TRIMEDYNE INC
Form 10QSB
May 24, 2004

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549
FORM 10-QSB
QUARTERLY REPORT

PURSUANT TO SECTION 13 OR 15 (d) OF THE

SECURITIES EXCHANGE ACT OF 1934

| FOR THE QUARTER ENDED | COMMISSION FILE NUMBER |
|---|---|
| MARCH 31, 2004 | 0-10581 |

TRIMEDYNE, INC.

(Exact name of Registrant as specified in its charter)

| Nevada | 36-3094439 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (IRS Employer Identification Number) |

15091 Bake Parkway, Irvine, CA 92618
(Address of principal executive offices) (Zip Code)

(949/951-3800)

(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report).

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), (2) has been subject to such filing requirements for the past 90 days.

YES [X]      NO [_]

Indicate the number of shares outstanding of each of the issuer's class of common stock, as of the last practicable date.

| Class | Outstanding at May 24, 2004 |
|---|---|
| Common Stock, $.01 par value | 14,698,540 shares |

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TRIMEDYNE, INC.
CONSOLIDATED BALANCE SHEET
(UNAUDITED)

ASSETS

| | March 31, 2004 |
|---|---|
| Current assets: | |
| Cash and cash equivalents | $ 1,449,000 |
| Trade accounts receivable, net of allowance for doubtful accounts of $86,000 | 730,000 |
| Inventories | 1,633,000 |
| Other | 33,000 |
| Total current assets | 3,845,000 |
| Goodwill | 544,000 |
| Other assets | 44,000 |
| Property and equipment, net | 439,000 |
| | $ 4,872,000 |

LIABILITIES AND STOCKHOLDERS' EQUITY

| | |
|---|---|
| Current liabilities: | |
| Accounts payable | $ 498,000 |
| Accrued expenses | 397,000 |
| Deferred revenue | 90,000 |

| | |
|---|---|
| Accrued warranty | 21,000 |
| Current portion of long-term debt | 24,000 |
| Total current liabilities | 1,030,000 |
| Senior convertible secured notes due to officer | 200,000 |
| Accrued interest due officer | 50,000 |
| Long-term debt, net of current portion | 6,000 |
| Total liabilities | 1,286,000 |
| Stockholders' equity: | |
| Preferred stock - $0.01 par value, 1,000,000 shares authorized, none issued and outstanding | |
| Common stock - $0.01 par value; 30,000,000 shares authorized, 14,698,540 shares issued, 14,534,831 shares outstanding | 148,000 |
| Capital in excess of par value | 47,944,000 |
| Accumulated deficit | (43,793,000) |
| | 4,229,000 |
| Treasury stock, at cost (101,609 shares) | (713,000) |
| Total stockholders' equity | 3,586,000 |
| | $ 4,872,000 |

See accompanying notes to consolidated financial statements

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TRIMEDYNE, INC.
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

| | Three Months Ended March 31, | | Six Mon Mar |
|---|---|---|---|
| | 2004 | 2003 | 2004 |
| Net revenues | $ 1,274,000 | $ 1,653,000 | $ 2,654,000 |
| Cost of revenues | 664,000 | 827,000 | 1,368,000 |
| Gross profit | 610,000 | 826,000 | 1,286,000 |
| Operating expenses: | | | |
| Selling, general and administrative | 540,000 | 580,000 | 1,107,000 |
| Research and development | 94,000 | 36,000 | 161,000 |
| Total operating expenses | 634,000 | 616,000 | 1,268,000 |

| | | | |
|---|---|---|---|
| Income (loss) from operations | (24,000) | 210,000 | 18,000 |
| Other income, net | 177,000 | 23,000 | 300,000 |
| Income before income taxes | 153,000 | 233,000 | 318,000 |
| Provision for income taxes | 4,000 | 26,000 | 4,000 |
| Net income | $ 149,000 | $ 207,000 | $ 314,000 |
| Net income per share: | | | |
| Basic | $ 0.01 | $ 0.02 | $ 0.02 |
| Diluted | $ 0.01 | $ 0.02 | $ 0.02 |
| Weighted average number of shares outstanding: | | | |
| Basic | 14,576,541 | 13,147,760 | 14,523,859 |
| Diluted | 15,409,509 | 13,729,760 | 15,346,422 |

See accompanying notes to consolidated financial statements.

