug development system for the minimally invasive treatment of neuropathies;
- the repayment of outstanding debt obligations to Lighthouse Capital Partners IV, L.P. of approximately $3.1 million; and
- general corporate purposes, including potential acquisitions of complementary products, technologies or businesses, as described below.

Our debt obligations to Lighthouse Capital Partners were incurred in several advances between August 2003 and December 2003 under a secured line of credit, which we entered into in May 2003. The total amount of our borrowings was $3.0 million and these borrowings bear interest at a nominal rate of 11% per annum. We used the proceeds from these borrowings for general corporate purposes. Under the terms of the agreement governing this secured line of credit, we must repay each advance, plus outstanding interest, in equal monthly installments beginning approximately six months after the date of the advance and continuing for a period of 30 months, or until the full amount of the principal is repaid. Upon the final maturity date or the earlier prepayment of each advance, we also must pay Lighthouse Capital Partners an additional amount equal to 11% of the advance. Also in May 2003, we granted Lighthouse Capital Partners a seven-year warrant to purchase up to 400,000 shares of our Series E-1 preferred stock at an exercise price of $1.50 per share as additional payment for the secured credit line. As of July 19, 2004, we had approximately $2.8 million in advances outstanding under this secured line of credit, with final maturity dates ranging from August 2006 to December 2006.

Although we have no current plans, agreements or commitments with respect to any acquisition, we may, if the opportunity arises, use an unspecified portion of the net proceeds to acquire or invest in new products, technologies or businesses.

As of the date of this prospectus, we cannot specify with certainty all of the particular uses for the net proceeds to be received upon the completion of this offering. The amounts and timing of our actual expenditures will depend on numerous factors, including the status of our product development efforts, our sales and marketing activities, the amount of cash generated or used by our operations and competition. Accordingly, our management will have broad discretion in the application of the net proceeds and investors will be relying on the judgment of our management regarding the application of the net proceeds of this offering.

Until we use the net proceeds of this offering for the above purposes, we intend to invest the funds in short-term, investment grade, interest-bearing securities. We cannot predict whether these investments will yield a favorable return.

DIVIDEND POLICY

We have never declared or paid any cash dividends on our common stock. For the foreseeable future, we intend to retain any earnings in our business, and we do not anticipate paying any cash dividends. Whether or not to declare any dividends will be at the discretion of our board of directors, considering then-existing conditions, including our financial condition and results of operations, capital requirements, business prospects and other factors that our board of directors considers relevant.

CAPITALIZATION

The following table sets forth our capitalization as of March 31, 2004:

- on an actual basis; and
- on an as adjusted basis to reflect (a) the conversion of all of our outstanding shares of redeemable convertible preferred stock into an aggregate of 7,488,758 shares of common stock upon the closing of this offering, (b) the automatic conversion of the existing warrant to purchase 400,000 shares of Series E-1 preferred stock into a warrant to purchase 100,000 shares of common stock upon the closing of this offering, and (c) the receipt of net proceeds of $20.7 million from the sale of 3,000,000 shares of common stock offered by this prospectus after deducting the underwriting discount and estimated offering expenses payable by us.

You should read this table together with our financial statements and related notes appearing at the end of this prospectus and the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section of this prospectus.

	As of March 31, 2004	
	Actual	As Adjusted
	(in thousands, except share data)	
Long-term debt, net of current portion	$ 1,732	$ 1,732
Warrants for redeemable convertible preferred stock	450	
Redeemable convertible preferred stock, $0.001 par value; 27,615,630 shares authorized, actual; no shares authorized, as adjusted; 24,548,870 shares issued and outstanding, actual; no shares issued and outstanding, as adjusted	66,623	
Stockholders' (deficit) equity:		
Common stock, $0.0001 par value; 37,000,000 shares authorized, actual and as adjusted; 1,042,990 shares issued and outstanding, actual; 11,531,748 shares issued and outstanding, as adjusted		1
Additional paid-in capital		87,792
Subscription receivable	(2)	(2)
Deferred compensation	(635)	(635)
Accumulated deficit	(53,974)	(53,974)
Total stockholders' (deficit) equity	(54,611)	33,182
Total capitalization	$ 14,194	$ 34,914

