ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/
Form 10-Q
November 13, 2001

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

[X] Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended SEPTEMBER 30, 2001 or

[_] Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from ______ to ______

1-9731
(Commission file No.)

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

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

25 SAWYER PASSWAY

FITCHBURG, MASSACHUSETTS 01420

(Address of principal executive office and zip code)

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

1101 SOUTH CAPITAL OF TEXAS HIGHWAY

BUILDING G - SUITE 200

AUSTIN, TEXAS 78746

(former address of principal executive office)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [_].

As of October 31, 2001 there were 2,949,635 shares of common stock outstanding.

This report consists of 9 pages.

ARRHYTHMIA RESEARCH TECHNOLOGY, INC.

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September 30, 2001

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

ASSETS

Current assets:
- Cash and cash equivalents....
- Trade and other accounts receivable, net of allowance for doubtful accounts of $50,000 and $52,827....
- Inventories, net....
- Deposits, prepaid expenses and other current assets....
- Income tax recoverable....

Total current assets....

Property and equipment, net of accumulated depreciation of $4,469,813 and $4,028,956....
Goodwill, net of accumulated amortization of $1,113,910 and $1,016,493....
Other intangibles, net of accumulated amortization of $576,667 and $558,419....
Deferred income taxes, net....
Other assets....

Total assets	

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:	
Current portion of capital lease obligations	
Current maturities of bonds payable and other long-term debt	
Accounts payable	
Accrued expenses	
Total current liabilities	
Bonds payable	
Deferred revenue	
Total liabilities	
Shareholders' equity:	
Preferred stock, $1 par value; 2,000,000 shares authorized, none issued	
Common stock, $.01 par value; 10,000,000 shares authorized; 3,758,181 and 3,729,681 issued	
Additional paid-in-capital	
Common stock held in treasury, 808,546 and 563,446 shares at cost	
Retained earnings	
Total shareholders' equity	
Total liabilities and shareholders' equity	

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

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

	Three Months Ended Sept. 30,	
	2001	2000
Revenue	$ 1,637,050	$ 2,108,247
Cost of sales	1,180,898	1,581,090
Gross profit	456,152	527,157
Selling and marketing	10,748	29,868
General and administrative	295,635	437,257
Research and development	50,078	40,953
Amortization of goodwill	32,472	32,472
Total expenses	388,933	540,550
Income from operations	67,219	(13,393)

Other income (expense):		
Interest expense	(18,165)	(22,316)
Other income (expense), net	8,712	(358)
Income before income taxes	57,766	(36,067)
Income taxes	(23,000)	(58,000)
Net income	$ 80,766	$ 21,933
Net income per share - basic	$ 0.03	$ 0.01
Weighted average number of common shares outstanding	2,976,724	3,323,229
Net income per share - dilutive	$ 0.03	$ 0.01
Dilutive average number of common equivalent shares outstanding	3,150,890	3,480,313

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

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

	Common Shares		Additional Paid-in Capital	Treasury Stock	Unearned ESOP Compensati
	Number	Amount			
December 31, 1998	3,679,216	$ 36,792	$ 8,909,307	$ (913,084)	$ (39,277)
Issuance of common stock	32,667	327	36,986		
Treasury stock purchase of 153,891 shares				(238,808)	
ESOP payments					39,277
Net income					
December 31, 1999	3,711,883	37,119	8,946,293	(1,151,892)	-
Issuance of common stock	17,798	178	26,322		
Treasury stock purchase of 265,040 shares				(502,772)	
Value of warrants with bond renewal			194,000		
Net income					
December 31, 2000	3,729,681	37,297	9,166,615	(1,654,664)	-
Issuance of common stock	28,500	285	29,996		
Treasury stock purchase of 245,100 shares				(551,192)	
Net income					
September 30, 2001	3,758,181	$ 37,582	$ 9,196,611	$ (2,205,856)	$ -

