TRIMEDYNE INC
Form 10QSB
February 14, 2006

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
December 31, 2005	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 [_]

(Issuers involved in bankruptcy procedings during the past five years)

Not applicable

Indicate by check mark whether the registrant is a shell company (as defined in Rule 122b-2 of the Exchange Act).

Yes [ ] No [X]

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 February 13, 2006
Common Stock, $0.01 par value	14,602,931 shares

ITEM 1.

TRIMEDYNE, INC.

		Page Number
PART I.	Financial Information	3
ITEM 1.	Financial Statements (Unaudited)	3
	Consolidated Balance Sheet	3
	Consolidated Statements of Income	4
	Consolidated Statements of Cash Flows	5
	Notes to Consolidated Financial Statements	6
ITEM 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	14
ITEM 3.	Controls and Procedures	17
PART II.	Other Information	18
SIGNATURE PAGE		19
CERTIFICATIONS		20

2

TRIMEDYNE, INC.
CONSOLIDATED BALANCE SHEET
(UNAUDITED)

ASSETS

	December 31, 2005
Current assets:	
Cash and cash equivalents	$ 1,699,000
Trade accounts receivable, net of allowance for doubtful accounts of $12,000	718,000
Inventories	1,972,000
Other	176,000
Total current assets	4,565,000
Goodwill	544,000
Other assets	95,000
Property and equipment, net	337,000

	$ 5,541,000

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:	
Accounts payable	$ 312,000
Accrued expenses	340,000
Deferred revenue	40,000
Accrued warranty	58,000
Income tax payable	8,000
Current portion of long-term debt	12,000
Total current liabilities	770,000
Senior convertible secured notes due to officer	200,000
Accrued interest due officer	93,000
Long-term debt, net of current portion	4,000
Total liabilities	1,067,000
Commitments and contigencies	
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, 14,704,540 shares issued, 14,602,931 shares outstanding	148,000
Additional paid-in capital	47,945,000
Accumulated deficit	(42,906,000)
	5,187,000
Treasury stock, at cost (101,609 shares)	(713,000)
Total stockholders' equity	4,474,000
	$ 5,541,000

See accompanying notes to consolidated financial statements

TRIMEDYNE, INC.
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

	Three Months Ended December 31,	
	2005	2004
Net revenues	$ 1,785,000	$ 1,839,000
Cost of revenues	1,148,000	936,000
Gross profit	637,000	903,000

Operating expenses:		
Selling, general and administrative	580,000	623,000
Research and development	145,000	133,000
Total operating expenses	725,000	756,000
(Loss) income from operations	(88,000)	147,000
Other income, net	103,000	26,000
Income before income taxes	15,000	173,000
Provision for income taxes	1,000	--
Net income	$ 14,000	$ 173,000
Net income per share:		
Basic	$ 0.00	$ 0.01
Diluted	$ 0.00	$ 0.01
Weighted average number of shares outstanding:		
Basic	14,704,540	14,704,540
Diluted	15,445,735	15,388,385

See accompanying notes to consolidated financial statements.

4

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

	Three Months Ended December 31, 2005	2004
Cash flows from operating activities:		
Net income	$ 14,000	$ 173,0
Adjustment to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	36,000	44,0
Loss on disposal of property and equipment	3,000	3,0
Changes in operating assets and liabilities:		
Accounts receivable	62,000	(13,0
Inventories	166,000	152,0

Other assets	21,000	101,0
Accounts payable	(38,000)	(40,0
Accrued expenses	(59,000)	(144,0
Deferred revenue	(3,000)	1,0
Accrued warranty	15,000	(1,0
Accrued interest due officer	6,000	6,0
Income taxes payable	(6,000)	
Net cash provided by operating activities	217,000	282,0
Cash flows from investing activities:		
Purchase of property and equipment	(12,000)	(21,0
Net cash used in investing activities	(12,000)	(21,0
Cash flows from financing activities:		
Payments on debt	(29,000)	(43,0
Net cash used in financing activities	(29,000)	(43,0
Net increase in cash and cash equivalents	176,000	218,0
Cash and cash equivalents at beginning of period	1,523,000	1,683,0
Cash and cash equivalents at end of period	$ 1,699,000	$1,901,0

Cash paid for income taxes during the three months ended December 31, 2005 and 2004 was $6,000 and $0, respectively. Cash paid for interest in the the three months ended December 31, 2005 and 2004 was approximately $1,000 and $5,000, respectively.