The number of shares of common stock outstanding after this offering is based on 1,042,990 shares outstanding as of March 31, 2004 on an actual basis and excludes:

- 444,430 shares of common stock issuable upon the exercise of outstanding stock options as of March 31, 2004 at a weighted average exercise price per share of $1.82; and
- 100,000 shares of common stock issuable upon the exercise of an outstanding warrant as of March 31, 2004 at an exercise price per share of $6.00, assuming the automatic conversion of the existing warrant to purchase 400,000 shares of Series E-1 preferred stock into a warrant to purchase 100,000 shares of common stock, which is to occur upon the closing of this offering.

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DILUTION

If you invest in our common stock, your interest will be diluted immediately to the extent of the difference between the public offering price per share you will pay in this offering and the pro forma net tangible book value per share of our common stock immediately after this offering.

Our net tangible book value as of March 31, 2004 was approximately $(54.6) million, or $(52.36) per share of common stock. Net tangible book value per share is equal to our total tangible assets minus total liabilities, all divided by the number of shares of common stock outstanding as of March 31, 2004.

Our pro forma net tangible book value per share as of March 31, 2004 was approximately $1.46 per share. Pro forma net tangible book value per share gives effect to the conversion of all of our outstanding shares of redeemable convertible preferred stock into an aggregate of 7,488,758 shares of common stock, upon the closing of this offering, and the automatic conversion of the existing warrant to purchase 400,000 shares of Series E-1 preferred stock into a warrant to purchase 100,000 shares of common stock upon the closing of this offering.

After giving effect to the receipt of net proceeds of $20.7 million from the sale of the 3,000,000 shares of common stock offered by this prospectus, after deducting the underwriting discount and estimated offering expenses payable by us, our pro forma as adjusted net tangible book value as of March 31, 2004 would have been approximately $33.2 million, or $2.88 per share. This represents an immediate increase in pro forma net tangible book value of $1.42 per share to existing stockholders and an immediate dilution of $5.12 per share to new investors. The following table illustrates this calculation on a per share basis:

Initial public offering price per share		$ 8.00
Net tangible book value per share as of March 31, 2004	$ (52.36)	
Increase in net tangible book value per share attributable to conversion of preferred stock	53.82	
Pro forma net tangible book value per share of common stock as of March 31, 2004	1.46	
Increase per share attributable to this offering	1.42	
Pro forma as adjusted net tangible book value per share of common stock after this offering		2.88
Pro forma dilution per share to new investors		$ 5.12

If the underwriters exercise their over-allotment option in full, pro forma as adjusted net tangible book value will increase to $3.05 per share, representing an increase to existing holders of $1.59 per share, and there will be an immediate dilution of $4.95 per share to new investors.

The following table summarizes, on a pro forma as adjusted basis as of March 31, 2004, after giving effect to this offering, and the pro forma adjustments referred to above, the total number of shares of our common stock purchased from us and the total consideration and average price per share paid by existing stockholders and by new investors:

	Shares Purchased		Total Consideration		
	Number	Percentage	Amount	Percentage	Average Price per Share
Existing stockholders	8,531,748	74.0%	$ 43,498,315	64.4%	$ 5.10
New investors	3,000,000	26.0	24,000,000	35.6	8.00
	11,531,748	100.0%	$ 67,498,315	100.0%	

If the underwriters exercise their over-allotment option in full, the following will occur:

- the pro forma as adjusted percentage of shares of our common stock held by existing stockholders will decrease to approximately 71.2% of the total number of pro forma as adjusted shares of our common stock outstanding after this offering; and

- the pro forma as adjusted number of shares of our common stock held by new public investors will increase to 3,450,000, or approximately 28.8% of the total pro forma as adjusted number of shares of our common stock outstanding after this offering.

