ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/
Form 10-Q
November 14, 2008

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

[x] Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2008 or

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

001-9731
(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 offices)

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

Indicate by check whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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___.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated filer [ ]   Accelerated filer [ ]   Non-Accelerated filer [ ]   Smaller reporting company [X]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes __ No X

As of October 28, 2008 there were 2,711,680 shares of the Company’s common stock outstanding.

ARRHYTHMIA RESEARCH TECHNOLOGY, INC.

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September 30, 2008

PART I - FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY

Consolidated Balance Sheets

ASSETS	September 30, 2008 (Unaudited)	December 31, 2007 (Audited)
Current assets:		
Cash and cash equivalents	$ 2,062,770	$ 1,684,411
Trade and other accounts receivable, net of allowance for doubtful accounts of $48,367 and $49,830	3,890,856	2,759,491
Inventories, net	3,704,398	3,001,520
Deferred income taxes, net	46,000	46,000
Deposits, prepaid expenses and other current assets	851,858	926,970
Total current assets	10,555,882	8,418,392
Property and equipment, net of accumulated depreciation of $8,773,888 and $7,872,887	7,300,881	7,610,258
Goodwill	1,564,966	1,564,966
Other intangible assets, net	160,652	221,482
Other assets	3,036	24,785
Total assets	$ 19,585,417	$ 17,839,883
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Current liabilities:		
Accounts payable	$ 2,070,863	$ 633,413
Accrued expenses	429,888	352,194
Current portion of acquisition note payable	-	134,083
Short term loan payable	661,164	735,655
Total current liabilities	3,161,915	1,855,345
Long term liabilities:		
Long term deferred tax liability	149,000	139,000
Total long term liabilities	149,000	139,000
Total liabilities	3,310,915	1,994,345
Shareholders’ equity:		
Preferred stock, $1 par value; 2,000,000 shares authorized, none issued	--	--

Common stock, $0.01 par value; 10,000,000 shares authorized, 3,926,491 shares issued, 2,711,680 outstanding		39,265		39,265
Additional paid-in-capital		10,220,673		10,143,339
Common stock held in treasury, 1,214,811 shares at cost		(3,326,579)		(3,326,579)
Retained earnings		9,341,143		8,989,513
Total shareholders’ equity		16,274,502		15,845,538
Total liabilities and shareholders’ equity	$	19,585,417	$	17,839,883

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 Income

(Unaudited)

	Three months ended September 30, 2008	Three months ended September 30, 2007	Nine months ended September 30, 2008	Nine months ended September 30, 2007
Revenue	$ 5,838,390	$ 4,457,688	$ 17,724,252	$ 14,867,182
Cost of sales	4,996,830	3,203,293	14,424,783	11,280,833
Gross profit	841,560	1,254,395	3,299,469	3,586,349
Selling and marketing	200,887	209,459	615,915	570,923
General and administrative	521,548	574,865	1,917,496	1,630,776
Research and development	35,682	14,594	248,355	44,971
Total expense	758,117	798,918	2,781,766	2,246,670
Income from operations	83,443	455,477	517,703	1,339,679
Other income (expense), net	(5,304)	(1,935)	(6,073)	(11,957)
Income before income taxes	78,139	453,542	511,630	1,327,722
Income tax provision	10,000	33,000	160,000	227,000
Net income	$ 68,139	$ 420,542	$ 351,630	$ 1,100,722
Net income per share – basic	$ 0.03	$ 0.16	$ 0.13	$ 0.41
Net income per share – diluted	$ 0.03	$ 0.15	$ 0.12	$ 0.40
Weighted average common shares outstanding – basic	2,711,680	2,711,680	2,711,680	2,709,973
Weighted average common shares outstanding – diluted	2,712,481	2,765,103	2,926,089	2,785,411

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

ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY

Consolidated Statements of Cash Flows

(Unaudited)

