

Patient Safety Technologies, Inc  
Form 10-K/A  
April 22, 2008

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-K/A  
Amendment No. 1**

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2007

**OR**

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

COMMISSION FILE NUMBER: 001-09727

**PATIENT SAFETY TECHNOLOGIES, INC.**  
(Exact name of registrant as specified in its charter)

**Delaware**  
(State of Incorporation)

**13-3419202**  
(I.R.S. Employer Identification Number)

**43460 Ridge Park Drive, Suite 140, Temecula, CA 92590**  
(Address of principal executive offices) (Zip Code)

**Registrant's telephone number, including area code: (951) 587-6201**

**Securities registered pursuant to Section 12(b) of the Act: None**

**Securities registered pursuant to Section 12(g) of the Act:**

| <b><u>Title of each class</u></b>        | <b><u>Name of each exchange on which registered</u></b> |
|--|---|
| Common Stock, par value \$0.33 per share | OTC Bulletin Board                                      |

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required

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to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No .

Indicate by check mark, if disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

As of April 11, 12,079,602 shares of the issuer's Common Stock were outstanding. The aggregate market value of the voting stock held by non-affiliates on April 11, 2008 was approximately \$9,303,000 based on the average of the bid and asked prices of the issuer's common stock in the over-the-counter market on such date as reported by the OTC Bulletin Board.

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**EXPLANATORY NOTE**

Patient Safety Technologies, Inc. (the “Company”) is filing this Amendment No. 1 on Form 10-K/A (this “Amendment”) to its Annual Report on Form 10-K for the fiscal year ended December 31, 2007, which was originally filed on April 15, 2008 (the “Original Filing”).

The purpose of this Amendment is to correct a typographical error in footnote 20 of Item 8 of Part II of Form 10-K. This Amendment amends and restates in their entirety only the cover page and Item 8 of Part II. This Amendment does not affect any other parts of or exhibits to the Original Filing, and those unaffected parts or exhibits are not included in this Amendment.

Except as expressly stated herein, this Amendment continues to speak as of the date of the Original Filing and the Company has not updated the disclosure contained herein to reflect events that have occurred since the filing of the Original Filing. Accordingly, this Amendment should be read in conjunction with the Company’s other filings, if any, made with the Securities and Exchange Commission subsequent to the filing of the Original Filing, including any amendments to those filings, if any.

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**PART II**

**FORM 10-K  
FOR PATIENT SAFETY TECHNOLOGIES, INC  
FOR THE YEAR ENDED DECEMBER 31, 2007**

**Item 8. Financial Statements and Supplementary Data.**

**PATIENT SAFETY TECHNOLOGIES, INC.  
INDEX TO FINANCIAL STATEMENTS**

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The schedules for which provision is made in the applicable regulation of the Securities and Exchange Commission are not required under the related instruction or are inapplicable and, therefore, have been omitted

***Report of Independent Registered Public Accounting Firm***

To the Board of Directors and Stockholders of  
Patient Safety Technologies, Inc.

We have audited the accompanying balance sheet of Patient Safety Technologies, Inc. (the "Company") as of December 31, 2007 and 2006, and the related statements of operations and comprehensive loss, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Patient Safety Technologies, Inc. as of December 31, 2007 and 2006, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the financial statements, the Company has reported recurring losses from operations through December 31, 2007 and has a significant accumulated deficit and a significant working capital deficit at December 31, 2007. These factors raise substantial doubt about the Company's ability to continue as a going concern. Management's plans as to these matters are described in Note 1. The accompanying financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Squar, Milner, Peterson, Miranda & Williamson, LLP

San Diego, California  
April 15, 2008

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of  
Patient Safety Technologies, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Patient Safety Technologies, Inc. (formerly known as Franklin Capital Corporation) and Subsidiaries (collectively the, "Company") as of December 31, 2005, and the related consolidated statements of operations and comprehensive loss, stockholders' equity, and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Patient Safety Technologies, Inc. as of December 31, 2005, and the results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1, the Company has a significant accumulated deficit and working capital deficit, and has incurred a significant net loss from operations. Further, the Company has yet to generate revenues from its medical products and healthcare solutions segments. These matters raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 1. The accompanying consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Rothstein, Kass & Company, P.C.

Roseland, New Jersey  
April 10, 2006

## PATIENT SAFETY TECHNOLOGIES, INC. AND SUBSIDIARIES

## Consolidated Balance Sheets

|   | December 31,<br>2007 | December 31,<br>2006 |
|---|----------------------|----------------------|
| <b>ASSETS</b>   |                      |                      |
| <b>CURRENT ASSETS</b>   |                      |                      |
| Cash  | \$ 405,413           | \$ 3,775             |
| Accounts receivable   | 71,840               | 65,933               |
| Inventories   | —                    | 42,825               |
| Prepaid expenses  | 104,723              | 78,834               |
| Other current assets  | 19,174               | 13,125               |
| <b>TOTAL CURRENT ASSETS</b>   | <b>601,150</b>       | <b>204,492</b>       |
| Restricted certificate of deposit   | 87,500               | 87,500               |
| Notes receivable  | 153,545              | 153,668              |
| Property and equipment, net   | 663,391              | 328,202              |
| Assets held for sale, net   | 405,986              | 3,189,674            |
| Goodwill  | 1,832,027            | 1,687,527            |
| Patents, net  | 3,763,908            | 4,088,850            |
| Long-term investments   | 666,667              | 1,441,533            |
| <b>TOTAL ASSETS</b>   | <b>\$ 8,174,174</b>  | <b>\$ 11,181,446</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                      |                      |
| <b>CURRENT LIABILITIES</b>  |                      |                      |
| Notes payable, current portion - net  | \$ 1,172,380         | \$ 3,517,149         |
| Accounts payable  | 708,593              | 1,295,849            |
| Accrued liabilities   | 520,749              | 824,466              |
| <b>TOTAL CURRENT LIABILITIES</b>  | <b>2,401,722</b>     | <b>5,637,464</b>     |
| Notes payable, less current portion - net   | 2,530,558            | 2,527,562            |
| Deferred tax liabilities  | 1,499,329            | 1,473,066            |
| <b>COMMITMENTS AND CONTINGENCIES (Note 18)</b>  |                      |                      |
| <b>STOCKHOLDERS' EQUITY</b>   |                      |                      |
| Convertible preferred stock, \$1.00 par value, cumulative 7% dividend:                                |                      |                      |
| 1,000,000 shares authorized; 10,950 issued and outstanding at December 31, 2007 and December 31, 2006 |                      |                      |

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(Liquidation preference of \$1,229,138 at December 31, 2007 and \$1,190,813 at

|   |              |               |
|---|--------------|---------------|
| December 31, 2006)  | 10,950       | 10,950        |
| Common stock, \$0.33 par value: 25,000,000 shares authorized;<br>12,054,602 shares issued and outstanding as of December 31, 2007;<br>7,489,026<br>shares issued and 6,874,889 shares outstanding at December 31,<br>2006 | 3,978,019    | 2,471,379     |
| Additional paid-in capital  | 34,320,134   | 29,654,341    |
| Accumulated deficit   | (36,566,538) | (29,483,910)  |
|   | 1,742,565    | 2,652,760     |
| Less: 614,137 shares of treasury stock, at cost, at December 31, 2006   | —            | (1,109,406)   |
| <b>TOTAL STOCKHOLDERS' EQUITY</b>   | 1,742,565    | 1,543,354     |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>   | \$ 8,174,174 | \$ 11,181,446 |

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



## PATIENT SAFETY TECHNOLOGIES, INC. AND SUBSIDIARIES

## Consolidated Statements of Operations and Comprehensive Loss

|  | For The Year Ended December 31, |                 |                |
|--|---------------------------------|-----------------|----------------|
|  | 2007                            | 2006            | 2005           |
| <b>REVENUES</b>  | \$ 1,089,001                    | \$ 244,529      | \$ 562,374     |
| <b>COST OF SALES</b>                                       | 716,292                         | 158,902         | —              |
| <b>Gross margin</b>  | 372,709                         | 85,627          | 562,374        |
| <b>OPERATING EXPENSES</b>                                  |                                 |                 |                |
| Salaries and employee benefits                             | 2,737,235                       | 3,722,822       | 4,182,466      |
| Professional fees  | 843,207                         | 2,161,044       | 2,523,035      |
| Rent   | 78,937                          | 131,129         | 88,368         |
| Insurance  | 88,327                          | 87,674          | 113,921        |
| Taxes other than income taxes                              | 66,309                          | 101,536         | 104,238        |
| Amortization of patents                                    | 324,942                         | 324,942         | 270,785        |
| General and administrative                                 | 1,388,327                       | 1,162,041       | 1,101,712      |
| <b>Total operating expenses</b>                            | 5,527,284                       | 7,691,188       | 8,384,525      |
| <b>Operating loss</b>                                      | (5,154,575)                     | (7,605,561)     | (7,822,151)    |
| <b>OTHER INCOME (EXPENSES)</b>                             |                                 |                 |                |
| Interest, dividend income and other                        | 4,287                           | 2,251           | 42,476         |
| Liquidated damages   | (193,346)                       | —               | —              |
| Equity in loss of investee                                 | —                               | —               | (74,660)       |
| Realized gain (loss) on investments, net                   | 22,394                          | (1,541,506)     | 2,014,369      |
| Gain on debt extinguishment                                | —                               | 190,922         | —              |
| Interest expense   | (1,468,045)                     | (3,155,853)     | (135,414)      |
| Unrealized (loss) gain on marketable securities, net       | (24,578)                        | 16,901          | 32,335         |
| <b>Loss from continuing operations before income taxes</b> | (6,813,863)                     | (12,092,846)    | (5,943,045)    |
| <b>Income tax expense (benefit)</b>                        | (26,264)                        | 116,979         | 97,482         |
| <b>Loss from continuing operations</b>                     | (6,840,127)                     | (11,975,867)    | (5,845,563)    |
| <b>Loss from discontinued operations</b>                   | (165,851)                       | (1,647,285)     | (61,960)       |
| <b>Net loss</b>  | (7,005,978)                     | (13,623,152)    | (5,907,523)    |
| <b>Preferred dividends</b>                                 | (76,650)                        | (76,650)        | (75,700)       |
| <b>Loss applicable to common shareholders</b>              | \$ (7,082,628)                  | \$ (13,699,802) | \$ (5,983,223) |
| <b>Basic and diluted net loss per common share</b>         |                                 |                 |                |
| <b>Continuing operations</b>                               | \$ (0.68)                       | \$ (1.89)       | \$ (1.10)      |

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|  |    |             |    |              |    |              |
|--|----|-------------|----|--------------|----|--------------|
| <b>Discontinued operations</b>   | \$ | (0.02)      | \$ | (0.26)       | \$ | (0.01)       |
| <b>Net loss</b>  | \$ | (0.70)      | \$ | (2.15)       | \$ | (1.11)       |
| <b>Weighted average common shares outstanding - basic and diluted</b>                            |    | 10,066,940  |    | 6,362,195    |    | 5,373,318    |
| <b>Comprehensive loss:</b>   |    |             |    |              |    |              |
| <b>Net loss</b>  | \$ | (7,005,978) | \$ | (13,623,152) | \$ | (5,907,523)  |
| <b>Other comprehensive (loss) gain, unrealized gain (loss) on available-for-sale investments</b> |    | —           |    | (2,374,858)  |    | 2,374,858.00 |
| <b>Total comprehensive loss</b>  | \$ | (7,005,978) | \$ | (15,998,010) | \$ | (3,532,665)  |