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TRIMEDYNE, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

| | Six Months Ended March 31, 2004 | 2003 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income | $ 314,000 | $ 497,0 |
| Adjustment to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 127,000 | 60,0 |
| Loss from disposal of property and equipment | 5,000 | |
| Changes in operating assets and liabilities: | | |
| Trade accounts receivable | (93,000) | (125,0 |
| Inventories | (128,000) | 360,0 |
| Other assets | 114,000 | 85,0 |
| Accounts payable | (26,000) | (238,0 |
| Accrued expenses | (226,000) | (81,0 |
| Deferred revenue | 31,000 | (7,0 |
| Accrued warranty | (21,000) | 5,0 |

| | | |
|---|---|---|
| Accrued interest | 12,000 | 14,0 |
| Other liabilities | -- | (25,0 |
| Net cash provided by operating activities | 109,000 | 545,0 |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (55,000) | |
| Cash flows from financing activities: | | |
| Excercise of stock options | 69,000 | |
| Payments on debt | (20,000) | |
| Net cash provided by financing activities | 49,000 | |
| Net increase in cash and cash equivalents | 103,000 | 545,0 |
| Cash and cash equivalents at beginning of period | 1,346,000 | 317,0 |
| Cash and cash equivalents at end of period | $ 1,449,000 | $ 862,0 |

See accompanying notes to consolidated financial statements

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TRIMEDYNE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2004 and 2003
(UNAUDITED)

NOTE 1 - Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Trimedyne, Inc., its wholly owned subsidiary, Mobile Surgical Technologies, Inc. ("MST"), and its 90% owned subsidiary, Cardiodyne, Inc. ("Cardiodyne") (collectively, the "Company"). All intercompany accounts and transactions have been eliminated in consolidation.

Unaudited Interim Financial Information

In the opinion of management, the accompanying condensed consolidated financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the Company's consolidated financial position as of March 31, 2004 and the results of operations and its cash flows for the three and six-month periods ended March 31, 2004 and 2003. Results for the three and six months ended March 31, 2004 are not necessarily indicative of the results to be expected for the year ending September 30, 2004.

While management believes that the disclosures presented are adequate to make the information not misleading, it is suggested that these consolidated financial statements be read in conjunction with the consolidated financial statements and the notes included in the Company's 2003 annual report on Form

10-KSB. Certain prior period amounts have been reclassed to conform to the current period presentation.

Accounts Receivable

The Company performs ongoing credit evaluations of its customers and generally does not require collateral. The Company maintains reserves for potential credit losses and such losses have been within management's expectation.

Revenue Recognition

In accordance with Staff Accounting Bulletin 104, "Revenue Recognition," the Company recognizes revenue from products sold once all of the following criteria for revenue recognition have been met: (i) persuasive evidence that an arrangement exists, (ii) the products have been shipped, (iii) the prices are fixed and determinable and not subject to refund or adjustment, and (iv) collection of the amounts due is reasonably assured.

Revenues from the sale of delivery and disposable devices are recognized upon shipment and passage of title of the products, provided that all other revenue recognition criteria have been met. Generally, customers are required to insure the goods from the Company's place of business. Accordingly, the risk of loss transfers to the customer once the goods have been shipped from the Company's warehouse. The Company sells its products primarily through commission sales representatives in the United States and distributors in foreign countries. In cases where the Company utilizes distributors, it recognizes revenue upon shipment, provided that all other revenue recognition criteria have been met, and ownership risk has transferred.

Goodwill

Goodwill represents the excess of the cost over the acquired assets of MST. On October 1, 2002, the Company adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets." As a result of adoption SFAS No. 142, the Company's goodwill is no longer amortized, but is subject to an annual impairment test, or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. There was no impairment of goodwill at March 31, 2004.

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Stock Option Plans

The Company accounts for its stock-based compensation plans under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. The Company has adopted the disclosure provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" - an amendment of FASB Statement No. 123. The following table illustrates the effect on net income and net income per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation:

| | Three months ended March 31, | | Six m |
|---|---|---|---|
| | 2004 | 2003 | 2004 |

| | | | |
|---|---|---|---|
| Net income, as reported | $ 149,000 | $ 207,000 | $ 314,0 |
| Deduct: total stock-based employee compensation expense determined under fair value based method for awards, net of related tax effects | 5,000 | 23,000 | 10,0 |
| Pro forma net income | $ 144,000 | $ 184,000 | $ 304,0 |
| Net income per share - basic: | | | |
| As reported | $ 0.01 | $ 0.02 | $ 0. |
| Pro forma | $ 0.01 | $ 0.02 | $ 0. |
| Net income per share - diluted: | | | |
| As reported | $ 0.01 | $ 0.02 | $ 0. |
| Pro forma | $ 0.01 | $ 0.02 | $ 0. |

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used:

| | Three months ended March 31, | | Six months ended March 31, | |
|---|---|---|---|---|
| | 2004 | 2003 | 2004 | 2003 |
| Dividend yield | -- | -- | -- | -- |
| Expected volatility | 80% | 78% | 80% | 78% |
| Risk-free interest rate | 2.11% | 2.11% | 2.11% | 2.11% |
| Expected lives | 5 years | 5 years | 5 years | 5 years |

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility and time to exercise. Because awards held by employees and directors have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in the opinion of management, the existing models do not necessarily provide a reliable single measure of the fair value of these options.