	Nine months Ended September 30, 2008	2007
Cash flows from operating activities:		
Net income	$ 351,630	$ 1,100,722
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,044,334	837,163
Provision for doubtful accounts	(1,463)	20,000
Deferred Income tax provision	10,000	-
Share based compensation	77,334	32,325
Changes in operating assets and liabilities:		
Trade and other accounts receivable	(1,129,902)	(100,419)
Inventories	(702,878)	(690,523)
Deposits, prepaid expenses and other assets	96,861	(157,182)
Accounts payable and accrued expenses	1,515,144	256,282
Net cash provided by operating activities	1,261,060	1,499,206
Cash flows from investing activities:		
Capital expenditures, net of disposals	(674,127)	(1,417,210)
Net cash used in investing activities	(674,127)	(1,417,210)
Cash flows from financing activities:		
Payments on acquisition note payable	(134,083)	(45,747)
Payments on short term equipment loan (obligation)	(74,491)	-
Tax benefit from exercise of stock options	-	33,549
Proceeds from the exercise of stock options	-	59,160
Net cash provided by (used in) financing activities	(208,574)	46,962
Net increase in cash and cash equivalents	378,359	128,958
Cash and cash equivalents at beginning of period	1,684,411	2,065,645
Cash and cash equivalents at end of period	$ 2,062,770	$ 2,194,603

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

Notes to the Consolidated Financial Statements

1. Basis of Presentation:

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 complete 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 Arrhythmia Research Technology, Inc. and subsidiary (the "Company") Annual Report on Form 10-K for the year ended December 31, 2007.

The information presented reflects, in the opinion of the management of the Company, all adjustments necessary for a fair presentation of the financial results for the interim period presented.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make 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. Operating results for interim periods are not necessarily indicative of results that may be expected for the entire fiscal year.

2. Inventories:

Inventories consist of the following as of:		September 30, 2008		December 31, 2007
Raw materials	$	1,545,244	$	872,758
Work-in-process		633,736		538,309
Finished goods		1,525,418		1,590,453
Total	$	3,704,398	$	3,001,520

3. Share-Based Compensation:

The Company accounts for share based compensation under Statement of Financial Accounting Standards (SFAS) 123(R), Share-Based Payment, which accounts for equity instruments exchanged for employee services. Under the provisions of SFAS 123(R), share-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as an expense over the employee's requisite service period (generally the vesting period of the equity grant).

The Company estimates the fair value of stock options using the Black-Scholes valuation model. Key input assumptions used to estimate the fair value of stock options include the exercise price of the award, the expected option term, the expected volatility of the Company's stock over the option's expected term, the risk-free interest rate over the option's expected term, and the Company's expected annual dividend yield. The Company believes that the valuation technique and the approach utilized to develop the underlying assumptions are appropriate in calculating the fair values of the Company's stock options. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by persons who receive equity awards.

The following assumptions were used to estimate the fair market value of options granted using the Black Scholes valuation method:

	Nine months Ended September 30, 2008	2007
Dividend Yield	0%	0.44%
Expected Volatility	40.65%	43%
Risk Free Interest Rate	3.28%	5.5%
Expected Option Terms (in years)	4.5	6

The Company recognized share-based compensation expense of $77,334 and $32,325 in general and administrative expense for the nine months ended September 30, 2008 and 2007, respectively. Grants totaling 107,500 options to 24 persons, including directors and management, were made during the nine months ended September 30, 2008 compared with two grants totaling 20,000 for the same period in 2007. The weighted average fair value of options at grant for the nine months ended September 30, 2008 and 2007 was $2.74 and $8.83, respectively.

Share-based Incentive Plan

At September 30, 2008, the Company has one stock option plan that includes both incentive stock options and non-statutory stock options to be granted to certain eligible employees, non-employee directors, or consultants of the Company. At the annual shareholder meeting on May 11, 2007, the shareholders approved an amendment to the plan adding an additional 200,000 shares for future grant. The maximum number of shares reserved for issuance is 400,000 shares. The options granted have six-year contractual terms and either vest immediately or vest annually over a five-year term.

