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

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

[x] Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 For the quarterly period ended June 30, 2002 or

[ ] 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 incorporation or organization)	(I.R.S. employer identification no.)

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 [X] No [ ].

As of July 31, 2002 there were 2,928,413 shares of common stock outstanding.

This report consists of 10 pages.

ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY

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June 30, 2002

PART I - FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

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

	June 30, 2002
ASSETS	
Current assets:	
Cash and cash equivalents	$ 1,555,684
Trade and other accounts receivable, net of allowance for doubtful accounts of $51,000	1,115,672
Inventories, net	1,090,115
Deposits, prepaid expenses and other current assets	67,323
Total current assets	3,828,794
Property and equipment, net of accumulated depreciation of $4,129,541 and $4,358,954	3,177,047
Goodwill, net of accumulated amortization of $1,079,073 and $1,147,326	1,244,000
Deferred income taxes, net	370,923
Total assets	$ 8,620,764
LIABILITIES AND SHAREHOLDERS' EQUITY	
Current liabilities:	
Current maturities of 11% bonds payable	-
Accounts payable	282,932

Accrued expenses	276,926
Total current liabilities	559,858
Shareholders' equity:	
Preferred stock, $1 par value; 2,000,000 shares authorized, none issued	-
Common stock, $.01 par value; 10,000,000 shares authorized; 3,888,131 and 3,758,181 issued	38,882
Additional paid-in-capital	9,161,706
Common stock held in treasury, 959,718 and 869,305 shares at cost	(2,619,118
Retained earnings	1,479,436
Total shareholders' equity	8,060,906
Total liabilities and shareholders' equity	$ 8,620,764

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

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

	Three Months Ended June 3	
	2002	2001
Revenue	$ 1,832,237	$ 1,874,662
Cost of sales	1,255,057	1,239,995
Gross profit	577,180	634,667
Selling and marketing	10,442	17,457
General and administrative	395,880	358,792
Research and development	20,576	56,839
Amortization of goodwill	-	32,473
Income from operations	150,282	169,106
Other income (expense):		
Interest expense	(4,819)	(23,508
Other income, net	7,977	8,054
Income before income taxes and cumulative effect of change in accounting principle	153,440	153,652
Income tax provision	52,000	51,000
Income before cumulative effect of change in accounting principle	101,440	102,652
Cumulative effect of change in accounting principle, net of tax	-	-

Net income	$ 101,440	102,652
Net income per share - basic and dilutive	$ 0.03	$ 0.03
Weighted average common shares outstanding - basic	2,918,922	3,015,213

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

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

	Common Shares		Additional Paid-in Capital	Treasury Stock	Retained Earnings
	Number	Amount			
December 31, 1999	3,711,883	$ 37,119	$ 8,946,293	$ (1,151,892)	$ 390,219
Issuance of common stock	17,798	178	26,322		
Treasury stock purchase of 265,040 shares				(502,772)	
Value of warrants with bond renewal			194,000		
Net income					620,127
December 31, 2000	3,729,681	37,297	9,166,615	(1,654,664)	1,010,346
Issuance of common stock	28,500	285	29,996		
Warrants repurchased			(197,030)		
Treasury stock purchase of 305,859 shares				(702,615)	
Net income					222,629
December 31, 2001	3,758,181	37,582	8,999,581	(2,357,279)	1,232,975
Exercise of stock options and warrants	129,950	1,300	162,125		
Treasury stock purchase of 90,413 shares				(261,839)	
Net income					246,461
June 30, 2002	3,888,131	$ 38,882	$ 9,161,706	$ (2,619,118)	$ 1,479,436

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)

	Six Months Ended June 30, 2002	2001
Cash flows from operating activities:		
Net income	$ 246,461	$ 136,704
Adjustments to reconcile net income to net cash provided by operating activities:		
Cumulative effect of change in accounting principle, net of tax	57,000	-
Depreciation	304,172	327,948
Amortization	11,972	122,028
Deferred income tax provision	74,000	70,000
Changes in assets and liabilities:		
Trade and other accounts receivable	(261,246)	414,730
Inventories	(193,028)	(14,244)
Deposits, prepaid expenses and other assets	(39,436)	(34,356)
Accounts payable and accrued expenses	(72,992)	(130,612)
Net cash provided by operating activities	126,903	892,198
Cash flows from investing activities:		
Capital expenditures, net of disposals	(208,627)	(281,161)
Net cash used in investing activities	(208,627)	(281,161)
Cash flows from financing activities:		
Issuance of common stock	163,425	-
Payment of bonds	(125,000)	-
Principle payment on long term debt	-	(175,000)
Purchase of treasury stock	(261,839)	(376,642)
Net cash used in financing activities	(223,414)	(551,642)
Net increase (decrease) in cash and cash equivalents	(305,138)	59,395
Cash and cash equivalents at beginning of period ..	1,860,822	1,999,292
Cash and cash equivalents at end of period	$ 1,555,684	$2,058,687

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

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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 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. and its subsidiary, Micron Products, Inc., ("the Company"), 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:

	June 30, 2002	December 31, 2001
Raw materials	$ 174,059	$ 166,835
Work-in-process	285,923	318,070
Finished goods	630,133	412,182
Total	$ 1,090,115	$ 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 six months ended June 30, 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 June 30, 2002.