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

## PATIENT SAFETY TECHNOLOGIES, INC. AND SUBSIDIARIES

## Consolidated Statements of Cash Flows

|   | For The Year Ended December 31, |                 |                |
|---|---------------------------------|-----------------|----------------|
|   | 2007                            | 2006            | 2005           |
| Cash flows from operating activities:                                       |                                 |                 |                |
| Net loss  | \$ (7,005,978)                  | \$ (13,623,152) | \$ (5,907,523) |
| Adjustments to reconcile net loss to net cash used in operating activities: |                                 |                 |                |
| Depreciation  | 205,673                         | 136,056         | 14,943         |
| Amortization of patents   | 324,942                         | 324,942         | 270,785        |
| Non-cash interest   | 1,083,813                       | 2,983,417       | —              |
| Goodwill impairment   | —                               | 971,036         | —              |
| Realized (gain) loss on investments, net                                    | (32,561)                        | 1,541,506       | (2,014,369)    |
| Gain on debt extinguishment   | —                               | (190,922)       | —              |
| Unrealized gain on marketable securities                                    | 24,578                          | (16,901)        | (32,335)       |
| Stock-based compensation to employees and directors                         | 1,097,123                       | 2,403,173       | 3,116,674      |
| Stock-based compensation to consultants                                     | 57,249                          | 898,294         | 1,387,612      |
| Stock-based compensation for liquidated damages                             | 193,346                         | —               | —              |
| Stock received for services   | —                               | —               | (666,249)      |
| Loss on investee  | —                               | —               | 74,660         |
| Income tax expense (benefit)  | 26,264                          | (116,979)       | (97,482)       |
| Minority interest   | —                               | —               | (47,008)       |
| Changes in operating assets and liabilities:                                |                                 |                 |                |
| Restricted cash   | —                               | —               | (87,500)       |
| Accounts receivable   | (5,907)                         | (65,933)        | —              |
| Receivables from investments  | —                               | 934,031         | (934,031)      |
| Marketable securities, net  | —                               | 809,260         | 2,439,665      |
| Inventories   | 42,825                          | 34,656          | (77,481)       |
| Prepaid expenses  | 474,111                         | 33,900          | 43,278         |
| Other current assets  | (6,049)                         | 105,269         | (38,896)       |
| Notes receivable  | 123                             | (32,603)        | —              |
| Assets held for sale, net   | 21,818                          | —               | —              |
| Accounts payable  | (587,256)                       | 878,372         | 494,918        |
| Accrued liabilities   | 320,770                         | —               | —              |
| Due to broker   | —                               | (801,863)       | 341,087        |
| Net cash used in operating activities                                       | (3,765,116)                     | (2,794,441)     | (1,719,252)    |
| Cash flows from investing activities:                                       |                                 |                 |                |
| Purchase of property and equipment  | (561,068)                       | (2,305,657)     | (829,537)      |
| Purchase of SurgiCount  | —                               | —               | (432,398)      |
| Proceeds from sale of property and equipment                                | 42,600                          | —               | —              |
| Proceeds from sale of assets held for sale, net                             | 3,178,023                       | —               | —              |
| Proceeds from sale of long-term investments                                 | 333,333                         | 289,409         | 1,371,522      |
| Purchases of long-term investments  | —                               | —               | (903,173)      |
| Net cash provided by (used in) investing activities                         | 2,992,888                       | (2,016,248)     | (793,586)      |

|   |                  |                  |                  |
|---|------------------|------------------|------------------|
| <b>Cash flows from financing activities:</b>        |                  |                  |                  |
| Proceeds from issuance of common stock and warrants | 4,484,406        | 527,850          | 250,000          |
| Proceeds from exercise of stock options             | —                | —                | 26,250           |
| Purchases of treasury stock                         | —                | —                | (36,931)         |
| Proceeds from notes payable                         | 100,000          | 7,549,683        | 1,621,627        |
| Payments and decrease on notes payable              | (3,372,215)      | (3,342,442)      | (95,976)         |
| Payments of preferred dividends                     | (38,325)         | —                | (19,163)         |
| <b>Net cash provided by financing activities</b>    | <b>1,173,866</b> | <b>4,735,091</b> | <b>1,745,807</b> |
| <b>Net increase (decrease) in cash</b>              | <b>401,638</b>   | <b>(75,598)</b>  | <b>(767,031)</b> |
| Cash at beginning of period                         | 3,775            | 79,373           | 846,404          |
| Cash at end of period                               | \$ 405,413       | \$ 3,775         | \$ 79,373        |

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

## PATIENT SAFETY TECHNOLOGIES, INC. AND SUBSIDIARIES

## Consolidated Statements of Cash Flows (continued)

|   | For The Year Ended December 31, |            |              |
|---|---------------------------------|------------|--------------|
|   | 2007                            | 2006       | 2005         |
| Supplemental disclosures of cash flow information:                                |                                 |            |              |
| Cash paid during the period for interest  | \$ 255,245                      | \$ 216,779 | \$ 61,593    |
| Supplemental schedule of non cash investing and financing activities:             |                                 |            |              |
| Dividends accrued   | \$ 38,325                       | \$ 76,650  | \$ 75,700    |
| Issuance of common stock and warrants in connection with Surgicount acquisition   | \$ 144,500                      | \$ —       | \$ 4,232,178 |
| Issuance of common stock in payment of notes payable and accrued interest         | \$ 695,732                      | \$ —       | \$ —         |
| Issuance of common stock for inventory  | \$ 500,000                      | \$ —       | \$ —         |
| Payment of accrued liability with long-term investments                           | \$ 10,969                       | \$ —       | \$ —         |
| Reclassification of accrued interest to notes payable, less current portion - net | \$ 348,614                      | \$ —       | \$ —         |
| Reclassification of long term investments to assets held for sale                 | \$ 430,564                      | \$ —       | \$ —         |
| Issuance of common stock in connection with asset purchase agreement              | \$ —                            | \$ —       | \$ 66,895    |
| Issuance of common stock in connection with land acquisition                      | \$ —                            | \$ —       | \$ 85,619    |
| Issuance of common stock in connection with purchase of marketable securities     | \$ —                            | \$ —       | \$ 101,640   |
| Issuance of common stock in connection with prepaid legal services                | \$ —                            | \$ 50,000  | \$ —         |
| Accrued purchase price of investment  | \$ —                            | \$ —       | \$ (165,240) |
| Assumption of accrued liabilities   | \$ —                            | \$ —       | \$ 15,000    |
| Capitalized interest  | \$ —                            | \$ —       | \$ 28,840    |
| Reclassification of other current asset to purchase of Surgicount                 | \$ —                            | \$ —       | \$ 20,000    |

Purchase of the remaining 50% interest in ASG, through issuance of common stock, resulting in the following asset acquired and liabilities assumed during the quarter ended March 31, 2006 as follows:

|                     | ASG          |
|---------------------|--------------|
| Goodwill            | \$ 357,008   |
| Common stock issued | \$ (610,000) |
| Minority interest   | \$ 252,992   |

In connection with the Company's acquisitions of Surgicount and ASG, equity instruments were issued

and liabilities assumed during 2005 as follows:

|                               |              | ASG |           |
|-------------------------------|--------------|-----|-----------|
| Surgicount                    |              |     |           |
| Fair value of assets acquired | \$ 6,372,103 | \$  | 1,095,211 |
| Cash paid                     | (452,398)    |     | (300,000) |
| Equity instruments issued     | (4,232,178)  |     |           |
| Minority interest             |              |     | (300,000) |
| Liabilities assumed           | \$ 1,687,527 | \$  | 495,211   |

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

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## PATIENT SAFETY TECHNOLOGIES, INC. AND SUBSIDIARIES

**Consolidated Statements of Stockholders' Equity**  
 For the Three Years Ended December 31, 2007

|  | Preferred Stock<br>Shares | Preferred Stock<br>Amount | Common Stock Issued<br>Shares | Common Stock Issued<br>Amount | Paid-In<br>Capital | Other<br>Comprehensive<br>Income | Accumulated<br>Deficit | Treasury<br>Shares |          |
|--|---------------------------|---------------------------|-------------------------------|-------------------------------|--------------------|----------------------------------|------------------------|--------------------|----------|
| <b>BALANCES,</b><br>December 31, 2004                        | 10,950                    | \$ 10,950                 | 6,128,067                     | \$ 2,022,262                  | \$ 13,950,774      | \$ —                             | — (9,800,885)          | (1,457,364)        | \$ —     |
| Net loss   | —                         | —                         | —                             | —                             | —                  | —                                | — (5,907,523)          | —                  | —        |
| Other comprehensive<br>income                                | —                         | —                         | —                             | —                             | —                  | — 2,374,858                      | —                      | —                  | —        |
| Preferred Dividends  | —                         | —                         | —                             | —                             | —                  | —                                | — (75,700)             | —                  | —        |
| Issuance of common<br>stock for:                             |                           |                           |                               |                               |                    |                                  |                        |                    |          |
| Cash   | —                         | —                         | —                             | —                             | 129,904            | —                                | —                      | —                  | 65,319   |
| Purchase of<br>investments/Surgicount<br>acquisition         | —                         | —                         | 600,000                       | 198,000                       | 3,579,916          | —                                | —                      | —                  | 58,444   |
| Exercise of stock<br>options                                 | —                         | —                         | —                             | —                             | 16,150             | —                                | —                      | —                  | 5,625    |
| Services   | —                         | —                         | 96,961                        | 31,998                        | 408,220            | —                                | —                      | —                  | 15,756   |
| Compensation expense<br>due to warrant<br>issuances          | —                         | —                         | —                             | —                             | 918,132            | —                                | —                      | —                  | —        |
| Compensation expense<br>due to restricted stock<br>issuances | —                         | —                         | 170,248                       | 56,181                        | 1,463,666          | —                                | —                      | —                  | —        |
| Compensation expense<br>due to stock option<br>issuances     | —                         | —                         | —                             | —                             | 1,596,825          | —                                | —                      | —                  | —        |
| Warrants issued in<br>purchase of Surgicount                 | —                         | —                         | —                             | —                             | 536,578            | —                                | —                      | —                  | —        |
| Repurchases of<br>common stock                               | —                         | —                         | —                             | —                             | —                  | —                                | —                      | —                  | (10,611) |
| <b>BALANCES,</b><br>December 31, 2005                        | 10,950                    | \$ 10,950                 | 6,995,276                     | \$ 2,308,441                  | \$ 22,600,165      | \$ 2,374,858                     | — (15,784,108)         | (1,322,831)        | \$ —     |
| Net loss   | —                         | —                         | —                             | —                             | —                  | —                                | — (13,623,152)         | —                  | —        |
| Other comprehensive<br>income                                | —                         | —                         | —                             | —                             | —                  | — (2,374,858)                    | —                      | —                  | —        |

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|  |        |           |            |              |               |    |                 |             |
|--|--------|-----------|------------|--------------|---------------|----|-----------------|-------------|
| Preferred Dividends                                    | —      | —         | —          | —            | —             | —  | (76,650)        | —           |
| Issuance of common stock for:                          |        |           |            |              |               |    |                 |             |
| Cash   | —      | —         | —          | —            | (263,178)     | —  | —               | 438,000     |
| Purchase of ASG  | —      | —         | —          | —            | 248,751       | —  | —               | 200,000     |
| Services   | —      | —         | 79,144     | 26,118       | 331,288       | —  | —               | 70,694      |
| Compensation expense due to warrant issuances          | —      | —         | —          | —            | 593,215       | —  | —               | —           |
| Compensation expense due to restricted stock issuances | —      | —         | 414,606    | 136,820      | 968,565       | —  | —               | —           |
| Compensation expense due to stock option issuances     | —      | —         | —          | —            | 1,117,788     | —  | —               | —           |
| Warrants issued in connection with debt financings     | —      | —         | —          | —            | 4,057,747     | —  | —               | —           |
| <b>BALANCES,</b>                                       |        |           |            |              |               |    |                 |             |
| December 31, 2006                                      | 10,950 | \$ 10,950 | 7,489,026  | \$ 2,471,379 | \$ 29,654,341 | \$ | —\$(29,483,910) | (614,137)\$ |
| Net loss   | —      | —         | —          | —            | —             | —  | —               | (7,005,978) |
| Preferred Dividends                                    | —      | —         | —          | —            | —             | —  | —               | (76,650)    |
| Issuance of common stock for:                          |        |           |            |              |               |    |                 |             |
| Cash   | —      | —         | 3,639,863  | 1,201,155    | 2,828,026     | —  | —               | 584,137     |
| Contingent payment due to SurgiCount acquisition       | —      | —         | 100,000    | 33,000       | 111,500       | —  | —               | —           |
| Services   | —      | —         | 33,000     | 10,890       | 38,610        | —  | —               | —           |
| Payment of debt  | —      | —         | 551,197    | 181,895      | 513,836       | —  | —               | —           |
| Compensation expense due to warrant issuances          | —      | —         | —          | —            | 210,578       | —  | —               | —           |
| Compensation expense due to restricted stock issuances | —      | —         | 241,516    | 79,700       | 289,054       | —  | —               | 30,000      |
| Compensation expense due to stock option issuances     | —      | —         | —          | —            | 674,189       | —  | —               | —           |
|  | 10,950 | \$ 10,950 | 12,054,602 | \$ 3,978,019 | \$ 34,320,134 | \$ | —\$(36,566,538) | —\$         |

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





**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**December 31, 2007**

**1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION**

Patient Safety Technologies, Inc. ("*PST*" or the "*Company*") is a Delaware corporation. The Company's operations are conducted at its wholly-owned operating subsidiary, SurgiCount Medical, Inc. ("*SurgiCount*"), a California corporation.