At September 30, 2008, there were 133,000 shares available for future grants under the above stock option plan. The weighted average exercise price of options outstanding was $8.75 at September 30, 2008.

The following table presents the average price and contractual life information about options outstanding and exercisable at September 30, 2008:

Exercise Price	Number of Outstanding Shares	Weighted Average Remaining Contractual Life (years)	Options Currently Exercisable
$ 4.85	25,000	0.83	25,000
7.15	100,000	5.26	-
9.86	69,000	3.22	69,000
12.42	10,000	3.84	4,000
23.10	10,000	4.43	2,000

The aggregated intrinsic value of options outstanding and vested at September 30, 2008 was $0 and $20,400, respectively. The Company expects 95,900 of the 114,000 unvested options to vest over their remaining life.

The following table summarizes the status of Company's non-vested options since December 31, 2007:

	Non-Vested Options	
	Number of Shares	Weighted Average Fair Value
Non-vested at December 31, 2007	33,000	$ 3.67
Granted	107,500	2.74
Vested	(9,000)	3.95
Forfeited	(17,500)	5.11
Non-vested at September 30, 2008	114,000	$ 3.45

At September 30, 2008, there was $328,293 of total unrecognized cost related to non-vested share-based compensation arrangements granted under the Plan. This cost is expected to be recognized over a weighted average period of 5.05 years.

4. Income Taxes:

On January 1, 2007, the Company adopted FASB Interpretation No. 48 ("FIN 48"), Accounting for Uncertainty in Income Taxes which is an interpretation of SFAS No. 109, Accounting for Income Taxes. FIN 48 requires management to perform a two-step evaluation of all tax positions, ensuring that these tax return positions meet the "more-likely than not" recognition threshold and can be measured with sufficient precision to determine the benefit recognized in the financial statements.

The Company files income tax returns in the U.S. Federal jurisdiction and various state jurisdictions. The periods from 2005 to 2007 remain open to examination by the IRS, and 2004 to 2007 remain open in state jurisdictions. The Company believes it is not subject to any significant tax risk. As of the date of adoption of FIN No. 48, the Company did not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense recognized during the nine months ended September 30, 2008.

5. Earnings per share:

In accordance with SFAS No. 128, the basic earnings per share is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding. Diluted earnings per share is computed similar to basic earnings per share except that the denominator is increased to include the number of additional shares that would have been outstanding if the potential shares had been issued and if the additional shares were dilutive. At September 30, 2008, 209,500 of the 231,500 in stock equivalents were anti-dilutive and excluded in the earnings per share computation.

6. Asset Impairment:

Asset impairment charges of $22,378 were recorded in the nine months ended September 30, 2008. These charges were related to equipment used in the testing of sensors in the assembly of electrodes. The equipment has been written down to its estimated net realizable value.

7. Subsequent Events:

In October 2008 the Company’s board of directors authorized the repurchase in the open market from time to time of up to $650,000 of the Company’s outstanding common stock. No shares have been acquired to date.

8. Recent Accounting Pronouncements:

In December 2007, the SEC issued SAB No. 110. SAB 110 allows for the continued use of a "simplified" method, as discussed in SAB No. 107, in developing an estimate of expected term of "plain vanilla" share options in accordance with SFAS 123 (revised 2004). Originally the SEC staff stated in SAB 107 that it would not expect a company to use the simplified method for share option grants after December 31, 2007. Accordingly, the SEC staff will continue to accept, under certain circumstances, the use of the simplified method beyond December 31, 2007. The Company will continue the use of the simplified method for determining the value of options granted as allowed by SAB 110.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations. SFAS No. 141(R) establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. SFAS No. 141(R) also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The provisions of SFAS No. 141(R) are applicable to business combinations consummated on or after December 15, 2008 with early adoption prohibited.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements - an amendment of ARB No. 51. SFAS No. 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary for the deconsolidation of a subsidiary. SFAS No. 160 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim statements within those fiscal years. The Company does not currently have any noncontrolling interests.