The tables and calculations above are based on 1,042,990 shares of our common stock outstanding as of March 31, 2004, on an actual basis, and exclude:

- 444,430 shares of common stock issuable upon the exercise of outstanding stock options as of March 31, 2004 at a weighted average exercise price per share of $1.82; and

- 100,000 shares of common stock issuable upon the exercise of an outstanding warrant as of March 31, 2004 at an exercise price per share of $6.00, assuming the automatic conversion of the existing warrant to purchase 400,000 shares of Series E-1 preferred stock into a warrant to purchase 100,000 shares of common stock, which is to occur upon the closing of this offering.

If all of our outstanding options and our outstanding warrant as of March 31, 2004 had been exercised as of that date, the pro forma as adjusted net tangible book value per share after this offering would be $2.86 per share and total dilution to new investors would be $5.14 per share, assuming no exercise of the over-allotment option by the underwriters.

SELECTED FINANCIAL DATA

The selected financial data shown below for the years ended December 31, 2001, 2002 and 2003 and as of December 31, 2002 and 2003 have been derived from our financial statements audited by PricewaterhouseCoopers LLP, independent registered public accounting firm, and included elsewhere in this prospectus. The selected financial data shown below for the years ended December 31, 1999 and 2000 and as of December 31, 1999, 2000 and 2001 have been derived from our financial statements not included in this prospectus. The selected financial data shown below for the three months ended March 31, 2003 and 2004 have been derived from our unaudited financial statements included elsewhere in this prospectus. The selected financial data should be read in conjunction with our financial statements and related notes, "Capitalization" and "Management's Discussion and Analysis of Financial Condition and Results of Operations," which are included elsewhere in this prospectus.

	Year Ended December 31,					Three Months Ended March 31,	
	1999	2000	2001	2002	2003	2003	2004
	(Unaudited)	(Unaudited)				(Unaudited)	
	(in thousands, except share and per share data)						
Statement of Operations Data:							
Revenues	$ 112	$ 979	$ 3,464	$ 4,225	$ 9,168	$ 1,621	$ 3,030
Cost of revenues	133	634	1,424	1,370	2,707	477	827
Gross margin	(21)	345	2,040	2,855	6,461	1,144	2,203
Operating expenses:							
Research and development (1)	1,483	1,984	2,561	2,146	2,397	541	650
Sales and marketing (1)	1,331	3,477	5,304	2,870	4,768	1,047	1,335
General and administrative (1)	1,492	2,325	3,228	2,673	2,850	597	855
Total operating expenses	4,306	7,786	11,093	7,689	10,015	2,185	2,840
Loss from operations	(4,327)	(7,441)	(9,053)	(4,834)	(3,554)	(1,041)	(637)
Interest income (loss), net	476	459	336	41	(113)	(0)	(143)
Net loss	(3,851)	(6,982)	(8,717)	(4,793)	(3,667)	(1,041)	(780)
Accretion of dividend on redeemable convertible preferred stock	(1,058)	(1,104)	(1,757)	(1,893)	(2,009)	(502)	(534)
Deemed dividend on redeemable convertible preferred stock				(6,873)			(788)
Beneficial conversion feature associated with redeemable convertible preferred stock							(7,051)
Net loss attributable to common stockholders	$ (4,909)	$ (8,086)	$ (10,474)	$ (13,559)	$ (5,676)	$ (1,543)	$ (9,153)
Net loss per common share:							
Basic and diluted	$ (5.33)	$ (8.36)	$ (10.47)	$ (13.17)	$ (5.46)	$ (1.49)	$ (8.78)
Weighted average basic and diluted common shares outstanding	921,494	967,435	1,000,323	1,029,210	1,038,817	1,037,007	1,042,990
Pro forma basic and diluted net loss per common share (2)					$ (0.54)		$ (1.01)
Shares used in computing pro forma basic and diluted net loss per common share					6,764,884		8,531,748

(1) Non-cash stock-based compensation expense included in these amounts as follows:

Research and development	$ 1	$ 5	$ 8	$ 7	$ 35	$ 4	$ 16
Sales and marketing	4	10	15	6	37	7	17
General and administrative	58	37	33	37	24	3	12
Total non-cash stock-based compensation	$ 63	$ 52	$ 56	$ 50	$ 96	$ 14	$ 45

(2) Pro forma basic and diluted net loss per common share is calculated assuming the conversion of all then-outstanding shares of redeemable convertible preferred stock into shares of common stock.