NOTE 2 - Balance Sheet Items

| | March 31, 2004 |
|---|---|
| Inventories consist of the following: | |
| Raw material | $ 730,000 |
| Work-in-process | 426,000 |
| Finished goods | 477,000 |
| Total inventory | $ 1,633,000 |
| Property and equipment consist of the following: | |
| Furniture and equipment | $ 2,386,000 |
| Leasehold improvements | 218,000 |
| Other | 166,000 |
| | 2,770,000 |
| Less accumulated depreciation and amortization | (2,331,000) |
| Total property and equipment | $ 439,000 |
| Accrued expenses consist of the following: | |
| Loss contigency | $ 100,000 |
| Accrued compensation | 89,000 |
| Sales and use tax | 74,000 |
| Accrued payroll tax | 5,000 |
| Sublease deposit | 15,000 |
| Customer deposits | 34,000 |
| Accrued commissions | 16,000 |
| Other | 64,000 |
| Total accrued expenses | $ 397,000 |

NOTE 3 - Earnings Per Share Information

Basic income per share is based on the weighted-average number of shares of common stock outstanding during the period. Diluted income per share also includes the effect of stock options and other common stock equivalents outstanding during the period, and assumes the conversion of the Company's senior convertible secured notes due to officers for the period of time such notes were outstanding, if such stock options and convertible notes are dilutive.

The following table sets forth the computation of the numerator and denominator of basic and diluted earnings per share:

| Three months ended | Six months |
|---|---|

| | March 31, | | March |
| --- | --- | --- | --- |
| | 2004 | 2003 | 2004 |
| Denominator | | | |
| Weighted average common shares outstanding used in calculating basic earnings per share | 14,576,541 | 13,147,760 | 14,523,839 |
| Effect of Dilutive Options | 357,968 | 107,000 | 347,583 |
| Effect of Senior Convertible Secured Notes due to Officer | 475,000 | 475,000 | 475,000 |
| Weighted average common shares outstanding used in calculating diluted earnings per share | 15,409,509 | 13,729,760 | 15,346,422 |
| Numerator | | | |
| Net income | $ 149,000 | $ 207,000 | $ 314,000 |
| Add - interest on Senior Convertible Secured Note due to Officer | 6,000 | 6,000 | 12,000 |
| Net income available to common shareholders | $ 155,000 | $ 213,000 | $ 326,000 |



NOTE 4 - Contingencies

Litigation

The Company was a defendant and counterclaimant in Lumenis, Inc. ("Lumenis") v. Trimedyne, Inc. Lumenis alleged that the Company had infringed on two of its patents. The Company filed an answer to Lumenis' complaint and also filed counterclaims against Lumenis alleging infringement of two of the Company's patents, unfair business practices, trade libel and anti-trust violations. The Company was a party to a license agreement (the "License Agreement"), which required it to pay royalties to Lumenis. At September 30, 2003, the Company had accrued royalties under this license agreement in the amount of $88,000.

On November 25, 2003, the Company and Lumenis entered into a settlement agreement (the "Settlement Agreement"), under which the court dismissed the litigation between them. The Settlement Agreement also provided that Lumenis would apply a credit to royalties due by the Company under the License Agreement, which the Company had accrued, and pay the Company $5,000 for the remaining overpayment of royalties due under the License Agreement. The Settlement Agreement also provided that the Company and Lumenis would enter into an original equipment manufacture ("OEM") agreement whereby Lumenis would pay the Company a technology access fee of $150,000 and purchase from the Company certain side-firing and angled-firing fiber optic devices, which Lumenis will market with its lasers, plus an amount equal to 7.5% of Lumenis' sales of side-firing and angled-firing devices manufactured by Lumenis or purchased by Lumenis from third-party suppliers.

In January and March 2004, the Company received $155,000 in technology fees and $26,000 in royalties, respectively, in connection with the terms of the settlement agreement, which is included in other income for the three and six month periods ended March 31, 2004.