The Company's primary focus is development, manufacturing and distribution of products and services focused primarily in the health care and medical products field, particularly the patient safety markets. SurgiCount is a developer and manufacturer of patient safety products and services. The SurgiCount Safety-Sponge System is a patented turn-key array of modified surgical sponges, line-of-sight scanning SurgiCounters, and printPAD printers integrated together to form a comprehensive counting and documentation system.

Until June 29, 2007, the Company also operated a car wash through Automotive Services Group, Inc. ("*Automotive Services Group*"), which held the Company's investment in Automotive Services Group, LLC ("*ASG*"), its wholly-owned subsidiary. As discussed in Note 4, during the fourth quarter of 2006 the Company began marketing the assets held in ASG for sale and on June 29, 2007, the sale of ASG's one operating car wash was completed. In addition, the Company holds various other unrelated investments including investments in real estate and in a financial services company, which it is in the process of liquidating as part of a strategic plan adopted during 2006 to dispose of all of the Company's non patient safety related assets.

**2. LIQUIDITY AND GOING CONCERN**

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. At December 31, 2007, the Company has an accumulated deficit of approximately \$36.6 million and a working capital deficit of approximately \$1.8 million. For the year ended December 31, 2007, the Company incurred a loss of approximately \$7.1 million and has used approximately \$3.8 million in cash in its operations. Further, as of December 31, 2007 the Company has only generated minimal revenues from its medical products and healthcare solutions segments. These conditions raise substantial doubt about the Company's ability to continue as a going concern. The Company has relied on liquidating investments and short-term debt financings to fund a large portion of its operations. In order to ensure the continued viability of the Company, equity financing must be obtained and profitable operations must be achieved in order to repay the existing short-term debt and to provide a sufficient source of operating capital. Although the Company has received equity financing during the year ended December 31, 2007, the Company is currently seeking additional financing and believes that it will be successful. However, no assurances can be made that it will be successful obtaining a sufficient amount of equity financing to continue to fund its operations or that the Company will achieve profitable operations and positive cash flow from its medical products segment. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Principles of Consolidation**

The accompanying consolidated financial statements for 2007 include the accounts of the Company and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

**Use of Estimates**

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. These estimates are based on knowledge of current events and anticipated future events and accordingly, actual results may differ from those estimates.

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**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

**Cash and Cash Equivalents**

The Company considers only highly-liquid investments such as money market funds and commercial paper with maturities of three months or less at the date of their acquisition as cash and cash equivalents.

**Concentration of Credit Risk**

From time to time, the Company maintains its cash balances at a financial institution that exceeds the Federal Deposit Insurance Corporation coverage of \$100,000. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash.

**Shipping and Handling Costs**

Shipping and handling costs are classified as cost of sales.

**Accounts Receivable**

Accounts receivable are recorded at the invoice amount and do not bear interest. Account balances are reviewed individually for collectibility. Historically, the Company has not incurred any credit losses on extended credits. An allowance for bad debts has not been recorded and is not considered necessary due to the nature of the Company's customer base and the lack of historical write offs.

**Inventories**

Inventories, consisting primarily of hand held scanners at December 31, 2006, are stated at the lower of cost or market on the first-in, first-out basis. There was no inventory recorded as of December 31, 2007.

**Investments - Debt and Equity Securities**

The Company complies with accounting and reporting requirements of Statement of Financial Accounting Standards ("*SFAS*") No. 115, *Accounting for Certain Investments in Debt and Equity Securities* ("*SFAS No. 115*"). SFAS No. 115 requires that certain debt and equity securities be classified into one of three categories: held-to-maturity, available-for-sale or trading securities.

*Trading Securities.* The Company's investment in marketable securities that are bought and held principally for the purpose of selling them in the near-term are classified as trading securities. Trading securities are recorded at fair value on the balance sheet in current assets, with the change in fair value during the period included in earnings in the statement of operations.

*Available-for-Sale Investments.* Investments designated as available-for-sale include both marketable equity and debt (including redeemable preferred stock) securities. Investments that are designated as available-for-sale are reported at fair value, with unrealized gains and losses recorded in stockholders' equity. Realized gains and losses on the sale or exchange of equity securities and declines in value judged to be other than temporary are recorded in realized gains (losses) on investments, net. During the year ended December 31, 2006, \$2,375,000 of other comprehensive income was reclassified into earnings.

**Investments**

The Company complies with Accounting Principles Board (“**APB**”) Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*. Investments are accounted for using the equity method of accounting if the investment provided the Company the ability to exercise significant influence, but not control, over an investee. Significant influence is generally deemed to exist if the Company has an ownership interest in the voting stock of the investee of between 20% and 50%, although other factors, such as representation on the investee's board of directors, are considered in determining whether the equity method of accounting is appropriate. The Company records its investments in equity method investees meeting these characteristics under Long-Term Investments in the accompanying consolidated financial statements. These investments are carried at cost, adjusted for the Company's proportionate share of their undistributed earnings or losses. The Company's proportionate share of income or losses are recorded in equity in income (loss) of investee in the statements of operations.

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**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

Other investments that the Company has less than 20% ownership of common stock of the investee is accounted for under the cost method of accounting.

*Valuation of Investments.* Security investments which are publicly traded on a national exchange or Nasdaq Stock Market are stated at the last reported sales price on the day of valuation or, if no sale was reported on that date, then the securities are stated at the last quoted bid price. The Company may determine, if appropriate, to discount the value where there is an impediment to the marketability of the securities held.

Investments for which there is no ready market are initially valued at cost and, thereafter, at fair value. To determine fair value, an impairment analysis is performed based upon the financial condition and operating results of the issuer and other pertinent factors. Other pertinent factors taken into consideration to determine the fair value of an investment includes, but are not limited to, assumptions related to future results of operations and growth of the investee company, the nature and value of any collateral, the investee company's ability to make payments, the markets in which the investee company does business, comparison to valuations of publicly traded companies, comparisons to recent sales of comparable companies, the discounted value of the cash flows of the portfolio company and other relevant factors. The financial condition and operating results have been derived utilizing both audited and unaudited data. In the absence of a ready market for an investment, numerous assumptions are inherent in the valuation process. Some or all of these assumptions may not materialize. Unanticipated events and circumstances may occur subsequent to the date of the valuation and values may change due to future events. Therefore, the actual amounts eventually realized from each investment may vary from the valuations shown and the differences may be material.

The Company complies with the FASB's Emerging Issues Task Force ("*EITF*") Issue No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, to determine whether certain investments are considered impaired, whether that impairment is other-than-temporary, and the measurement and recognition of an impairment loss. The EITF Issue No. 03-1 also provides guidance on accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have been recognized as other-than-temporary impairments.

Investments identified as having an indicator of impairment are subject to further analysis to determine if the investment is other than temporarily impaired, in which case the investment is written down to its impaired value. When an investee company is not considered viable from a financial or technological point of view, the entire investment is written down since we consider the estimated fair market value to be nominal. If an investee company obtains additional funding at a valuation lower than the Company's carrying amount or requires a new round of equity funding to stay in operation and the new funding does not appear imminent, a presumption is made that the investment is other than temporarily impaired, unless specific facts and circumstances indicate otherwise. No impairment charges were recognized during the year ended December 31, 2007. During the years ended December 31, 2006 and 2005, included in realized gain (loss) on investments, net, is a \$1,458,000 impairment charge from the Company's investment in Ipex, Inc. and a \$50,000 impairment charge from the Company's investment China Nurse, LLC, respectively.

**Gains (Losses) on Sale of Investments**

Amounts reported as realized gains (losses) are measured by the difference between the proceeds of sale or exchange and the cost basis of the investment. Gains (losses) are considered realized when sales or dissolution of investments are consummated.



**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

**Fair Value of Financial Instruments**

The fair value of the Company's assets and liabilities, which qualify as financial instruments under SFAS No. 107, *Disclosures About Fair Value of Financial Instruments*, approximate the carrying amounts presented in the accompanying Consolidated Balance Sheets.

**Revenue Recognition**

The Company complies with SEC Staff Accounting Bulletin ("**SAB**") 101, *Revenue Recognition in Financial Statements*, amended by SAB 104, *Revenue Recognition*. Consulting service contract revenue is recognized when the service is performed. Consequently, the recognition of such consulting service contract revenue is deferred until each phase of the contract is complete. Revenues generated by the Company's previously owned automated car wash subsidiary, Automotive Services Group were recognized at the time of service. Revenues from sales of the Safety-Sponge System are recorded upon shipment.

**Goodwill and Intangible Assets**

In accordance with SFAS No. 142, *Goodwill and Intangible Assets*, goodwill is tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis in the Company's fourth fiscal quarter or more frequently if indicators of impairment exist. The performance of the test involves a two-step process. The first step of the impairment test involves comparing the fair value of the Company's reporting units with each respective reporting unit's carrying amount, including goodwill. The fair value of reporting units is generally determined using the income approach. If the carrying amount of a reporting unit exceeds the reporting unit's fair value, the second step of the goodwill impairment test is performed to determine the amount of any impairment loss. The second step of the goodwill impairment test involves comparing the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill.

**Long-Lived Assets**

The Company evaluates long-lived assets for impairment in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, which requires impairment evaluation on long-lived assets used in operations when indicators of impairment are present. Reviews are performed to determine whether the carrying value of an asset is impaired, based on a comparison to undiscounted expected future cash flows. If this comparison indicates that there is impairment, the impaired asset is written down to fair value, which is typically calculated using discounted expected future cash flows and a discount rate based upon the Company's weighted average cost of capital adjusted for risks associated with the related operations. Impairment is based on the excess of the carrying amount over the fair value of those assets.

**Stock-Based Compensation**

The Company adopted SFAS No. 123(R), *Share-Based Payment*, as of January 1, 2005 using the modified retrospective application method as provided by SFAS 123(R) and accordingly, financial statement amounts for the prior periods in which the Company granted employee stock options have been restated to reflect the fair value method of expensing prescribed by SFAS 123(R). During the years ended December 31, 2007, 2006 and 2005, the Company had stock-based compensation expense, related to issuances to the Company's employee and directors, included in reported net loss, of \$1,097,000, \$2,223,000 and \$3,117,000, respectively. The total amount of stock-based compensation for the year ended December 31, 2007 of \$1,097,000, included restricted stock grants valued at \$423,000 and stock options valued at \$674,000. The total amount of stock-based compensation for the year



ended December 31, 2006 of \$2,223,000, included restricted stock grants valued at \$1,105,000 and stock options valued at \$1,118,000. The total amount of stock based compensation for the year ended December 31, 2005 of \$3,117,000, included restricted stock grants valued at \$1,520,000 and stock options valued at \$1,597,000.

During the years ended December 31, 2007, 2006 and 2005, the Company had stock-based compensation expense, from issuances of restricted stock and warrants to consultants of the Company of \$57,000, \$898,000 and \$1,388,000, respectively.

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**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

**Property and Equipment**

Property and equipment are stated at cost and are depreciated on the straight-line method over the estimated useful lives of the assets as follows:

|                                 | <b>Estimated<br/>Useful Lives</b> |
|---------------------------------|-----------------------------------|
| Furniture and fixtures          | 5-7 Years                         |
| Computer software and equipment | 3-5 Years                         |

Maintenance and repairs are charged to operations, while betterments and improvements are capitalized.

