

ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/  
Form 10QSB  
August 16, 2004  
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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D. C. 20549**

**Form10-QSB**

Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended **June 30, 2004** or

Transition report under 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 small business issuer as specified in its charter)*

**DELAWARE**

*(State or other jurisdiction of incorporation or  
organization)*

**72-0925679**

*(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)*

Check whether the issuer (1) 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  No .

As of July 31, 2004 there were 2,646,132 shares of the Company's common stock outstanding.

Transitional Small Business Disclosure Format Yes  No

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SIGNATURES

Exhibit 31.1 Certification of Chief Executive Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 31.2 Certification of Chief Financial Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 32.1 Certification of Chief Executive Officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002

Exhibit 32.2 Certification of Chief Financial Officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002

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**PART I FINANCIAL INFORMATION**

**Item 1. Consolidated Financial Statements**

**ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY**

Consolidated Balance Sheets

(Unaudited)

ASSETS

June 30,  
2004

December 31,  
2003

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## Current assets:

|   |                      |                     |
|---|----------------------|---------------------|
| Cash and cash equivalents   | \$ 1,649,575         | \$ 2,121,665        |
| Trade and other accounts receivable, net of allowance for doubtful accounts of \$8,960 and \$15,173 | 2,035,999            | 1,447,697           |
| Inventories, net  | 1,067,395            | 939,964             |
| Deposits, prepaid expenses and other current assets   | 149,406              | 62,926              |
| <b>Total current assets</b>   | <b>4,902,375</b>     | <b>4,572,252</b>    |
| Property and equipment, net of accumulated depreciation of \$5,139,332 and \$4,873,203              | 4,159,509            | 3,065,513           |
| Goodwill  | 1,538,306            | 1,244,000           |
| Other intangible assets, net  | 238,765              | -                   |
| Deferred income taxes, net  | 334,923              | 398,923             |
| Other assets  | 20,053               | 20,260              |
| <b>Total assets</b>   | <b>\$ 11,193,931</b> | <b>\$ 9,300,948</b> |

**LIABILITIES AND SHAREHOLDERS' EQUITY**

## Current liabilities:

|  |                      |                     |
|--|----------------------|---------------------|
| Accounts payable   | \$ 553,219           | \$ 283,483          |
| Accrued expenses   | 388,891              | 165,976             |
| Accrued acquisition expenses   | 77,107               | -                   |
| Acquisition price payable  | 546,356              | -                   |
| <b>Total current liabilities</b>   | <b>1,565,573</b>     | <b>449,459</b>      |
| 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 and 3,917,491 shares issued | 39,265               | 39,175              |
| Additional paid-in-capital   | 9,353,333            | 9,224,169           |
| Common stock held in treasury, 1,280,359 and 1,287,918 shares at cost                                      | (3,506,057)          | (3,526,756)         |
| Retained earnings  | 3,741,817            | 3,114,901           |
| <b>Total shareholders' equity</b>  | <b>9,628,358</b>     | <b>8,851,489</b>    |
| <b>Total liabilities and shareholders' equity</b>  | <b>\$ 11,193,931</b> | <b>\$ 9,300,948</b> |

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

## ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY

Consolidated Statements of Income

(Unaudited)

|               | Three Months Ended June 30, |              | Six Months Ended June 30, |              |
|---------------|-----------------------------|--------------|---------------------------|--------------|
|               | <u>2004</u>                 | <u>2003</u>  | <u>2004</u>               | <u>2003</u>  |
| Revenue       | \$ 3,113,875                | \$ 1,939,635 | \$ 5,265,992              | \$ 3,815,203 |
| Cost of sales | 1,912,024                   | 1,201,140    | 3,250,009                 | 2,374,668    |