Product liability

The Company is currently a defendant in three product liability lawsuits. These cases relate to injuries that occurred in connection to medical procedures in which the Company's lasers were used. All of these cases are currently in litigation. The Company has insurance to cover product liability claims. This insurance provides the Company with $5,000,000 of coverage for each occurrence with a general aggregate of $5,000,000. Trimedyne's liability is limited to a maximum of $50,000 per occurrence unless the judgment against the Company exceeds the insurance coverage. In such case, Trimedyne would be liable for any liability in excess of $5,000,000. Management has accrued in prior periods a loss contingency for these claims in the amount of $100,000 ($50,000 for each of the two claims), based on the deductible under the insurance policy. In another product liability lawsuit, the cost of defense has exceeded the insurance deductible that was accrued in prior periods. Management is not accruing any additional provision for this claim, as it is not expected that this claim will exceed the limits of the insurance coverage.

In the ordinary course of business, the Company is from time to time involved in various pending or threatened legal actions. The litigation process is inherently uncertain and it is possible that the resolution of such matters might have a material adverse effect upon the financial condition and/or results of operations of the Company. However, in the opinion of the Company's management, matters currently pending or threatened against the Company, as discussed above, are not expected to have a material adverse effect on the financial position, results of operations or cash flows of the Company.

Licensing

The Company has license agreements with a number of universities and inventors, under which royalties on sales, if any, are payable. Sales of products covered by these licenses are presently not material. The Company has one license agreement with a competitor under which royalties have been waived. Patent applications have been filed with the U.S. Patent Office and U.S. Patents covering certain of the Company's products have been issued to officers and employees of the Company and have been assigned to the Company without royalty. The above patent applications are currently being processed by the U.S. Patent Office and, to the Company's knowledge, are proceeding in the normal course of review.

NOTE 5 - Other Income

During the six months ended March 31, 2004, the Company settled litigation with Lumenis which resulted in a reduction of $88,000 previously accrued for royalties. In January and March 2004, the Company received $155,000 in technology fees and $26,000 in royalties, respectively, in connection with the terms of the above settlement, which is included in other income for the three and six month periods ended March 31, 2004 (see Note 4). The Company also received $53,000 from an insurance settlement for a damaged laser.

NOTE 6 Segment Information

The Company's revenue base is derived from the sales of medical products and services. Products consist of lasers, and related products such as disposable systems and component parts. Services consist of rentals, fees on a per-case basis, as well as service and warranty repairs and maintenance. Data with respect to these operating activities for the three months and six months ended March 31, 2004 and March 31, 2003 are as follows:

| | For the quarter ended March 31, 2004 | | | For the q |
|---|---|---|---|---|
| | Products | Service and Rental | Total | Products |
| Revenue | $ 837,000 | $ 437,000 | $ 1,274,000 | $ 1,289,000 |
| Cost of sales | 571,000 | 93,000 | 664,000 | 663,000 |
| Gross profit | 266,000 | 344,000 | 610,000 | 626,000 |
| Expenses: | | | | |
| Selling, general and administrative | 389,000 | 151,000 | 540,000 | 448,000 |
| Reasearch and development | 94,000 | -- | 94,000 | 36,000 |
| Income (loss) from operations | $ (217,000) | $ 193,000 | (24,000) | $ 142,000 |
| Other: | | | | |
| Interest income | | | 2,000 | |
| Interest expense | | | (6,000) | |
| Royalty income | | | 26,000 | |
| Settlements and recoveries | | | 155,000 | |
| Income taxes | | | (4,000) | |
| Net income | | | $ 149,000 | |

| | For the six months ended March 31, 2004 | | | For the s |
|---|---|---|---|---|
| | Products | Service and Rental | Total | Products |
| Revenue | $ 1,802,000 | $ 852,000 | $ 2,654,000 | $ 2,576,000 |
| Cost of sales | 1,035,000 | 333,000 | 1,368,000 | 1,297,000 |
| Gross profit | 767,000 | 519,000 | 1,286,000 | 1,279,000 |
| Expenses: | | | | |
| Selling, general and administrative | 804,000 | 303,000 | 1,107,000 | 788,000 |
| Research and development | 161,000 | -- | 161,000 | 103,000 |

| | | | | |
|---|---|---|---|---|
| Income (loss) from operations | $ (198,000) | $ 216,000 | 18,000 | $ 388,000 |
| Other: | | | | |
| Interest income | | | 2,000 | |
| Interest expense | | | (19,000) | |
| Loss on disposal of equipment | | | (5,000) | |
| Royalty income | | | 26,000 | |
| Settlements and recoveries | | | 298,000 | |
| Income taxes | | | (4,000) | |
| Net income | | | $ 314,000 | |

