

ANGEION CORP/MN
Form 10QSB/A
January 29, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB/A

(Amended Quarterly Report)

Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the quarterly period ended July 31, 2006

OR

Transition report under Section 13 or 15(d) of the Exchange Act.

For the transition period from to .

Commission file number 001-13543

Angeion Corporation

(Exact name of small business issuer as specified in its charter)

Minnesota
(State or other jurisdiction of
incorporation or organization)

41-1579150
(I.R.S. Employer
Identification No.)

350 Oak Grove Parkway, Saint Paul, Minnesota 55127-8599

(Address of principal executive offices)

(651) 484-4874

(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 issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

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Yes No

Check whether the registrant filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act of 1934 after distribution of securities under a plan confirmed by a court.

Yes No

The Company had 3,630,677 shares of common stock, \$0.10 par value, outstanding as of September 8, 2006.

EXPLANATORY STATEMENT

This Form 10-QSB/A amends and restates the Company's Form 10-QSB for the quarter ended July 31, 2006, initially filed with the Securities and Exchange Commission (the SEC) on September 11, 2006 (the Original Filing), and is being filed to reflect the restatement of the financial statements and other financial information of the Company for the third fiscal 2006 quarter and nine months ended July 31, 2006.

In connection with the audit of the Company's consolidated financial statements as of and for the year ended October 31, 2006, the Company concluded that its consolidated financial statements for the first, second and third quarters of fiscal year 2006 should be restated as a result of a misapplication of an accounting principle regarding the accounting for income taxes in those financial statements. The restatement does not change income before taxes and will have no cash impact on the results of these three periods.

During the first, second and third quarters of fiscal 2006 the Company did not correctly apply Generally Accepted Accounting Principles (GAAP) relating to accounting for the utilization of pre-emergence bankruptcy net operating loss (NOL) carry forwards. The Company has determined that during the first three quarters of the fiscal year, it should have applied American Institute of Certified Public Accountants Statement of Position 90-7, *Financial Reporting by Entities in Reorganization Under the Bankruptcy Code* (SOP 90-7) to the utilization of its pre-emergence bankruptcy NOL carry forwards. Angeion was in Chapter 11 Bankruptcy Reorganization from June 2002 to October 2002.

Under SOP 90-7, the benefits realized from pre-emergence bankruptcy NOLs should not have been reflected on the Company's consolidated statements of operations as a reduction in the provision for taxes. Instead, the benefits should have been reflected in the consolidated financial statements first by reducing the specified intangible assets (including goodwill) resulting from the reorganization until exhausted and thereafter been reported as an increase to additional paid-in capital.

It is important to note that the application of this accounting principle changes only the financial reporting related to income taxes. The amount of income taxes payable is determined after utilizing the Company's pre-emergence bankruptcy NOLs and does not change cash flows.

Therefore, the Company has:

- Increased the provision for tax from continuing operations by \$261,000 and \$435,000 for the three and nine months ended July 31, 2006, respectively,
- Increased tax expense related to discontinued operations by \$97,000 for the nine months ended July 31, 2006, and
- Decreased goodwill by \$328,000, decreased intangible assets by \$393,000, increased other current liabilities and accrued expenses by \$17,000 and decreased deferred income tax liabilities by \$207,000 as of July 31, 2006.

See Note 11 to the Consolidated Financial Statements, Restatement of Quarterly Financial Statements, for further details.

In addition to the adjustments discussed above, this restatement includes adjustments for the reclassification of bonus expenses previously included in general and administrative expenses to other statement of operations expense captions to properly classify bonus expense to the salary of the employee who earned the bonus. We refer to these as Other Adjustments, which were immaterial, individually and in the aggregate, to the previously issued financial statements.

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For the convenience of the reader, this Form 10-QSB/A sets forth the Original Filing in its entirety. However, this Form 10-QSB/A only amends and restates certain information in Items 1, 2 and 3 of Part I of the Original Filing, in each case solely as a result of and to reflect the restatement, and no other information in the Original Filing is amended. The foregoing items have not been updated to reflect other events occurring after the Original Filing or to modify or update those disclosures affected by subsequent events. Among other things, forward looking statements made in the Original Filing have not been revised to reflect events, results or developments that occurred or facts that became known to the Company after the date of the Original Filing (other than the restatement), and these forward looking statements should be read in their historical context. In addition, pursuant to the rules of the SEC, Item 6 of Part II of the Original Filing has been amended to include certifications re-executed as of the date of this Form 10-QSB/A from the Company's Chief Executive Officer and Chief Financial Officer as required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002. The certifications of the Chief Executive Officer and Chief Financial Officer are attached to this Form 10-QSB/A as exhibits 31 and 32.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

ANGEION CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets

July 31, 2006 and October 31, 2005

(unaudited, in thousands except share and per share data)

| | Restated July 31, 2006 | October 31, 2005 |
|---|------------------------------|---------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 2,461 | \$ 1,072 |
| Cash restricted for discontinued operations | | 400 |
| Accounts receivable, net of allowance for doubtful accounts of \$177 and \$210, respectively | 6,037 | 4,100 |
| Inventories | 5,603 | 3,455 |
| Prepaid expenses and other current assets | 234 | 280 |
| Current assets of discontinued operations | | 700 |
| Total current assets | 14,335 | 10,007 |
| Property and equipment, net of accumulated depreciation of \$1,799 and \$1,598, respectively | 1,106 | 1,035 |
| Intangible assets, net | 4,496 | 5,498 |
| Goodwill | | 328 |
| Total Assets | \$ 19,937 | \$ 16,868 |
| Liabilities and Shareholders Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 1,844 | \$ 1,184 |
| Employee compensation | 1,724 | 1,166 |
| Advance payments from customers | 1,045 | |
| Deferred income | 958 | 871 |
| Warranty reserve | 275 | 175 |
| Other current liabilities and accrued expenses | 313 | 366 |
| Current liabilities of discontinued operations | | 517 |
| Total current liabilities | 6,159 | 4,279 |
| Long-term liabilities: | | |
| Long-term deferred income | 792 | 319 |
| Deferred income taxes | 132 | 337 |
| Total long-term liabilities | 924 | 656 |
| Total Liabilities | 7,083 | 4,935 |
| Shareholders equity: | | |
| Common stock, \$0.10 par value, authorized 25,000,000 shares, issued and outstanding, 3,630,677 shares in 2006 and 3,609,325 shares in 2005 | 363 | 361 |
| Additional paid-in capital | 17,812 | 17,589 |
| Deferred compensation | | (14) |
| Accumulated deficit | (5,321) | (6,003) |
| Total shareholders equity | 12,854 | 11,933 |
| Total Liabilities and Shareholders Equity | \$ 19,937 | \$ 16,868 |

See accompanying notes to consolidated financial statements.

ANGEION CORPORATION AND SUBSIDIARIES

Consolidated Statements of Operations

(unaudited, in thousands except per share amounts)