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

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

Cash flows from operating activities:	
Net income	$
Adjustments to reconcile net income to net cash provided by operating activities:	
Directors fees paid in stock	
Depreciation	
Amortization	
Deferred income tax provision	
Changes in assets and liabilities:	
Trade and other accounts receivable	
Inventories	
Deposits, prepaid expenses and other assets	
Accounts payable, accrued expenses and other liabilities	
Net cash provided by operating activities	1
Cash flows from investing activities:	
Capital expenditures, net of disposals	
Deposits on capital equipment, acquisitions and other	
Patent and software development expenditures	
Increase in assets for sale	
Net cash used in investing activities	
Cash flows from financing activities:	
Issuance of common stock	
Increase in bonds payable due to amortization	
Principal payment on long-term debt	
Purchase of treasury stock	
Net cash used in financing activities	
Net increase (decrease) in cash and cash equivalents	
Cash and cash equivalents at beginning of period	1
Cash and cash equivalents at end of period	$2

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

SUPPLEMENTAL NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The unaudited interim consolidated financial statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to such rules and regulations. The accompanying unaudited interim consolidated financial statements and related notes should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's most recent Form 10-K covering the year ended December 31, 2000.

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

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

Reclassifications:

Certain accounts in the 2000 financial statements have been reclassified to conform with the 2001 presentation.

New Accounting Standard:

In June 2001, the Financial Accounting Standards Board finalized FASB Statements No.141, Business Combinations (SFAS 141), and No.142, Goodwill and Other Intangible Assets (SFAS 142). SFAS 141 requires the use of the purchase method of accounting and prohibits the use of the pooling-of-interests method for business combinations initiated after June 30, 2001. SFAS 142 requires, among other things, that companies no longer amortize goodwill in fiscal years beginning after December 15, 2001, but test goodwill for impairment at least annually.

The Company's previous business combinations were accounted for using the purchase method. As of September 30, 2001 the net carrying amount of goodwill is $1,359,416. Amortization expense during the nine month period ended September 30, 2001 was $97,417. Currently the Company is assessing but has not yet determined how the adoption of SFAS 141 and SFAS 142 will impact its financial position and results of operations.

Inventories:

Inventories consist of the following as of:

	Sept. 30, 2001	Dec. 31, 2000
Raw materials	$ 156,441	$ 123,962
Work-in-process	272,395	197,254
Finished goods	493,294	538,945
Total	$ 922,130	$ 860,161

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Liquidity and Capital Resources

At September 30, 2001, the Company had working capital of $3,235,191 compared to $3,671,443 at December 31, 2000. The $436,252 decrease in working capital resulted from $470,003 of bonds payable (maturity value of $550,000) that became a current liability in May 2001.

The Company has a $1,000,000 line of credit with a bank that was extended through June 2002. There were no borrowings on the line of credit at September 30, 2001 or during the first nine months of 2001.

In September 2001, the Company announced the continuation of its Stock Buy-Back Program and its intention to purchase up to an additional 200,000 shares of the common stock of the Company. For the nine months ended September 30, 2001, the Company acquired 245,100 shares of its common stock at an average cost of $2.25 per share. It is intended that the repurchased shares become treasury stock of the Company.

Results of Operations

Total revenue for the third quarter of 2001 was $1,637,050 or a decrease of 22% from the third quarter of 2000 revenue. Of the $471,197 decline in third quarter revenue, $306,859 reflects the lower sales of snaps to a major customer of Micron Products, Inc. (a wholly owned subsidiary of the Company) which switched to an alternate supplier. Net income for the third quarter of 2001 was $80,766, or $58,833 better than the third quarter of 2000. The improvement in third quarter 2001

earnings compared to 2000 resulted primarily from $160,742 savings in selling, general and administrative expenses associated with the consolidation of the Texas office into the Massachusetts facility and the reduction of management personnel.