See accompanying notes to consolidated financial statements

5

TRIMEDYNE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 and 2004
(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 December 31, 2005 and the results of operations and its cash flows for the three months ended December 31, 2005 and 2004. Results for the three months ended December 31, 2005 are not necessarily indicative of the results to be expected for the year ending September 30, 2006.

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 2005 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. Revenues from the rental of equipment is recognized over the rental period. Revenues from service contracts are recognized monthly throughout the term of the service agreement.

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 December 31, 2005.

Impairment of Long-Lived Assets

SFAS No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets", requires that long-lived assets, such as property and equipment and purchased intangibles subject to amortization, be reviewed for impairment whenever eventsor changes in circumstances indicate that the carrying amount of an asset

may not be recoverable. Recoverability of the asset is measured by comparison of its carrying amount to undiscounted future cash flows the asset is expected to generate. If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the asset exceeds its fair market value. Estimates of expected future cash flows represent management's best estimate based on currently available information and reasonable and supportable assumptions. Any impairment recognized in accordance with SFAS No. 144 is permanent and may not be restored. To date, the Company has not recognized any impairment of long-lived assets in connection with SFAS No. 144.

Stock Option Plans

SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," prescribes accounting and reporting standards for all stock-based compensation plans, including employee stock option plans. As allowed by SFAS No. 123, the Company has elected to continue to account for its employee stock-based compensation plan using the intrinsic value method in accordance with Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations, which does not require compensation to be recorded if the consideration to be received is at least equal to the fair value of the common stock to be received at the measurement date. Under the requirements of SFAS No. 123, non-employee stock-based transactions require compensation to be recorded based on the fair value of the securities issued or the services received, whichever is more reliably measurable.

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 December 31,	
	2005	2004
Net income, as reported	$ 10,000	$ 173,000
Deduct: total stock-based employee compensation expense determined under fair value based method for awards, net of related tax effects	(1,000)	--
Pro forma net income	$ 9,000	$ 173,000
Net income per share - basic:		
As reported	$ 0.00	$ 0.01
Pro forma	$ 0.00	$ 0.01
Net income per share - diluted:		
As reported	$ 0.00	$ 0.01
Pro forma	$ 0.00	$ 0.01

7

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 December 31, 2005	2004
Dividend yield	--	--
Expected volatility	80%	80%
Risk-free interest rate	3.50%	3.50%
Expected lives	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.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates and assumptions include inventory valuation, allowances for doubtful accounts and deferred income tax assets, recoverability of goodwill and long-lived assets, losses for contingencies and certain accrued liabilities.

Fair Value of Financial Instruments

The Company's financial instruments consist primarily of cash and cash equivalents, accounts Receivable, accounts payable, accrued expenses and long-term debt, and two senior convertible secured notes due to the Chief Executive Officer. The carrying amounts of the Company's financial instruments generally approximate their fair values as of December 31, 2005 because of the short maturity of these instruments. Senior convertible secured notes due to officer cannot be objectively and fairly valued due to the related party nature of the instruments.

Warranty Costs

The Company provides warranties for certain products and maintains warranty reserves for estimated product warranty costs at the time of sale. In estimating its future warranty obligations, the Company considers various relevant factors,

including the Company's stated warranty policies and practices, the historical frequency of claims and the cost to replace or repair its products under warranty. The following table provides a reconciliation of the activity related to the Company's accrued warranty expense:

	Three Months Ended December 31,	
	2005	2004
Balance at beginning of period	$ 43,000	$ 44,000
Charges to costs and expenses	36,000	16,000
Costs incurred	(21,000)	(17,000)
Balance at end of period	$ 58,000	$ 43,000

Research and development costs

All research and development costs, including licensing costs, are charged to expense as incurred. In accordance with this policy, all costs associated with the design, development and testing of the Company's products have been expensed as incurred.