| | Three Months Ended July 31, Restated 2006 | | Nine Months Ended July 31, Restated 2006 | |
|--|--|------------|---|-------------|
| | 2005 | | 2005 | |
| Revenues | | | | |
| Equipment and supply sales | \$ 8,159 | \$ 5,363 | \$ 20,970 | \$ 15,015 |
| Service revenue | 638 | 695 | 1,972 | 2,105 |
| | 8,797 | 6,058 | 22,942 | 17,120 |
| Cost of goods sold | | | | |
| Cost of equipment and supplies | 4,393 | 2,968 | 11,258 | 8,482 |
| Cost of service revenue | 95 | 89 | 317 | 316 |
| | 4,488 | 3,057 | 11,575 | 8,798 |
| Gross margin | 4,309 | 3,001 | 11,367 | 8,322 |
| Operating expenses: | | | | |
| Selling and marketing | 2,013 | 1,744 | 5,818 | 5,309 |
| General and administrative | 809 | 659 | 2,328 | 1,937 |
| Research and development | 633 | 482 | 1,687 | 1,519 |
| Amortization of intangibles | 203 | 203 | 609 | 609 |
| | 3,658 | 3,088 | 10,442 | 9,374 |
| Operating income (loss) | 651 | (87) | 925 | (1,052) |
| Interest income | 22 | 10 | 50 | 26 |
| Income (loss) before taxes | 673 | (77) | 975 | (1,026) |
| Provision for taxes | 279 | | 464 | |
| Income (loss) from continuing operations | 394 | (77) | 511 | (1,026) |
| Gain (loss) from discontinued operations, net of income taxes | | (191) | 171 | (191) |
| Net income (loss) | \$ 394 | \$ (268) | \$ 682 | \$ (1,217) |
| Earnings (loss) per share - basic | | | | |
| Continuing operations | \$ 0.11 | \$ (0.02) | \$ 0.14 | \$ (0.29) |
| Discontinued operations | | (0.05) | 0.05 | (0.05) |
| Net income (loss) | \$ 0.11 | \$ (0.07) | \$ 0.19 | \$ (0.34) |
| Earnings (loss) per share - diluted | | | | |
| Continuing operations | \$ 0.10 | \$ (0.02) | \$ 0.14 | \$ (0.29) |
| Discontinued operations | | (0.05) | 0.04 | (0.05) |
| Net income (loss) | \$ 0.10 | \$ (0.07) | \$ 0.18 | \$ (0.34) |
| Weighted average common shares outstanding | | | | |
| Basic | 3,626 | 3,607 | 3,619 | 3,605 |
| Diluted | 3,789 | 3,607 | 3,755 | 3,605 |

See accompanying notes to consolidated financial statements.

ANGEION CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(unaudited, in thousands)

| | Nine Months Ended July 31, Restated | |
|--|---|-------------------|
| | 2006 | 2005 (Revised) |
| Cash Flows From Operating Activities: | | |
| Net income (loss) | \$ 682 | \$ (1,217) |
| (Gain) loss from discontinued operations | (171) | 191 |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 810 | 919 |
| Stock-based compensation | 187 | 25 |
| Tax benefit from stock options exercised | 1 | |
| Deferred income taxes | 516 | |
| Provision for doubtful accounts | (2) | (73) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (1,935) | 253 |
| Inventories | (2,148) | (502) |
| Prepaid expenses and other current assets | 46 | 113 |
| Accounts payable | 660 | (429) |
| Employee compensation | 558 | 316 |
| Advance payments from customers | 1,045 | |
| Deferred income | 560 | 79 |
| Warranty reserve | 100 | |
| Other current liabilities and accrued expenses | (53) | 73 |
| Net cash provided by (used in) continuing operations | 856 | (252) |
| Cash provided by (used in) operating activities of discontinued operations | 754 | (660) |
| Net cash provided by (used in) operating activities | 1,610 | (912) |
| Cash Flows From Investing Activities: | | |
| Purchase of property and equipment | (272) | (188) |
| Net cash used in investing activities | (272) | (188) |
| Cash Flows From Financing Activities: | | |
| Proceeds from issuance of common stock | 51 | 14 |
| Net cash provided by financing activities of continuing operations | 51 | 14 |
| Cash provided by (used in) financing activities of discontinued operations: | | |
| Promissory note payments | (400) | |
| Cash restricted for discontinued operations | 400 | (400) |
| Net cash provided by (used in) financing activities | 51 | (386) |
| Net increase (decrease) in cash and cash equivalents | 1,389 | (1,486) |
| Cash and cash equivalents at beginning of period | 1,072 | 2,390 |
| Cash and cash equivalents at end of period | \$ 2,461 | \$ 904 |

Supplemental disclosure of non-cash investing activities:

During the nine months ended July 31, 2006, the Company decreased goodwill \$328,000 and intangible assets \$393,000 with an offsetting decrease to the deferred tax valuation allowance of \$721,000 for the usage of pre-emergence bankruptcy net operating loss carry forwards.

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

July 31, 2006

(Unaudited)

1. Basis of Presentation

The accompanying consolidated balance sheet as of July 31, 2006 and the consolidated statements of operations for the three and nine months ended July 31, 2006 and the consolidated statement cash flows for the nine months ended July 31, 2006 have been restated. The nature of the restatement and the effect on the financial statement line items are discussed in Note 11 to the Consolidated Financial Statements, Restatement of Quarterly Financial Statements.

The consolidated balance sheet as of July 31, 2006, the consolidated statements of operations for the three and nine months ended July 31, 2006 and 2005, and the consolidated statements of cash flows for the nine months ended July 31, 2006 and 2005, and the related information presented in these notes have been prepared by management in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-QSB and Rule 10-01 of Regulation S-X, without audit. Accordingly, they do not include all of the information and notes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation of results have been included. The consolidated balance sheet at October 31, 2005 was derived from the audited consolidated financial statements as of that date. Operating results for the three and nine months ended July 31, 2006 are not necessarily indicative of the results that may be expected for the year ending October 31, 2006. For further information, refer to the consolidated financial statements and notes thereto included in Angeion Corporation's Annual Report on Form 10-KSB for the year ended October 31, 2005.

Comprehensive income is a measure of all non-owner changes in shareholders' equity and includes items such as net income (loss), certain foreign currency translation items, minimum pension liability adjustments and changes in the value of available-for-sale securities. For the three and nine months ended July 31, 2006 and 2005, comprehensive income (loss) for Angeion Corporation was equivalent to net income (loss) as reported.

Preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities made in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Estimates include accounts receivable, product warranty and inventory reserves, and depreciable lives of property, equipment and intangible assets.

2. Revenue Recognition

In accordance with the SEC's Staff Accounting Bulletin No. 104, *Revenue Recognition*, the Company recognizes revenue when persuasive evidence of an arrangement exists, transfer of title has occurred or services have been rendered, the selling price is fixed or determinable and collectibility is reasonably assured. The Company's products are sold for cash or on credit terms requiring payment based on the shipment date. Credit terms can vary between customers due to many factors, but are generally 30-60 days. Revenue, net of discounts, is recognized upon shipment or delivery to customers in accordance with written sales terms. Standard sales terms do not include customer acceptance conditions, future credits, rebates, price protection or general rights of return. The terms of sales to both domestic customers and international distributors are identical. In instances when a customer order specifies final

acceptance of the system, revenue is deferred until all customer acceptance criteria have been met. Estimated warranty obligations are recorded upon shipment.

Service contract revenue is based on a stated contractual rate and is deferred and recognized ratably over the service period, which is typically from one to four years. In accordance with paragraph 4, of the Emerging Issues Task Force abstract 00-21, *Revenue Arrangements with Multiple Deliverables*, the Company applies Financial Accounting Standards Board (FASB) Technical Bulletin No. 90-1 to service contract revenue. Revenue from installation and training services provided to domestic customers is deferred until the service has been performed. The total amount of deferred revenue was \$1,750,000 and \$1,190,000 at July 31, 2006 and October 31, 2005, respectively.

When a sale involves multiple deliverables, such as equipment, installation services and training, the amount of the consideration from an arrangement is allocated to each respective element based on the residual method and recognized as revenue when revenue recognition criteria for each element is met. Consideration allocated to delivered equipment is equal to the total arrangement consideration less the fair value of installation and training. The fair value of installation and training services is based on specific objective evidence, including third-party invoices.

Advance Payments from Customers. The Company typically does not receive advance payments from its customers in connection with the sale of its products. The Company occasionally enters into an arrangement under which a customer agrees to purchase a large quantity of product that is to be delivered over a period of time. Depending on the size of these arrangements, the Company may negotiate an advance payment from these customers. At July 31, 2006, advance payments from customers aggregated \$1,045,000, of which \$964,000 was from a single customer for product to be shipped and services to be delivered over the next several quarters. Revenue recognition for customer orders that include advance payments is consistent with the Company's revenue recognition policy described above.

3. New Accounting Pronouncements

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 clarifies the accounting and reporting for income taxes recognized in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken on income tax returns. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact of adopting FIN 48 on its consolidated financial statements.

