EYE DYNAMICS INC
Form 10QSB
November 16, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 10-QSB

(X) Quarterly Report under Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended September 30, 2004

Commission File No. 0-27857

EYE DYNAMICS, INC.
(Name of small business issuer as specified in its charter)

Nevada	88-0249812
(State or other jurisdiction of incorporation)	(I.R.S. Employer Identification No.)

2301 W. 205th Street, #102, Torrance, CA 90501
(Address of principal executive offices)

310-328-0477
(Issuer's telephone number)

The number of shares outstanding of the issuer's common stock as of September 30, 2004 was 17,883,081.

Transitional Small Business Disclosure Format (check one) ( ) Yes; (X) No.

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

EYE DYNAMICS, INC.

BALANCE SHEET (UNAUDITED)
SEPTEMBER 30, 2004

ASSETS

Current Assets	
Cash	$ 760,292
Accounts receivable	173,513
Employee loans and advances, net of allowance for loan loss of $58,218	500
Inventory	350,137
Prepaid expenses and taxes	29,547

Total current assets	1,313,989
Property and equipment, net of accumulated depreciation of $13,512	932
Other assets	218,098
TOTAL ASSETS	$ 1,533,019

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities	
Accounts payable	$ 19,362
Accrued expenses	12,005
Notes payable, current portion	23,762
Total current liabilities	55,129
Long-term debt and accrued interest	330,076
Total liabilities	385,205
Stockholders' Equity	
Common stock, $0.001 par value; 50,000,000 shares authorized; 17,883,081 shares issued and outstanding	17,883
Paid-in capital	3,497,069
Accumulated deficit	(2,367,138)
Total stockholders' equity	1,147,814
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 1,533,019

See Notes to Interim Unaudited Financial Statements

1

EYE DYNAMICS, INC.

STATEMENTS OF OPERATIONS (UNAUDITED)

	For Three Months ended September 30,		For Nine Months ended September 3	
	2004	2003	2004	2
Net Sales				
Products	$ 437,421	$ 1,095,602	$ 1,502,878	$ 2,4
Service	--	5,500	--	
	437,421	1,101,102	1,502,878	2,4

Cost of Sales				
Products	206,037	529,334	712,470	1,2
Service	--	800	--	
	206,037	530,134	712,470	1,2
Gross profit	231,384	570,968	790,408	1,2
Selling, general and administrative expenses	180,190	188,541	528,343	5
Operating income	51,194	382,427	262,065	6
Other income(expenses)				
Interest and other income	9,240	155	9,300	
Interest and other expenses	(789)	(802)	(2,819)	(
Total other income(expenses)	8,451	(647)	6,481	(
Net income before taxes	59,645	381,780	268,546	6
Provision for income taxes	--	33,173	800	
Net income	$ 59,645	$ 348,607	$ 267,746	$ 6
Net income per share-basic	$ 0.00	$ 0.02	$ 0.01	$
Net income per share-diluted	$ 0.00	$ 0.02	$ 0.01	$
Shares used in per share calculation-Basic	17,883,081	17,850,313	17,883,081	17,8
Shares used in per share calculation-Diluted	21,710,174	21,706,001	21,710,174	21,6

See Notes to Interim Unaudited Financial Statements

EYE DYNAMICS, INC.

STATEMENTS OF CASH FLOWS (UNAUDITED)

FOR NINE MONTHS ENDED SEPTEMBER 30,	2004	2003
Cash Flow From Operating Activities:		
Net income	$ 267,746	$ 606,301
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	171	306
(Increase) Decrease in:		
Accounts receivable	(42,093)	(42,139)
Inventory	(30,184)	(31,884)
Prepaids and other assets	6,587	(19,962)
Increase (decrease) in:		
Accounts payable and accrued expenses	(72,595)	17,301
Contingent liabilities	--	(13,271)

Accrued interest	2,100	(74,602)
CASH FLOWS PROVIDED BY OPERATING ACTIVITIES	131,732	442,050
Cash Flow From Investing Activities:		
Purchase of property and equipment	--	(1,113)
Employee loans and advances	(500)	(407)
CASH FLOWS (USED IN) INVESTING ACTIVITIES	(500)	(1,520)
Cash Flow From Financing Activities:		
Net repayments on notes payable	(71,284)	(74,617)
CASH FLOWS (USED IN) FINANCING ACTIVITIES	(71,284)	(74,617)
NET INCREASE IN CASH	59,948	365,913
Cash balance at beginning of period	700,344	177,668
CASH BALANCE AT END OF PERIOD	$ 760,292	$ 543,581
Supplemental Disclosures of Cash Flow Information:		
Interest Paid	$ --	$ 78,889
Taxes Paid	58,555	39,242
Taxes (Refund)	(9,118)	--

See Notes to Interim Unaudited Financial Statements

EYE DYNAMICS, INC.