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

Forward-Looking Statements

Any forward-looking statements made herein are based on current expectations of the Company, involve a number of risks and uncertainties and should not be considered as guarantees of future performance. The factors that could cause actual results to differ materially include: fluctuations in customer delivery schedules, interruptions or cancellation of existing contracts, inability to integrate acquisitions, 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 changing economic conditions and an inability to arrange additional debt or equity financing. More information about factors that potentially could affect the Company's financial results is included in the Company's filings with the Securities and Exchange Commission, including its Annual Report on Form 10-K for the year ended December 31, 2007 filed on March 31, 2008.

Overview

Arrhythmia Research Technology, Inc. (“ART”) is engaged in the licensing of medical software, which acquires data and analyzes electrical impulses of the heart to detect and aid in the treatment of potentially lethal arrhythmias. Micron Products, Inc. (“Micron”), a wholly owned subsidiary, is the primary source of consolidated revenues. Micron manufactures disposable electrode sensors used as a component part in the manufacture of integrated disposable electro-physiological sensors. These disposable medical devices are used world wide in the monitoring of electric signals in various medical applications. Micron has expanded into custom plastic injection molded products and product life cycle management. Revenues in this sector are primarily custom injection molding, tooling, and end-to-end product life cycle management through a comprehensive portfolio of value-added services such as design, engineering, prototyping, manufacturing, machining, assembly and packaging.

Results of Operations

Revenue for the three months ended September 30, 2008 was $5,838,390 versus $4,457,688 for the three months ended September 30, 2007, an increase of 31%. Sales of sensors and snaps with silver surcharge increased by $495,000 and high volume precision molded products and other miscellaneous sales increased by $26,000. The increase in revenue of sensors, snaps and high precision molded product sales was due, in part, to the periodic fluctuations in customer production schedules. A decrease of $47,000 in revenue from NEM's custom molded products was offset by an increase of $1,043,000 in revenue from MIT's product life cycle management programs as a direct result of the growing metal related business. This increase includes $246,000 in precision medical machining and $1,207,000 in the sale of imported forgings for a new customer. This was offset by a periodic decrease of $410,000 in defense industry revenue. Revenue from the Leominster Tool division decreased by $136,000 and does not include orthopedic implant production and tools produced for customers of the other divisions. Engineering and tooling revenue included above increased by $4,600 as compared to the same period in 2007. Engineering and tooling revenues typically occur at the beginning of a product life cycle or when a customer changes its manufacturing source. After the design and manufacture of the prototype and/or production tooling, the Company should benefit from product sales as it begins to utilize the customer owned tooling.

Revenue for the nine months ended September 30, 2008 was $17,724,252 versus $14,867,182 for the nine months ended September 30, 2007, an increase of 19%. Sales of sensors and snaps with silver surcharge increased by $316,000 and high volume precision molded products and other miscellaneous sales increased by $63,000. A decrease of $164,000 in revenue from NEM's custom molded products was offset by an increase of $2,397,000 from MIT's product life cycle management programs as a direct result of the growing metal related business. This increase includes but is not limited to $670,000 in precision medical machining and $2,777,000 from the sale of imported forgings for a new large customer, and offset by a decrease of $1,056.000 in MIT's defense industry revenue. The decrease in defense industry revenue is due to the irregular delivery schedule of our customer and does not reflect a change in the long term expectation of deliveries. Revenue in the Leominster Tool division increased by $245,000 in revenues and does not include orthopedic implant production and tools produced for customers of the other divisions. Engineering and tooling revenue included above increased by $242,000 as compared to the same period in 2007. Engineering and tooling revenues typically occur at the beginning of a product life cycle or when a customer changes its manufacturing source. After the design and manufacture of the prototype and/or production tooling, the Company should benefit from product sales as it begins to utilize the customer owned tooling. There were no sales of the Company's SAECG products in the first nine months of 2008 or 2007.