**Beneficial Conversion Feature of Convertible Notes Payable**

The convertible feature of certain notes payable provides for a rate of conversion that is below market value. Such feature is normally characterized as a Beneficial Conversion Feature (“**BCF**”). Pursuant to EITF Issue No. 98-5, *Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratio*, EITF No. 00-27, *Application of EITF Issue No. 98-5 To Certain Convertible Instruments* and APB 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants*, the estimated fair value of the BCF is recorded in the consolidated financial statements as a discount from the face amount of the notes. Such discounts are amortized to accretion of convertible debt discount over the term of the notes (or conversion of the notes, if sooner).

**Income Taxes**

The Company accounts for income taxes in accordance with the provisions of SFAS No. 109, *Accounting for Income Taxes*. The significant components of deferred tax assets and liabilities are principally related to the Company's net operating loss carryforward and its unrealized appreciation of investments.

Deferred income taxes are provided in amounts sufficient to give effect to temporary differences between financial and tax reporting, principally related to net operating loss carryforwards. Valuation allowances are provided to the extent realization of recorded tax assets is not considered likely.

**Earnings per Common Share**

Loss per common share is based on the weighted average number of common shares outstanding. The Company complies with SFAS No. 128, *Earnings Per Share*, which requires dual presentation of basic and diluted earnings per share on the face of the consolidated statements of operations. Basic loss per common share excludes dilution and is computed by dividing income (loss) available to common stockholders by the weighted-average common shares outstanding for the period. Diluted loss per common share reflects the potential dilution that could occur if convertible preferred stock or debentures, options and warrants were to be exercised or converted or otherwise resulted in the issuance of common stock that then shared in the earnings of the entity.

Since the effects of outstanding options, warrants and the conversion of convertible preferred stock and convertible debt are anti-dilutive in all periods presented, shares of common stock underlying these instruments have been excluded from the computation of loss per common share.



**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

**Treasury Stock**

Shares of common stock repurchased by the Company are recorded at cost as treasury stock and result in a reduction of stockholders' equity in the accompany consolidated balance sheets. When shares are reissued, the Company uses the weighted average cost method for determining cost. The difference between the cost of the shares and the issuance price is added or deducted from additional paid-in capital.

**Comprehensive Income (Loss)**

The Company applies SFAS No. 130, *Reporting Comprehensive Income*. Comprehensive income (loss) consists of the after tax net change in unrealized gains and losses on securities classified as available-for-sale that have been excluded from net loss and reflected instead in stockholders' equity. At December 31, 2005, the only investments designated as available-for-sale were the Company's restricted holdings in IPEX, Inc. ("**IPEX**") and its investment in Digicorp and Alacra Corporation ("**Alacra**"). During the year ended December 31, 2006, the Company sold its investment in Digicorp and recorded an impairment charge for the entire amount of its investment in IPEX leaving Alacra as the only remaining investment designated as available-for-sale as of December 31, 2007.

**Recent Accounting Pronouncements**

In September 2006, the Financial Accounting Standards Board ("**FASB**") issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ("**SFAS 157**"). SFAS 157 does not require new fair value measurements but rather defines fair value, establishes a framework for measuring fair value and expands disclosure of fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We are currently assessing the impact of SFAS 157 on our consolidated financial position and results of operations.

On January 1, 2007, we adopted Emerging Issues Task Force Issue No. 06-2, *Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43* ("**EITF 06-2**"). EITF 06-2 requires companies to accrue the costs of compensated absences under a sabbatical or similar benefit arrangement over the requisite service period. Upon adoption, no liability for unrecognized compensated absences was recognized.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment to FASB Statement No. 115* ("**SFAS 159**"). This statement permits companies to choose to measure many financial instruments and other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This statement is expected to expand the use of fair value measurement of accounting for financial instruments. The fair value option established by this statement permits all entities to measure eligible items at fair value at specified election dates. This statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. We are currently assessing the impact adoption of SFAS No. 159 will have on our consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R), *Business Combinations* ("**SFAS 141(R)**"). This statement requires the acquiring entity in a business combination to record all assets acquired and liabilities assumed at their respective acquisition-date fair values, changes the recognition of assets acquired and liabilities assumed arising from contingencies, changes the recognition and measurement of contingent consideration, and requires the expensing of acquisition-related costs as incurred. SFAS 141(R) also requires

additional disclosure of information surrounding a business combination, such that users of the entity's financial statements can fully understand the nature and financial impact of the business combination. We will implement SFAS No. 141(R) on January 1, 2009 and will apply prospectively to business combinations completed on or after that date.

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**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB 51* (“**SFAS 160**”). SFAS 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also established reporting requirements that provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owner. We will implement SFAS No. 160 on January 1, 2009. We do not expect the adoption of this standard to have a material impact on our income statement, financial position or cash flows.

**4. DISCONTINUED OPERATIONS**

As part of a strategic plan to dispose of all the Company's non-patient safety related assets, during the fourth quarter of 2006 the Company began marketing for sale the assets of ASG, located in Alabama. The Company completed the sale of one operating car wash on June 29, 2007 and two parcels of undeveloped land during the three months ended September 30, 2007. The assets of ASG met the “held for sale” and “discontinued operations” criteria in accordance with SFAS 144.

The following sets forth the discontinued operations for the years ended December 31, 2007, 2006 and 2005 related to the held for sale assets of Automotive Services Group:

|                                   | <b>Years Ended December 31,</b> |                |             |
|-----------------------------------|---------------------------------|----------------|-------------|
|                                   | <b>2007</b>                     | <b>2006</b>    | <b>2005</b> |
| Operating revenues                | \$ 309,455                      | \$ 343,431     | \$ —        |
| Operating expenses                | 262,323                         | 530,285        | 61,960      |
| Depreciation and amortization     | 21,819                          | 31,529         | —           |
| Goodwill impairment               | —                               | 971,036        | —           |
| Interest expense                  | 201,331                         | 457,866        | —           |
| Gain (loss) on sale of assets     | 10,167                          | —              | —           |
| Loss from discontinued operations | \$ (165,851)                    | \$ (1,647,285) | \$ (61,960) |

The following sets forth the assets that are held for sale that are related to the discontinued operations:

|   | <b>December<br/>31,<br/>2007</b> | <b>December<br/>31,<br/>2006</b> |
|---|----------------------------------|----------------------------------|
| Property and equipment, net             | \$ —                             | \$ 3,189,674                     |
| Goodwill                                | —                                | —                                |
| Other assets                            | —                                | —                                |
| Total assets of discontinued operations | \$ —                             | \$ 3,189,674                     |

**5. RESTRICTED CERTIFICATE OF DEPOSIT**

At December 31, 2007, the Company had a restricted certificate of deposit of \$87,500 held by a financial institution securing a letter of credit. This restricted certificate of deposit is held to cover a portion of the security deposit for the Company's prior corporate offices that it occupied with Ault Glazer & Company Investment Management LLC (“**Ault Glazer**”), a related party. Ault Glazer provided an additional certificate of deposit, in the amount of \$262,500,

required to be held at the financial institution under the terms of the non-cancelable operating lease. (see Operating Lease, Note 19)

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**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

**6. PROPERTY AND EQUIPMENT**

Property and equipment at December 31, 2007 and 2006 are comprised of the following:

|                                 | <b>December<br/>31,<br/>2007</b> | <b>December<br/>31,<br/>2006</b> |
|---------------------------------|----------------------------------|----------------------------------|
| Computer software and equipment | \$ 767,004                       | \$ 356,642                       |
| Furniture and equipment         | 215,423                          | 71,687                           |
| Other                           | —                                | 20,206                           |
| Property and equipment, gross   | 982,427                          | 448,535                          |
| Less: accumulated depreciation  | (319,036)                        | (120,333)                        |
| Property and equipment, net     | \$ 663,391                       | \$ 328,202                       |

Depreciation expense for the years ended December 31, 2007, 2006 and 2005 was \$205,673, \$136,056 and \$14,943, respectively.

**7. ACQUISITIONS**

*Surgicount Medical, Inc.*

In February 2005, the Company invested \$4,035,600, excluding acquisition costs, to acquire 100% of the common stock of SurgiCount. The Company acquired SurgiCount for its patents related to the Safety-Sponge System, an innovation which the Company believes will allow it to capture a significant portion of the United States and European surgical sponge sales. SurgiCount's operating results from the closing date of the acquisition, February 25, 2005, through December 31, 2007, are included in the consolidated financial statements.

At closing, the purchase price, including acquisition costs was determined to be \$4,684,576, comprised of \$340,000 in cash payments and 600,000 shares of the Company's common stock valued at \$3,695,600 issued to SurgiCount's equity holders. Additionally, the Company incurred approximately \$112,398 in direct costs and issued 150,000 warrants, valued at \$536,578, to purchase the common stock of the Company to consultants providing advisory services for the acquisition. The value assigned to the stock portion of the purchase price is \$6.16 per share based on the average closing price of the Company's common stock for the five days beginning two days prior to and ending two days after February 4, 2005, the date of the Agreement and Plan of Merger and Reorganization (the "Merger"). In addition, since the cumulative gross revenues of SurgiCount exceeded \$1,000,000 prior to the fifth anniversary of the closing of the Merger, the Company issued a total of an additional 100,000 shares of the Company's common stock, of which 50,000 shares were issued on June 29, 2007 and 50,000 shares were issued on December 31, 2007, valued at \$144,500, to certain SurgiCount shareholders. Such amount is not included in the aggregate closing purchase price but rather was recorded upon issuance as an increase to goodwill.

The acquisition of Surgicount was accounted for under the purchase method of accounting in accordance with SFAS No. 141, *Business Combinations*. Under the purchase method, assets acquired and liabilities assumed are recorded at their estimated fair values. Fair value of the patents was determined by an independent appraisal. Goodwill is recorded to the extent the purchase price, including acquisition costs, exceeds fair value of the net identifiable tangible and intangible assets acquired less liabilities assumed at the date of acquisition.





**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

The components of the initial purchase price are allocated as follows:

|                        |              |
|------------------------|--------------|
| Patents                | \$ 4,684,576 |
| Deferred tax liability | (1,687,527)  |
| Net assets acquired    | 2,997,049    |
| Goodwill               | 1,687,527    |
|                        | \$ 4,684,576 |

The patents are being amortized for book purposes over their estimated useful life of 14.4 years. Approximate annual amortization expense for patents is expected to be \$325,000.

The following pro forma data summarizes the results of operations for the periods indicated as if the Surgicount acquisition had been completed as of the beginning of each period presented. The pro forma data gives effect to actual operating results prior to the acquisition, adjusted to include the pro forma effect of amortization of intangibles. These pro forma amounts do not purport to be indicative of the results that would have actually been obtained if the acquisition occurred as of the beginning of each period presented or that may be obtained in future periods:

|   | Year ended<br>December 31,<br>2005 |
|---|------------------------------------|
| Revenue                                     | \$ 562,374                         |
| Net loss                                    | \$ (6,013,000)                     |
| Basic and diluted net loss per common share | \$ (1.12)                          |

*Automotive Services Group, LLC*

In July 2005, the Company purchased 50% of the outstanding equity interests of Automotive Services Group, LLC (“**ASG**”), an Alabama limited liability company, from an unrelated party for \$300,000. ASG was formed to develop and operate automated car wash sites under the trade name “Bubba’s Express Wash”. ASG’s first site, developed in Birmingham, Alabama, had its grand opening on March 8, 2006. From the Company’s initial purchase through November 2005, the Company accounted for its 50% investment in ASG under the equity method of accounting. However, as a result of negotiations which commenced during the 4<sup>th</sup> quarter of 2005, and ultimately resulted in the Company’s acquisition of the remaining 50% equity interest of ASG on March 15, 2006, the Company determined that it became the primary beneficiary of ASG, a Variable Interest Entity as determined by Financial Accounting Standards Board (“**FASB**”) Interpretation No. 46R, “*Consolidation of Variable Interest Entities*” (“**FIN 46R**”). Accordingly, the Company has consolidated the accounts of ASG since the 4<sup>th</sup> quarter of 2005.