The FASB issued SFAS No. 123 (Revised 2004), *Share-Based Payment*, (SFAS No. 123R) in December 2004. SFAS No. 123R is a revision of FASB Statement 123, *Accounting for Stock-Based Compensation* and supersedes Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, (APB No. 25) and its related implementation guidance. The Statement focuses primarily on accounting for transactions in which an entity obtains employee services through share-based payment transactions. SFAS No. 123R requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions). That cost will be recognized over the period during which an employee is required to provide service in exchange for the award. The Company will adopt the standard for fiscal 2007 using the modified prospective method. While the Company cannot precisely determine the impact on net earnings as a result of the adoption of SFAS No. 123R, estimated compensation expense related to prior periods can be found in *Stock Based Compensation* below. The ultimate amount of increased compensation expense will depend on a number of factors, including the number of option shares granted,

their timing and vesting period and the method used to calculate the fair value of the awards. We have yet to determine the impact of SFAS No. 123R on the Company's consolidated financial statements.

In June 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections*, (SFAS No. 154) a replacement of APB Opinion No. 20 and FASB Statement No. 3. The statement applies to all voluntary changes in accounting principle, and changes the requirements of accounting for and reporting a change in accounting principle. SFAS No. 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impractical. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Earlier application is permitted for accounting changes and corrections of errors occurring in fiscal years beginning after June 1, 2005. The statement does not change the transition provisions of any existing accounting pronouncements, including those that are in a transition phase as of the effective date of the statement. The Company has adopted SFAS No. 154. See Note 11 to the Consolidated Financial Statements, *Restatement of Quarterly Financial Statements*, for further details.

4. Stock Based Compensation

The Company applies the intrinsic-value method prescribed under APB No. 25 and related interpretations to account for the issuance of stock incentives to employees and directors. Accordingly, no compensation expense related to employees' and directors' stock incentives has been recognized in the consolidated financial statements. In accordance with the provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, the Company is required to present pro forma information reflecting compensation cost for such issuances. Had the Company determined compensation costs based on the fair value at the date of grant for options granted, the Company's net income (loss) would have been decreased or increased to the pro forma amounts indicated in the following table:

| (In thousands, except for per share amounts) | Three Months Ended July 31, Restated | | Nine Months Ended July 31, Restated | |
|---|--|------------|---|-------------|
| | 2006 | 2005 | 2006 | 2005 |
| Net income (loss) | | | | |
| As reported | \$ 394 | \$ (268) | \$ 682 | \$ (1,217) |
| Add: Stock-based employee compensation expense included in reported net income (loss), net of related tax effects | 32 | 25 | 118 | 25 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (258) | (21) | (286) | (63) |
| Pro forma | \$ 168 | \$ (264) | \$ 514 | \$ (1,255) |
| Net income (loss) per share - basic | | | | |
| As reported | \$ 0.11 | \$ (0.07) | \$ 0.19 | \$ (0.34) |
| Pro forma | \$ 0.05 | \$ (0.07) | \$ 0.14 | \$ (0.35) |
| Net income (loss) per share - diluted | | | | |
| As reported | \$ 0.10 | \$ (0.07) | \$ 0.18 | \$ (0.34) |
| Pro forma | \$ 0.04 | \$ (0.07) | \$ 0.14 | \$ (0.35) |

The above table reflects the acceleration of vesting for 46,800 options during the quarter ended July 31, 2006 due to the action taken by the Compensation Committee of the Board of Directors. As further described below, this increased pretax stock-based compensation expense under the intrinsic-value method during the three and nine months ended July 31, 2006 by \$50,000. In addition, this acceleration also increased pretax stock-based compensation expense under the fair value method for the three and nine months ended July 31, 2006 by \$38,000. The table also reflects the granting of 93,000 options to purchase the Company's common stock on May 25, 2006 to the Company's directors and officers. These new option grants were granted at an exercise price of \$5.08 per share, the closing price for the Company's stock on May 25, 2006, and were immediately vested. The fair value of these awards was determined to be \$370,000.

Variable Stock Option Grants

In September 2003 and July 2004, the Company granted employees' options with an exercise price of \$2.00 that vested at increasing rates as the Company's common stock traded for increasing prices for 20 of 30 consecutive days. There were 78,000 and 75,000 of these options outstanding at October 31, 2005 and July 31, 2006, respectively. Notwithstanding the performance vesting schedule, these options were exercisable in full beginning October 1, 2009. The options became exercisable earlier if the Company's stock traded at the following prices for 20 of 30 consecutive trading days.

| Closing Price | Percent of Options Exercisable | |
|---------------|--------------------------------------|---|
| \$ 4.00 | 15 | % |
| 4.50 | 40 | |
| 5.00 | 60 | |
| 5.50 | 80 | |
| 6.00 | 100 | |

Because the vesting for these grants is dependent on achieving these common stock price milestones, the Company has accounted for the unvested option grants using variable accounting in accordance with APB No. 25. Accordingly, the Company determined the intrinsic value of unvested variable option grants at each balance sheet date and recorded the changes in intrinsic value as deferred compensation.

During the second quarter of 2006, the Company's stock traded at or above \$4.50 per share for more than 20 of 30 consecutive trading days and therefore 31,200, or 40% of these options vested. On July 18, 2006, the Compensation Committee of the Board of Directors immediately vested the remaining 46,800 options. When the options were granted in 2003 and 2004, the Company had not yet achieved profitability after emerging from bankruptcy. As part of its overall strategy, the Company granted options with exercise prices of \$2.00, \$6.23 and \$7.79 per share, all above the \$1.40 and \$1.68 closing market prices for the Company's stock on the option grant dates. The \$2.00 options were granted with the closing price exercisability provisions to reward employees as the stock price achieved these higher levels, in order to align these employees' interests with those of shareholders. The Compensation Committee believes that this goal has been largely achieved. The Committee concluded that the significant additional stock-based compensation expense that the Company would incur in connection with the vesting of the additional options would adversely affect the Company's future earnings.

Upon vesting, the options are considered fixed plan awards with no further adjustment to the aggregate intrinsic value. In addition, all previously recorded deferred compensation expense is charged to earnings upon vesting. Stock based compensation expense associated with these variable options was \$50,000 and \$187,000 for the three and nine months ended July 31, 2006, respectively. These amounts include all of the intrinsic value of the options that vested during the second and third quarters of 2006.

The total additional non-cash expense that the Company incurred in the third quarter of 2006 in connection with the accelerated vesting was \$50,000.

5. Inventories

Inventories consisted of the following at July 31, 2006 and October 31, 2005:

| (In thousands) | 2006 | 2005 |
|------------------|----------|----------|
| Raw materials | \$ 2,043 | \$ 1,304 |
| Work-in-progress | 539 | 186 |
| Finished goods | 3,021 | 1,965 |
| | \$ 5,603 | \$ 3,455 |

6. Intangible Assets and Goodwill

Intangible assets consisted of the following at July 31, 2006 and October 31, 2005:

| (In thousands) | Restated 2006 | 2005 |
|-------------------------------------|------------------|----------|
| Intangible assets: | | |
| Developed technology | \$ 6,900 | \$ 6,900 |
| Trade name (unamortized) | 607 | 1,000 |
| | 7,507 | 7,900 |
| Amortization - developed technology | (3,011) | (2,402) |
| | \$ 4,496 | \$ 5,498 |

Amortization expense was \$609,000 for each of the nine-month periods ended July 31, 2006 and 2005.