Revenue from domestic and foreign sales is as follows:

	Three Months Ending September 30,				Nine months Ending September 30,			
	2008	%	2007	%	2008	%	2007	%
United States	$ 3,532,956	61	$ 2,653,515	60	$ 10,472,345	59	$ 8,358,543	56
Canada	1,338,178	23	1,130,046	25	4,001,374	23	4,041,121	27
Europe	729,500	12	506,457	11	2,442,681	14	1,884,500	13
Pacific Rim	115,349	2	72,939	2	351,711	2	278,189	2
Other	122,407	2	94,731	2	456,141	2	304,829	2
Total	$ 5,838,390	100	$ 4,457,688	100	$ 17,724,252	100	$ 14,867,182	100

Cost of sales was $4,996,830 or 85.6% of revenue and $3,203,293 or 71.9% of revenue for the three months ended September 30, 2008 and 2007, respectively. Cost of sales was $14,424,783 or 81.4% for the nine months ended September 30, 2008 as compared to $11,280,833 or 75.9% for the same period in 2007. The stabilization of material costs continues to be a major focus of management efforts. The forged products in the MIT division have higher than expected costs as quality problems from a subcontractor have required extensive internal time and effort. All current products, services and programs, including those in development, are being evaluated for contribution and value to our overall business strategy and results. Products, services and programs that are underperforming from an overall contribution standpoint and not expected to improve will be phased out or discontinued so that the Company's resources can be put to use in developing those of more strategic value. Although management has been successful in stabilizing a portion of the electricity costs by negotiating a long-term purchase agreement, energy costs for the nine months ended September 30, 2008 are $111,000 higher than the same period in 2007. Other manufacturing costs continue to rise adding pressure to our margins. While some synergistic benefits will be realized in 2009, the integration of the Leominster Tool division into the Fitchburg complex will add costs in the next interim period. Management continues to investigate strategies to both stabilize and improve the overall gross margin without sacrificing product quality and to expand higher margin product lines and product lines with more stable demand forecasts.

Selling and marketing expense was $200,887 or 3.4% of revenue and $209,459 or 4.7% of revenue for the three months ended September 30, 2008 and 2007, respectively. Selling and marketing expense was $615,915 or 3.5% for the nine months ended September 30, 2008 as compared to $570,923 or 3.8% for the same period in 2007. Selling expenses are expected to be stable as a percentage of sales.

General and administrative expense was $521,548 or 8.9% of revenue and $574,865 or 12.9% of revenue for the three months ended September 30, 2008 and 2007, respectively. General and administrative expense was $1,917,496 or 10.8% for the nine months ended September 30, 2008 as compared to $1,630,776 or 11% for the same period in 2007. Included in the increase of expense for the nine months ended September 30, 2008 is a one time charge of $250,000 for costs associated with a terminated acquisition following due diligence. During this same period, the cost of additional administrative personnel of $32,000, and $71,000 of additional depreciation for the technology upgrades in preparation for Section 404 of the Sarbanes-Oxley Act of 2002 compliance increased the expense when compared to the similar period in 2007. Although the delay by the SEC for outside auditor attestation requirements of Section 404 will limit a previously expected increase in audit fees for the end of 2008, the costs associated with internal control documentation with outside consultants cost $69,000 for the nine months in 2008, and continues as planned. The Company expects the new enterprise resource planning solution to improve data collection and reporting in all aspects of the business.

Research and development expense was $35,682 or 0.6% of revenue and $14,594 or 0.3% of revenue for the three months ended September 30, 2008 and 2007, respectively. Research and development expense was $248,355 or 1.4% of revenue for the nine months ended September 30, 2008 as compared to $44,971 or 0.3% of revenue for the same period in 2007. The nine months ended September 30, 2008 included $52,000 of expense for equipment tested in a process improvement project with the sensor product line as well as the impairment of equipment used for final product testing. Other costs are related to ART's product, Predictor®7. Although base development work on Predictor 7 has been completed, expenses continue with technical support of a National Institute of Health research project utilizing ART's proprietary Signal Averaged ECG products and patented algorithms. The remaining portion of the research and development expense is associated with continued work on patentable technologies on the Micron sensor and snap product line. This work is expected to continue through the end of 2008.