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|  |            |            |            |            |
|--|------------|------------|------------|------------|
| Gross profit   | 1,201,851  | 738,495    | 2,015,983  | 1,440,535  |
| Selling and marketing                                | 77,411     | 49,447     | 119,353    | 96,760     |
| General and administrative                           | 396,534    | 297,572    | 671,337    | 568,738    |
| Research and development                             | 32,317     | 2,208      | 39,413     | 3,705      |
| Income from operations                               | 695,589    | 389,268    | 1,185,880  | 771,332    |
| Other income (expense)                               |            |            |            |            |
| Interest expense                                     | -          | (2,578)    | -          | (5,106)    |
| Other income, net                                    | 4,825      | 8,291      | 11,965     | 14,110     |
| Other income and interest expense, net               | 4,825      | 5,713      | 11,965     | 9,004      |
| Income before income taxes                           | 700,414    | 394,981    | 1,197,845  | 780,336    |
| Income tax provision                                 | 260,000    | 110,000    | 439,000    | 216,000    |
| Net income   | \$ 440,414 | \$ 284,981 | \$ 758,845 | \$ 564,336 |
| Net income per share - basic                         | \$ 0.17    | \$ 0.11    | \$ 0.29    | \$ 0.21    |
| Net income per share - diluted                       | \$ 0.16    | \$ 0.11    | \$ 0.28    | \$ 0.21    |
| Cash dividends declared per share                    | \$ -       | \$ -       | \$ 0.05    | \$ -       |
| Weighted average common shares outstanding - basic   | 2,643,142  | 2,600,213  | 2,637,791  | 2,643,785  |
| Weighted average common shares outstanding - diluted | 2,674,875  | 2,624,412  | 2,673,973  | 2,667,984  |

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 Months Ended June 30, |             |
|--|---------------------------|-------------|
|  | <u>2004</u>               | <u>2003</u> |
| Cash flows from operating activities:  |                           |             |
| Net income   | \$ 758,845                | \$ 564,336  |
| Adjustments to reconcile net income to net cash provided by operating activities, net of effects of acquisition: |                           |             |
| Depreciation and amortization  | 290,820                   | 253,892     |
| Changes in operating assets and liabilities:   |                           |             |
| Trade and other accounts receivable  | (326,430)                 | 115,513     |
| Inventories  | (9,656)                   | 40,742      |
| Deposits, prepaid expenses and other assets  | (11,318)                  | (87,319)    |
| Accounts payable and accrued expenses  | 352,936                   | 246,471     |

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|  |              |              |
|--|--------------|--------------|
| Net cash provided by operating activities                | 1,055,197    | 1,133,635    |
| Cash flows from investing activities:                    |              |              |
| Capital expenditures, net of disposals                   | (545,312)    | (202,559)    |
| Cash paid for acquisitions                               | (900,000)    | -            |
| Net cash used in investing activities                    | (1,445,312)  | (202,559)    |
| Cash flows from financing activities:                    |              |              |
| Cash dividend paid                                       | (131,929)    | -            |
| Proceeds from the exercise of stock options and warrants | 49,954       | -            |
| Purchase of treasury stock                               | -            | (438,640)    |
| Net cash used in financing activities                    | (81,975)     | (438,640)    |
| Net increase (decrease) in cash and cash equivalents     | (472,090)    | 492,436      |
| Cash and cash equivalents at beginning of period         | 2,121,665    | 1,773,412    |
| Cash and cash equivalents at end of period               | \$ 1,649,575 | \$ 2,265,848 |

Supplemental Information:

At June 30, 2004 the company has \$857 of dividends payable.  
 Included in the acquisition, \$100,000 worth of treasury stock was issued.  
 Included in the acquisition is a payable for \$546,000 with the seller.

**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. (the Company) Annual Report on Form 10-KSB for the year ended December 31, 2003.

The information furnished 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.

