

ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/  
Form 10-Q  
May 13, 2002

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 For the quarterly period ended March 31, 2002 or  
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Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 For the transition period from \_\_\_\_\_ to \_\_\_\_\_

1-9731  
(Commission file No.)

ARRHYTHMIA RESEARCH TECHNOLOGY, INC.  
(Exact name of registrant as specified in its charter)

DELAWARE 72-0925679  
(State or other jurisdiction of (I.R.S. employer identification no.)  
incorporation or organization)

25 Sawyer Passway

Fitchburg, Massachusetts 01420

(Address of principal executive office and zip code)

(978) 345-5000  
(Registrant's telephone number, including area code)

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 preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No  \_\_\_\_\_  
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As of May 2, 2002 there were 2,912,076 shares of common stock outstanding.

This report consists of 9 pages.

ARRHYTHMIA RESEARCH TECHNOLOGY, INC.

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ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY  
 CONSOLIDATED BALANCE SHEETS  
 (Unaudited)

| ASSETS   |  | Ma              |
|--|--|-----------------|
|  |  | 2               |
|  |  | -----           |
| Current assets:  |  |                 |
| Cash and cash equivalents .....  |  | \$ 1,6          |
| Trade and other accounts receivable, net of allowance for doubtful accounts<br>of \$51,000 ..... |  | 9               |
| Inventories, net .....   |  | 9               |
| Deposits, prepaid expenses and other current assets .....  |  |                 |
|  |  | -----           |
| Total current assets .....   |  | 3,6             |
| Property and equipment, net of accumulated depreciation of \$4,507,230 and \$4,358,954 .....     |  | 3,3             |
| Goodwill, net of accumulated amortization of \$1,079,073 and \$1,147,326 .....                   |  | 1,2             |
| Deferred income taxes, net .....   |  | 4               |
|  |  | -----           |
| Total assets .....   |  | \$ 8,6<br>===== |
| LIABILITIES AND SHAREHOLDERS' EQUITY   |  |                 |
| Current liabilities:   |  |                 |
| Current maturities of 11% bonds payable .....  |  | 1               |
| Accounts payable .....   |  | 1               |
| Accrued expenses .....   |  | 3               |
|  |  | -----           |
| Total current liabilities .....  |  | 6               |

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Shareholders' equity:

|  |        |
|--|--------|
| Preferred stock, \$1 par value; 2,000,000 shares authorized, none issued .....                       | 9,0    |
| Common stock, \$.01 par value; 10,000,000 shares authorized;<br>3,830,181 and 3,758,181 issued ..... | (2,4   |
| Additional paid-in-capital .....   | 1,3    |
| Common stock held in treasury, 918,105 and 869,305 shares at cost .....                              |        |
| Retained earnings .....  |        |
| <hr/>  |        |
| Total shareholders' equity .....   | 7,9    |
| <hr/>  |        |
| Total liabilities and shareholders' equity .....   | \$ 8,6 |
|  | =====  |

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

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ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF INCOME  
(Unaudited)

|   | Three Months Ended Mar |              |
|---|------------------------|--------------|
|   | 2002                   | 2001         |
|   | <hr/>                  |              |
| Revenue .....   | \$ 1,915,097           | \$ 1,753,000 |
| Cost of sales .....   | 1,282,716              | 1,249,000    |
|   | <hr/>                  | <hr/>        |
| Gross profit .....  | 632,381                | 504,000      |
|   | <hr/>                  | <hr/>        |
| Selling and marketing .....   | 13,037                 | 23,000       |
| General and administrative .....  | 316,845                | 360,000      |
| Research and development .....  | 23,335                 | 44,000       |
| Amortization of goodwill .....  | -                      | 32,000       |
|   | <hr/>                  | <hr/>        |
| Income from operations .....  | 279,164                | 44,000       |
| Other income (expense):   |                        |              |
| Interest expense .....  | (6,057)                | (5,000)      |
| Other income (expense), net .....   | (2,086)                | 3,000        |
|   | <hr/>                  | <hr/>        |
| Income before income taxes and cumulative effect of change<br>in accounting principle ..... | 271,021                | 42,000       |
| Income tax provision .....  | 69,000                 | 8,000        |
|   | <hr/>                  | <hr/>        |
| Income before cumulative effect of change in accounting principle .....                     | 202,021                | 34,000       |
| Cumulative effect of change in accounting principle, net of tax .....                       | (57,000)               |              |
|   | <hr/>                  | <hr/>        |

