ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/
Form 10-Q
August 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 JUNE 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.)

1101 SOUTH CAPITAL OF TEXAS HIGHWAY BUILDING G - SUITE 200 AUSTIN, TEXAS	78746
(Address of principal executive office)	(Zip code)

(512) 347-9640
(Registrant's telephone number, including area code)

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 August 7, 2001 there were 2,982,820 shares of common stock outstanding.

This report consists of 9 pages.

ARRHYTHMIA RESEARCH TECHNOLOGY, INC.

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

ASSETS	June 3 2001
Current assets:	
Cash and cash equivalents	$ 2,058,
Trade and other accounts receivable, net of allowance for doubtful accounts of $49,074 and $52,827	1,189,
Inventories, net	874,
Deposits, prepaid expenses and other current assets	42,
Income tax recoverable	100,
Total current assets	4,265,
Property and equipment, net of accumulated depreciation of $4,302,101 and $4,028,956	3,264,
Goodwill, net of accumulated amortization of $1,081,437 and $1,016,493	1,391,
Other intangibles, net of accumulated amortization of $570,585 and $558,419	35,
Deferred income taxes, net	374,
Other assets	85,
Total assets	$ 9,417,

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:	
Current portion of capital lease obligations	$ 15,
Current maturities of bonds payable and other long-term debt	444,
Accounts payable	393,
Accrued expenses	243,
Total current liabilities	1,096,
Bonds payable	-
Deferred revenue	1,
Total liabilities	1,098,
Shareholders' equity:	
Preferred stock, $1 par value; 2,000,000 shares authorized, none issued	-
Common stock, $ 01 par value; 10,000,000 shares authorized; 3,729,681 issued	37,
Additional paid-in-capital	9,166,
Common stock held in treasury, 869,846 and 563,446 shares at cost	(2,031,
Retained earnings	1,147,
Total shareholders' equity	8,319,
Total liabilities and shareholders' equity	$ 9,417,

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 OPERATIONS
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
Revenues	$ 1,874,662	$ 2,863,091	$ 3,628,636	$ 5,406,917
Cost of sales	1,239,995	1,354,596	2,489,462	3,093,230
Gross profit	634,667	1,508,495	1,139,174	2,313,687
Selling and marketing	17,457	23,617	41,195	129,197
General and administrative	358,792	531,622	718,834	956,760
Research and development	56,839	26,407	100,968	79,334
Amortization of goodwill	32,473	32,473	64,945	64,945

Total expenses	465,561	614,119	925,942	1,230,236
Income from operations	169,106	894,376	213,232	1,083,451
Other income (expense):				
Interest expense	(23,508)	(28,080)	(29,109)	(47,319)
Other income (expense), net	8,054	(38,454)	11,581	(54,559)
Income before income taxes	153,652	827,842	195,704	981,573
Income taxes	51,000	183,000	59,000	235,000
Net income	$ 102,652	$ 644,842	$ 136,704	$ 746,573
Net income per share - basic......	$ 0.03	$ 0.19	$ 0.04	$ 0.22
Weighted average number of common shares outstanding.......	3,015,213	3,376,710	3,063,359	3,421,316
Net income per share - dilutive...............	$ 0.03	$ 0.18	$ 0.04	$ 0.21
Dilutive average number of common equivalent shares outstanding....................	3,223,109	3,547,419	3,228,066	3,506,670

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		Unearne
	Number	Amount	Paid-in Capital	Treasury Stock	ESOP Compensa
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)	-
Treasury stock purchase of 179,400 shares.......				(376,642)	
Net income................					
June 30, 2001............	3,729,681	$ 37,297	$ 9,166,615	$ (2,031,306)	$ -

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

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

	Six
Cash flows from operating activities:	
Net income	$
Adjustments to reconcile net income to net cash provided by operating activities:	
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	
Cash flows from investing activities:	
Capital expenditures, net of disposals	(
Deposits on capital equipment, acquisitions and other	
Patent and software development expenditures	
Net cash used in investing activities	(
Cash flows from financing activities:	

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 June 30, 2001 the net carrying amount of goodwill is

$1,391,889. Amortization expense during the six month period ended June 30, 2001 was $64,945. 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:

	JUNE 30, 2001	DECEMBER 31, 2000
Raw materials	$ 136,890	$ 123,962
Work-in-process	234,197	197,254
Finished goods	503,318	538,945
Total	$ 874,405	$ 860,161

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

Liquidity and Capital Resources

At June 30, 2001, the Company had working capital of $3,168,311 compared to $3,671,443 at December 31, 2000. Of the $503,132 reduction in working capital in the first six months of 2001, $414,730 is equally ascribed to lower receivables from improved collection cycles and overall lower sales. The cash generated from receivables was used primarily to finance the $175,000 payment on a note due Astro-Med and $376,642 to purchase shares of the Company's stock under a continuation of its Stock Buy Back program announced in March 2001.