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

*2. Inventories:*

Inventories consist of the following as of:

| June 30, 2004 | December 31,<br>2003 |
|---------------|----------------------|
| _____         | _____                |

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|                 |    |                   |    |                   |
|-----------------|----|-------------------|----|-------------------|
| Raw materials   | \$ | 315,732           | \$ | 144,486           |
| Work-in-process |    | 341,776           |    | 347,592           |
| Finished goods  |    | 409,887           |    | 447,886           |
|                 |    | <u>          </u> |    | <u>          </u> |
| Total           | \$ | 1,067,395         | \$ | 939,964           |
|                 |    | <u>          </u> |    | <u>          </u> |

3. Stock-Based Compensation:

The Company accounts for stock options at intrinsic value in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ( APB 25 ), and related interpretations. Had compensation cost for the Company's stock options been determined based upon the fair value at the grant date for awards under the plans consistent with the methodology prescribed under Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* ( SFAS 123 ), the Company's net income would have been adjusted to the pro forma amounts indicated below:

|   | Three months ended June 30, |            | Six months ended June 30, |            |
|---|-----------------------------|------------|---------------------------|------------|
|   | 2004                        | 2003       | 2004                      | 2003       |
| Net income - as reported  | \$ 440,414                  | \$ 284,981 | \$ 758,845                | \$ 564,336 |
| Deduct: Total stock-based compensation expense determined under fair value based method | (7,876)                     | (7,876)    | (7,876)                   | (7,876)    |
| Net income - pro forma  | \$ 432,538                  | \$ 277,105 | \$ 750,969                | \$ 556,460 |
| Basic earnings per share:   |                             |            |                           |            |
| as reported   | \$ 0.17                     | \$ 0.11    | \$ 0.29                   | \$ 0.21    |
| pro forma   | \$ 0.16                     | \$ 0.11    | \$ 0.28                   | \$ 0.21    |
| Diluted earnings per share:   |                             |            |                           |            |
| as reported   | \$ 0.16                     | \$ 0.11    | \$ 0.28                   | \$ 0.21    |
| pro forma   | \$ 0.16                     | \$ 0.11    | \$ 0.28                   | \$ 0.21    |

4. Acquisition:

On May 7, 2004, the Company issued a press release reporting that its wholly-owned subsidiary, Micron Products, Inc., completed the purchase of substantially all of the operating assets of privately-held Shrewsbury Molders Inc. formally known as New England Molders, Inc. ( NEMI ) of Shrewsbury, Massachusetts. Micron paid NEMI a total purchase price of \$1,500,000, including \$1,100,000 in cash and \$400,000 in ART common stock or cash at ART's option. Micron funded the cash portion of the purchase out of working capital. At closing \$900,000 was paid, with the remaining required cash payment of \$200,000 due in 90 days subject to adjustments in current assets and selected assumed liabilities. At closing 7,559 shares were issued to cover the first \$100,000 stock payment. The price of the stock is the ten day average closing price prior to the payment date. The remaining \$300,000 payable in ART common stock or cash at our option is payable in 3 equal payments at 90 day intervals. The purchase price has been allocated to net assets acquired based on their estimated fair values. The preliminary valuation is subject to further review which may result in adjustments to allocation of the purchase price in the future. The Company has recorded approximately \$18,300 in amortization related to the acquired intangible assets from the date of the acquisition through June 30, 2004. New England Molders is a high quality custom injection molder with the majority of its customer base in the medical industry. It will be a division of the wholly owned subsidiary Micron Products, Inc.

The Company expects to complete the move of the division into its newly renovated white room molding facility located at its Fitchburg facility by the beginning of the fourth quarter of 2004. The relocation will provide operation synergies and cost savings in manufacturing and administration.