Intangible assets are being amortized using the straight-line method over the estimated useful lives of the assets that range from three to ten years. If the Company utilizes pre-emergence bankruptcy net operating loss carryforwards (NOLs), the Company will sequentially reduce the cost of goodwill, trade name and developed technology until the net carrying cost of these assets is zero. To the extent that utilization of these NOLs reduces the cost of developed technology, future amortization expense will be reduced. Estimated amortization expense for the remainder of fiscal year 2006 and for each of the succeeding years based on the intangible assets as of July 31, 2006, which does not reflect the possible reduction discussed above, is as follows:

| (In thousands) | Amortization |
|--------------------------------------|--------------|
| Three months ending October 31, 2006 | \$ 203 |
| 2007 | 779 |
| 2008 | 779 |
| 2009 | 778 |
| 2010 | 450 |
| Thereafter | 900 |
| | \$ 3,889 |

Goodwill and Trade name consisted of the following at July 31, 2006 and October 31, 2005:

| (In thousands) | Goodwill | Trade Name |
|--|----------|------------|
| Balance at October 31, 2005 | \$ 328 | \$ 1,000 |
| Reduction in balance due to utilization of pre-emergence bankruptcy NOL (restated) | (328) | (393) |
| Balance at July 31, 2006 (restated) | \$ | \$ 607 |

7. Warranty Reserve

Sales of the Company's equipment are subject to a warranty obligation. Equipment warranties typically extend for a period of twelve months from the date of installation. Standard warranty terms are included in customer contracts. Under the terms of these warranties, the Company is obligated to repair or replace any components or assemblies that it deems defective in workmanship or materials. The Company reserves the right to reject warranty claims where it determines that failure is due to normal wear, customer modifications, improper maintenance or misuse. The Company maintains a warranty reserve that reflects the estimated expenses that it will incur to honor the warranties on its products. The Company adjusts the warranty reserve based on the number and type of equipment that is subject to warranty, adjusted for the remaining months of warranty coverage. The warranty reserve adjustment reflects the Company's historical warranty experience based on type of equipment. Warranty activity for the nine months ended July 31, 2006 and 2005 was as follows:

| (In thousands) | 2006 | 2005 |
|------------------------------|--------|--------|
| Balance, beginning of period | \$ 175 | \$ 155 |
| Warranty provisions | 352 | 210 |
| Warranty claims | (252) | (210) |
| Balance, end of period | \$ 275 | \$ 155 |

8. Net Income (Loss) per Share

Basic income (loss) per share is computed by dividing net income (loss) by the weighted average shares outstanding during the reporting period. Diluted income (loss) per share is computed similarly to basic income (loss) per share except that the weighted average shares outstanding are increased to include additional shares from the assumed exercise of stock options and warrants, if dilutive, using the treasury stock method. The number of additional shares is calculated by assuming that outstanding stock options or warrants were exercised and that the proceeds from the exercise were used to acquire shares of common stock at the average market price during the reporting period.

Shares used in the earnings (loss) per share computations for the three and nine months ended July 31, 2006 and 2005 are as follows:

| (In thousands) | | Three Months Ended | | Nine Months Ended | |
|--|---------|--------------------|-------|-------------------|-------|
| | | July 31, 2006 | 2005 | July 31, 2006 | 2005 |
| Weighted average common shares outstanding | basic | 3,626 | 3,607 | 3,619 | 3,605 |
| Dilutive effect of stock options | | 163 | | 136 | |
| Weighted average common shares outstanding | diluted | 3,789 | 3,607 | 3,755 | 3,605 |

The dilutive effect of stock options in the above table excludes all options for which the exercise price was higher than the average market price for the period. The number of option shares excluded from the calculation was 455,800 for the three and nine months ended July 31, 2006. As a result of the net loss, there were no dilutive common shares outstanding for the three and nine months ended July 31, 2005, and accordingly, 482,800 were excluded from the calculation.

The Company had warrants outstanding at July 31, 2006 and 2005 to purchase 179,480 and 179,481 shares, respectively, of its common stock that were considered antidilutive and therefore not considered to have been exercised.

9. Discontinued Operations and Related Litigation

On April 12, 2006, Angeion Corporation and Medmarc Casualty Insurance Company (Medmarc) agreed to a settlement that resolved all matters with respect to the pending lawsuit between the parties related to the recovery of insurance proceeds for a claim associated with the Company's former ICD business. Medmarc made the settlement payment to the Company on June 9, 2006 and each party agreed to dismiss with prejudice all claims against the other in the pending lawsuit.

As a result of the settlement with Medmarc, the Company recorded a \$171,000 gain, net of \$103,000 taxes, from discontinued operations for the nine months ended July 31, 2006. There were no adjustments made to discontinued operations during the third quarter of 2006. The Company expects that the only expense for discontinued operations in the future will be the purchase of product liability insurance for as long as the Company believes it necessary to cover ICDs that remain implanted in patients. The current policy for product liability insurance covering ICDs expires in July 2007.

The \$191,000 loss from discontinued operations for the three and nine months ended July 31, 2005 primarily consisted of legal expenses and the purchase of liability insurance coverage for claims associated with the Company's discontinued ICD products.

10. Income Taxes (Restated)

The Company has recorded a provision for taxes from continuing operations of \$279,000 and \$464,000 for the three and nine months ended July 31, 2006, respectively. The Company has also allocated \$103,000 of the provision for taxes to discontinued operations for the nine months ended July 31, 2006. The provision for taxes has been calculated and presented in the statement of operations as if the Company's earnings were fully taxable. The amount of income taxes payable is determined after utilizing the Company's pre-emergence bankruptcy NOLs. Under American Institute of Certified Public Accountants Statement of Position 90-7, *Financial Reporting by Entities in Reorganization Under the Bankruptcy Code* (SOP 90-7), the tax benefit for the utilization of these loss carry forwards must be recognized as a reduction of intangibles rather than a reduction of the provision for taxes in the statement of operations. See Note 11 to the Consolidated Financial Statements, Restatement of Quarterly Financial Statements, for further details.

The Company had a federal net operating loss carry forward at October 31, 2005 of approximately \$130.6 million, which is available to reduce income taxes payable in future years. If not used, this carry forward will expire in years 2006 through 2025. Approximately \$72.5 million of this carry forward will expire over the next five years. In addition, the Company has a general business tax credit carry forward of approximately \$989,000 that is available to reduce future federal income taxes, if any. If not used, these general business tax credits will expire in years 2006 through 2014. Approximately \$515,000 of the general business tax carry forward will expire over the next five years. The Company also has \$90,000 of alternative minimum tax credit carry forwards that do not have expiration dates. Under the Tax Reform Act of 1986, the utilization of these tax loss and tax credit carry forwards may be limited as a result of significant changes in ownership. Even though the Company has

substantial federal net operating loss carry forwards, any income is still subject to U.S. and State alternative minimum taxes and deferred taxes on non-amortizable intangible assets other than goodwill.

The Company has recorded a full valuation allowance against its net deferred tax asset, excluding the effect of deferred tax liability which is unable to be used as a source of income against these deferred tax assets, based on its belief that it is more likely than not that the asset will not be realized in the future. This determination was made in a prior fiscal year and is still applicable for the third quarter of 2006. The Company will continue to assess the need for a full valuation allowance in future quarters. The Company has recognized a deferred tax liability of \$132,000 as of July 31, 2006 related to an indefinite lived intangible that is being amortized for tax purposes. Under SOP 90-7, a substantial portion of any future reversal of the valuation allowance will first reduce any intangible assets and then be credited directly to additional paid-in capital. After the exhaustion of pre-emergence bankruptcy NOLs, approximately \$2.3 million of the valuation allowance is related to post-bankruptcy NOLs and would be available to reduce the provision for taxes in the statement of operations.

11. Restatement of Quarterly Financial Statements

In connection with the audit of the Company's consolidated financial statements as of and for the year ended October 31, 2006, the Company concluded that its consolidated financial statements for the first, second and third quarters of fiscal year 2006 should be restated as a result of a misapplication of an accounting principle regarding the accounting for income taxes in those financial statements. The restatement does not change income before taxes and will have no cash impact on the results of these three periods.

During the first, second and third quarters of fiscal 2006 the Company did not correctly apply Generally Accepted Accounting Principles (GAAP) relating to accounting for the utilization of pre-emergence bankruptcy net operating loss (NOL) carry forwards. The Company has determined that during the first three quarters of the fiscal year, it should have applied SOP 90-7 to the utilization of its pre-emergence bankruptcy NOL carry forwards. Angeion was in Chapter 11 Bankruptcy Reorganization from June 2002 to October 2002.