On March 15, 2006, the Company entered into a Unit Purchase Agreement (the “**Agreement**”) for Automotive Services Group to purchase the remaining 50% equity interest (the “**Membership Interest**”) in ASG. After completing the transaction, Automotive Services Group owned 100% of the outstanding equity interests in ASG. As consideration for the Membership Interest, the Company issued 200,000 shares of the Company’s common stock valued at \$610,000, based on the closing stock price at March 15, 2006.

The Company has not provided pro forma data summarizing the results of operations for the periods indicated as if the ASG acquisition had been completed as of the beginning of each period presented since the effects were considered

immaterial to actual operating results.

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**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

Upon initial measurement, components of the purchase price were as follows:

|                         |            |
|-------------------------|------------|
| Land                    | \$ 480,211 |
| Furniture and equipment | 972        |
| Notes payable           | (495,211)  |
| Net liabilities assumed | (14,028)   |
| Goodwill                | 614,028    |
| Minority interest       | (300,000)  |
| Purchase price          | \$ 300,000 |

In March 2006, upon the purchase of the remaining 50% interest, components of the purchase price were as follows:

|                   |            |
|-------------------|------------|
| Goodwill          | \$ 357,008 |
| Minority interest | 252,992    |
| Purchase price    | \$ 610,000 |

As discussed in Note 10, all goodwill previously recorded in connection with the acquisition of ASG was written off during the quarters ended June 30, 2006 and September 30, 2006.

## 8. GOODWILL AND PATENTS

The Company's goodwill relates to the Medical Products reporting segment. During the year ended December 31, 2007, cumulative gross revenues of SurgiCount exceeded \$1,000,000 and as such the Company issued 100,000 shares of common stock to the SurgiCount founders. The Company recorded \$144,500 of goodwill as a result of these issuances, based on the estimated fair value of the shares.

During the year ended December 31, 2006, the Company recognized a goodwill impairment charge of \$971,000. As discussed in Note 1, the Company has both a significant accumulated deficit and a working capital deficit. These financial constraints prevented the Company from continuing the planned build-out of the additional car wash facilities. In response to these financial constraints, coupled with the Company's emphasis on the patient safety markets, the Company elected to divest the car wash services segment. Recognizing that revenues and cash flows would be lower than expected from the car wash services segment, the Company determined that a triggering event had occurred and conducted an interim goodwill impairment analysis in the quarters ended June 30, 2006 and September 30, 2006 which resulted in the recording of total goodwill impairment charges during 2006 of \$971,000 in the car wash services operating segment. This impairment related to goodwill that resulted from the Company's acquisition of ASG

The change in goodwill for year ended December 31, 2007, is as follows:

|   | <b>Goodwill</b> |
|---|-----------------|
| Balance as of December 31, 2006               | \$ 1,687,527    |
| Issuance of contingent payment for SurgiCount | 144,500         |
| Balance as of December 31, 2007               | \$ 1,832,027    |

Patents, net, as of December 31, 2007 are composed of the following:

|                          |              |
|--------------------------|--------------|
| Patents                  | \$ 4,684,576 |
| Accumulated amortization | (920,668)    |

\$ 3,763,908

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**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

The patents are subject to amortization over their estimated useful life of 14.4 years. The following table presents estimated amortization expense for each of the succeeding five calendar years and thereafter.

|            |              |
|------------|--------------|
| 2008       | \$ 325,000   |
| 2009       | 325,000      |
| 2010       | 325,000      |
| 2011       | 325,000      |
| 2012       | 325,000      |
| Thereafter | 2,138,908    |
|            | \$ 3,763,908 |

**9. LONG-TERM INVESTMENTS AND ASSETS HELD FOR SALE**

Long-term investments at December 31, 2007 and December 31, 2006 are comprised of the following:

|                            | <b>December<br/>31, 2007</b> | <b>December<br/>31, 2006</b> |
|----------------------------|------------------------------|------------------------------|
| Alacra Corporation         | \$ 666,667                   | \$ 1,000,000                 |
| Investments in Real Estate | —                            | 430,563                      |
| Digicorp                   | —                            | 10,970                       |
|                            | \$ 666,667                   | \$ 1,441,533                 |

*Alacra Corporation*

At December 31, 2007, the Company had an investment in shares of Series F convertible preferred stock of Alacra Corporation (“*Alacra*”), recorded at its cost of \$666,667, and classified as an available-for-sale investment. The Company has the right, to the extent that Alacra has sufficient available capital, to have the Series F convertible preferred stock redeemed by Alacra for face value plus accrued dividends beginning on December 31, 2006. During the year ended December 31, 2007, Alacra redeemed one-third of the Series F convertible preferred stock. Alacra, based in New York, is a global provider of business and financial information.

*Investments in Real Estate*

At December 31, 2006, the Company’s real estate investments consisted of approximately 8.5 acres of undeveloped land in Heber Springs, Arkansas and 0.61 acres of undeveloped land in Springfield, Tennessee, which were recorded at their cost of \$430,563. At December 31, 2007, these real estates investments met the “held for sale” criteria in accordance with SFAS 144 and were classified as such.

**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

**10. NOTES PAYABLE**

Notes payable at December 31, 2007 and 2006 are comprised of the following:

|  | December<br>31, 2007 | December<br>31, 2006 |
|--|----------------------|----------------------|
| Note payable to Winstar Radio Networks, LLC (a)        | \$ —                 | \$ 450,000           |
| Notes payable to Ault Glazer Capital Partners, LLC (b) | 2,530,558            | 2,575,528            |
| Note payable to Steven J. Caspi (c)                    | —                    | 1,000,000            |
| Note payable to Steven J. Caspi (d)                    | —                    | 1,495,281            |
| Notes payable to Herb Langsam (e)                      | 600,000              | 600,000              |
| Note payable to Charles Kalina III (f)                 | 400,000              | 400,000              |
| Other notes payable                                    | 172,380              | 598,232              |
| Total notes payable                                    | 3,702,938            | 7,119,041            |
| Less: debt discount on beneficial conversion feature   | —                    | (1,074,330)          |
|  | 3,702,938            | 6,044,711            |
| Less: current portion                                  | (1,172,380)          | (3,517,149)          |
| Notes payable - long-term portion                      | \$ 2,530,558         | \$ 2,527,562         |

Aggregate future required principal payments on these notes during the twelve month period subsequent to December 31, 2007 are as follows:

|      |              |
|------|--------------|
| 2007 | \$ 1,172,380 |
| 2008 | —            |
| 2009 | —            |
| 2010 | 2,530,558    |
|      | \$ 3,702,938 |

(a) On August 28, 2001, the Company made an investment in Excelsior Radio Networks, Inc. (“*Excelsior*”) which was completely liquidated during 2005. As part of the purchase price paid by the Company for its investment in Excelsior, the Company issued a \$1,000,000 note to Winstar Radio Networks, LLC, a Delaware limited liability company (“*Winstar*”). This note was due February 28, 2002 with interest at 3.54% per annum but in accordance with the agreement the Company had a right of offset against certain representations and warranties made by Winstar. The Company applied offsets of \$215,000 against the principal balance of the note relating to legal fees attributed to our defense of certain lawsuits filed against us. The Company has consistently asserted that the due date of the note was extended until the lawsuit discussed in Note 13 is settled. However, on February 3, 2006, Winstar Global Media, Inc. (“*WGM*”) filed a lawsuit against the Company in an attempt to collect upon the \$1,000,000 note between the Company and Winstar. On September 5, 2006, the Company reached a settlement agreement with WGM whereas the Company agreed to pay Winstar \$750,000, pursuant to an agreed upon payment schedule, on or before July 2, 2007. On November 7, 2006, The United States Bankruptcy Court for the District of Delaware approved the Company’s settlement agreement with WGM. Pursuant to the settlement agreement, the Company made payments of \$300,000 during 2006 and the remaining \$450,000 during the three months ended March 31, 2007. The Company recorded a gain during 2006 of \$191,000 on the elimination of principal and interest in excess of the settlement amount which is included in gain on debt extinguishment in the accompanying statement of operations.





**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

(b) On February 8, 2006, Ault Glazer Capital Partners, LLC (formerly AGB Acquisition Fund) (the "**Fund**"), a related party, loaned \$687,000 to ASG. As consideration for the loan, ASG issued the Fund a secured promissory note in the principal amount of \$687,000 (the "**ASG Note**") and granted a real estate mortgage in favor of the Fund relating to certain real property located in Jefferson County, Alabama (the "**ASG Property**"). The ASG Note, as amended, had an interest rate of 10% per annum and was due on September 15, 2006. The Fund received warrants to purchase 20,608 shares of the Company's common stock at an exercise price of \$3.86 per share as additional consideration for entering into the loan agreement. The Company recorded debt discount in the amount of \$44,000 as the estimated value of the warrants. The debt discount was amortized as non-cash interest expense over the initial term of the debt using the effective interest method. The entire amount of the debt discount was amortized as interest expense. As security for the performance of ASG's obligations pursuant to the ASG Note, ASG had granted the Fund a security interest in all personal property and fixtures located at the ASG Property. During the year ended December 31, 2007 and 2006, the Company incurred interest expense, excluding amortization of debt discount, of \$28,000 and \$61,000, respectively, on the ASG Note.

As of December 31, 2006, the Fund loaned \$1,495,000 to ASG in addition to the ASG Note. The loans were advanced to ASG, pursuant to the terms of a Real Estate Note dated July 27, 2005, as amended (the "**Real Estate Note**"). The Real Estate Note had an interest rate of 3% above the Prime Rate as published in the Wall Street Journal. All unpaid principal, interest and charges under the Real Estate Note were due in full on July 31, 2010. The Real Estate Note was collateralized by a mortgage on certain real estate owned by ASG pursuant to the terms of a Future Advance Mortgage Assignment of Rents and Leases and Security Agreement dated July 27, 2005 between ASG and the Fund. During the year ended December 31, 2007 and 2006, the Company incurred interest expense of \$70,000 and \$160,000, respectively, on the Real Estate Note.

Effective June 1, 2007, the entire unpaid principal and interest under the ASG Note and Real Estate Note were restructured into a new Convertible Secured Promissory Note (the "**AG Partners Convertible Note**") in the principal amount of \$2,530,558 with an effective date of June 1, 2007. The AG Partners Convertible Note bears interest at the rate of 7% per annum and is due on the earlier of December 31, 2010, or the occurrence of an event of default. In the event that the average closing price of the Company's common stock is in excess of \$5.00 per share for thirty (30) consecutive trading days, the Company will have the right to redeem the promissory note in shares or in cash. In the event of redemption in shares, the principal is convertible into shares of the Company's common stock at a conversion price of \$2.50. The promissory note is secured by all of the Company's assets. Should the Company raise up to \$2,000,000 in a new credit facility, including any replacement credit facilities, the Fund is required to subordinate its security interest in favor of the new credit facility. During the year ended December 31, 2007, the Company incurred interest expense of \$103,000 on the AG Partners Convertible Note.

From March 7, 2006 through October 16, 2006, the Fund loaned the Company a total of \$524,000, of which \$130,000 was repaid during 2006. The loans were advanced to the Company pursuant to a Revolving Line of Credit Agreement (the "**Revolving Line of Credit**") entered into with the Fund on March 7, 2006. The Revolving Line of Credit allowed the Company to request advances of up to \$500,000 from the Fund. Each advance under the Revolving Line of Credit was evidenced by a secured promissory note and a security agreement. The secured promissory notes issued pursuant to the Revolving Line of Credit required repayment with interest at the Prime Rate plus 1% within 60 days from issuance. The outstanding principal balance of \$394,000 and accrued interest of \$28,000, which was in default, was converted into 337,439 shares of the Company's common stock at a conversion price of \$1.25 per share. During the year ended December 31, 2007 and 2006, the Company incurred interest expense of \$15,000 and \$16,000, respectively, on the Revolving Line of Credit.