	As of December 31,					As of March 31,
	1999	2000	2001	2002	2003	2004
	(Unaudited)	(Unaudited)	(Unaudited)			(Unaudited)
	(in thousands)					
Balance Sheet Data:						
Cash and cash equivalents	$ 11,305	$ 5,389	$ 5,396	$ 2,701	$ 1,623	$ 10,900
Working capital	11,084	4,996	6,380	3,724	2,754	12,179
Total assets	12,242	7,158	9,899	7,053	7,218	17,079
Long-term debt and other long-term liabilities	18	964	331	124	2,232	1,933
Warrants for redeemable convertible preferred stock					450	450
Redeemable convertible preferred stock	19,712	20,816	34,995	45,684	47,694	66,623
Accumulated deficit	(8,098)	(15,851)	(26,321)	(39,860)	(44,901)	(53,974)
Total stockholders' deficit	(7,983)	(16,014)	(26,431)	(39,928)	(45,502)	(54,611)

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion of our financial condition and results of operations in conjunction with our selected financial data, our financial statements and the accompanying notes to those financial statements included elsewhere in this prospectus. This discussion contains forward-looking statements that involve risks and uncertainties. As a result of many factors, such as those set forth under the section entitled "Risk Factors" and elsewhere in this prospectus, our actual results may differ materially from those anticipated in these forward-looking statements.

Overview

NEUROMetrix was founded in June 1996. We design, develop and sell proprietary medical devices used to diagnose neuropathies. Our proprietary technology provides physicians with an in-office diagnostic system, the NC-stat System, that enables physicians to make rapid and accurate diagnoses of neuropathies. The NC-stat System is comprised of: (1) disposable NC-stat biosensors that are placed on the patient's body; (2) the NC-stat monitor and related components; and (3) the NC-stat docking station, an optional device that enables the physician's office to transmit data to our onCall Information System. Each component of the NC-stat System is also sold separately. The sensitivity of the nervous system to metabolic and mechanical damage, compounded by its limited regenerative ability, creates a robust market opportunity for a medical device that can assist in point-of-service diagnoses of neuropathies in a manner that is cost-effective for the patient and third-party payer. We believe the ease of use, accuracy and convenience provided by the NC-stat System position it to become a standard of care for the assessment of neuropathies at the point of service.

From our inception until May 1999, we had devoted substantially all of our efforts to designing and developing the NC-stat System and other potential products, raising capital and recruiting personnel. We believe that one of our strengths is our ability to develop and commercialize innovative products for neurological applications. In May 1999, we shipped our first NC-stat System. At that time we sold one type of biosensor, for the testing of the median motor nerve. In 2000, we introduced an additional biosensor for the testing of the ulnar motor nerve. In 2002, we introduced our second-generation NC-stat System, as well as two additional biosensors. In 2003, we added to our product line two biosensors with higher functionality that have the ability to test both motor and sensory nerves. In 2003, we more than doubled our revenues from the prior year, generating $9.2 million in revenues, of which 85.8% was attributable to sales of NC-stat biosensors. Our gross margin percentage in 2003 was 70.5%. In the first quarter of 2004, we generated total revenues of $3.0 million, of which 89.0% was attributable to sales of NC-stat biosensors. Our gross margin percentage in the first quarter of 2004 was 72.7%. In 2004, we introduced a new biosensor to test the ulnar nerve at the elbow, as well as components for the NC-stat monitor to utilize this biosensor.