8

Recently Issued Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 151 "Inventory Costs, an amendment of ARB No. 43, Chapter 4." The amendments made by Statement 151 clarify that abnormal amounts of facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and require the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. The guidance is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Earlier application is permitted for inventory costs incurred during fiscal years beginning after November 23, 2004. The Company has adopted SFAS No. 151 and determined there was no impact on the Company's overall results of operations or financial position.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment" ("Statement 123(R)") to provide investors and other users of financial statements with more complete and neutral financial information by requiring that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. Statement 123(R) covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. Statement 123(R) replaces SFAS No. 123, "Accounting for Stock-Based Compensation," and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS No. 123, as originally issued in 1995, established as preferrable a fair-value-based method of accounting for share-based payment transactions with employees. However, that Statement permitted entiti es the option of continuing to apply the guidance in Opinion 25, as long as the footnotes to financial statements disclosed what net income would have been had the preferable fair-value-based method been used. The Company is required to adopt this standard during the fiscal quarter ending December 31, 2006. The Company is in the process of evaluating whether the adoption of SFAS 123(R) will have a significant impact on the Company's overall

results of operations or financial position.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections -- a replacement of APB Opinion No. 20 and FASB Statement No. 3." This statement applies to all voluntary changes in accounting principle and changes required by an accounting pronouncement where no specific transition provisions are included. SFAS No. 154 requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. Retrospective application is limited to the direct effects of the change; the indirect effects should be recognized in the period of the change. This statement carries forward without change the guidance contained in APB Opinion No. 20 for reporting the correction of an error in previously issued financial statements and a change in accounting estimate. However, SFAS No. 154 redefines restatement as the revising of previously issued financial statements to reflect the correction of an error. The provisions of SFAS No. 154 are effective for accounting changes and corrections of errors made in fiscal periods that begin after December 15, 2005, although early adoption is permitted. The Company does not anticipate that the implementation of this standard will have a material impact on its condensed consolidated results of operations, cash flows or financial position

NOTE 2 - Balance Sheet Items

	December 31, 2005
Inventories, net of reserves, consist of the following:	
Raw material	$ 632,000
Work-in-process	439,000
Finished goods	901,000
	$ 1,972,000

Other current assets consist of the following:	
Royalty receivable	$ 84,000
Prepaid insurance	47,000
Prepaid rent	30,000
Other	15,000
Total other current assets	$ 176,000

Property and equipment consist of the following:	
Furniture and equipment	$ 2,482,000
Leasehold improvements	214,000
Other	216,000
	2,912,000
Less accumulated depreciation and amortization	(2,575,000)
Total property and equipment	$ 337,000

Accrued expenses consist of the following:

Accrued vacation	$ 125,000
Customer deposits	58,000
Accrued professional expenses	42,000
Sales and use tax	38,000
Accrued salaries and wages	28,000
Accrued commissions	26,000
Accrued litigation	14,000
Accrued payroll taxes	7,000
Other	2,000
Total accrued expenses	$ 340,000

NOTE 3 - Long-term Debt

Loan payable to leasing company, bearing interest at 8% per annum: principal and interest due monthly in equal installments of $211 through May 2008. The loan is secured by the related forklift.	$ 6,000
Notes payable to finance company, issued in connection with financing certain insurance policies. The notes bear interest at 5.979% per annum and require monthly principal and interest payments of $9,732 through January 2006.	10,000
	16,000
Less: current portion	(12,000)
	$ 4,000

NOTE 4 - Senior Secured Convertible Notes Due to Officer

At December 31, 2005, the Company had two outstanding senior, secured convertible notes due to its chief executive officer. These notes mature, with interest at 12% per annum, in February and April 2007, and are convertible at prices of $0.40 and $0.50 per share.	$ 200,000

Accrued interest on these notes was $93,000 at December 31, 2005.