(c)

On January 12, 2006, Steven J. Caspi loaned \$1,000,000 to ASG. As consideration for the loan, ASG issued Mr. Caspi a promissory note in the principal amount of \$1,000,000 (the "*Caspi Note*") and granted Mr. Caspi a mortgage on certain real estate owned by ASG and a security interest on all personal property and fixtures located on such real estate as security for the obligations under the Caspi Note. In addition, the Company entered into an agreement guaranteeing ASG's obligations pursuant to the Caspi Note and Mr. Caspi received warrants to purchase 30,000 shares of the Company's common stock at an exercise price of \$4.50 per share. The Company recorded debt discount in the amount of \$92,000 based on the estimated fair value of the warrants. The debt discount was amortized as non-cash interest expense over the initial term of the debt using the effective interest method. The entire amount of the debt discount was amortized as interest expense. The Caspi Note initially accrued interest at the rate of 10% per annum, which together with principal, was due to be repaid on July 13, 2006. The Caspi Note was not repaid until June 29, 2007. During the period of time that the Caspi Note was in default interest accrued at the rate of 18% per annum. During the year ended December 31, 2007 and 2006, the Company incurred interest expense of \$89,000 and \$130,000, respectively, on the Caspi Note.

**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

(d) From September 8, 2006 through September 19, 2006, Mr. Caspi loaned the Company a total of \$1,495,281. As consideration for the loan, the Company issued Mr. Caspi a Convertible Promissory Note in the principal amount of \$1,495,281 (the "**Second Caspi Note**"). The Second Caspi Note accrued interest at the rate of 12% per annum and was due upon the earlier of March 31, 2008 or, the occurrence of an event of default. As security for the performance of the Company's obligations pursuant to the Second Caspi Note, the Company granted Mr. Caspi a security interest in certain real property. Mr. Caspi received warrants to purchase 250,000 shares of the Company's common stock at an exercise price of \$1.25 per share as additional consideration for entering into the loan agreement. The Second Caspi Note was repaid on August 13, 2007. During the year ended December 31, 2007 and 2006, the Company incurred interest expense, excluding amortization of debt discount, of \$109,000 and \$56,000, respectively, on the Second Caspi Note.

As the effective conversion price of the Second Caspi Note on the date of issuance was below the fair market value of the underlying common stock, the Company recorded debt discount in the amount of \$769,000 based on the intrinsic value of the beneficial conversion feature of the note.

The warrant issued to Mr. Caspi in conjunction with the Second Caspi Note will expire after September 8, 2011. The Company recorded debt discount in the amount of \$231,000 based on the estimated fair value of the warrants. The debt discount as a result of the beneficial conversion feature of the note and the estimated fair value of the warrants was amortized as non-cash interest expense over the term of the debt using the effective interest method. During the year ended December 31, 2007 and 2006, interest expense of \$877,000 and \$123,000 has been recorded from the debt discount amortization.

(e) On May 1, 2006, Herbert Langsam, a Class II Director of the Company, loaned the Company \$500,000. The loan is documented by a \$500,000 Secured Promissory Note (the "**Langsam Note**") payable to the Herbert Langsam Irrevocable Trust. The Langsam Note accrues interest at the rate of 12% per annum and had a maturity date of November 1, 2006. This note was not repaid by the scheduled maturity and to date has not been extended, therefore the Langsam Note is recorded in current liabilities. Accordingly, the note is currently in default and therefore accruing interest at the rate of 16% per annum. Pursuant to the terms of a Security Agreement dated May 1, 2006, the Company granted the Herbert Langsam Revocable Trust a security interest in all of the Company's assets as collateral for the satisfaction and performance of the Company's obligations pursuant to the Langsam Note.

On November 13, 2006, Mr. Langsam, loaned the Company an additional \$100,000. The loan is documented by a \$100,000 Secured Promissory Note (the "**Second Langsam Note**") payable to the Herbert Langsam Irrevocable Trust. The Second Langsam Note accrues interest at the rate of 12% per annum and has a maturity date of May 13, 2007. Mr. Langsam received warrants to purchase 50,000 shares of the Company's common stock at an exercise price of \$1.25 per share as additional consideration for entering into the loan agreement. The Company recorded debt discount in the amount of \$17,000 as the estimated value of the warrants. The debt discount was amortized as non-cash interest expense over the term of the debt using the effective interest method. During the year ended December 31, 2007 and 2006, interest expense of \$12,000 and 5,000, respectively, has been recorded from the debt discount amortization. Pursuant to the terms of a Security Agreement dated November 13, 2006, the Company granted the Herbert Langsam Revocable Trust a security interest in all of the Company's assets as collateral for the satisfaction and performance of the Company's obligations pursuant to the Second Langsam Note.

**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

During the year ended December 31, 2007 and 2006, the Company incurred interest expense, excluding amortization of debt discount, of \$88,000 and \$50,000, respectively, on the Langsam Notes. At December 31, 2007 and 2006, accrued interest on the Langsam Notes totaled \$138,000 and \$50,000, respectively.

(f) On July 12, 2006 the Company, executed a Convertible Promissory Note in the principal amount of \$250,000 (the "*Kalina Note*") and a warrant for the purchase of 85,000 Shares of the Company's common stock (the "*Kalina Warrant*") in favor of Charles J. Kalina, III, an existing shareholder of the Company. The Kalina Note accrued interest at the rate of 12% per annum throughout the term of the loan. The principal amount of the Kalina Note and any accrued but unpaid interest was due to be paid on October 10, 2006. Principal and interest on the Kalina Note was convertible into shares of the Company's common stock at a conversion price of \$3.00 per share.

The Kalina Warrant has an exercise price of \$ 2.69 per share and will expire on July 11, 2011. The Company recorded debt discount in the amount of \$161,000 based on the estimated fair value of the Kalina Warrants. The debt discount was amortized as non-cash interest expense over the initial term of the debt using the effective interest method.

On November 3, 2006 the balance due under the Kalina Note was added to a new Convertible Promissory Note in the principal amount of \$400,000 (the "*Second Kalina Note*"), pursuant to which the Company received proceeds of approximately \$150,000. The Second Kalina Note bears interest at the rate of 12% per annum and is due on January 31, 2008 or, the occurrence of an event of default. Mr. Kalina received warrants to purchase 250,000 shares of the Company's common stock at an exercise price of \$1.25 per share as additional consideration for entering into the loan agreement. During the year ended December 31, 2007 and 2006, the Company incurred interest expense, excluding amortization of debt discount of \$46,000 and \$20,000, respectively, on the Second Kalina Note. At December 31, 2007 and 2006, accrued interest on the Second Kalina Note totaled \$8,000 and \$10,000, respectively.

As the effective conversion price of the Second Kalina Note on the date of issuance was below the fair market value of the underlying common stock, the Company recorded debt discount in the amount of \$77,000 based on the intrinsic value of the beneficial conversion feature of the note.

The warrant issued to Mr. Kalina in conjunction with the Second Kalina Note will expire after November 3, 2011. The Company recorded debt discount in the amount of \$29,000 based on the estimated fair value of the warrants. The debt discount as a result of the beneficial conversion feature of the note and the estimated fair value of the warrants was amortized as non-cash interest expense over the term of the debt using the effective interest method. During the year ended December 31, 2007 and 2006, interest expense of \$91,000 and \$15,000, respectively, has been recorded from the debt discount amortization.

**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

**11. ACCRUED LIABILITIES**

Accrued liabilities at December 31, 2007 and 2006 are comprised of the following:

|                                      | December 31,<br>2007 | December 31,<br>2006 |
|--------------------------------------|----------------------|----------------------|
| Accrued interest                     | \$ 168,449           | \$ 520,114           |
| Accrued professional fees            | —                    | 10,000               |
| Accrued dividends on preferred stock | 134,138              | 95,812               |
| Accrued salaries                     | 212,000              | 197,495              |
| Other                                | 6,162                | 1,045                |
|                                      | \$ 520,749           | \$ 824,466           |

**12. EQUITY TRANSACTIONS**

On March 30, 2005, stockholders' approval was obtained to (i) decrease the authorized number of shares of common stock from 50,000,000 shares to 25,000,000 shares, (ii) decrease the authorized number of shares of preferred stock from 10,000,000 shares to 1,000,000 shares and (iii) to reduce the par value of the common stock from \$1.00 per share to \$0.33 per share and effect a three-for-one split of the common stock. Stockholders' equity has been restated to give retroactive recognition to the stock split for all periods presented. In addition, all per share and weighted average share amounts have been restated to reflect this stock split.

The convertible preferred stock has a cumulative 7% quarterly dividend and is convertible into the number of shares of common stock by dividing the purchase price for the convertible preferred stock by conversion price in effect, currently \$4.44. The convertible preferred stock has anti-dilution provisions, which can change the conversion price in certain circumstances. In the event the Company subdivides its outstanding shares of common stock into a greater number of shares of common stock the conversion price in effect would be reduced, thereby increasing the total number of shares of common stock that the convertible preferred stock is convertible into. The holder has the right to convert the shares of convertible preferred stock at any time until February 22, 2010 into common stock. Upon liquidation, dissolution or winding up of the Company, the stockholders of the convertible preferred stock are entitled to receive \$100 per share plus any accrued and unpaid dividends before distributions to any holder of the Company's common stock.

During the year ended December 31, 2005, the Company issued 5,625 shares of common stock held in treasury upon exercise of options under the Company's 1997 Stock Incentive Plan and 20,444 shares of common stock held in treasury to purchase 0.61 acres of vacant land in Springfield, Tennessee.

On April 5, 2005, the Company entered into a consulting agreement with Health West Marketing Incorporated, a California corporation ("Health West"). Under the agreement, Health West agreed to help the Company establish a comprehensive manufacturing and distribution strategy for the Company's Safety-Sponge System worldwide. The initial term of the agreement is for a period of two years. After the initial two-year term, the agreement will terminate unless extended by the parties for one or more additional one-year periods.

In consideration for Health West's services, the Company agreed to issue Health West 42,017 shares of the Company's common stock, to be issued as follows: (a) 10,505 shares, valued at \$62,505, were issued upon signing the agreement; (b) an additional 15,756 shares, valued at \$93,748, of the Company's common stock held in treasury were issued as a result of Health West's assistance in structuring a comprehensive manufacturing agreement with A Plus International

Inc. (“**A Plus**”), which was entered into on August 17, 2005; and (c) during 2007 the Company issued the remaining 15,756 shares for Health West’s services in developing a regional distribution network to integrate the Safety-Sponge™ System into the existing acute care supply chain. As an additional incentive, in 2005 the Company granted Health West warrants to purchase a total of 175,000 shares of the Company’s common stock as discussed in Note 13.

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**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

On April 22, 2005, the Company entered into a subscription agreement pursuant to which the Company sold to an investor shares of the Company's common stock held in treasury and warrants to purchase an additional 20,000 shares of the Company's common stock. The warrants are exercisable for a period of five years, have an exercise price equal to \$6.05, and 50% of the warrants are callable. In the event the closing sale price of the Company's common stock equals or exceeds \$7.50 for at least five consecutive trading days, the Company, upon 30 days prior written notice, may call the callable warrants at a redemption price equal to \$0.01 per share of common stock then purchasable pursuant to such warrants. Notwithstanding such notice, the warrant holder may exercise the callable warrant prior to the end of the 30-day notice period. The Company received gross proceeds of \$100,000 from the sale of stock and warrants.

On July 19, 2005, the Company entered into a stock purchase agreement pursuant to which the Company sold to an investor 38,000 shares of the Company's common stock held in treasury. As consideration, the Company received 12,000 shares of Tuxis Corporation ("**Tuxis**") common stock valued at approximately \$102,000.

On October 19, 2005, the Company entered into a subscription agreement with an accredited investor, pursuant to which the Company sold shares of the Company's common stock held in treasury at a price of \$3.00 per share. The Company received gross proceeds of \$50,000 from the sale of the stock.

On November 3, 2005, the Company entered into a subscription agreement with Herbert Langsam, a current director of the Company, pursuant to which the Company sold shares of the Company's common stock held in treasury at a price of \$3.49 per share. The Company received gross proceeds of \$100,000 from the sale of the stock.

In August 2006, the Company entered into subscription agreements pursuant to which the Company sold to investors shares of the Company's common stock held in treasury at a price of \$1.25 per share. The Company received gross proceeds of \$250,000 from the sale of stock.