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|   |            |       |
|---|------------|-------|
| Net income .....  | \$ 145,021 | \$ 34 |
|   | =====      | ===== |
| Net income per share - basic and dilutive .....                       | \$ 0.05    | \$    |
|   | =====      | ===== |
| Weighted average number of common<br>shares outstanding - basic ..... | 2,920,540  | 3,111 |
|   | =====      | ===== |

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

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ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY  
(Unaudited)

|  | Common Shares |           | Additional<br>Paid-in<br>Capital | Treasury<br>Stock |
|--|---------------|-----------|----------------------------------|-------------------|
|  | Number        | Amount    |                                  |                   |
| December 31, 1999 .....                            | 3,711,883     | \$ 37,119 | \$ 8,946,293                     | \$ (1,151,892)    |
| Issuance of common stock .....                     | 17,798        | 178       | 26,322                           |                   |
| Treasury stock purchase of 265,040<br>shares ..... |               |           |                                  | (502,772)         |
| Value of warrants with<br>bond renewal .....       |               |           | 194,000                          |                   |
| Net income .....                                   |               |           |                                  |                   |
| December 31, 2000 .....                            | 3,729,681     | 37,297    | 9,166,615                        | (1,654,664)       |
| Issuance of common stock .....                     | 28,500        | 285       | 29,996                           |                   |
| Warrants repurchased .....                         |               |           | (197,030)                        |                   |
| Treasury stock purchase of 305,859<br>shares ..... |               |           |                                  | (702,615)         |
| Net income .....                                   |               |           |                                  |                   |
| December 31, 2001 .....                            | 3,758,181     | 37,582    | 8,999,581                        | (2,357,279)       |
| Issuance of common stock .....                     | 72,000        | 720       | 75,780                           |                   |
| Treasury stock purchase of 48,800<br>shares .....  |               |           |                                  | (137,000)         |
| Net income .....                                   |               |           |                                  |                   |
| March 31, 2002 .....                               | 3,830,181     | \$ 38,302 | \$ 9,075,361                     | \$ (2,494,279)    |
|  | =====         | =====     | =====                            | =====             |

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

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ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

|   |        |
|---|--------|
|   | Three  |
|   | -----  |
|   | 2      |
|   | -----  |
| Cash flows from operating activities:   |        |
| Net income .....  | \$ 1   |
| Adjustments to reconcile net income to net cash provided by operating activities: |        |
| Cumulative effect of change in accounting principle, net of tax .....             | 1      |
| Depreciation .....  | 1      |
| Amortization .....  | 1      |
| Changes in assets and liabilities:  |        |
| Trade and other accounts receivable .....   | (      |
| Inventories .....   | (      |
| Deposits, prepaid expenses and other assets .....                                 | (1     |
| Accounts payable, accrued expenses and other liabilities .....                    | )----- |
| Net cash provided by operating activities .....                                   | )----- |
| Cash flows from investing activities:   |        |
| Capital expenditures, net of disposals .....                                      | (2     |
| Net cash used in investing activities .....                                       | )----- |
| Cash flows from financing activities:   |        |
| Issuance of common stock .....  | (1     |
| Payments on capital leases .....  | )----- |
| Purchase of treasury stock .....  | )----- |
| Net cash used in financing activities .....                                       | )----- |
| Net increase (decrease) in cash and cash equivalents .....                        | (2     |
| Cash and cash equivalents at beginning of period .....                            | 1,8    |
| Cash and cash equivalents at end of period .....                                  | )----- |
|   | \$ 1,6 |
|   | =====  |

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

SUPPLEMENTAL NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The unaudited interim consolidated financial statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to such rules and regulations. The accompanying unaudited interim consolidated financial

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statements and related notes should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's most recent Form 10-K covering the year ended December 31, 2001.