NOTES TO INTERIM UNAUDITED FINANCIAL STATEMENTS

NOTE 1 - NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NATURE OF BUSINESS: Eye Dynamics, Inc. (the "Company') designs, develops, produces and markets diagnostic equipment that measures, tracks and records human eye movements, utilizing the Company's proprietary technology and computer software. The products perform separate, but related, functions and target two separate markets. First, the Company markets a neurological diagnostic product that tracks and measures eye movements during a series of standardized tests, as an aid in diagnosing problems of the vestibular (balance) system and other balance disorders. Second, the Company's impairment detection devices target the corporate and criminal justice markets and are designed to test individuals for impaired performance resulting from the influences of alcohol, drugs, illness, stress and other factors that affect eye and pupil performance. The Company is a Nevada corporation formed in 1989.

A summary of significant accounting policies follows:

PRESENTATION OF INTERIM INFORMATION: The financial information at September 30, 2004 and for the three and nine months ended September 30, 2004 and 2003 is unaudited but includes all adjustments (consisting only of normal recurring adjustments) that the Company considers necessary for a fair presentation of the financial information set forth herein, in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information, and with the instructions to Form 10-QSB. Accordingly, such information does not include all of the information and footnotes required by U.S. GAAP for annual financial statements. For further information refer to the Consolidated Financial Statements and footnotes thereto included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2003.

The results for the three and nine months ended September 30, 2004 may not be indicative of results for the year ending December 31, 2004 or any future periods.

RECLASSIFICATION: Certain prior period balances have been reclassified to conform to the current period presentation.

NEW ACCOUNTING STANDARDS: In December 2003, the SEC issued Staff Accounting Bulletin (SAB) No. 104, "Revenuer Recognition," which codifies, revises and rescinds certain sections of SAB No. 101, "Revenue Recognition," in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The changes noted in SAB No. 104 did not have a material effect on the Company's results of operations, financial positions or cash flows.

NOTE 2 - WIND DOWN OF SUBSIDIARY

On September 15, 2003, the Board of Directors approved to wind down the Company's sole subsidiary, Oculokinetics, Inc., which was inactive and has no asset or liability as of that date.

EYE DYNAMICS, INC.

NOTES TO INTERIM UNAUDITED FINANCIAL STATEMENTS

NOTE 3 - BALANCE SHEET DETAILS

The following tables provide details of selected balance sheet items:

At September 30,	2004	2003
Prepaid expenses and taxes		
Prepaid insurance	$ 8,694	$ --
Prepaid income taxes	15,760	--
Other prepaid expenses	5,093	5,247
Total	$ 29,547	$ 5,247
Property and equipment, net		
Furniture and Fixtures	$ 1,113	$ 1,113
Equipment	13,331	13,331
	14,444	14,444
Less: accumulated depreciation	(13,512)	(13,239)

Total	$ 932	$ 1,205
Other Assets		
Deferred tax assets	$ 205,436	$ --
Deposits	12,662	29,674
Total	$ 218,098	$ 29,674
Accrued expenses		
Commission payable	$ 4,000	$ 18,099
Warranty reserve	7,859	--
Income taxes payable	--	46,365
Other	146	22,339
Total	$ 12,005	$ 86,803

NOTE 4 - INCOME TAXES

The Company accounts for income taxes using a balance sheet approach whereby deferred tax assets and liabilities are determined based on the differences in financial reporting and income tax basis of assets and liabilities. The differences are measured using the income tax rate in effect during the year of measurement.

The Company experienced significant net losses in prior fiscal years resulting in a net operating loss carryforward ("NOLC") for federal income tax purposes of approximately $1,531,790 at December 31, 2003. The Company's NOLC will expire through 2021. The Company also has state NOLC of $901,140, which was suspended in years of 2002 and 2003. The state NOLC will expire through 2013.

EYE DYNAMICS, INC.