We derive our revenues from the sale of NC-stat biosensors, monitors and docking stations directly to end users, which are generally physicians. Our NC-stat biosensors are disposable products that are used once and inactivated after use. The NC-stat monitor is an electronic instrument that is used with the NC-stat biosensors to perform nerve conduction studies for the purpose of diagnosing neuropathies. The NC-stat monitor displays the pertinent results of nerve conduction studies on an LCD screen immediately at the conclusion of each study. The NC-stat docking station is an optional device that is used to transmit to the onCall Information System data generated by the nerve conduction study performed with the NC-stat monitor. The onCall Information System formulates the data it receives for each test into a detailed report that is provided to the customer through facsimile or e-mail.

Diagnostic device revenues include revenues derived from the sale of our NC-stat monitors and NC-stat docking stations. Biosensor revenues include revenues derived from the sale of various types of disposable biosensors used to perform nerve conduction studies with the NC-stat monitor. Our revenue

recognition policy is to recognize revenue from our monitors and biosensors upon shipment if the fee is fixed and determinable, persuasive evidence of an arrangement exists, collection of the resulting receivables is probable and product returns are reasonably estimable. Revenues from our docking station are deferred and recognized over the shorter of the estimated customer relationship period or the estimated useful life of the product, currently three years.

Reimbursement from third-party payers is an important element of success for medical products companies. To date, we believe nearly all of the nerve conduction studies performed by our customers with the NC-stat System have been satisfactorily covered by third-party payers. However, widespread adoption of the NC-stat System by the medical community is unlikely to occur if physicians do not continue to receive satisfactory reimbursement from third-party payers for procedures performed with the NC-stat System.

One of the primary challenges we face in our business is successfully expanding the market for nerve conduction studies. A successful market expansion will depend upon, in part, our targeting of primary care physicians who traditionally have not been targeted by companies selling equipment used to perform nerve conduction studies and our ability to alter physicians' practices relating to the diagnosis of neuropathies. In order to successfully implement this growth strategy, we plan to significantly increase our sales force and our total headcount subsequent to this offering and participate in various industry conferences in order to accelerate the market awareness and adoption of our products. These efforts, as well as the overall expansion of our business, will provide challenges to our organization and may strain our management and operations. We are focused on monitoring our business as it grows and appropriately acquiring and allocating resources to address these issues, with a goal of achieving and sustaining profitability.

Since our inception in 1996, we have incurred losses every quarter. We incurred net losses of approximately $8.7 million in 2001, $4.8 million in 2002 and $3.7 million in 2003. In the first quarter of 2004, we incurred a net loss of $780,000. We do not know whether or when we will become profitable. At March 31, 2004, we had an accumulated deficit of approximately $54.0 million. We have financed our operations through the private placement of equity and debt securities. At March 31, 2004, we had $3.0 million of secured debt outstanding. As of March 31, 2004, we had received net proceeds of $43.5 million from the issuance of redeemable convertible preferred stock.

Our financial objective is to achieve and sustain profitable growth. Our efforts in 2004 will be focused primarily on expanding our sales and marketing for the NC-stat System and continuing our ongoing program of making enhancements and improvements to the NC-stat System, including the introduction of new biosensors. We are also in the early stages of designing a drug delivery system for the minimally invasive treatment of neuropathies by both primary care and specialist physicians. We are also focusing our efforts on the management of accounts receivable and control of inventory balances. Executing these objectives is expected to require the hiring of additional sales and administrative personnel, additional investments in research and development and the introduction of new and enhanced product offerings, with the goal of increasing our market penetration. We believe that the accomplishment of these combined efforts will have a positive impact on our cash flow from operations.

Results of Operations

The following table presents certain statement of operations information stated as a percentage of total revenues:

	Year Ended December 31,			Three Months Ended March 31,	
	2003	2002	2001	2004	2003
Revenues:					
Diagnostic device	14.2%	17.1%	22.6%	11.0%	17.7%
Biosensor	85.8	82.9	77.4	89.0	82.3
Total revenues	100.0	100.0	100.0	100.0	100.0
Cost of revenues	29.5	32.4			