Under SOP 90-7, the benefits realized from pre-emergence bankruptcy NOLs should not have been reflected on the Company's consolidated statements of operations as a reduction in the provision for taxes. Instead, the benefits should have been reflected in the consolidated financial statements first by reducing the specified intangible assets (including goodwill) resulting from the reorganization until exhausted and thereafter been reported as an increase to additional paid-in capital.

The following adjustments have been recorded to the previously issued financial statements:

- (1) The Company has increased the provision for taxes from continuing operations by \$261,000 and \$435,000 for the three and nine months ended July 31, 2006, respectively, increased tax expense related to discontinued operations by \$97,000 for the nine months ended July 31, 2006, and decreased goodwill by \$328,000, decreased intangible assets by \$393,000, increased other current liabilities and accrued expenses by \$17,000 and decreased deferred income tax liabilities by \$207,000 as of July 31, 2006 to properly account for income taxes.
- (2) The Company has reclassified \$145,000 and \$341,000, for the three and nine months ended July 31, 2006, respectively, of bonus expenses previously included in general and administrative expenses to other statement of operations expense captions to properly classify bonus expense to the salary of the employee who earned the bonus.

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The Company has restated its balance sheet as of July 31, 2006, its statements of operations for the three and nine months ended July 31, 2006 and statement of cash flows for the nine months ended July 31, 2006 for the impact of the above items as follows (adjustment number corresponds with the adjustments noted above):

| (In thousands) | As of July 31, 2006 | | | As Restated |
|--|------------------------|--------------------|-----|-------------|
| | As Previously Reported | Adjustments Amount | No. | |
| <u>Balance Sheet Data:</u> | | | | |
| Intangible assets, net | \$ 4,889 | \$ (393) | 1 | \$ 4,496 |
| Goodwill | 328 | (328) | 1 | |
| Total Assets | 20,658 | (721) | | 19,937 |
| Other current liabilities and accrued expenses | 296 | 17 | 1 | 313 |
| Total current liabilities | 6,142 | 17 | | 6,159 |
| Deferred income taxes | 339 | (207) | 1 | 132 |
| Total long-term liabilities | 1,131 | (207) | | 924 |
| Total Liabilities | 7,273 | (190) | | 7,083 |
| Additional paid-in capital | 17,811 | 1 | 1 | 17,812 |
| Accumulated deficit | (4,789) | (532) | 1 | (5,321) |
| Total shareholders equity | 13,385 | (531) | | 12,854 |
| Total Liabilities and Shareholders Equity | \$ 20,658 | \$ (721) | | \$ 19,937 |

Three Months Ended July 31, 2006

| (In thousands) | As Previously Reported | Adjustments Amount | No. | As Restated |
|---|------------------------------|-----------------------|-----|----------------|
| <u>Statement of Operations Data:</u> | | | | |
| Revenues: | | | | |
| Equipment and supply sales | \$ 8,159 | \$ | | \$ 8,159 |
| Service revenue | 638 | | | 638 |
| | 8,797 | | | 8,797 |
| Cost of goods sold: | | | | |
| Cost of equipment and supply sales | 4,355 | 38 | 2 | 4,393 |
| Cost of service revenue | 95 | | | 95 |
| | 4,450 | 38 | | 4,488 |
| Gross margin | 4,347 | (38) | | 4,309 |
| Operating expenses: | | | | |
| Selling and marketing | 1,936 | 77 | 2 | 2,013 |
| General and administrative | 954 | (145) | 2 | 809 |
| Research and development | 603 | 30 | 2 | 633 |
| Amortization of intangibles | 203 | | | 203 |
| | 3,696 | (38) | | 3,658 |
| Operating income | 651 | | | 651 |
| Interest income | 22 | | | 22 |
| Income before taxes | 673 | | | 673 |
| Provision for taxes | 18 | 261 | 1 | 279 |
| Income from continuing operations | 655 | (261) | | 394 |
| Gain from discontinued operations, net of \$0 taxes | | | | |
| Net income | \$ 655 | \$ (261) | | \$ 394 |
| Earnings per share - basic | | | | |
| Continuing operations | \$ 0.18 | \$ (0.07) | | \$ 0.11 |
| Discontinued operations | | | | |
| Net Income | \$ 0.18 | \$ (0.07) | | \$ 0.11 |
| Earnings per share - diluted | | | | |
| Continuing operations | \$ 0.17 | \$ (0.07) | | \$ 0.10 |
| Discontinued operations | | | | |
| Net Income | \$ 0.17 | \$ (0.07) | | \$ 0.10 |

Nine Months Ended July 31, 2006

| (In thousands) | As Previously Reported | Adjustments Amount | No. | As Restated |
|----------------|------------------------------|-----------------------|-----|----------------|
|----------------|------------------------------|-----------------------|-----|----------------|

Statement of Operations Data:

Revenues:

| | | | | |
|----------------------------|-----------|----|--|-----------|
| Equipment and supply sales | \$ 20,970 | \$ | | \$ 20,970 |
| Service revenue | 1,972 | | | 1,972 |
| | 22,942 | | | 22,942 |

Cost of goods sold:

| | | | | |
|------------------------------------|--------|----|---|--------|
| Cost of equipment and supply sales | 11,165 | 93 | 2 | 11,258 |
| Cost of service revenue | 317 | | | 317 |

| | | | | |
|--------------|--------|-------|--|--------|
| | 11,482 | 93 | | 11,575 |
| Gross margin | 11,460 | (93) | | 11,367 |

Operating expenses:

| | | | | |
|-----------------------|-------|-----|---|-------|
| Selling and marketing | 5,633 | 185 | 2 | 5,818 |
|-----------------------|-------|-----|---|-------|

| | | | | |
|----------------------------|-------|--------|---|-------|
| General and administrative | 2,669 | (341) | 2 | 2,328 |
|----------------------------|-------|--------|---|-------|

| | | | | |
|--------------------------|-------|----|---|-------|
| Research and development | 1,624 | 63 | 2 | 1,687 |
|--------------------------|-------|----|---|-------|

| | | | | |
|-----------------------------|--------|-------|--|--------|
| Amortization of intangibles | 609 | | | 609 |
| | 10,535 | (93) | | 10,442 |

| | | | | |
|------------------|-----|--|--|-----|
| Operating income | 925 | | | 925 |
|------------------|-----|--|--|-----|

| | | | | |
|-----------------|----|--|--|----|
| Interest income | 50 | | | 50 |
|-----------------|----|--|--|----|

| | | | | |
|---------------------|-----|--|--|-----|
| Income before taxes | 975 | | | 975 |
|---------------------|-----|--|--|-----|

| | | | | |
|---------------------|----|-----|---|-----|
| Provision for taxes | 29 | 435 | 1 | 464 |
|---------------------|----|-----|---|-----|

| | | | | |
|-----------------------------------|-----|--------|--|-----|
| Income from continuing operations | 946 | (435) | | 511 |
|-----------------------------------|-----|--------|--|-----|

| | | | | |
|---|-----|-------|---|-----|
| Gain from discontinued operations, net of \$103 taxes | 268 | (97) | 1 | 171 |
|---|-----|-------|---|-----|

| | | | | |
|------------|----------|-----------|--|--------|
| Net income | \$ 1,214 | \$ (532) | | \$ 682 |
|------------|----------|-----------|--|--------|

Earnings per share basic

| | | | | |
|-----------------------|---------|------------|--|---------|
| Continuing operations | \$ 0.26 | \$ (0.12) | | \$ 0.14 |
|-----------------------|---------|------------|--|---------|

| | | | | |
|-------------------------|------|---------|--|------|
| Discontinued operations | 0.08 | (0.03) | | 0.05 |
|-------------------------|------|---------|--|------|

| | | | | |
|------------|---------|------------|--|---------|
| Net Income | \$ 0.34 | \$ (0.15) | | \$ 0.19 |
|------------|---------|------------|--|---------|

Earnings per share - diluted

| | | | | |
|-----------------------|---------|------------|--|---------|
| Continuing operations | \$ 0.25 | \$ (0.11) | | \$ 0.14 |
|-----------------------|---------|------------|--|---------|

| | | | | |
|-------------------------|------|---------|--|------|
| Discontinued operations | 0.07 | (0.03) | | 0.04 |
|-------------------------|------|---------|--|------|

| | | | | |
|------------|---------|------------|--|---------|
| Net Income | \$ 0.32 | \$ (0.14) | | \$ 0.18 |
|------------|---------|------------|--|---------|

Nine Months Ended July 31, 2006

As

Previously

Adjustments

No.