NOTES TO INTERIM UNAUDITED FINANCIAL STATEMENTS

NOTE 5 - NET INCOME PER SHARE

The following table sets forth the computation of basic and diluted net income per share:

	Three Months ended Sep. 30, 2004	2003	Nine Mon 2004
Basic earnings per share:			
Net income	$ 59,645	$ 348,607	$ 267,7
Weighted average number of common shares	17,883,081	17,850,313	17,883,0
Basic earnings per common share	$ 0.00	$ 0.02	$ 0
Diluted earnings per share:			
Net income	$ 59,645	$ 348,607	$ 267,7
Addback: Debenture interest	700	762	2,1

Adjusted net income	$ 60,345	$ 349,369	$ 269,8
Weighted average number of common shares	17,883,081	17,850,313	17,883,0
Incremental shares from assumed conversion:			
Convertible debt	3,591,799	3,591,799	3,591,7
Stock warrants	235,294	263,889	235,2
Adjusted weighted average number of common shares	21,710,174	21,706,001	21,710,1
Diluted earnings per common share	$ 0.00	$ 0.02	$ 0.

Approximately, 200,000 shares outstanding stock warrants were excluded from the calculation of diluted earnings per share for 2003 because the exercise price of the stock warrants was greater than the average share price of the common stock and, therefore, the effect would have been antidilutive.

NOTE 6 - MAJOR CUSTOMERS

During the three months ended September 30, 2004 and 2003, the private label distributor accounted for $271,592 and $643,132 or 62.1% and 58.4% of total revenues, respectively.

During the nine months ended September 30, 2004, two customers accounted for $1,063,303 or 70.8% of total revenues.

Special Instrument Dealer 15.1%
Private label distributor 55.7%

During the nine months ended September 30, 2003, the private label distributor accounted for $1,376,347 or 56.4% of total revenues.

NOTE 7 - SEGMENT INFORMATION

SFAS No. 131 "Disclosures about Segments of an Enterprise and Related Information" requires that a publicly traded company must disclose information about its operating segments when it presents a complete set of financial statements. Since the Company has only one segment; accordingly, detailed information of the reportable segment is not presented.

6

EYE DYNAMICS, INC.

NOTES TO INTERIM UNAUDITED FINANCIAL STATEMENTS

NOTE 8 - MANUFACTURING, SALES, LICENSING, AND SOFTWARE AGREEMENT

On March 22, 2004, the Company entered into an exclusive manufacturing, sales, and licensing and software ownership agreement with its private label distributor ("Distributor"). Under the terms and conditions of the contract, the Distributor agrees to purchase all of its current and future Video ENG products exclusively from the Company. In addition, the Company grants the Distributor the exclusive marketing rights for all of its Video ENG products throughout the United States.

NOTE 9 - GUARANTEES AND PRODUCT WARRANTIES

The Company from time to time enters into certain types of contracts that contingently require the Company to indemnify parties against third party claims. These contracts primarily relate to: (i) divestiture agreements, under which the Company may provide customary indemnifications to purchasers of the Company's businesses or assets; (ii) certain real estate leases, under which the Company may be required to indemnify property owners for environmental and other liabilities, and other claims arising from the Company's use of the applicable premises; and (iii) certain agreements with the Company's officers, directors and employees, under which the Company may be required to indemnify such persons for liabilities arising out of their employment relationship.

The terms of such obligations vary. Generally, a maximum obligation is not explicitly stated. Because the obligated amounts of these types of agreements often are not explicitly stated, the overall maximum amount of the obligations cannot be reasonably estimated. Historically, the Company has not been obligated to make significant payments for these obligations, and no liabilities have been recorded for these obligations on its balance sheet as of September 30, 2004.

In general, the Company offers a one-year warranty for most of the products it sold. To date, the Company has not incurred any material costs associated with these warranties. The Company provides reserves for the estimated costs of product warranties based on its historical experience of known product failure rates, use of materials to repair or replace defective products and service delivery costs incurred in correcting product failures. In addition, from time to time, specific warranty accruals may be made if unforeseen technical problems arise with specific products. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

The following table presents the changes in the Company's warranty reserve during the first nine months of 2004:

Balance as of December 31, 2003	$ 8,044
Provision for warranty	3,609
Utilization of reserve	(3,894)
Balance as of September 30, 2004	$ 7,859

ITEM 2. Management's Discussion and Analysis or Plan of Operation

RESULTS OF OPERATIONS FOR THE PERIODS OF THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2004 AS COMPARED TO THE PERIODS OF THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2003

Revenues from the sale of medical products during the third quarter were $437,421, with a profit after taxes of $59,645. This represents a 60% decrease in revenues compared to the same quarter in 2003. Profit after taxes decreased commensurately, but is still 13% of revenues for the quarterly period. Revenues for the nine month period of 2004 were $1,502,878, compared to $2,441,728 for the same period of 2003. After tax income was $267,746, compared to $606,301 in 2003. Earnings per share was $0.02 for the nine month period of 2004, compared to $0.03 per share in 2003.