The information furnished reflects, in the opinion of the management of Arrhythmia Research Technology, Inc. ("ART"), all adjustments necessary for a fair presentation of the financial results for the interim period presented.

Interim results are subject to year-end adjustments and audit of year-end results by independent certified public accountants.

### Inventories:

Inventories consist of the following as of:

|                       | March 31,<br>2002 | December 31,<br>2001 |
|-----------------------|-------------------|----------------------|
|                       | -----             | -----                |
| Raw materials .....   | \$ 201,122        | \$ 166,835           |
| Work-in-process ..... | 274,714           | 318,070              |
| Finished goods .....  | 516,518           | 412,182              |
|                       | -----             | -----                |
| Total .....           | \$ 992,354        | \$ 897,087           |
|                       | =====             | =====                |

### Goodwill:

Effective January 1, 2002 the Company adopted FASB Statements No.141, Business Combinations ("SFAS 141") and No. 142, Goodwill and Other Intangible Assets ("SFAS 142"). SFAS 141 requires the use of the purchase method of accounting and prohibits the use of the pooling-of-interest method of accounting for business combinations initiated after June 30, 2001. SFAS 141 also requires that the Company recognize acquired intangible assets apart from goodwill if the acquired intangible assets meet certain criteria. SFAS 141 applies to all business combinations initiated after June 30, 2001 and for purchase business combinations completed on or after July 1, 2001. It also requires, upon adoption of SFAS 142, that the Company reclassify the carrying amounts of intangible assets and goodwill based on the criteria in SFAS 141.

SFAS 142 requires, among other things, that companies no longer amortize goodwill, but instead test goodwill for impairment at least annually. In addition, SFAS 142, requires that the Company identify reporting units for the purpose of assessing potential future impairments of goodwill, reassess the useful lives of other existing recognized intangible assets, and cease amortization of intangible assets with an indefinite useful life. An intangible asset with an indefinite useful life should be tested for impairment in accordance with the guidelines in SFAS 142. SFAS 142 is required to be applied to all goodwill and other intangible assets regardless of when those assets were initially recognized.

As of January 1, 2002, the Company's goodwill of \$1,326,000 was composed of \$82,000 associated with attaching machine assets purchased from Newmark, Inc. in 1997 and \$1,244,000 associated with the acquisition of Micron Products, Inc. in 1992. As a result of the transitional impairment tests, the goodwill associated with the Newmark agreement was determined to be impaired as determined by using the present value of future cash flows solely related to attaching machines. The balance of \$82,000 (\$57,000 net of tax) is being reported as the cumulative effect of change in accounting principle for the

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three months ended March 31, 2002. The diminishing number of leases and sales of attaching machines used for the assembly of disposable medical electrodes in this mature industry lead to the impairment of Newmark goodwill. No adjustment to the \$1,244,000 balance of goodwill associated with the Micron Products acquisition was deemed necessary as of March 31, 2002.

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Goodwill-(continued)

The effect on reported net income due to the cumulative effect of change in accounting principle and the discontinuance of goodwill amortization is as follows:

|  | Three months ended Mar<br>2002 | 2001 |
|--|--------------------------------|------|
| Reported net income  | \$ 145,021                     | \$ 3 |
| Cumulative effect of change in accounting principle  | 57,000                         |      |
| Goodwill amortization  | -                              | 3    |
| <hr/>  |                                |      |
| Adjusted net income before cumulative effect of change in accounting principle and discontinuance of goodwill amortization                     | \$ 202,021                     | \$ 6 |
| <hr/>  |                                |      |
| Earnings per share (basic and dilutive) as reported  | \$ .05                         | \$   |
| Cumulative effect of change in accounting principle  | .02                            |      |
| Goodwill amortization  | -                              |      |
| <hr/>  |                                |      |
| Earnings per share (basic and dilutive) before cumulative effect of change in accounting principle and discontinuance of goodwill amortization | \$ .07                         | \$   |
| <hr/>  |                                |      |

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Liquidity and Capital Resources

Working capital was \$2,968,985 at March 31, 2002 compared to \$2,869,344 at December 31, 2001, an increase of \$99,641. Inventory has increased \$95,267 since December 31, 2001 of which \$37,000 is in preparation for a new supply agreement for radiotranslucent sensors and snaps in 2002. The balance of the increase in inventory was due to March 2002 shipments being 30% below forecast which the Company believes will be realized over the remainder of the year.