As

Restated

(In thousands)

Statement of Cash Flows Data:

Cash Flows From Operating Activities:

| | | | | |
|--|----------|-----------|---|----------|
| Net income | \$ 1,214 | \$ (532) | 1 | \$ 682 |
| Gain from discontinued operations | (268) | 97 | 1 | (171) |
| Tax benefit from stock options exercised | | 1 | 1 | 1 |
| Deferred income taxes | 2 | 514 | 1 | 516 |
| Other current liabilities and accrued expenses | (70) | 17 | 1 | (53) |
| Net cash provided by continuing operations | 759 | 97 | | 856 |
| Cash provided by operating activities of discontinued operations | 851 | (97) | 1 | 754 |
| Net cash provided by operating activities | \$ 1,610 | \$ | | \$ 1,610 |

Item 2. Management's Discussion and Analysis.

Forward-Looking Statements and Risk Factors

The discussion above contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements by their nature involve substantial risks and uncertainties. Our actual results may differ materially depending on a variety of factors including:

- Our ability to successfully operate our business including our ability to develop, improve, and update our cardiorespiratory diagnostic products,
- Our ability to effectively manufacture and ship products in required quantities to meet customer demands,
- Our ability to successfully defend the Company from product liability claims related to our cardiorespiratory diagnostic products and claims associated with our prior cardiac stimulation products,
- Our ability to protect our intellectual property,
- Our ability to develop and maintain an effective system of internal controls and procedures and disclosure controls and procedures, and
- Our dependence on third-party vendors.

Additional information with respect to the risks and uncertainties faced by the Company may be found in, and the following discussion is qualified in its entirety by, the other risk factors that are described from time to time in the Company's Securities and Exchange Commission reports, including but not limited to the Annual Report on Form 10-KSB for the year ended October 31, 2005, and subsequently filed reports.

Overview

The Company is a medical device manufacturer with reported product revenues of \$23.8 million for the year ended October 31, 2005. Domestic product sales and service revenues accounted for 83.5% of revenue for the year ended October 31, 2005 while international product sales accounted for the remaining 16.5%.

The Company, through its Medical Graphics Corporation subsidiary, designs and markets non-invasive cardiorespiratory diagnostic systems that are sold under the MedGraphics and New Leaf brand and trade names. These cardiorespiratory diagnostic systems have a wide range of applications in healthcare, wellness and health and fitness.

Healthcare professionals use these cardiorespiratory diagnostic systems products to diagnose shortness of breath and lung diseases such as asthma and emphysema, and manage related treatment. Through breath-by-breath analysis, some of the Company's cardiorespiratory diagnostic systems measure fitness or conditioning levels to help physicians diagnose heart diseases such as heart failure and coronary disease. Other health professionals use cardiorespiratory diagnostic systems to measure calorie consumption and to prescribe safe and effective exercise in rehabilitation, weight management, general fitness, and athletic performance. All of these applications are accomplished by measuring air flow and the concentrations of inhaled and exhaled gases such as oxygen and carbon dioxide while a person is at rest, or exercising on a bike or treadmill. Professionals use this same assessment of gases and air flow to determine nutritional requirements of critically ill patients in a hospital or to design a weight loss program for members in a health club wishing to assess the number of calories they should consume and burn daily.

Revenues consist of equipment and supply sales and service revenues. Equipment and supply sales reflect sales of non-invasive cardiorespiratory diagnostic equipment and aftermarket sales of peripherals and supplies. Service revenues reflect revenues from extended service contracts, non-warranty service visits and additional training.

Total revenue for the third quarter of 2006 was \$8.8 million, an increase of 45.2% from \$6.1 million in 2005. Operating expenses for the third quarter of 2006 were \$3.7 million, an increase of 18.5% from \$3.1 million in 2005. Income from continuing operations for the three months ended July 31, 2006 was \$394,000, or \$0.10 per diluted share, compared to a loss of \$77,000, or \$0.02 per diluted share, for the same period in 2005. Net income for the three months ended July 31, 2006 was \$394,000 or \$0.10 per diluted share, compared to a net loss of \$268,000, or \$0.07 per diluted share, for the same period in 2005, which included a \$191,000 loss from discontinued operations.

For the nine months ended July 31, 2006, total revenue increased 34.0% to \$22.9 million from \$17.1 million for the same period in 2005. Operating expenses for the nine months ended July 31, 2006 increased 11.4% to \$10.4 million from \$9.4 million for the same period in 2005. Income from continuing operations for the nine months ended July 31, 2006 was \$511,000, or \$0.14 per diluted share, compared to a loss of \$1.0 million, or \$0.29 per diluted share, for the same period in 2005. Net income for the nine months ended July 31, 2006 was \$682,000, or \$0.18 per diluted share, and included a \$171,000 gain from discontinued operations. Net loss for the nine months ended July 31, 2005 was \$1.2 million, or \$0.34 per diluted share, and included a \$191,000 loss from discontinued operations.

In its press release dated January 9, 2006, the Company included the following as some of its objectives and goals for fiscal 2006:

- A drive toward achieving and sustaining profitability;
- A fourth consecutive year of double-digit year-over-year revenue growth;
- The introduction of new cardiorespiratory diagnostic products;
- Continuation of the expansion of our domestic and international sites offering New Leaf brand active metabolic assessments; and
- Further expansion of the New Leaf brand products for weight management, exercise and athletic performance.

After nine months, the Company has made significant progress against these objectives and goals.

- The third quarter of 2006 marked the Company's fourth consecutive profitable quarter;
- The Company achieved double-digit year-over-year revenue growth for the ninth quarter in a row. With year-over-year revenue growth for the nine months ended July 31, 2006 of 34.0%, the Company's annual goal is clearly within reach. Third quarter 2006 revenue of \$8.8 million is another record revenue quarter;
- While important progress in the development of new cardiorespiratory diagnostic products has been made, the Company is now planning to introduce these new products in 2007;
- The Company has grown the number of new sites offering New Leaf brand active metabolic assessments and generated a record number of new consumers participating in the New Leaf Active Metabolic Training™ program; and
- The New Leaf branded *EnergySmart* online nutrition, meal planning and tracking system was launched in February 2006. This program is designed to help consumers from weight conscious adults and children to recreational and elite athletes properly fuel and train their metabolism.

Restatement of Financial Statements

In connection with the audit of the Company's consolidated financial statements as of and for the year ended October 31, 2006, the Company concluded that its consolidated financial statements for the first, second and third quarters of fiscal year 2006 should be restated as a result of a misapplication of an accounting principle regarding the accounting for income taxes in those financial statements. The restatement does not change income before taxes and will have no cash impact on the results of these three periods.

During the first, second and third quarters of fiscal 2006 the Company did not correctly apply Generally Accepted Accounting Principles (GAAP) relating to accounting for the utilization of pre-emergence bankruptcy net operating loss (NOL) carry forwards. The Company has determined that during the first three quarters of the fiscal year, it should have applied American Institute of Certified Public Accountants Statement of Position 90-7, *Financial Reporting by Entities in Reorganization Under the Bankruptcy Code* (SOP 90-7) to the utilization of its pre-emergence bankruptcy NOL carry forwards. Angeion was in Chapter 11 Bankruptcy Reorganization from June 2002 to October 2002.