Sales and gross profit to customers by similar products and services for the three and six months ended March 31, 2004 (unaudited) and March 31, 2003 were as follows:



| | For the three months ended March 31, | | For the six mo |
|---|---|---|---|
| | 2004 | 2003 | 2004 |
| By similar products and services: | | | |
| Revenues: | | | |
| Products: | | | |
| Laser equipment and accessories | $ 96,000 | $ 557,000 | $ 189,000 |
| Delivery and disposable devices | 741,000 | 732,000 | 1,613,000 |
| Service and rental | 437,000 | 364,000 | 852,000 |
| Total | $1,274,000 | $1,653,000 | $ 2,654,000 |
| Gross profit | | | |
| Products: | | | |
| Laser equipment and accessories | $ 33,000 | $ 255,000 | $ 55,000 |
| Delivery and disposable devices | 233,000 | 371,000 | 712,000 |
| Service and rental | 344,000 | 200,000 | 519,000 |
| Total | $ 610,000 | $ 826,000 | $ 1,286,000 |

The Company's revenue base is derived from the sales of medical products and services on a worldwide basis originating from the United States. Export sales during the three months ended March 31, 2004 decreased by $299,000 or 68% to $137,000 from $436,000 from the prior year three month period. Export sales during the six months ended March 31, 2004 decreased by $540,000 or 57% to $401,000 from $941,000 from the prior year six month period. Although discrete components that earn revenues and incur expenses exist, significant expenses such as research and development and corporate administration are not incurred by nor allocated to these operating units but rather are employed by the entire enterprise. Additionally, the chief operating decision maker evaluates resource allocation not on a product or geographic basis, but rather on an enterprise-wide basis. Therefore, the Company has concluded that it contains only one reportable segment, which is the medical systems business.

Sales in foreign countries for the quarters ended March 31, 2004 and March 31, 2003 accounted for approximately 8% and 26% of the Company's total sales, respectively. Sales in foreign countries for the six months ended March 31, 2004 and March 31, 2003 accounted for approximately 15% and 17% of the Company's total sales, respectively. The breakdown by geographic region is as follows:

| | Three months ended March 31, 2004 | Three months ended March 31, 2003 | Six months ended March 31, 2004 | Six months ended March 31, 2003 |
|---|---|---|---|---|
| Asia | $ 83,000 | $ 237,000 | $ 172,000 | $ 565,000 |
| Europe | 34,000 | 32,000 | 197,000 | 198,000 |
| Latin America | 9,000 | 159,000 | 9,000 | 161,000 |
| Middle East | 3,000 | 5,000 | 12,000 | 14,000 |
| Other | 8,000 | 3,000 | 11,000 | 3,000 |
| | $ 137,000 | $ 436,000 | $ 401,000 | $ 941,000 |

All long-lived assets were located in the United States during the three and six months ended March 31, 2004 and 2003.

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

CRITICAL ACCOUNTING POLICIES

Revenue Recognition

In accordance with Staff Accounting Bulletin 104, "Revenue Recognition," the Company recognizes revenue from products sold once all of the following criteria for revenue recognition have been met: (i) persuasive evidence that an arrangement exists, (ii) the products have been shipped, (iii) the prices are fixed and determinable and not subject to refund or adjustment, and (iv) collection of the amounts due is reasonably assured.

Revenues from the sale of delivery and disposable devices are recognized upon shipment and passage of title of the products, provided that all other revenue recognition criteria have been met. Generally, customers are required to insure the goods from the Company's place of business. Accordingly, the risk of loss transfers to the customer once the goods have been shipped from the Company's warehouse. The Company sells its products primarily through commission sales representatives in the United States and distributors in foreign countries. In cases where the Company utilizes distributors, it recognizes revenue upon shipment, provided that all other revenue recognition criteria have been met, and ownership risk has transferred.

Allowance for Doubtful Accounts

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of the Company's customers to make required payments. The allowance for doubtful accounts is based on specific identification of customer accounts and the Company's best estimate of the likelihood of potential loss, taking into account such factors as the financial condition and payment history of major customers. The Company evaluates the collectibility of our receivables at least quarterly. If the financial condition of the Company's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. The differences could be material and could significantly impact cash flows from operating activities.

Goodwill

Goodwill represents the excess of the cost over the acquired assets of MST. On October 1, 2002, the Company adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Tangible Assets." As a result of adoption SFAS No. 142, the Company's goodwill is no longer amortized, but is subject to an annual impairment test, or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. There was no impairment of goodwill at March 31, 2004.

Deferred Taxes

The Company records a valuation allowance to reduce the deferred tax assets to the amount that is more likely than not to be realized. The Company has considered estimated future taxable income and ongoing tax planning strategies in assessing the amount needed for the valuation allowance. Based on these estimates, all of the Company's deferred tax assets have been reserved. If actual results differ favorably from those estimates used, the Company may be able to realize all or part of the Company's net deferred tax assets. Such realization could positively impact our operating results and cash flows from operating activities.