Between November 30, 2006 and December 15, 2006, the Company entered into a subscription agreement with several accredited investors in a private placement exempt from the registration requirements of the Securities Act of 1933, as amended (the "**Securities Act**"). The Company issued and sold to these accredited investors an aggregate of 238,000 shares of its common stock and warrants to purchase an additional 119,000 shares of its common stock. The warrants are exercisable for a period of three years, have an exercise price equal to \$2.00, and 50% of the warrants are callable upon the occurrence of any one of a number of specified events when, after any such specified occurrence, the average closing price of the Company's common stock during any period of five consecutive trading days exceeds \$4.00 per share. These issuances resulted in aggregate gross proceeds to the Company of \$297,500.

On January 29, 2007, the Company entered into a subscription agreement with A Plus, pursuant to which the Company sold to A Plus 800,000 shares of its common stock and warrants to purchase an additional 300,000 shares of its common stock. The Company received gross proceeds of \$500,000 in cash and during the year ended December 31, 2007, received \$500,000 in product. The warrants have a term of five (5) years and an exercise price equal to \$2.00 per share.

Between January 29, 2007 and June 7, 2007, the Company entered into a subscription agreement with several accredited investors in a private placement exempt from the registration requirements of the Securities Act of 1933, as amended (the "**Securities Act**"). The Company issued and sold to the investors an aggregate of 2,152,000 shares of its common stock and warrants to purchase an additional 1,076,000 shares of its common stock. The warrants are exercisable for a period of three to five years, have an exercise price equal to \$2.00, and 50% of the warrants are callable upon the occurrence of any one of a number of specified events when, after any such specified occurrence, the

average closing price of the Company's common stock during any period of five consecutive trading days exceeds \$4.00 per share. These issuances resulted in aggregate gross proceeds to the Company of \$2,690,000. The Company was required to file a registration statement within 120 days after April 5, 2007 covering the resale of 2,000,000 shares of our Common Stock purchased in these private placements. The registration statement was not filed until November 16, 2007 and we therefore issued, as liquidated damages, warrants with a term of five years and an exercise price of \$2.00 per share to purchase 200,000 shares of our Common Stock. We recognized \$193,000 in expense as a result of these liquidated damages.

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**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

Pursuant to the Merger between the Company and SurgiCount, in the event that prior to the fifth anniversary of the closing of the Merger the cumulative gross revenues of SurgiCount exceed \$1,000,000, the Company is obligated to issue an additional 100,000 shares of the Company's common stock to certain SurgiCount founders. As discussed in Note 7, cumulative gross revenues of SurgiCount exceeded \$1,000,000 and therefore the Company issued an additional 100,000 shares of the Company's common stock, valued at \$144,500. The Company recorded \$144,500 of goodwill as a result of these issuances, based on the estimated fair value of the shares.

On October 17, 2007, the Company sold, in a private placement exempt from the registration requirements of the Securities Act, 1,270,000 shares of the Company's common stock at \$1.25 price per share and issued five-year warrants to purchase 763,000 shares of common stock at an exercise price of \$1.40 per share, pursuant to a Securities Purchase Agreement entered into with Francis Capital Management, LLC, ("*Francis Capital*") an accredited investor. The investor paid \$1,500,000 in cash and agreed to extinguish \$90,000 in existing debt owed to it by the Company.

**13. WARRANTS**

During the year ended December 31, 2007, a total of 2,872,120 warrants, at an average exercise price of \$1.75 per share were issued primarily in connection with the various subscription agreements entered into by the Company as well as payment for services and accrued interest. The warrants were valued using the Black-Scholes valuation model assuming expected dividend yield, risk-free interest rate, expected life and volatility of 0%, 4.50%, five years and 63% - 101%, respectively. Warrants granted during the year ended December 31, 2006 were valued using an expected dividend yield, risk-free interest rate, expected life and volatility of 0%, 3.75% - 4.50%, three to five years and 63% - 88%, respectively. As of December 31, 2007, a total of 6,114,521 warrants, at exercise prices ranging from \$1.25 to \$6.05 remain outstanding.

**14. STOCK REPURCHASE PROGRAM**

In May 2005, the Board of Directors authorized a stock repurchase program under which up to 150,000 shares of the Company's common stock could be repurchased from time to time with available funds. The primary purpose of the stock repurchase program is to allow the Company the flexibility to repurchase its common stock to potentially reduce stock dilution and seek to improve its long-term earnings per share. Repurchases may be made in the open market or in privately negotiated transactions, subject to regulatory considerations, and may be discontinued at any time. The only repurchases made by the Company during the last three years occurred during the year ended December 31, 2005 when the Company repurchased 10,611 shares of common stock for \$36,931. Although the Company's stock repurchase program remains in place, the Company does not currently intend to make a material amount of repurchases. Future repurchases, if any, will depend on subsequent developments, corporate needs and market conditions. If subsequent developments occur or corporate needs and market conditions change that might cause the Company to make one or more repurchases, the Company would not necessarily make a public announcement about it at that time.

**15. STOCK OPTION PLANS**

In September 2005, the Board of Directors of the Company approved the Amended and Restated 2005 Stock Option and Restricted Stock Plan (the "*2005 SOP*") and the Company's stockholders approved the Plan in November 2005. The Plan reserves 2,500,000 shares of common stock for grants of incentive stock options, nonqualified stock options, warrants and restricted stock awards to employees, non-employee directors and consultants performing services for the Company. Options granted under the Plan have an exercise price equal to or greater than the fair market value of the underlying common stock at the date of grant and become exercisable based on a vesting schedule determined at

the date of grant. The options expire 10 years from the date of grant. Restricted stock awards granted under the Plan are subject to a vesting period determined at the date of grant.

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**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

A summary of stock option activity for the year ended December 31, 2007 is presented below:

|                              | Shares<br>Available for<br>Grant | Number of<br>Shares | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Life (years) | Aggregate<br>Intrinsic<br>Value |
|------------------------------|----------------------------------|---------------------|--|---|---------------------------------|
| <b>December 31, 2004</b>     | <b>56,250</b>                    | <b>5,625</b>        | <b>\$ 4.67</b>                           | <b>5.08</b>   |                                 |
| Adoption of Amended 2005 SOP | 2,500,000                        |                     |  |   |                                 |
| Exercises                    |                                  | (5,625)             | \$ 4.67                                  | 5.00  |                                 |
| Restricted Stock Awards      | (438,046)                        |                     |  |   |                                 |
| Grants                       | (1,044,000)                      | 1,044,000           | \$ 5.02                                  | 9.39  |                                 |
| <b>December 31, 2005</b>     | <b>1,074,204</b>                 | <b>1,044,000</b>    | <b>\$ 5.02</b>                           | <b>9.39</b>   |                                 |
| Cancellation of 1997 Plans   | (56,250)                         |                     |  |   |                                 |
| Restricted Stock Awards      | (331,928)                        |                     |  |   |                                 |
| Grants                       | (785,000)                        | 785,000             | \$ 3.80                                  | 9.21  |                                 |
| Cancellations                | 125,000                          | (125,000)           | \$ 4.51                                  | 8.87  |                                 |
| <b>December 31, 2006</b>     | <b>26,026</b>                    | <b>1,704,000</b>    | <b>\$ 4.50</b>                           | <b>8.73</b>   | <b>\$ —</b>                     |
| Restricted Stock Awards      | (79,036)                         |                     |  |   |                                 |
| Grants                       | (545,000)                        | 545,000             | \$ 1.53                                  | 9.76  |                                 |
| Cancellations                | 599,000                          | (599,000)           | \$ 4.59                                  | 8.25  |                                 |
| <b>December 31, 2007</b>     | <b>990</b>                       | <b>1,650,000</b>    | <b>\$ 3.49</b>                           | <b>8.43</b>   | <b>\$ —</b>                     |
| Options exercisable at:      |                                  |                     |  |   |                                 |
| December 31, 2005            |                                  | 220,125             | \$ 5.27                                  | 9.25  | \$ —                            |
| December 31, 2006            |                                  | 832,625             | \$ 4.90                                  | 8.54  | \$ —                            |
| December 31, 2007            |                                  | 782,500             | \$ 4.40                                  | 7.83  | \$ —                            |

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (i.e., the difference between our closing stock price on December 31, 2007 and the exercise price, times the number of shares) that would have been received by the option holders had all option holders exercised their options on December 31, 2007. There have been 5,625 options exercised during the year ended December 31, 2005.

**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

A summary of the changes in the Company's nonvested options during the year ended December 31, 2007 is as follows:

| Nonvested Shares               | Shares    | Weighted<br>Average Grant<br>Date Fair Value |
|--------------------------------|-----------|--|
| Nonvested at December 31, 2006 | 871,375   | \$ 2.31                                      |
| Granted                        | 545,000   | \$ 1.16                                      |
| Vested                         | (330,125) | \$ 2.07                                      |
| Cancelled and forfeited        | (218,750) | \$ 2.02                                      |
| Nonvested at December 31, 2007 | 867,500   | \$ 1.75                                      |

All options that the Company granted during 2005 through 2007 were granted at the per share fair market value on the grant date. Vesting of options differs based on the terms of each option. The Company utilized the Black-Scholes option pricing model and the assumptions used for each period are as follows:

|   | Year ended December 31, |         |         |
|---|-------------------------|---------|---------|
|   | 2007                    | 2006    | 2005    |
| Weighted average risk free interest rate                            | 4.50%                   | 3.75%   | 3.75%   |
| Weighted average life (in years)                                    | 5.00                    | 4.16    | 3.0     |
| Volatility  | 98 - 101%               | 89%     | 83%     |
| Expected dividend yield   | 0%                      | 0%      | 0%      |
| Weighted average grant-date fair value per share of options granted | \$ 1.16                 | \$ 2.50 | \$ 2.48 |

During the year ended December 31, 2007, the Company recorded compensation costs related to stock options of \$674,189. As of December 31, 2007, total unrecognized compensation cost related to unvested stock options was \$899,000. The cost is expected to be recognized over a weighted average period of 1.43 years.

## 16. RELATED PARTY TRANSACTIONS

### *Due from Related Parties*

During the three months ended March 31, 2007 and year ended December 31, 2006, the Company paid approximately 25% of the base rent on the corporate offices and The Ault Glazer Group, Inc. ("**Ault Glazer**") paid the remaining base rent based upon their respective usage of the facilities. Together, Milton "Todd" Ault III, our former Chairman and Chief Executive Officer of the Company, and Louis Glazer, a Class I Director of the Company, and Melanie Glazer, the former Manager of our real estate segment, (together, the "**Glazers**") own a controlling interest in the outstanding capital stock of Ault Glazer. As of December 31, 2007 and 2006, Ault Glazer, Mr. Ault and the Glazers indirectly beneficially own or control approximately 10% of the outstanding common stock of the Company and beneficially own approximately 98% of the outstanding preferred stock of the Company.

### *IPEX, Inc.*

During the years ended December 31, 2007, 2006 and 2005, the Company recognized revenue of nil, \$104,000 and \$552,000, respectively, in connection with consulting services provided to IPEX. The Company's former Chairman and Chief Executive Officer and significant beneficial owner of the Company served as a director of IPEX during that

period. Further, the former Chief Executive Officer of ASG served as an IPEX director and member of IPEX's Audit Committee from August 2005 through January 2006.

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**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

*Digicorp*

At December 31, 2006, the Company had an investment in Digicorp recorded in long-term investments. The Company's Chief Executive Officer and Chief Financial Officer was also Chief Financial Officer of Digicorp and remains a director of the Company. Further, certain Company officers and directors, both past and present, served in various management and director roles at Digicorp.

*Loans*

During the year ended December 31, 2007 and 2006, the Company received loans from Ault Gazer Capital Partners, LLC (the "**Fund**"). Ault Glazer & Company Investment Management, LLC ("**AG & Company IM**") is the managing member of the Fund. The managing member of AG & Company IM is Ault Glazer. Mr. Ault is Chairman, Chief Executive Officer and President of Ault Glazer. Until June 8, 2006, the Company's current Chief Executive Officer and Chief Financial Officer was also Chief Financial Officer of Ault Glazer.