Under SOP 90-7, the benefits realized from pre-emergence bankruptcy NOLs should not have been reflected on the Company's consolidated statements of operations as a reduction in the provision for taxes. Instead, the benefits should have been reflected in the consolidated financial statements first by reducing the specified intangible assets (including goodwill) resulting from the reorganization until exhausted and thereafter been reported as an increase to additional paid-in capital.

It is important to note that the application of this accounting principle changes only the financial reporting related to income taxes. The amount of income taxes payable is determined after utilizing the Company's pre-emergence bankruptcy NOLs and does not change cash flows.

Therefore, the Company has:

- Increased the provision for taxes by \$261,000 and \$435,000 for the three and nine months ended July 31, 2006, respectively,
- Increased tax expense related to discontinued operations by \$97,000 for the nine months ended July 31, 2006, and
- Decreased goodwill by \$328,000, decreased intangible assets by \$393,000, increased other current liabilities and accrued expenses by \$17,000 and decreased deferred income tax liabilities by \$207,000 as of July 31, 2006.

In addition to the adjustments discussed above, this restatement includes adjustments for the reclassification of bonus expenses previously included in general and administrative expenses to other statement of operations expense captions to properly classify bonus expense to the salary of the employee who earned the bonus. We refer to these as Other Adjustments, which were immaterial, individually and in the aggregate, to the previously issued financial statements.

See Note 11 to the Consolidated Financial Statements, *Restatement of Quarterly Financial Statements*, in this Form 10-QSB/A for additional discussion of the accounting for income taxes and the use of pre-emergence bankruptcy NOLs.

Revenue

The increase in total revenue of 45.2% for the third quarter of 2006 marked the Company's largest year-over-year quarterly increase. Domestic product revenue for the third quarter of 2006 has

increased by 27.0%. International product revenue increased 146.0% while service revenue decreased 8.2% as a result of the 12-month warranty included with new system sales.

For the nine months ended July 31, 2006, year-over-year total revenue increased by 34.0%. Domestic product revenue has increased by 28.4%. International product revenue increased 88.0% while service revenue decreased 6.3% due to the amount of new systems sold that include a 12-month warranty.

Sales of the Ultima PF cardiorespiratory diagnostic system are contributing significantly to both domestic and international revenue growth. Third quarter revenue grew as a result of new equipment and service sales to one of our clinical research customers. The Company sells its cardiorespiratory diagnostic systems and services to this customer for use in conducting safety and efficacy clinical trial studies both in the United States and internationally. This customer accounted for 37.7% and 18.4% of revenue for the three and nine months ended July 31, 2006, respectively. The Company expects revenue from this customer to continue in the next two quarters at levels that exceed 10% of revenues.

Although sales to the single customer had an important impact on the third quarter, it should be noted that 2006 year-to-date revenue without that customer exceeded revenue reported for the same period in 2005. When you subtract the revenue associated with this single customer, revenue for the nine months ended July 31, 2006 increased by \$1.6 million or 9.3% to \$18.7 million compared to \$17.1 million for the same period in 2005.

Service revenue decreased \$57,000 during the third quarter of 2006 compared to the same quarter in 2005. For the nine months ended July 31, 2006, service revenue decreased \$133,000 compared to the same period in 2005. These decreases are due to the number of new systems purchased that include 12-month warranties, which reduces our extended service contract revenue. The Company believes this is temporary and will change as newly installed equipment becomes eligible for extended service contracts or billable service calls.

Gross Margin

Gross margin percentage for the three month period ended July 31, 2006 of 49.0% of revenue was comparable to 49.5% for the same period in 2005. For the nine months ended July 31, 2006, gross margin percentage increased to 49.5% from 48.6% for the same period in 2005. The Company's gross margin percentage for the last two sequential quarters has been consistent and has also been comparable to gross margin percentages reported for the same periods in 2005. The Company anticipates similar gross margin performance in this year's fourth quarter and 2007's first quarter.

Selling and Marketing

Selling and marketing expenses for the three months ended July 31, 2006 increased by 15.4% to \$2.0 million compared to \$1.7 million for the same period in 2005. For the nine months ended July 31, 2006, selling and marketing expenses increased by 9.6% to \$5.8 million compared to \$5.3 million for the same period in 2005.

Third quarter 2006 selling and marketing expenses related to new sales and sales support personnel, travel and customer support expenses increased in the aggregate by \$116,000. In addition, the cost of equipment sales demonstrations to potential customers increased by \$39,000 to contribute to the overall increase in selling and marketing expenses for the quarter.

For the nine months ended July 31, 2006, selling and marketing expenses related to new sales and sales support personnel and travel increased by \$174,000. In addition, increased expenses for

commissions, equipment demonstrations and trade shows of \$65,000, \$59,000 and \$46,000, respectively, are components of the overall increase in selling and marketing expenses for the nine months ended July 31, 2006.

General and Administrative

General and administrative expenses for the three months ended July 31, 2006 increased by \$150,000 to \$809,000 compared to \$659,000 for the same period in 2005. For the nine months ended July 31, 2006, general and administrative expenses increased by \$391,000 to \$2.3 million compared to \$1.9 million for the same period in 2005.

General and administrative expenses included non-cash expenses of \$50,000 and \$187,000 for the three and nine months ended July 31, 2006, respectively, for stock-based compensation associated with variable options compared to \$25,000 for both comparable periods in 2005. The Company's Compensation Committee accelerated the vesting of all unvested variable options. Consequently, there will be no further expenses for these options. See Note 4 to the Consolidated Financial Statements, "Stock-Based Compensation," in this Form 10-QSB/A for additional discussion of variable options.

In addition, there was a \$71,000 difference in general and administrative expenses due to decreases of \$2,000 and \$73,000 in the accrual for doubtful accounts for the nine months ended July 31, 2006 and 2005, respectively. These decreases generally lower the allowance for doubtful accounts that is no longer necessary because of improved cash collections for past due customer accounts. Future changes to the provision for doubtful accounts are directly related to payment patterns and outstanding balances of a few customers together with variations in the total balance of outstanding receivables.

Professional fees decreased by \$49,000 and \$96,000 for the three and nine months ended July 31, 2006. Directors' compensation increased by \$15,000 and \$34,000 and consulting expenses increased by \$24,000 and \$58,000 for the same three and nine month periods, offsetting the decrease in professional fees.

General and administrative expenses also included \$15,000 in consulting expenses associated with Sarbanes-Oxley compliance for the third quarter of 2006 compared to \$21,000 for the same period in 2005. For the nine months ended July 31, general and administrative expenses included \$49,000 for Sarbanes-Oxley compliance in 2006 compared to \$74,000 for the same period in 2005.

Research and Development

Research and development expenses for the three months ended July 31, 2006 increased \$151,000 to \$633,000 from \$482,000 for the same period in 2005. For the nine months ended July 31, 2006, research and development expenses increased \$168,000 to \$1.7 million compared to \$1.5 million for the same period in 2005.

Research and development expenses for new personnel increased by \$74,000 and \$71,000 for the three and nine months ended July 31, 2006, respectively. These expenses account for the majority of the increase in research and development costs for the respective periods. The Company's current new product development initiatives include products targeted for asthma, allergy and primary care physicians, health & fitness club professionals as well as international markets. Initial product development phases have been completed and these new products are planned for release in 2007. In addition, the Company is also developing new designs and new components for use in existing cardiorespiratory diagnostic products.

Amortization of Intangibles

Amortization of developed technology was \$203,000 for each of the three month periods ended July 31, 2006 and 2005 and \$609,000 for each of the nine-month periods ended July 31, 2006 and 2005. As further described in Note 6 above, as the Company utilizes pre-emergence bankruptcy net operating loss carry forwards, the Company will sequentially reduce the cost of trade names and developed technology until the net carrying cost is zero. To the extent that utilization of these NOLs reduces the cost of developed technology, future amortization expense will be reduced.

Interest Income

Interest income for the three months ended July 31, 2006 increased to \$22,000 from \$10,000 for the same period in 2005. For the nine months ended July 31, 2006, interest income increased to \$50,000 as compared to \$26,000 for the same period in 2005. The increase in interest income is principally due to an increase in interest rates.