Included in last year's revenues and net income for the nine months ended September 30, 2000 was $1,000,000 of revenue and $760,000 of net income from a one time payment by GE/Prucka to terminate a commission agreement for CardioLab sales. Excluding the one time commission payment, year to date revenues for 2001 were $5,265,686 compared to $6,515,164 for 2000. The $1,249,478 decline in revenue is attributed to $741,390 in lower snap sales and accelerated pre-Y2K sales that reduced early 2001 sales. Year to date, net income for 2001 is $217,470 compared to $8,506 for 2000 excluding the one time commission payment. In addition to the $364,960 in savings in 2001 from the reduction of selling, general and administrative personnel and programs, no major legal expenses have been reported in 2001, whereas in 2000 reported $121,710 for legal costs at Micron. The savings in selling, general and administrative expenses in 2001 more than offset the $245,518 loss of gross profit on the lower sales in 2001, excluding the one time commission payment.

Domestic and foreign sales for the third quarter and nine months are as follows:

	Third Quarter				Nine Months	
	2001	%	2000	%	2001	%

Foreign Sales	$1,326,656	81	$ 1,456,483	69	$4,355,652	83	$
Domestic Sales	310,394	19	651,764	31	910,034	17	
Domestic Commission	--	--	--	--	--	--	
Total	$1,637,050	100	$ 2,108,247	100	$5,265,686	100	$

Foreign sales continue to increase in proportion to the Company's total sales as two major Micron customers have consolidated the majority of their production of ECG electrodes into Canadian plants.

Cost of sales was 72% of revenue in the third quarter of 2001 compared to 75% for the same period in 2000. Cost of sales was 70% for the nine months of 2001 compared to 72% for the same period in 2000, excluding the one time commission payment. The lower costs in 2001 reflect the lower sales volume of snaps for which Micron acts as a distributor that have a higher cost than its own ECG silver plated sensors.

Selling and marketing expenses are $19,120 and $107,122 below the prior year for the third quarter and the nine months then ended, respectively. Selling and marketing expenses have been lowered during the upgrading of ART's SAECG products as discussed below.

Research and development expenses are $9,125 and $30,759 over the prior year for the third quarter and the nine months then ended, respectively. The additional funds were spent incorporating two signal averaging programs into a single software package and evaluating alternative acquisition devices used in conjunction with the Company's SAECG applications.

General and administrative expenses were lower in the third quarter of 2001 by $141,622 and for the nine months of 2001 by $379,548 as compared to similar periods in 2000. In the first half of 2000, $121,710 of legal expenses were incurred at Micron that did not repeat in 2001. The remainder of the savings are primarily attributed to the lower management personnel and severance costs from that which were reported in 2000.

Income taxes for the third quarters of 2001 and 2000 were both tax credits of $23,000 and $58,000, respectively. The tax credits arise due to the recognition of deferred Federal income tax deductions that are estimated to be used in 2001 and subsequent years. The Company has available approximately $1,200,000 of deferred Federal tax credits that can be utilized to offset Federal taxes payable to the extent the Company has taxable income. Income taxes for the nine months ended 2001 and 2000 were 14% and 19%, respectively.

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

Any forward looking statements made herein are based on current expectations of the Company that involves a number of risks and uncertainties and should not be considered as guarantees of future performance. These statements are made under the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995. The factors that could cause actual results to differ materially include: interruptions or cancellation of existing contracts, impact of competitive products and pricing,

product demand and market acceptance risks, the presence of competitors with greater financial resources than the Company, product development and commercialization risks and an inability to arrange additional debt or equity financing.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings - none

Item 2. Changes in Securities - none

Item 3. Defaults Upon Senior Securities - none

Item 4. Submission of Matters to a Vote of Security Holders - none

Item 5. Other Information - none

Item 6. Exhibits and Reports on Form 8-K - none

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Arrhythmia Research Technology, Inc.

/s/ E.P. Marinos
Chairman of the Board

/s/ Richard A Campbell
Vice President of Finance

November 13, 2001