*ASG*

During the period from June 29, 2007 to August 13, 2007, Automotive Services Group sold its express car wash and underlying real estate and a parcel of undeveloped land located in Birmingham, Alabama to Charles H. Dellaccio and Darrell Grimsley. Mr. Grimsley is the Chairman of the Board and Chief Executive Officer of Automotive Services Group.

*A Plus International, Inc.*

During the years ended December 31, 2007, 2006 and 2005, the Company recognized cost of goods sold of 467,000, \$44,000 and nil, respectively, in connection with surgical sponges provided by A Plus. Wayne Lin, a director and significant beneficial owner of the Company is a founder and significant owner of A Plus.

**17. INCOME TAXES**

In June 2006, the FASB issued FASB Interpretation Number 48 ("**FIN 48**"), *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109*, which clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*, and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position that an entity takes or expects to take in a tax return. Under FIN 48, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is, more-likely-than-not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. Additionally, FIN 48 provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 was effective for the Company beginning January 1, 2007.

The Company adopted the provisions of FIN 48 on January 1, 2007, and has commenced analyzing filing positions in all of the federal and state jurisdictions where it is required to file income tax returns, as well as all open tax years in these jurisdictions. As a result of adoption, the Company has recorded no additional tax liability. As of December 31, 2007, the Company has not yet completed its analysis of the deferred tax assets for net operating losses of \$25.5 million. As such, these amounts and the offsetting valuation allowance have been removed from the Company's deferred tax assets. The Company will complete a Section 382 analysis regarding the limitation of the net operating

losses.

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**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

A rollforward of the changes in the Company's unrecognized tax benefits related to FIN48 positions is shown below:

|  |    |   |
|--|----|---|
| Balance at January 1, 2007                                   | \$ | — |
| Additions based on tax positions related to the current year |    | — |
| Additions for tax positions of prior years                   |    | — |
| Reductions for tax positions of prior years                  |    | — |
| Settlements  |    | — |
| Balance at December 31, 2007                                 | \$ | — |

Due to the existence of the valuation allowance, future changes in our unrecognized tax benefits will not impact the Company's effective tax rate.

The Company is subject to taxation in the U.S. and state jurisdictions. The Company's tax years for 2002 and forward are subject to examination by the U.S. and California tax authorities due to the carryforward of unutilized net operating losses. The Company is currently not under examination by any taxing authorities.

The Company's practice is to recognize interest and/or penalties related to income tax matters in income tax expense. During the twelve months ended December 31, 2007, the Company did not recognize any interest or penalties. Upon adoption of FIN 48 on January 1, 2007, the Company did not record any interest penalties.

The adoption of FIN 48 did not impact the Company's financial condition, results of operations or cash flows. At December 31, 2007, the Company had net deferred tax assets of \$2.0 million. Due to uncertainties surrounding the Company's ability to generate future taxable income to realize these assets, a full valuation has been established to offset the net deferred tax asset. Additionally, the future utilization of the Company's net operating loss to offset future taxable income may be subject to an annual limitation as a result of ownership changes that may have occurred previously or that could occur in the future. The Company has not yet determined whether such an ownership change has occurred; however the Company will be completing a Section 382 analysis regarding the limitation of the net operating loss. Until this analysis has been completed the Company has removed the deferred tax assets associated with these carryforwards from its deferred tax asset schedule and has recorded a corresponding decrease in its valuation allowance. When the Section 382 analysis is completed, the Company plans to update its unrecognized tax benefits under FIN 48.

Deferred income taxes reflect the net tax effects of temporary differences between carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Significant components of the Company's deferred tax assets as of December 31, 2007 and 2006 are as follows:

|  | 2007        | 2006          |
|--|-------------|---------------|
| Deferred tax assets:   |             |               |
| Federal net operating loss carryforward                      | \$          | —\$ 6,931,000 |
| State net operating loss carryforward                        |             | — 1,041,000   |
| Stock based compensation                                     | 1,959,000   | 1,840,000     |
| Other  | 120,000     | 19,000        |
| Total deferred tax asset                                     | 2,079,000   | 9,831,000     |
| Deferred tax liability:                                      |             |               |
| Book and tax bases difference arising from purchased patents | (1,499,000) | (1,473,066)   |
| Total net deferred tax asset                                 | 580,000     | 8,357,934     |
| Less valuation allowance                                     | (2,079,000) | (9,831,000)   |



|                            |    |             |    |             |
|----------------------------|----|-------------|----|-------------|
| Net deferred tax liability | \$ | (1,499,000) | \$ | (1,473,066) |
|----------------------------|----|-------------|----|-------------|

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**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

For the years ended December 31, 2007, 2006 and 2005, a reconciliation of the federal statutory tax rate to the Company's effective tax rate is as follows:

|  | 2007     | 2006     | 2005     |
|--|----------|----------|----------|
| Federal statutory tax rate                               | (34.00)% | (34.00)% | (34.00)% |
| State and local income taxes, net of federal tax Benefit | 0.08     | 0.01     | 0.01     |
| Non deductible items                                     | 6.44     | 8.30     | 1.76     |
| Valuation allowance                                      | 27.89    | 24.83    | 30.61    |
| Total effective tax rate                                 | 0.41%    | (0.86)   | (1.62)%  |

**18. COMMITMENTS AND CONTINGENCIES**

*Operating Lease*

During November 2007, the Company entered into an operating agreement for office space for Surgicount. The lease requires monthly payments of \$9,424, subject to an annual increase of 3.5% per year, from January 1, 2008 through December 31, 2010. Future minimum annual rent payments of \$113,082, \$117,040 and \$121,136 due during the years ended December 31, 2008, 2009 and 2010, respectively, represent the remaining obligation under the Company's existing operating lease.

Rent expense during the years ended December 31, 2007, 2006 and 2005 was \$78,937, \$131,129 and \$88,368, respectively.

*Legal Proceedings*

On October 15, 2001, Jeffrey A. Leve and Jeffrey Leve Family Partnership, L.P. filed a lawsuit (the "**Leve Lawsuit**") against the Company, Sunshine Wireless, LLC ("**Sunshine**"), and four other defendants affiliated with Winstar Communications, Inc. ("**Winstar**"). On February 25, 2003, the case against the Company and Sunshine was dismissed, however, on October 19, 2004, Jeffrey A. Leve and Jeffrey Leve Family Partnership, L.P. exercised their right to appeal. The initial lawsuit alleged that the Winstar defendants conspired to commit fraud and breached their fiduciary duty to the plaintiffs in connection with the acquisition of the plaintiff's radio production and distribution business. The complaint further alleged that the Company and Sunshine joined the alleged conspiracy. On June 1, 2005, the United States Court of Appeals for the Second Circuit affirmed the February 25, 2003 judgment of the district court dismissing the claims against the Company.

On July 28, 2005, Jeffrey A. Leve and Jeffrey Leve Family Partnership, L.P. filed a new lawsuit (the "**new Leve Lawsuit**") against the Company, Sunshine Wireless, LLC ("**Sunshine**"), and four other defendants affiliated with Winstar Communications, Inc. ("**Winstar**"). The new Leve Lawsuit attempts to collect a federal default judgment of \$5,014,000 entered against only two entities, i.e., Winstar Radio Networks, LLC and Winstar Global Media, Inc., by attempting to enforce the judgment against a number of additional entities who are not judgment debtors. Further, the new Leve Lawsuit attempts to enforce the plaintiffs default judgment against entities who were dismissed on the merits from the underlying action in which plaintiffs obtained their default judgment. An unfavorable outcome in the lawsuit, may have a material adverse effect on the Company's business, financial condition and results of operations. The Company believes the lawsuit is without merit and intends to vigorously defend itself. These consolidated interim financial statements do not include any adjustments for the possible outcome of this uncertainty.



**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

*Employment Agreements*

The Company has entered into employment agreements with certain of its executives, which provide for annual base compensation plus, in most cases, bonuses and other benefits. As of December 31, 2007, approximate future annual base compensation under these agreements are as follows:

|  | <b>Years ended December 31,</b> |             |              |
|--|---------------------------------|-------------|--------------|
|  | <b>2008</b>                     | <b>2009</b> | <b>Total</b> |
|  | \$ 581,250                      | \$ 112,500  | \$ 693,750   |

**19. SEGMENT REPORTING**

The Company reports segment information in accordance with SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*. The segment information previously provided reflected the three distinct lines of business within the Company's past organizational structure: medical products, financial services and real estate, and car wash services. The Company has restructured its operations such that its only continuing operations are related to the medical products segment. Accordingly, since the Company only operates within a single industry, segment information is no longer reported.

**20. SELECTED QUARTERLY RESULTS (UNAUDITED)**

|   | <b>March 31</b> | <b>June 30</b> | <b>September 30</b> | <b>December 31</b> |
|---|-----------------|----------------|---------------------|--------------------|
| <b>2007 Quarter Ended</b>                   |                 |                |                     |                    |
| Total assets                                | \$ 13,038,354   | \$ 10,447,051  | \$ 8,205,147        | \$ 8,174,174       |
| Revenues                                    | \$ 307,158      | \$ 313,461     | \$ 212,999          | \$ 255,383         |
| Operating loss                              | \$ (1,102,234)  | \$ (1,409,279) | \$ (1,139,450)      | \$ (1,503,612)     |
| Net loss                                    | \$ (1,425,053)  | \$ (1,756,157) | \$ (1,939,542)      | \$ (1,885,226)     |
| Basic and diluted net loss per common share | \$ (0.18)       | \$ (0.18)      | \$ (0.18)           | \$ (0.19)          |
| <b>2006 Quarter Ended</b>                   |                 |                |                     |                    |
| Total assets                                | \$ 15,925,286   | \$ 14,036,035  | \$ 11,654,435       | \$ 11,181,446      |
| Revenues                                    | \$ 54,993       | \$ 48,882      | \$ 18,514           | \$ 122,140         |
| Operating loss                              | \$ (3,339,629)  | \$ (1,486,107) | \$ (1,525,689)      | \$ (1,608,125)     |
| Net loss                                    | \$ (3,573,532)  | \$ (2,917,733) | \$ (5,618,832)      | \$ (1,513,055)     |
| Basic and diluted net loss per common share | \$ (0.60)       | \$ (0.47)      | \$ (0.87)           | \$ (0.23)          |

**Patient Safety Technologies, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements (continued)**

**21. SUBSEQUENT EVENTS**

Between February 28, 2008 and March 20, 2008, Francis Capital, a related party, loaned \$500,000 to the Company. As consideration for the loan, the Company issued Francis Capital promissory notes in the principal amount of \$500,000 (the "***Francis Capital Note***"). Francis Capital beneficially owns 1,272,000 shares of the Company's common stock and warrants for purchase of 763,200 shares of the Company's common stock. John Francis, a director of the Company, has voting and investment control over the securities held by Francis Capital. The Francis Capital Note has an interest rate of 8% per annum and is due on May 31, 2008.

In March 2008, the Company completed the sale of approximately 8.5 acres of undeveloped land in Heber Springs, Arkansas for net proceeds of \$226,000, which resulted in a realized loss of \$25,000.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PATIENT SAFETY TECHNOLOGIES, INC.

Date: April 21, 2008

By: /s/ William B. Horne

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William B. Horne  
Chief Executive and Chief Financial Officer and  
Principal Accounting Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| <b>Signature</b>                              | <b>Title</b>          | <b>Date</b>    |
|---|-----------------------|----------------|
| /s/ Steven H. Kane<br>Steven H. Kane          | Chairman of the Board | April 21, 2008 |
| /s/ Arnold Spangler<br>Arnold Spangler        | Director              | April 21, 2008 |
| /s/ John Francis<br>John Francis              | Director              | April 21, 2008 |
| /s/ David Augustine<br>David Augustine        | Director              | April 21, 2008 |
| /s/ Louis Glazer<br>Louis Glazer, M.D., Ph.G. | Director              | April 21, 2008 |
| /s/ Herbert Langsam<br>Herbert Langsam        | Director              | April 21, 2008 |
| Wayne Lin                                     | Director              | April 21, 2008 |