Stock-based Compensation

The Company accounts for its employee stock-based compensation plans under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. The Company has adopted the disclosure provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" - an amendment of FASB Statement No. 123.

RESULTS OF OPERATIONS

The statements contained in this Quarterly Report on Form 10-QSB that are not historical facts may contain forward-looking statements that involve a number of known and unknown risks and uncertainties that could cause actual results to differ materially from those discussed or anticipated by management. Potential risks and uncertainties include, among other factors, general business conditions, government regulations governing medical device approvals and manufacturing practices, competitive market conditions, success of the Company's business strategy, delay of orders, changes in the mix of products sold, availability of suppliers, concentration of sales in markets and to certain customers, changes in manufacturing efficiencies, development and introduction of new products, fluctuations in margins, timing of significant orders, and other risks and uncertainties currently unknown to management.



Method of Presentation

The consolidated financial statements include the accounts of the Trimedyne, Inc., its wholly owned subsidiary Mobile Surgical Technologies, Inc. ("MST") and its 90% owned subsidiary, Cardiodyne, Inc. ("Cardiodyne").

Quarter ended March 31, 2004 compared to quarter ended March 31, 2003:

During the quarter ended March 31, 2004, net revenues were $1,274,000 as compared to $1,653,000 for the same period of the previous year, a $379,000 or 23% decrease. This overall decrease was the result of lower laser sales during the current period. Lasers typically sell between $35,000 and $110,000, depending upon the type of laser. The number of lasers sold in a typical quarter during the past two years has ranged from one to six per quarter. Net sales from delivery and disposable devices increased by $9,000 or 1% to $741,000 in the current quarter from $732,000 in the same quarter of the prior year. Net sales from service and rental increased by $73,000 or 20% to $437,000 from $364,000 for the same quarters. This increase was primarily due to the growth of the Company's subsidiary MST, which is expanding its territory into other states.

Cost of sales during the quarter ended March 31, 2004 was 52% of net sales as compared to 50% of net sales during the quarter ended March 31, 2003.

Selling, general and administrative expenses decreased in the current quarter to $540,000 from $580,000 in the prior year quarter, a decrease of $40,000 or 7%. The decrease in selling, general and administrative expenses was primarilty the result of the following: decreases of $42,000 in bad debt expense, $36,000 in commissions expense due to a decrease in sales, $16,000 in adminstrative payroll and $13,000 in miscellaneous adminstration expenses offset by increases of $36,000 in depreciation expense, $17,000 in audit and tax preparation expense and $11,000 in rent expense. Research and development expenditures for the quarter ended March 31, 2004, increased $58,000 to $94,000 as compared to $36,000 in the quarter ended March 31, 2003. This increase was a result of Trimedyne increasing its efforts to develop new delivery systems and Holmium lasers.

Other income increased by $154,000 or 670% from $23,000 in the second quarter of fiscal 2003 to $177,000 in the second quarter of 2004. During the three months ended December 31, 2003, the Company settled litigation with a competitor which resulted in the receipt of $155,000 in technology fees and royalties of $26,000 during the current quarter offset by interest accrued on notes due to the CEO.

For the current quarter, the Company had net income of $149,000 or $0.01 per share, based on 14,576,541 basic weighted average number of common shares outstanding, as compared to net income of $207,000, or $0.02 per share, based on 13,729,760 basic weighted average number of common shares outstanding in the same quarter of the previous year.

Six months ended March 31, 2004 compared to six months ended March 31, 2003:

During the six months ended March 31, 2004, net revenues were $2,654,000 as compared to $3,338,000 for the same period of the previous year, a $684,000 or 20% decrease. Net sales from lasers and accessories decreased by $774,000 or 23% to $1,802,000 during the six months ended March 31, 2004 from $2,576,000 in the the same period of the prior year. Export sales also decreased by $187,000 or 31% due to a reduction in laser sales in Asia and Latin America. Net revenues from delivery and disposable devices increased by $33,000 or 2% to $1,613,000 during the six months ended March 31, 2003 from $1,580,000 for the same period of the prior year. Net sales from service and rental increased by $90,000 or 11% to $852,000 from $762,000 for the same quarters in the prior year. This increase was primarily due to the growth of the Company's subsidiary MST, which is expanding its territory into other states.

Cost of sales remained relatively unchanged at 52% of net sales in the six months ended March 31, 2004 compared to 51% for the six months ended March 2003.