The Company has a \$1,000,000 revolving credit line with a bank that was established in December 1999. However, the Company has never made any borrowings under the credit line due to sufficient liquidity provided by its operations. The credit line, which is renewable in June 2002, provides for borrowings to be collateralized by accounts receivable and inventory.

Results of Operations

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Revenue for the first quarter ended March 31, 2002 was \$1,915,097 or 9% higher than those for the quarter ended March 31, 2001, which were \$1,753,974. Sales of Micron's silver plated sensors accounted for the revenue increase in the first quarter of 2002 in response to an increase in customer orders. No significant sales of ART's signal-averaging ECG products were recorded in the first quarter or are forecast for the year 2002.

Domestic and foreign sales for the first quarter are as follows:

|                | 2002         | %   | First Quarter |
|----------------|--------------|-----|---------------|
|                |              |     |               |
| Domestic ..... | \$ 331,741   | 18  | \$            |
| Foreign .....  | 1,583,356    | 82  |               |
| Total .....    | \$ 1,915,097 | 100 | \$            |

Cost of sales was 67% of revenue for the quarter ended March 31, 2002 compared to 71% for the same period in 2001. The change in the first quarter of 2002 was due to an 11% increase in Micron's production of sensors. The increased volume has reduced the unit cost of sensors by a greater number of pieces absorbing more of the fixed costs such as payroll, payroll benefits and depreciation. Material costs have remained stable over 2000, 2001 and early 2002.

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Selling and marketing expense was \$10,701 lower in the first quarter of 2002 compared to the first quarter of 2001 as a result of the elimination of a direct sales staff and marketing support for ART signal-averaging ECG products in 2001. The Company hopes in 2002 to market ART's software through license or sales agreements not requiring new sales personnel.

General and administrative expense was \$43,197 lower in the first quarter of 2002 compared to the first quarter of 2001, reflecting the savings associated with the closing of the Austin, Texas office in 2001.

Research and development expense was \$20,794 lower in the first quarter of 2002 compared to the first quarter of 2001 as the conversion and enhancements to ART's principal product, Predictor(R) 7, have been completed and no significant work is scheduled for other products in 2002.

Other income (expense) resulted in lower income of \$5,613 in the first quarter of 2002 compared to the first quarter of 2001. The decrease is attributed to the drop in market rates (\$20,529) on the Company's fixed return investments. The interest income decrease was partially offset by a \$14,456 expense reduction in the amortization of the Bond discount due to the early retirement of a majority of the 11% Bonds in December 2001.

Income taxes as a percent of income before income taxes and cumulative effect of change in accounting principle (net of tax) were 25% and 19% for the quarters ended March 31, 2002 and 2001, the lower rate reflecting a



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non-recurring state tax credit recorded in 2001.

Safe Harbor Under the Private Securities Litigation Reform Act of 1995.

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Any forward looking statements made herein are based on current expectations of the Company that involves a number of risks and uncertainties and should not be considered as guarantees of future performance. These statements are made under the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995. The factors that could cause actual results to differ materially include: interruptions or cancellation of existing contracts, impact of competitive products and pricing, product demand and market acceptance risks, the presence of competitors with greater financial resources than the Company, product development and commercialization risks and an inability to arrange additional debt or equity financing.

PART II - OTHER INFORMATION

- Item 1. Legal Proceedings - none
- Item 2. Changes in Securities - none
- Item 3. Defaults Upon Senior Securities - none
- Item 4. Submission of Matters to a Vote of Security Holders - none
- Item 5. Other Information - none
- Item 6. Exhibits and Reports on Form 8-K - none

SIGNATURES

Pursuant to the requirements 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.

Arrhythmia Research Technology, Inc.  
-----

/s/ James E. Rouse  
-----  
President and Chief Operating Officer

/s/ Richard A. Campbell  
-----  
Vice President of Finance

May 13, 2002