The preliminary allocation of the purchase price of NEMI, based on the purchase prices calculated for accounting purposes, is as follows:

|   |            |
|---|------------|
| Current assets                            | \$ 390,602 |
| Property, plant and equipment             | 821,219    |
| Identified intangible assets              | 257,050    |
| Goodwill                                  | 294,306    |
| Assumed liabilities and transaction costs | (216,821)  |

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\$ 1,546,356

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Identified intangible assets acquired in connection with the acquisition of NEMI consist primarily of acquired contracts, customer relationships and non-compete agreements with key employees. These intangible assets are amortized over their estimated useful lives of 1 to 8 years.

|   | <b>June 30, 2004</b> | <b>Weighted Average<br/>Useful Life</b> |
|---|----------------------|---|
| Gross carrying amount:                    |                      |   |
| Acquired orders                           | \$ 59,238            | 1 year                                  |
| Customer Relationships                    | 30,230               | (a)                                     |
| Key employee non-compete agreements       | 167,582              | 8 years                                 |
| <b>Total identified intangible assets</b> | <b>257,050</b>       |   |
| Accumulated amortization:                 |                      |   |
| Acquired orders                           | (15,143)             |   |
| Key employee non-compete agreements       | (3,142)              |   |
| <b>Total accumulated amortization</b>     | <b>(18,285)</b>      |   |
| <b>Identified intangible assets, net</b>  | <b>\$ 238,765</b>    |   |

(a) The identified intangible asset customer relationships represents the weighted average profit value of each customer relationship taking into account the rate of turnover. This intangible asset will be tested for possible impairment at least annually. The estimated annual amortization expense for 2004 will be \$80,000, with an estimated \$21,000 for each year following.

The unaudited pro forma and combined selected operating data are presented as if the acquisition of NEMI had occurred on January 1, 2003.

|  | <b>For the six months ended</b> |                |
|--|---------------------------------|----------------|
|  | June 30, 2003                   | June 30, 2004  |
| Revenue                                      | \$ 4,914,823                    | \$ 5,993,218   |
| Operating Income                             | \$ 890,113                      | \$ 1,293,097   |
| Net Income                                   | \$ 639,913                      | \$ 826,655     |
| <b>Earning per share - basic and diluted</b> | <b>\$ 0.24</b>                  | <b>\$ 0.31</b> |

## 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: 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, changing economic conditions in developing countries, 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-KSB for the year ended December 31, 2003.

### Results of Operations

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**Revenue** for the three months ended June 30, 2004 was \$3,113,875 versus \$1,939,635 for the quarter ended June 30, 2003, an increase of 61%. The acquisition completed on May 7, 2004 contributed revenues of \$377,661 in the partial period ended June 30, 2004. The remaining increase in revenue of \$796,579 in the quarter ending June 30, 2004 is due to continued growth in the sensor product line, and increases in sales of other unique electrode applications to our existing customer base. There were no significant sales of the Company's signal-averaging ECG products in the second quarter 2004.

Revenue from domestic and foreign sales for the first six months is as follows:

|               | <u>Six Months Ending June 30,</u> |            |                     |            |
|---------------|-----------------------------------|------------|---------------------|------------|
|               | 2004                              | %          | 2003                | %          |
| Europe        | \$ 2,036,199                      | 39         | \$ 1,438,395        | 38         |
| Canada        | 1,765,600                         | 34         | 1,682,618           | 44         |
| United States | 1,294,007                         | 25         | 564,112             | 15         |
| Pacific Rim   | 116,940                           | 2          | 113,626             | 3          |
| Other         | 53,246                            | -          | 16,452              | -          |
| <b>Total</b>  | <b>\$ 5,265,992</b>               | <b>100</b> | <b>\$ 3,815,203</b> | <b>100</b> |

The shift in distribution of sales to the domestic market is a result of the new division's higher percentage of domestic sales.

**Cost of sales** was 61% of revenue for the three months ended June 30, 2004 compared to 62% of revenue for the same period in 2003 and 62% for the six months ended June 30, 2004 and 2003. The process improvements made during the past year continue to contribute to the stability of the cost to manufacture product. These programs instituted over the last 18 months continue to improve and maintain margins, and result in the more efficient use of energy, materials and chemicals. The expansion of programs into the new division and its relocation into an adjoining facility expected to occur in the fourth quarter of 2004 presents an opportunity for further cost control. These improvements have had significant positive impact on the total cost of goods sold, and management continues to investigate new methods to increase the overall gross margin without sacrificing product quality.