Lower sales can be attributed to Medicare's continued scrutiny of reimbursements for ENG tests. This continues to cause potential new customers to delay or even abandon plans to purchase equipment. Medicare is generally requiring that the test be prescribed as a medical necessity and that the test be administered appropriately in order to be assured of reimbursement. This issue is being debated and is not yet settled.

The private label portion of our business accounted for 62% of revenues for the quarter, as compared to 58% for the same period in the prior year. Year to date private label portion represents 56% of total revenues, approximately the same as in the corresponding period of 2003.

Gross profit for the quarter was 52%, and year to date gross profit is also 52%. The Company's goal is to maintain a gross profit of at least 50% for each period. The Company is working to contain expenses and to reduce product costs in order to achieve the gross profit percentage goal. Principal operating expense category increases have been in insurance, including product liability, workers compensation and general liability. Product liability insurance was the greatest change, at four times the rate of 2003.

The Company incurred only the minimum California state income tax because the moratorium on the use of tax loss carryovers for the years 2002 and 2003 expired, and the use of net operating loss carryovers is again permissible. Federal tax loss carryovers were not affected and because of substantial NOL's, the Company is not required to accrue federal income taxes for 2004.

Liquidity And Capital Resources

Cash and cash equivalents as of September 30, 2004 were $760,292, which allows for payment of all outstanding invoices and our single note payment on a current basis. Accounts payable are current and the Company has not borrowed against credit lines.

Inventory of $350,137 at September 30, 2004 includes $25,000 of SafetyScope Impairment Detection Device items, which are not currently being marketed, but are used as production samples and demonstrators for capital raising activities related to that business. The inventory balance of $325,000 represents almost four months of consumption, and is balanced in content. However, management believes that the amount is too high for the volume of sales, and is in the process of reducing inventory to an appropriate level. The higher inventory is the result of the slowdown in sales. Sufficient time has not yet passed to reduce the inventory to an acceptable level, principally because of the importation of caloric irrigators from a supplier in Germany, which have to be scheduled and committed for delivery several months in advance.

Accounts receivable of $173,000 represent only 40 days accounts receivable aging, which is generally acceptable, and efforts to reduce it to a 30 day level have shown some substantial progress. At March 31, 2004 the accounts receivable balance was $366,000, so the current balance reflects a substantial reduction. The company's private label customer generally makes payments within the net 15 days term of sale. We are encouraging other customers to utilize leasing and credit cards with more frequency, providing for quicker collection of receivables. Some export customers use Letters of Credit, which often take substantial time to receive payment We are discouraging use of letters of credit and requesting cash transfers by wire as an alternative.

The Company continues to seek financing for the business plan to commercialize the SafetyScope product, which is an impairment detection device. The plan requires substantial financial resources to fully implement the commercialization of the product. Discussions and explorations of strategic alliances are ongoing with the goal of securing the financing; however the Company has no arrangements or agreements as to any such financing.

The Company continues to search out and evaluate other products and alliances to enhance its product lines and to augment revenues. The search for new products is an ongoing project.

Sales prospects for the rest of the year appear better than the third quarter, but not as robust as 2003. Some buyers are now moving forward with purchases that had been delayed earlier in the year.

Item 3. Controls and Procedures.

At the end of the period covered by this Form 10-QSB, the Company's management, including its Chief Executive and Financial Officer, conducted an evaluation of the effectiveness of the Company's disclosure controls and procedures. Based on this evaluation, the Chief Executive and Financial Officer determined that such controls and procedures are effective to ensure that information relating to the Company required to be disclosed in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. There have been no changes in the Company's internal controls over financial reporting that were identified during the evaluation that occurred during the Company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

The Company is not a party to any pending legal proceedings.

Item 2. Unregistered Sales of Equity Securities And Use Of Proceeds

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission Of Matters To A Vote Of Security Holders

There were no matters submitted to the vote of security holders during this quarterly reporting period.

Item 5. Other Information

None

Item 6. Exhibits

(a) Exhibits

31 Certificate of Chief Executive and Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32 Certificate of Chief Executive and Financial Officer pursuant to

Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: November 15, 2004

By: /s/ Charles E. Phillips

Charles E. Phillips, President