10

NOTE 5 - 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 officer 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

	December 31, 2005	December 31, 2004
Denominator		
Weighted average common shares outstanding used in calculating basic earnings per share	14,704,540	14,704,540
Effect of Dilutive Options	48,695	47,845
Effect of Senior Convertible Secured Notes due to Officer and accrued interest	692,500	636,000
Weighted average common shares outstanding used in calculating diluted earnings per share	15,445,735	15,388,385
Numerator		
Net income	$ 14,000	$ 173,000
Add - interest on Senior Convertible Secured Notes due to Officer	6,000	6,000
Net income available to common stockholders	$ 20,000	$ 179,000

NOTE 6 - Contingencies

Litigation

In November 2003, the Company settled its litigation against Lumenis, Inc. ("Lumenis"). Under the settlement agreement, Lumenis agreed to pay a 7.5% royalty on their sales of certain side-firing and angled-firing devices manufactured by Lumenis or purchased by Lumenis from third-party suppliers. In addition, Lumenis agreed to purchase a majority of its Angled-Firing (60 degree to 75 degree firing) and 100% of its Side-Firing (75 degree to 90 degree) Devices from the Company under an OEM Supply Agreement. The OEM Agreement was executed on September 8, 2005, and the Company has offered to manufacture a special version of its VaporMAX(TM) Side-Firing Device exclusively for Lumenis, for use with Lumenis' Holmium lasers for their cleared indications for use, which include the treatment of benign prostatic hyperplasia or "BPH", commonly referred to as an enlarged prostate. Royalties per the above agreement are currently being received and included in other income for the current quarters ended December 31, 2005 and 2004 (See Note 7).

Product liability

The Company is currently a defendant in one product liability lawsuit. This case relates to injuries that occurred in connection with medical procedures in which the Company's laser was used. 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 coverage 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 $5,000,000 insurance coverage. In such case, Trimedyne would be liable for any liability in excess of $5,000,000. Management has accrued $50,000 for this claim, of which $36,000 has been paid, based on the deductible under the insurance policy.

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.

11

Guarantees and Indemnities

The Company has made certain indemnities and guarantees, under which it may be required to make payments to a guaranteed or indemnified party. The Company indemnifies its directors, officers, employees and agents to the maximum extent permitted under the laws of the State of California. In connection with its facility leases, the Company has indemnified its lessors for certain claims arising from the use of the facilities. The duration of the guarantees and indemnities varies, and in many cases is indefinite. These guarantees and indemnities do not provide for any limitation of the maximum potential future payments the Company could be obligated to make. Historically, the Company has not been obligated to make any payments for these obligations and no liabilities have been recorded for these indemnities and guarantees in the accompanying consolidated balance sheet.

NOTE 7 - Other Income

During the three month period ended December 31, 2005 and 2004, the Company recognized $84,000 and $31,000, respectively, in royalties in connection with the terms of a settlement agreement and subsequent OEM agreement. These royalties are included in other income in the accompanying financial statemnts. (See Note 6).

NOTE 8 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 three months ended December 31, 2005 and December 31, 2004 are as follows:

	For the three months ended December 31, 2005 (Unaudited)			For
	Products	Service and Rental	Total	Products
Revenue	$ 1,342,000	$ 443,000	$ 1,785,000	$ 1,411,000
Cost of sales	825,000	323,000	1,148,000	626,000
Gross profit	517,000	120,000	637,000	785,000

Expenses:				
Selling, general and administrative	465,000	115,000	580,000	443,000
Research and development	145,000	--	145,000	133,000
(Loss) income from operations	$ (93,000)	$ 5,000	(88,000)	$ 209,000
Other:				
Interest income			5,000	
Interest expense			(6,000)	
Royalty income			84,000	
Settlements and recoveries			23,000	
Loss on disposal of equipment			(3,000)	
Income taxes			(1,000)	
Net income			$ 14,000	

Sales and gross profit to customers by similar products and services for the three ended December 31, 2005 (unaudited) and December 31, 2004 (unaudited) were as follows:

	For the three months ended December 31, (Unaudited)	
	2005	2004
By similar products and services:		
Revenues:		
Products:		
Laser equipment and accessories	$ 510,000	$ 491,000
Delivery and disposable devices	832,000	920,000
Service and rental	443,000	428,000
Total	$1,785,000	$1,839,000
Gross profit		
Products:		
Laser equipment and accessories	$ 58,000	$ 284,000
Delivery and disposable devices	458,000	501,000
Service and rental	121,000	118,000
Total	$ 637,000	$ 903,000

The Company's revenue base is derived from the sales of medical products and services on a worldwide basis originating from the United States. 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 December 31, 2005 (unaudited) and December 31, 2004 (unaudited) accounted for approximately 36% and 31% of the Company's total sales, respectively. The breakdown by geographic region is as follows:

	Three months ended December 31, 2005	Three months ended December 31, 2004
Asia	$ 363,000	$ 314,000
Europe	182,000	164,000
Latin America	4,000	81,000
Middle East	--	--
Other	100,000	3,000
	$ 649,000	$ 562,000

All long-lived assets were located in the United States during the three months ended December 31, 2005. With the exception of one demo 80 watt laser located in Belgium, all the Company's remaining long-lived assets were located in the United States at December 31, 2005.

ITEM 2.

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.

Inventories

Inventories consist of raw materials and component parts, work in process and finished good lasers and dispensing systems. Inventories are recorded at the lower of cost or market, cost being determined principally by use of the average-cost method, which approximates the first-in, first-out method. Cost is determined at the actual cost for raw materials, and at production cost (materials, labor and indirect manufacturing overhead) for work-in-process and finished goods.

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.

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 December 31, 2005 compared to quarter ended December 31, 2004

During the quarter ended December 31, 2005, net revenues were $1,785,000 as compared to $1,839,000 for the same period of the previous year, a $54,000 or 2.9% decrease. Net sales from lasers and accessories increased by $19,000 or 3.9% to $510,000 during the three months ended December 31, 2005 from $491,000 in the same period of the prior year. Net sales from delivery and disposable devices decreased by $89,000 or 9.7% to $831,000 in the current quarter from $920,000 in the same quarter of the prior year. Net sales from service and rental increased by $16,000 or 3.7% to $444,000 from $428,000 for the same quarters. Export sales increased by $87,000 or 15.5% due to an increase in laser sales in Asia.

Cost of sales during the quarter ended December 31, 2005 was 64% of net revenues as compared to 51% the prior year quarter. This increase was due to the sales mix of lasers and delivery systems. During the quarter ended December 31, 2005 sales of lasers, which carry relatively low profit margins, increased, while selling prices due to competition decreased, and sales of delivery systems, which carry relatively high profit margins, decreased as compared to the prior year quarter. The result was a lower gross profit for the current quarter ended December 31, 2005.

Selling, general and administrative expenses decreased in the current quarter to $580,000 from $623,000 in the prior year quarter, an decrease of $43,000 or 7%. The decrease in selling, general and administrative expenses was primarily the result of decreases of $14,000 in audit expenses, $11,000 in marketing expenses related to trade shows and conventions, $9,000 in expenses related to the recruitment of staff, and $7,000 in business related travel expenses.

Research and development expenditures for the quarter ended December 31, 2005, increased $12,000 to $145,000 as compared to $133,000 in the quarter ended December 31, 2004. This increase was a result the Company increasing its product development efforts and staff in readying its new VaporMAX(TM) Side-Firing Device for the market.

Other income, net increased by $77,000 or 296% to $103,000 in the first quarter ended December 31, 2005 from $26,000 in the first quarter of the prior year. Other income during the quarter ended December 31, 2005 primarily consisted of $84,000 of royalty income and $22,000 resulting from the write down of previous accruals, for which the Company no longer had obligations, offset by $6,000 in interest expense. During the three months ended December 31, 2004, the Company received $31,000 in royalty income offset by interest accrued on notes due to an officer.