For the six months ended March 31, 2004, selling, general and administrative expenses totaled $1,107,000 as compared to $1,055,000 for the same period of the previous year, a $52,000 or 5% increase. This increase in selling, general and administrative expenses since the prior year period is the result of the following: the Company being named in an additional product liability lawsuit and accruing a charge of $50,000 representing the contingency for insurance deductible, a rent increase of $18,000 per the leasing contract of the Company's Irvine location, a $47,000 increase in salaries and wages due to the hiring of additional operations staff, the increase of insurance expense of $17,000, and an increase of repairs and maintenance of $23,000 and depreciation of $30,000 due to the purchase of additional assets for the Company's subsidiary, MST, all offset by reductions in bad debt expense of $42,000, commissions expense of $67,000, telephone expense of $13,000 and reductions in miscellaneous administration expenses of $10,000.



Research and development expenditures for the six months ended March 31, 2004, increased $58,000 or 56% to $161,000 from $103,000. The increase is primarily due to Trimedyne increasing its product development efforts which include the testing and research of new and current products, along with preparation of regulatory submissions.

Other income increased by $268,000 to $300,000 in the current six-month period from $32,000 in the six-month period of fiscal 2003. In November 2003, the Company settled litigation with Lumenis, Inc. which resulted in the reduction of $88,000 in the liability for royalties in the previous quarter ended December 31, 2003 and the receipt of $155,000 in technology fees and royalties of $26,000 during the current quarter ended March 31, 2004. During the previous year's quarter ended December 31, 2003 the Company also received $53,000 for an unrelated cash insurance settlement for a damaged laser. Other income was primarily offset by interest accrued on notes due to the CEO.

For the six months ended March 31, 2004, Trimedyne had net income of $314,000 or $0.02 per share, based on 14,523,859 basic weighted average number of common shares outstanding, as compared to a net income of $497,000, or $0.04 per share, based on 13,729,760 basic weighted average number of common shares outstanding in the same period of the previous year, resulting from the above mentioned factors.

## Liquidity and Capital Resources

At March 31, 2004, the Company had working capital of $2,815,000 compared to $1,549,000 at the end of the second quarter ending March 31, 2003. Cash increased by $103,000 to $1,449,000 from $1,346,000 at the fiscal year ending September 30, 2003. We believe our existing working capital will be sufficient to meet Trimedyne's operating needs, and the operating needs of our 100% owned laser rental subsidiary for the next twelve months. During the six months period ended March 31, 2004, net cash provided by consolidated operations was $109,000. Net cash used in investing activities was $55,000 primarily as a result of the purchase of additional fixed assets to support the continuing expansion of MST. Net cash provided by financing activities was $49,000 of which $69,000 was the result of stock options exercised offset by $20,000 in payments on debt. While we expect to continue to operate at a profit, we could incur losses in the future if we fail to generate revenues sufficient to offset the costs associated with manufacturing and marketing our current products, our overhead, and the development of new products. If we fail to continue to operate profitability, or if we undertake the development, testing and marketing of additional new products in the future, we will likely need to raise substantial additional capital. There can be no assurance that we will be able to operate profitably in the future.

We have $200,000 of Senior Convertible Notes due to our chief executive officer (the "Notes") outstanding which are due, with interest at 12% per annum, in 2007. The Notes and accrued interest are convertible at prices of $0.40 and $0.50 per share. If the Notes and accrued interest are not converted, we may have to raise additional capital to pay the Note holder the principal and interest due on the Notes. Sources of such financing may include the sale of additional equity securities or the sale or licensing of patent rights. The issuance of additional common stock or shares of preferred stock will dilute the equity interests of our shareholders. There is no assurance such financing, if and when needed, will be available to us on acceptable terms.

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Item 3. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company's chief executive officer and chief financial officer carried out an evaluation of the effectiveness and operation of the Company's disclosure controls and procedures. They have concluded after evaluating the effectiveness of the Company's disclosure controls and procedures as of a date (the "Evaluation Date") within 90 days before the filing date of this quarterly report, that as of the Evaluation Date, the Company's disclosure controls and procedures were effective and designed to ensure that material information relating to the Company would be made known to them by others.

Changes in Internal Controls

There have been no significant changes in the Company's internal controls or in other factors that could significantly affect those controls subsequent to the Evaluation Date.

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Part II
Other Information

Item 1. Legal Proceedings

The Company was a defendant and counterclaimant in Lumenis, Inc. ("Lumenis") v. Trimedyne, Inc. Lumenis alleged that the Company had infringed on two of its patents. The Company filed an answer to Lumenis' complaint and also filed counterclaims against Lumenis alleging infringement of two of the Company's patents, unfair business practices, trade libel and anti-trust violations. The Company was a party to a license agreement (the "License Agreement"), which required it to pay royalties to Lumenis. At September 30, 2003, the Company had accrued royalties under this license agreement in the amount of $88,000.