Other income (expense), net was $5,304 in expense versus expense of $1,935 for the three months ended September 30, 2008 and 2007, respectively. Other expense was $6,073 and $11,957 for the nine months ended September 30, 2008 and 2007, respectively. Interest income of $25,987 and $20,921 in the nine months ended September 30, 2008 and 2007 was offset by interest expense in the same periods of $35,481 and $12,015 associated with acquisition and equipment notes.

Income taxes as a percent of income before income taxes were 12.8% and 31.3% for the three and nine months ended September 30, 2008, and 7.3% and 17.1% for the three and nine months ended September 30, 2007. The differences in effective tax rate are a result of the timing of tax credits earned. Management will continue to seek to implement any tax planning opportunities that could effectively reduce the Company's income tax provision in the future.

Basic earnings per share decreased to $0.03 from $0.16 for the three months ended September 30, 2008 and 2007, respectively, and decreased to $0.13 from $0.41 for the nine months ended September 30, 2008 and 2007, respectively. The increase in expenses described above had a direct impact to the earnings per share when comparing the three and nine months ended September 30, 2008 to the same period in the prior year. The decrease in the nine months ended September 30, 2008 includes non-recurring charges totaling $302,000, related to the acquisition and research and development activities. This charge, net of tax, decreased basic earnings per share during the nine months by $0.07.

Liquidity and Capital Resources

Working capital was $7,393,967 at September 30, 2008 compared to $6,563,047 at December 31, 2007, an increase of $830,920. Operating cash flow is expected to continue to increase faster than planned capital expenditure for the next nine months. Capital investment could decrease working capital with any significant investment resulting from future acquisition of assets or businesses, significant expansion of production capacity, a medical study, or further software development.

Net capital expenditures were $674,127 for the nine months of 2008 as compared to $1,417,210 for the same period in 2007. The capital expenditures during the first nine months of 2008 and 2007 were for the acquisition of additional production machinery and equipment, including upgrades in and replacement of existing machinery and tooling. Included in the capital expenditures for 2007 is the acquisition of an adjacent property to the Company's Fitchburg complex and technology upgrades for a new enterprise resource planning solution.

The Company has an unsecured $1,000,000 credit line with a large multinational bank. No funds have been drawn down on the line as of September 30, 2008 or December 31, 2007. In September 2007, a one year note for $813,000 at the fixed rate of 6.75% per annum for metal machining equipment was drawn down by $383,000. A second payment of $383,000 was made in January of 2008 for this equipment. This note was extended for a year with a decrease in the fixed rate to 6.5% per annum. This equipment note is amortized over six years with a balloon payment at September 15, 2009.

In October 2008 the Company's board of directors authorized the repurchase in the open market from time to time of up to $650,000 of the Company's outstanding common stock. No shares have been acquired to date.

The Company expects to meet cash demands for its operations at current levels with current operating cash flows for the foreseeable future.

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with generally accepted accounting principles requires management to make judgments, assumptions and estimates that affect the amounts reported. Certain of these significant accounting policies are considered to be critical accounting policies, as defined below.

A critical accounting policy is defined as one that is both material to the presentation of the Company's financial statements and requires management to make difficult, subjective, and complex judgments that could have a material effect on the Company's financial condition and results of operations. Specifically, critical accounting estimates have the following attributes: 1) the Company is required to make assumptions about matters that are highly uncertain at the time of the estimate; and 2) different estimates the Company could reasonably have used, or changes in the estimate that are reasonably likely to occur, would have a material effect on the Company's financial condition or results of operations.

Estimates and assumptions about future events and their effects cannot be determined with certainty. The Company bases its estimates on historical experience and on various other assumptions believed to be applicable and reasonable in the circumstances. These estimates may change as new events occur, as additional information is obtained and as the Company's operating environment changes. These changes have historically been minor and have been included in the consolidated financial statements as soon as they became known. In addition, management is periodically faced with uncertainties, the outcomes of which are not within its control and will not be known for prolonged periods of time. These uncertainties are discussed in the section above entitled "Forward-looking Statements." Based on a critical assessment of its accounting policies and the underlying judgments and uncertainties affecting the application of those policies, management believes that the Company's consolidated financial statements are fairly stated in accordance with generally accepted accounting principles, and present a meaningful presentation of the Company's financial condition and results of operations.