**Selling and marketing expense** was \$77,411 for the three months ended June 30, 2004 as compared to \$49,447 for the same period in 2003. The increase of \$27,964 is directly attributable to addition sales staff in the new division. The selling and marketing expense was 2.5% of sales in three months ended June 30, 2004 as well as 2003.

**General and administrative expense** was \$396,534 for the three months ended June 30, 2004 as compared to \$297,572 for the same period in 2003. The increase of \$98,962 is the combination of some administrative expense with the new division and approximately \$20,000 attributed to Sarbanes Oxley Act compliance. Management expects a decrease in general and administrative expenses with the consolidation of office operations following the relocation of the new division to the Fitchburg facilities.

**Research and development expense** was \$32,317 for the three months ended June 30, 2004 as compared to \$2,208 for the same period in 2003. The increase of \$30,109 in the second quarter of 2004 was related to research expenditures related to ART's principal product, Predictor® 7 as well as research related to specialized unique electrode sensor applications at Micron.

**Other income (expense)** was \$4,825 of income for the three months ended June 30, 2004 as compared to \$5,713 of income in the same period of 2003. The decrease is attributed to decrease in interest income associated with lower cash balances after the acquisition.

**Income taxes** as a percent of income before income taxes were 37% for the three and six months ended June 30, 2004 as compared to 28% for the three and six months ended June 30, 2003. The reduction of the deferred tax asset valuation allowance in the year ended December 31, 2003, and the increase in pretax earnings has increased the provision for income taxes. Management will continue to maximize any tax planning opportunities that could effectively reduce the Company's tax liability.

### Liquidity and Capital Resources

Working capital was \$3,336,802 on June 30, 2004 compared to \$4,122,793 at December 31, 2003, a decrease of \$785,991. The working capital requirements for the acquisition caused the decrease. Capital investment could decrease working capital further with any significant obligation resulting from another acquisition, significant expansion of production capacity, a medical study, or further software development.



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Net capital expenditures were \$545,312 for the first six months of 2004 as compared to \$202,559 for the same period in 2003. Capital expenditures in the first six months of 2004 include \$208,000 incurred in the renovation of 45,000 square feet of space expected to be partially occupied by the end of September 2004. The remaining capital expenditure included \$337,000 in new tools, production design technology, and machinery and equipment.

The Company's stock buyback program announced in June of 2003 resulted in the use of \$438,640 of operating cash flows to acquire 148,200 shares of common stock in the first nine months of 2003. There has been no stock buy back in the first six months of 2004.

The Company negotiated the terms of a demand line of credit with a different bank than that of the same period in 2003. The new bank has agreed to an unsecured \$1,000,000 credit line. This non-collateralized financial vehicle was in place in December of 2003. No funds have been drawn down on the line as of June 30, 2004.

The Company expects to meet cash demands with current operating cash flows for the foreseeable future. On May 7, 2004, the Company's wholly-owned subsidiary, Micron Products, Inc., completed the purchase of substantially all of the operating assets of privately-held Shrewsbury Molders Inc. formally known as New England Molders, Inc. ( NEMI ) of Shrewsbury, Massachusetts. Micron paid NEMI a total purchase price of \$1,500,000, including \$1,100,000 in cash including \$900,000 at closing and \$200,000 due within 90 days and \$400,000 in ART common stock or cash at ART's option. Micron funded the cash portion of the purchase out of working capital. The future cash payments required by the terms of this agreement are expected to be made from the operating cash flows of Micron Products and its new division.

### 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 or 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.

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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 under 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.

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

#### *Inventory and Inventory Reserves*

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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. 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 previously recorded a valuation allowance to reduce its deferred tax assets to the amount that is more likely than not to be realized. While the Company has considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, the Company determined in 2003 that it would be able to realize its deferred tax assets in the future faster than expected, an adjustment to the deferred tax asset was made and an increase to income in the period. At this time the Company does not have a valuation allowance on its deferred tax assets.