On November 25, 2003, the Company and Lumenis entered into a settlement agreement (the "Settlement Agreement"), under which the court dismissed the litigation between them. The Settlement Agreement also provided that Lumenis would apply a credit to royalties due by the Company under the License Agreement, which the Company had accrued, and pay the Company $5,000 for the remaining overpayment of royalties due under the License Agreement. The Settlement Agreement also provided that the Company and Lumenis would enter into an original equipment manufacture ("OEM") agreement whereby Lumenis would pay the Company a technology access fee of $150,000 and purchase from the Company certain side-firing and angled-firing fiber optic devices, which Lumenis will market with its lasers, plus an amount equal to 7.5% of Lumenis' sales of side-firing and angled-firing devices manufactured by Lumenis or purchased by Lumenis from third-party suppliers.

In January and March 2004, the Company received $155,000 in technology fees and $26,000 in royalties, respectively, in connection with the terms of the settlement agreement, which is included in other income for the three and six month periods ended March 31, 2004.

The Company is currently a defendant in three product liability lawsuits. These cases relate to injuries that occurred in connection to medical procedures in which the Company's lasers were used. All of these cases are currently in litigation. The Company has insurance to cover product liability claims. This insurance provides the Company with $5,000,000 of coverage for each occurrence with a general aggregate of $5,000,000. Trimedyne's liability is limited to a maximum of $50,000 per occurrence unless the judgment against the Company exceeds the insurance coverage. In such case, Trimedyne would be liable for any liability in excess of $5,000,000. Management has accrued in prior periods a loss contingency for these claims in the amount of $100,000 ($50,000 for each of the two claims), based on the deductible under the insurance policy. In another product liability lawsuit, the cost of defense has exceeded the insurance deductible that was accrued in prior periods. Management is not accruing any additional pr ovision for this claim, as it is not expected that this claim will exceed the limits of the insurance coverage.

Item 2. Changes in Securities
None

Item 3. Defaults Upon Senior Securities
None

Item 4. Submission of Matters to Vote of Security Holders
None

Item 5. Other Information
None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits
99.1 Officer Certification
99.2 Controller Certification

(b) Reports on Form 8-K
None



SIGNATURE PAGE

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 hereunto duly authorized.

TRIMEDYNE, INC.

Date: May 24, 2004 /s/ Marvin P. Loeb

Marvin P. Loeb
President and
Chief Executive Officer

Date: May 24, 2004 /s/ Jeffrey S. Rudner

Jeffrey S. Rudner
Controller

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CERTIFICATION

I, Marvin P. Loeb, hereby certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Trimedyne, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact, or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report; and

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial position, results of operations, and cash flows of the issuer as of, and for, the periods presented in this quarterly report.

4. I am responsible for establishing and maintaining disclosure controls and procedures for the issuer and have:

   (i) Designed such disclosure controls and procedures to ensure that material information relating to the issuer is made known to me, particularly during the period in which the periodic reports are being prepared;

   (ii) Evaluated the effectiveness of the issuer's disclosure controls and procedures as of March 31, 2004; and

   (iii) Presented in the report our conclusions about the effectiveness of the disclosure controls and procedures based on my evaluation as of the Evaluation Date;

5. I have disclosed, based on my most recent evaluation, to the issuer's auditors and the audit committee of the board of directors (or persons fulfilling the equivalent function):

   (i) All significant deficiencies in the design or operation of internal controls which could adversely affect the issuer's ability to record, process, summarize and report financial data and have identified for the issuer's auditors any material weaknesses in internal controls; and

(ii) Any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls; and

6. I have indicated in the report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 24, 2004

/s/ Marvin P. Loeb
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Marvin P. Loeb, CEO



CERTIFICATION

I, Jeffrey Rudner, hereby certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Trimedyne, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact, or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report; and

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial position, results of operations, and cash flows of the issuer as of, and for, the periods presented in this quarterly report.

4. I am responsible for establishing and maintaining disclosure controls and procedures for the issuer and have:

    a. Designed such disclosure controls and procedures to ensure that material information relating to the issuer is made known to me, particularly during the period in which the periodic reports are being prepared;

    b. Evaluated the effectiveness of the issuer's disclosure controls and procedures as of March 31, 2004; and

    c. Presented in the report our conclusions about the effectiveness of the disclosure controls and procedures based on my evaluation as of the Evaluation Date;

5. I have disclosed, based on my most recent evaluation, to the issuer's auditors and the audit committee of the board of directors (or persons fulfilling the equivalent function):

    a. All significant deficiencies in the design or operation of internal controls which could adversely affect the issuer's ability to record, process, summarize and report financial data and have identified for the issuer's auditors any material weaknesses in internal controls; and

b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls; and

6. I have indicated in the report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 24, 2004

/s/ Jeffrey Rudner
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