Management believes that the following are critical accounting policies:

Revenue Recognition and Accounts Receivable

Revenues from the sale of products are recorded when the product is shipped, title and risk of loss have transferred to the purchaser, payment terms are fixed or determinable and payment is reasonably assured.

The financing of customer purchased tooling utilizes the direct financing method of revenue recognition. This requires the gain on the sale of the tooling to be recorded at the time the tool is put into service while the expected payments are reflected as a lease receivable.

Based on management’s on-going analysis of accounts receivable balances, and after the initial recognition of the revenue, if an event occurs which may adversely affect the ultimate collectability of the related receivable, management will record an allowance for the bad debt. Bad debts have not had a significant impact on the Company’s financial condition, results of operations, or cash flows.

Stock-Based Compensation

The Company accounts for share based compensation under SFAS No. 123R, "Share Based Payment" ("FAS 123R"). FAS 123R requires that companies recognize and measure compensation expense for all share-based payments at the grant date based on the fair market value of the award. This share-based compensation expense must be included in the Company's statement of operations over the requisite service period.

The Company uses the Black-Scholes option pricing model which requires extensive use of financial estimates and accounting judgment, including the expected volatility of the Company's common stock over the estimated term, and estimates on the expected time period that employees will retain their vested options prior to exercising them. The number of shares that are expected to be forfeited before the options are vested are included in the calculation of compensation expense. The use of alternative assumptions could produce significantly different estimates of the fair value of the stock-based compensation and as a result, provide significantly different amounts recognized in the Company's statement of operations.

Inventory and Inventory Reserves

The Company values its inventory at the lower of cost or market. The Company reviews its inventory for quantities in excess of production requirements, obsolescence and for compliance with internal quality specifications. Any adjustments to inventory would be equal to the difference between the cost of inventory and the estimated net market value based upon assumptions about future demand, market conditions and expected cost to distribute those products to market. If actual market conditions are less favorable than those projected by management, additional inventory reserves may be required.

The Company maintains a reserve for excess, slow moving, and obsolete inventory as well as inventory with a carrying value in excess of its net realizable value. A review of inventory on hand is made at least annually and a provision for excess, slow moving, and obsolete inventory is recorded, if necessary. The review is based on several factors including a current assessment of future product demand, historical experience, and product expiration.

Deferred Tax Assets

The Company assesses its deferred tax assets based upon a more likely than not to be realized criteria. The Company considers future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance. In accordance with FIN 48 we recognize the benefits of a tax position if that position is more likely than not to be sustained on audit, based on the technical merit of the position.

Asset Impairment – Goodwill

The Company reviews the valuation of goodwill and intangible assets to assess potential impairments on an annual basis. The management evaluates the carrying value of goodwill and other intangible assets in accordance with the guidelines set forth in SFAS 142. The value assigned to intangible assets is determined by a valuation based on estimates and judgment regarding expectations for the success and life cycle of products and businesses acquired. To test for impairment, present values of an estimate of future discounted cash flows related to the intangible assets are calculated compared to the value of the intangible asset. When impairment exists it could have a material adverse effect on the Company's business, financial condition and results of operations. There was no impairment as of September 30, 2008.

Asset Impairment – Long Lived Assets

The Company assesses the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be fully recoverable. When it is determined that the carrying value of such assets may not be recoverable, the Company generally measures any impairment based on projected undiscounted future cash flows attributed to the asset and its carrying value. If the carrying value exceeds the future discounted cash flows, asset impairment would be recorded. In the nine months ended September 30, 2008, a long lived asset used in research and development was impaired for $22,378.