Working capital in the first half of 2001 was lowered by $444,408 of bonds payable, (maturity value of $550,000.) previously reported as long-term debt. The bonds are now current liabilities due to a May 2002 maturity date. The bonds have warrants to purchase 254,980 shares of the Company's stock that, if fully exercised, would provide $382,470 in cash proceeds.

The Company has available $1,000,000 of borrowing under a line of credit with a bank, collateralized by accounts receivable and inventory. The line expires September 30, 2001 and the Company does not anticipate any significant changes in renewing the line. There were no borrowings on the line of credit at June 30, 2001 or during the first half of 2001.

Results of Operations

Prior years results for the second quarter of 2000 included a one time commission payment that increased revenues by $1,000,000 and net income by $760,000. Excluding this special commission recorded in 2000, revenues for the second quarter of 2001 were $1,874,622 compared to $1,863,091 in 2000. Net income from normal operations for the second quarter of 2001 was $102,652

compared to a net loss of ($115,158) in 2000 (excluding the $760,000 effect of the special commission). The improvement in net income in 2001 is attributed to a higher sales mix of Micron's manufactured silver plated ECG sensors. Also, the second quarter of 2000 contained legal expenses of $90,821 associated with an environmental investigation that was closed out in 2000.

For the six months ended June 30, excluding the special commission income of $1,000,000 recorded in 2000, revenues were $3,628,636 in 2001 compared to $4,406,917 in 2000. The decline in revenues reflects lower sales of $435,379 of snaps distributed by Micron as a major account switched to an alternate supplier. Also, the early part of 2000 revenues included some customer inventory build related to Y2K concerns. Net income for the six months of 2001 was $136,704 compared to a net loss of ($13,427) in 2000 (excluding the $760,000 effect of the special commission). The improvement in net income was derived from savings in consolidating ART's Texas operations into Massachusetts, efficiencies in Micron's sensor production and the one time nature of $121,710 of special legal expenses incurred in 2000, all these combining to more than offset the 18% decline in revenues and related profits.

Domestic and foreign sales for the second quarter and six months are as follows:

	SECOND QUARTER				FIRST SIX M
	2001	%	2000	%	2001	%
Foreign Sales........	$1,615,881	86	$1,305,212	46	$3,028,996	83
Domestic Sales.......	258,781	14	557,879	19	599,640	17
Domestic Commission..	--	--	1,000,000	35	--	--
Total................	$1,874,662	100	2,863,091	100	$3,628,636	100

The higher percentage of foreign sales in 2001 compared to 2000 are the result of a major Micron customer transferring production from a US facility into a Canadian operation.

Cost of sales as a percent of sales was 66% in the second quarter of 2001 compared to 73% for the same period in 2000, exclusive of the effect of the $1,000,000 commission revenue. In the second quarter of 2000, Micron's plant was shutdown for one week due to a lack of orders which created significant underabsorbed manufacturing overhead, unlike 2001. Cost of sales for six months was 69% in 2001 compared to 70% reflecting the higher sales volume of sensor sales with the lower manufacturing costs than snap sales which are purchased for resale.

Selling and marketing expenses for the third quarter of 2001 have been consistent with those in the third quarter of 2000. For the six months ended June 30, selling and marketing expenses for 2001 are $88,002 lower than 2000 reflecting reduction in programs for ART's SAECG signal-averaging products until its new software applications are fully developed for re-introduction to the marketplace.

Research and development expenses have increased in 2001 in an effort to utilize programming consultants for enhancing ART's signal averaging products that are now Windows compatible.

General and administrative expenses were lower in the second quarter of 2001 by $172,830 and for the six months of 2001 by $237,926 as compared to similar periods in 2000. Legal expenses of $90,821 and $121,710, respectively, associated with the Micron environmental investigation concluded in 2000, were a major portion of the savings. The remaining savings are primarily attributed to the reduction of management personnel.

Income taxes as a percent of income for the second quarter of 2001 and six months then ended were 33% and 30% respectively. Income taxes for the second quarter of 2000 and the six months then ended were 22% and 24% 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.

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS - In March 2000, Astro-Med, Inc. ("Astro-Med") filed suit against ART in Superior Court of Kent County, Rhode Island (the "RI Litigation") alleging breach of contract, book account and unjust enrichment. ART subsequently filed a complaint and counter claim for breach of warranty. In May 2001, the matter was settled with both parties dismissing all litigation and ART making a $175,000 settlement payment on its obligations to Astro-Med. The income (expense) items associated with the suits had no significant effect on the results of operations.

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