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Goodwill-(continued)

The continued 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 June 30, 2002	Three Months Ended June 30, 2001	Six Months 2002
Reported net income	$ 101,440	$ 102,652	$ 246,461
Cumulative effect of change in accounting principle	-	-	57,000
Goodwill amortization	-	32,473	-
Adjusted net income before cumulative effect of change in accounting principle and discontinuance of goodwill amortization	$ 101,440	$ 135,125	$ 303,461
Net income per share (basic and dilutive) as reported	$ .03	$ .03	$ .08
Cumulative effect of change in accounting principle	-	-	.02
Goodwill amortization	-	.01	-
Net income per share (basic and dilutive) before cumulative effect of change in accounting principle and discontinuance of goodwill amortization	$ .03	$ .04	$ .10

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

Liquidity and Capital Resources

Working capital was $3,268,936 at June 30, 2002 compared to $2,869,344 at December 31, 2001. The $399,592 increase in working capital for the first six months of 2002 is principally attributed to the redemption of 11% bonds payable of $113,028 ($125,000 face value), that matured May 2002, and the increase of receivables ($261,246) and inventory ($193,028) to meet current and forecasted demand for Micron's ECG sensor products. The inventory increase of $193,028 in the six months ended June 30, 2002 is principally in quantities of finished goods that are under contract to ship over the remainder of 2002.

The Company has a $1,000,000 revolving line of credit with a bank that is scheduled for renewal September 30, 2002. The credit line provides for borrowings to be collateralized by accounts receivable and inventory. However, the Company has not used the credit line due to sufficient liquidity provided by operations.

Results of Operations

Revenue for the second quarter ended June 30, 2002 was $1,832,237 or substantially the same as the comparable period in 2001. For the six months ended June 30, 2002, total revenues are 3% higher than in 2001 due to sales of Micron's standard ECG sensor products. Micron was recently chosen to supply a new radiotranslucent ECG sensor to a major account with annual purchases estimated to increase Micron's annual sales by approximately 10% beginning in late 2002. Also, sales of standard sensors in 2002 have increased 5% over the comparable period in 2001.

Sales of metal snap fasteners distributed by Micron to ECG electrode manufacturers continued to decline as major accounts switch to direct purchase. There were no significant sales of ART's SAECG product in the first six months of 2002. These latter two product lines have combined for less than 10% of revenue for the six month period ending June 30, 2002.

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Domestic and foreign sales, which includes sales to Canadian operations of $812,718 for the three months ended June 30, 2002 and $1,619,103 for the six months ended June 30, 2002 are as follows:

	Three Months Ended June 30,				Six Mon
	2002	%	2001	%	2002
Foreign Sales	$1,592,725	87	$1,615,881	86	$3,176,081
Domestic Sales	239,512	13	258,781	14	571,253
Total	$1,832,237	100	$1,874,662	100	$3,747,334 1

Cost of sales was 68% of revenue for the six months ended June 30, 2002 compared to 69% of revenue for the same period in 2001. The improvement in 2002 was due to manufacturing efficiencies related to the increase in sales volume of Micron's ECG sensors. There have been no significant changes in material cost, wages, or production expenses over the last 12 months and none are expected for the remainder of 2002.

Selling and marketing expense was $7,015 lower in the second quarter of 2002 compared to the second quarter of 2001. In 2001, Micron initiated a program to expand sales of its ECG sensors in the Pacific Rim regions. This new venture has not resulted in a significant increase in the Company's revenue for the six month period ending June 30, 2002 due to the limited availability of the Company's foreign agent.

General and administrative expense includes approximately $98,000 of legal expenses in the three month period ended June 30, 2002, that was related to an attempt to acquire certain business assets of a competitor of Micron Products Inc. The negotiations to acquire the assets were discontinued in July 2002. These legal expenses accounted for the higher general and administrative expenses in the second quarter of 2002 compared to 2001.

Research and development expense was $36,263 lower for the second quarter of 2002 and $57,057 lower for the first six months of 2002 compared to similar periods in 2001 due to the elimination of ART's in-house R&D staff and overhead as part of closing the Austin, Texas office in 2001. The redesign of the Predictor(R) 7 software has been completed and minor maintenance is contracted through outside parties, if and when needed.

Interest expense is lower in both periods reported for 2002 when compared to 2001, principally as a result of the early redemption of $425,000 of 11% bonds payable in late 2001, and maturity of $125,000 in 2002. Other income includes interest earned on the Company's cash equivalents of $55,639 for the six months ended June 30, 2001 compared to $15,258 for the first six months of 2002. The reduction of interest income is due to the lower returns now available on fixed rate investments. Offsetting part of the loss of interest income was the elimination of amortization expense on debt discount when the 11% bonds were redeemed.

Income taxes as a percent of income for the quarters ended June 30, 2002 and 2001 were 34% and 33% respectively. For the six month periods ended June 30, 2002 and June 30, 2001, income taxes as a percent of income before income taxes and cumulative effect of change in accounting principle (net of tax) were 29% and 30% respectively. No Federal income taxes were owed for 2001 and the Company does not anticipate any Federal income taxes will be due for 2002 due to the utilization of Net Operating Loss carryforwards and deferred tax assets.

Market risk does not affect the Company's financial results because the Company's foreign sales contracts are denominated in U.S.Dollars.

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

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 -

Exhibit 99.1 - Certification of CEO and CFO

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

August 13, 2002