Item 3. Quantitative and Qualitative Disclosure About Market Risks

Not applicable.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this Quarterly Report, the Company’s management, with the participation of the Company’s Chief Executive Officer and Chief Financial Officer (“the Certifying Officers”), conducted evaluations of the Company’s disclosure controls and procedures. As defined under Sections 13a – 15(e) and 15d – 15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), the term “disclosure controls and procedures” means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission’s rules and forms. Disclosure controls and procedures include without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer’s management, included the Certifying Officers, to allow timely decisions regarding required disclosures. Based on this evaluation, the Certifying Officers have concluded that the Company’s disclosure controls and procedures were effective to ensure that material information is recorded, processed, summarized and reported by management of the Company on a timely basis in order to comply with the Company’s disclosure obligations under the Exchange Act and the rules and regulations promulgated thereunder.

Changes in Internal Control over Financial Reporting

Further, there were no changes in the Company’s internal control over financial reporting during the Company’s third fiscal quarter that materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1A. Risk Factors

In addition to the other information set forth in this Quarterly Report on Form 10-Q, one should carefully consider the factors discussed in Part I, “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2007.

Large OEM customers can change their demand on short notice, further adding to the unpredictability of our quarterly sales and earnings.

Our quarterly results have in the past and may in the future vary due to the lack of dependable long-term demand forecasts from our larger OEM customers. In addition to this risk, many of our OEM customers have the right to change their demand schedule, either up or down, within a relatively short time horizon. These changes may result in us incurring additional working capital costs and causing increased manufacturing expenses due to these short-term fluctuations. In particular, our quarterly operating results have in the past fluctuated as a result of some of the larger OEM customers changing their orders within a fiscal quarter. Our expense levels and inventory, to a large extent, are based on shipment expectations in the quarter. If sales levels fall below these expectations, through a delay in orders or otherwise, operating results are likely to be adversely affected. Although we have tried to lessen our dependency on a few large customers, this is the nature of the OEM customers that we serve and we can provide no assurance that we will be able to materially alter this dependency in the immediate future, if at all.

Item 6. Exhibits

(a) Exhibits

3.0	Articles of Incorporation(a)
3.1	By-laws(b)
10.43*	Employment agreement between James E. Rouse and the Company dated December 26th, 2006.(d)
10.44*	Employment agreement between David A. Garrison and the Company dated January 1st, 2007.(d)
31.1	Certification of the CEO pursuant to Rule 13a-14(a) or Rule 15(d)-14(a) on page X-1.
31.2	Certification of the CFO pursuant to Rule 13a-14(a) or Rule 15(d)-14(a) on page X-2.
32.1	Certification pursuant to 18 U.S.C. § 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 on page X-3.
32.2	Certification pursuant to 18 U.S.C. § 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 on Page X-4.
99.1	Press release dated October 6, 2008, re stock buy back program.

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* Indicates a management contract or compensatory plan required to be filed as an exhibit.

(a) Incorporated by reference from the Company's Registration Statement on Form S-18 as filed with the Commission in April 1988, Registration Statement No. 33-20945-FW

(b) Incorporated by reference from the Company's Form 8-K as filed with the Commission in December 2007.

(c) Incorporated by reference from the Company's Form 8-K as filed with the Commission on May 21, 2004.

(d) Incorporated by reference from the Company's Form 10-KSB for period ended December 31, 2006 as filed with the Commission in March of 2007.

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.

Dated: November 14, 2008

By: /s/ James E. Rouse

James E. Rouse
President and Chief Executive Officer
(Principal Executive Officer)

By: /s/ David A. Garrison
David A. Garrison
Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

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Index to Exhibits

Number	Exhibit	Page
31.1	Certification of the CEO pursuant to Rule 13a-14(a) or Rule 15(d)-14(a)	X-1
31.2	Certification of the DFO pursuant to Rule 13a-14(a) or Rule 15(d)-14(a)	X-2
32.1	Certification pursuant to 18 U.S.C. § 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X-3
32.2	Certification pursuant to 18 U.S.C. § 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X-4
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