### *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 acquired. To test for impairment, a present value of an estimate of future cash flows related to the intangible asset are calculated compared to the value of the intangible asset. Impairment may have a material adverse effect on the Company's financial condition or results of operations. There was no impairment at June 30, 2004.

### *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 on a projected discounted cash flow method using a discount rate determined by our management to be commensurate with the risk inherent in our current business model.

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## **Item 3. Controls and Procedures**

As of the end of the period covered by this interim report on Form 10-QSB, the Company carried out, under the supervision of, and with the participation of the Company's Chief Executive Officer and Chief Financial Officer (the Certifying Officers), an evaluation of the effectiveness of its disclosure controls and procedures (as the term is defined under Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934 as amended (the Exchange Act)). Based on this evaluation, the Certifying Officers have concluded that the Company's disclosure controls and procedures were effective to ensure that material information required to be disclosed in the Company's filings under the Exchange Act with respect to the Company and its consolidated subsidiaries is recorded, processed, summarized and reported 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.

Further, there were no changes in the Company's internal control over financial reporting during the Company's second 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 2. Changes in Securities and Small Business Issuer Purchases of Equity Securities.**

(c) The Company, as previously reported, in connection with the acquisition of the operating assets of Shrewsbury Molders, Inc. issued on or about May 7, 2004, as partial consideration for the assets, an aggregate of 7,559 unregistered shares of its common stock, par value \$0.01 per share, with a value of \$100,000 from shares held in treasury. In connection with the issuance, the Company relied upon the exemption from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

**Item 4. Submission of Matters to a Vote of Security Holders.**

On May 14, 2004, the Company held its 2004 Annual Meeting of Stockholders. The following is a tabulation of the voting on the proposals presented at the Annual Meeting.

Proposal 1; The following nominee was elected as a Class III director, to serve for three years and until his successor has been duly elected and qualified:

|                | <u>Shares Voted For</u> | <u>Shares Withheld</u> | <u>Broker Non-Votes</u> |
|----------------|-------------------------|------------------------|-------------------------|
| Paul F. Walter | 2,411,191               | 5,576                  | 221,806                 |

The terms of office of James E. Rouse and Russell C. Chambers (Class I directors) and E.P. Marinos and Julius Tabin (Class II directors) continued after the Annual Meeting.

Proposal 2; The appointment of BDO Seidman, LLP as the Company's independent certified public accountants for the year ending December 31, 2004 was ratified.

|  | <u>Shares Voted For</u> | <u>Shares Withheld</u> | <u>Shares Abstaining</u> | <u>Broker Non-Votes</u> |
|--|-------------------------|------------------------|--------------------------|-------------------------|
|  | 2,409,131               | 4,686                  | 2,950                    | 221,806                 |

**Item 6. Exhibits and Reports on Form 8-K**

(a) Exhibits

Exhibit 31.1 Certification of the CEO pursuant to Rule 13a-14(a) or Rule 15(d)-14(a) on page X-1.

Exhibit 31.2 Certification of the CFO pursuant to Rule 13a-14(a) or Rule 15(d)-14(a) on page X-2.

Exhibit 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.

Exhibit 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.

(b) Reports filed in the second quarter on Form 8-K

1. On May 13, 2004 the Company filed a current report on Form 8-K reporting the issuance of a press release announcing its financial results for the 1<sup>st</sup> quarter ended March 31, 2004.

2. On May 21, 2004 the Company filed a current report on Form 8-K reporting the acquisition of the selected operating assets of Shrewsbury Molders Inc. formerly known as New England Molders, Inc. No financial statements were included in the report.

**SIGNATURES**

In accordance with 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.

By: /s/ James E. Rouse  
James E. Rouse  
President and Chief Executive Officer  
(Principal Executive Officer)

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

August 16, 2004