For the current quarter, the Company had net income of $14,000 or $0.00 per share, based on 15,445,735 basic weighted average number of common shares

outstanding, as compared to net income of $173,000, or $0.01 per share, based on 14,704,540 basic weighted average number of common shares outstanding in the same quarter of the previous year.

Liquidity and Capital Resources

At December 31, 2005, the Company had working capital of $3,795,000 compared to $3,773,000 at the end of the fiscal year ended September 30, 2005. Cash increased by $176,000 to $1,699,000 from $1,523,000 at the fiscal year ended September 30, 2005. 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 three month period ended December 31, 2005 net cash provided by operating activities was $217,000. Net cash used in financing activities during the same three month period was $29,000 for payments on debt incurred for financing general business liability insurance. 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 profi tability, 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 an officer of the Company (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.

ITEM 3. CONTROLS AND PROCEDURES

As of December 31, 2005, an evaluation was carried out under the supervision and with the participation of the Company's management, including our Chief Executive Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation, the Chief Executive Officer concluded that the design and operation of these disclosure controls and procedures were effective. No significant changes were made in our internal controls or in other factors that could significantly affect these controls subsequent to December 31, 2005.

(a) Evaluation of Disclosure Controls and Procedures. The Company carried out an evaluation under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer ("CEO") of the

effectiveness of the Company's disclosure controls and procedures. Based upon that evaluation, the CEO concluded that as of December 31, 2005 our disclosure controls and procedures were effective in timely alerting them to the material information relating to the Company (or the Company's consolidated subsidiaries) required to be included in the Company's periodic filings with the SEC, subject to the various limitations on effectiveness set forth below under the heading, "LIMITATIONS ON THE EFFECTIVENESS OF INTERNAL CONTROLS," such that the information relating to the Company, required to be disclosed in SEC reports (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to the Company's management, including our CEO, as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in internal control over financial reporting. There has been no change in the Company's internal control over financial reporting that occurred during the fiscal quarter ended December 31, 2005 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

LIMITATIONS ON THE EFFECTIVENESS OF INTERNAL CONTROLS

The Company's management, including the CEO, does not expect that our disclosure controls and procedures or our internal control over financial reporting will necessarily prevent all fraud and material error. An internal control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of the control system must reflect the fact that there are resource constraints and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the internal control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, control may become inadequate because of changes in conditions, and/or the degree of compliance with the policies or procedures may deteriorate.

PART II
Other Information

ITEM 1. Legal Proceedings

In November 2003, the Company settled its litigation against Lumenis. Under the settlement agreement, Lumenis agreed to pay a 7.5% royalty on their sales of certain side-firing and angled-firing devices manufactured by Lumenis or purchased by Lumenis from third-party suppliers. In addition, Lumenis agreed to purchase a majority of its Angled-Firing (60 degree to 75 degree firing) and 100% of its Side-Firing (75 degree to 90 degree) Devices from the Company under an OEM Supply Agreement. The OEM Agreement was executed on September 8, 2005, and the Company has offered to manufacture a special version of its VaporMAX(TM) Side-Firing Device exclusively for Lumenis, for use with Lumenis' Holmium lasers for their cleared indications for use, which include the treatment of BPH.

Royalties per the above agreement are currently being received and included in other income for the current quarter ended December 31, 2005.

The Company is currently a defendant in one product liability lawsuit. This case relates to injuries that occurred in connection to medical procedures in which the Company's laser was used. This case is 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. During the fiscal year ended September 30, 2004, Management accrued a loss contingency for this claim in the amount of $50,000, based on the deductible under the insurance policy, of which $36,000 has been paid through December 31, 2005.

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

(a) Exhibits
- 31.1 Certification of CEO
- 31.2 Certification of Controler
- 32.1 Officer Certification
- 32.2 Controller Certification

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: February 14, 2006

/s/ Marvin P. Loeb

Marvin P. Loeb
Chairman and
Chief Executive Officer

Date: February 14, 2006

/s/ Jeffrey S. Rudner

Jeffrey S. Rudner
Controller