Provision for Taxes

The Company is required to present the provision for taxes for 2006 as if it were fully taxable in accordance with SOP 90-7. The Company has utilized its pre-emergence bankruptcy NOLs in the calculation of its income taxes payable but is required to pay only U.S. and State alternative minimum taxes (AMT) because it has substantial federal net operating loss carry forwards. The tax benefit for using pre-emergence bankruptcy NOLs has been recorded as a reduction of goodwill and intangible assets in the nine months ended July 31, 2006. See Note 11 to the Consolidated Financial Statements,

Restatement of Financial Statements, in this Form 10-QSB/A for additional discussion of the accounting for income taxes and the use of pre-emergence bankruptcy NOLs.

Discontinued Operations

The net gain from discontinued operations of \$171,000 for the nine months ended July 31, 2006 reflects the net difference after recording the agreed upon insurance recovery and the associated legal fees that were contingent upon the recovery together with other additional consulting fees and miscellaneous litigation expenses. The Company has allocated \$103,000 of the provision for taxes to discontinued operations for the nine-month period ended July 31, 2006. The \$191,000 loss from discontinued operations for the three and nine months ended July 31, 2005 primarily consisted of legal expenses and the purchase of liability insurance coverage for claims associated with the Company's discontinued ICD products. See Note 9 to the Consolidated Financial Statements, Discontinued Operations and Related Litigation, in this Form 10-QSB for additional discussion of the litigation settlement with Medmarc.

Liquidity and Capital Resources

The Company has financed its liquidity needs over the past several years through revenue generated by the operations of its wholly owned subsidiary, Medical Graphics Corporation, and through the use of cash balances.

The Company had cash and cash equivalents of \$2.5 million and working capital of \$8.2 million as of July 31, 2006. During the nine months ended July 31, 2006, the Company generated \$856,000 in cash from continuing operations in part because its net income of \$682,000 included non-cash expenses of \$810,000 for depreciation and amortization, \$187,000 for stock-based compensation and \$516,000 of deferred income taxes.

Cash was generated by increases of \$1.0 million in advance payments from customers, \$660,000 in accounts payable, \$558,000 in employee compensation and \$560,000 in deferred income. Advance payments from customers are associated with orders for equipment received from a new customer. Cash was used for increases of \$2.1 million and \$1.9 million in inventories and accounts receivable, respectively. The increases in both inventories and accounts payable are necessary to support the new customer's orders for cardiorespiratory diagnostic equipment.

On June 9, 2006, the Company received the settlement payment from Medmarc for the insurance recovery related to expenses associated with previously discontinued ICD products. As a result, the Company generated \$754,000 in cash from operating activities of discontinued operations. The cash received from operating activities of discontinued operations was net of the legal fees, consulting and other expenses related to the ELA Medical settlement and Medmarc litigation.

During the nine months ended July 31, 2006, the Company used \$272,000 in cash for the purchase of property and equipment. The Company has no material commitments for capital expenditures for fiscal year 2006.

In connection with the June 30, 2005 \$1.4 million settlement agreement with ELA Medical, the Company executed a \$400,000 promissory note that required a payment of \$200,000 that was made on December 31, 2005 and another \$200,000 payment made on June 30, 2006. These payments are reflected in the Consolidated Statement of Cash Flows for the nine months ended July 31, 2006 as promissory note payments within Cash Flows from Financing Activities. The promissory note was backed up with an irrevocable bank letter of credit. The Company was required to collateralize the irrevocable bank letter of credit with cash that was classified as cash restricted for discontinued operations at October 31, 2005.

The Company believes that its liquidity and capital resource needs for the next 12 months will be met through its current cash and cash equivalents and cash flows from operations.

Item 3. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures

Management, with the participation of the Company's chief executive officer, Rodney A. Young, and chief financial officer, Dale H. Johnson, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures, as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934, as of July 31, 2006. In this evaluation, the Company originally concluded that its disclosure controls and procedures were effective as of July 31, 2006, as disclosed in the Company's Form 10-QSB filed on September 11, 2006.

In connection with the restatement, management, under the direction of its chief executive officer and chief financial officer, reevaluated the disclosure controls and procedures and due to the identification of a material weakness in internal control over financial reporting related to the Company's accounting for income taxes, as described below, concluded that the Company's disclosure controls and procedures were not effective as of July 31, 2006.

The material weakness in internal control over financial reporting related to the Company's accounting for income taxes. Specifically, the Company did not have, and through its engagement of third party outside advisers did not acquire, adequate technical expertise to effectively oversee and review the Company's accounting for the utilization of pre-emergence bankruptcy NOL carry forwards in accordance with AICPA Statement of Position 90-7, *Financial Reporting by Entities in Reorganization*

under the Bankruptcy Code. As a result, the Company restated the financial information included in the first three quarters of the year ended October 31, 2006, including the three and nine months ended July 31, 2006, as included herein, to correct a material error in accounting for income taxes.

Due to this material weakness in internal control over financial reporting, the Company performed other procedures related to the presentation of income taxes and the use of pre-emergence bankruptcy NOL carry forwards in preparing its restated consolidated financial statements as of and for the three and nine months ended July 31, 2006 to ensure that these consolidated financial statements were presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles.

(b) Changes in Internal Control over Financial Reporting

There was no change in the Company's internal control over financial reporting during the quarter ended July 31, 2006 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

As of the date of the filing of this Quarterly Report on Form 10-QSB/A for the third fiscal quarter of 2006, the material weakness described above has not been remediated. The Company is taking steps to ensure that it remediates the material weakness by implementing enhanced control procedures over accounting for income taxes. These steps include education and training of Company management and staff to improve technical expertise with respect to income tax accounting. The Company is also evaluating whether to replace or augment its current third party tax consulting resources to assist with the Company's evaluation of complex issues concerning tax accounting to assist management in developing its judgments with respect to these issues.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

The Company is subject to certain claims and lawsuits that have been filed in the ordinary course of business. From time to time, the Company brings suit against others to enforce patent rights or to collect debts in the ordinary course of business. Management believes that the settlement of all litigation would not have a material effect on the results of operations or liquidity of the Company.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Recent Sales of Unregistered Securities

The Company had no unregistered sales of equity securities during the three months ended July 31, 2006.

Small Business Issuer Purchases of Equity Securities

The Company did not purchase any equity securities during the three months ended July 31, 2006.

Item 3. Defaults Upon Senior Securities.

None

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

On May 25, 2006, the Company held its Annual Meeting of Shareholders. At the meeting, the following action was taken:

Election of Directors

The following persons were elected to the Company's Board of Directors, receiving the votes set forth opposite their names:

| Name | Votes For | Votes Withheld |
|----------------------|-----------|----------------|
| Arnold A. Angeloni | 3,450,686 | 16,930 |
| K. James Ehlen, M.D. | 3,462,873 | 4,743 |
| John C. Penn | 3,463,488 | 4,128 |
| Rodney A. Young | 3,463,481 | 4,135 |

Ratify the Appointment of KPMG LLP as independent registered public accounting firm for the Company for the fiscal year ending October 31, 2006

The shareholders ratified the appointment of KPMG LLP as the Company's independent registered public accounting firm for the fiscal year ending October 31, 2006. The proposal was ratified by the following vote:

| | |
|----------------|-----------|
| For | 3,464,788 |
| Against | 1,122 |
| Abstain | 1,706 |
| Broker Nonvote | 0 |

Item 5. Other Information.

None

Item 6. Exhibits.

(a) The following exhibits are included herein:

- 31 Certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rules 13a-14 and 15d-14 of the Exchange Act).
- 32 Certifications pursuant Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. §1350).

SIGNATURES

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

Angeion Corporation
(Registrant)

Date: January 29, 2007

/s/ Rodney A. Young
Rodney A. Young
President and Chief Executive Officer
(Principal Executive Officer)

Date: January 29, 2007

/s/ Dale H. Johnson
Dale H. Johnson
Chief Financial Officer
(Chief Accounting Officer)

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