VASOMEDICAL INC
Form 10-Q
October 15, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the quarterly period ended August 31, 2008

[ ] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the transition period from _____ to _____

Commission File Number: 0-18105

VASOMEDICAL, INC.

(Exact name of registrant as specified in its charter)

Delaware	11-2871434
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)

180 Linden Ave., Westbury, New York 11590

(Address of principal executive offices)

Registrant's Telephone Number (516) 997-4600

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

Large Accelerated Filer [ ] Accelerated Filer [ ] Non-Accelerated Filer [X]

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

Yes [ ] No [X]

Number of Shares Outstanding of Common Stock, $.001 Par Value, at October 15, 2008 93,868,004

Vasomedical, Inc. and Subsidiaries

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ITEM 1. FINANCIAL STATEMENTS

Vasomedical, Inc. and Subsidiaries

CONSOLIDATED CONDENSED BALANCE SHEETS

ASSETS	August 31, 2008 (Unaudited)
CURRENT ASSETS	
Cash and cash equivalents	$ 2,140,403
Accounts receivable, net of an allowance for doubtful accounts of $135,617 at August 31, 2008, and $270,183 at May 31, 2008	881,685

Inventories, net	1,826,445
Other current assets	135,310
Total current assets	4,983,843
PROPERTY AND EQUIPMENT, net of accumulated depreciation of $2,057,558 at August 31, 2008, and $2,178,566 at May 31, 2008	60,052
DEFERRED DISTRIBUTOR COSTS, net of accumulated amortization of $127,219 at August 31, 2008, and $101,775 at May 31, 2008	381,657
OTHER ASSETS	201,610
	$ 5,627,162

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES	
Accounts payable and accrued expenses	$ 1,151,831
Sales tax payable	138,023
Deferred revenue	1,151,556
Deferred gain on sale of building	53,245
Accrued professional fees	52,563
Total current liabilities	2,547,218
LONG-TERM LIABILITIES	
Deferred revenue	511,126
Accrued rent expense	11,542
Deferred gain on sale of building	155,299
Other long-term liabilities	80,000
COMMITMENTS AND CONTINGENCIES	
STOCKHOLDERS' EQUITY	
Preferred stock, $.01 par value; 1,000,000 shares authorized; none issued and outstanding	-
Common stock, $.001 par value; 110,000,000 shares authorized; 93,768,004 shares at August 31, 2008, and 93,768,004 at May 31, 2008, issued and outstanding	93,768
Additional paid-in capital	48,073,746
Accumulated deficit	(45,845,537
Total stockholders' equity	2,321,977
	$ 5,627,162

The accompanying notes are an integral part of these consolidated condensed financial statements

Vasomedical, Inc. and Subsidiaries

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(Unaudited)

	Three months ended A
	2008

Revenues		
Equipment sales	$ 656,496	$
Equipment rentals and services	655,225	
Total revenues	1,311,721	
Cost of Sales and Services		
Cost of sales, equipment	528,281	
Cost of equipment rentals and services	282,878	
Total cost of sales and services	811,159	
Gross profit	500,562	
Operating Expenses		
Selling, general and administrative	943,759	
Research and development	132,347	
Total operating expenses	1,076,106	
Loss from operations	(575,544)	
Other Income (Expenses)		
Interest and financing costs	-	
Interest and other income, net	16,012	
Recognition of deferred gain on sale of building	13,311	
Total other income (expenses)	29,323	
Loss before income taxes	(546,221)	
Income tax expense, net	(3,750)	
Net loss	$ (549,971)	$
Net loss per common share		
- basic	$ (0.01)	$
- diluted	$ (0.01)	$
Weighted average common shares outstanding		
- basic	93,768,004	
- diluted	93,768,004	

The accompanying notes are an integral part of these consolidated condensed financial statements

Vasomedical, Inc. and Subsidiaries

CONSOLIDATED CONDENSED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(Unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	
Balance at June 1, 2008	93,768,004	$ 93,768	$ 48,068,432	
Stock-based compensation			5,314	
Net loss				
Balance at August 31, 2008	93,768,004	$ 93,768	$ 48,073,746	

The accompanying notes are an integral part of these consolidated condensed financial statements

Vasomedical, Inc. and Subsidiaries

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Mont
	2008
Cash flows provided by (used in) operating activities	
Net loss	$ (549,971
Adjustments to reconcile net loss to net cash provided by (used in) operating activities	
Depreciation and amortization	29,497
Amortization of deferred gain on sale of building	(13,311
Provision for doubtful accounts	-
Amortization of deferred distributor costs	25,444
Expenses paid for distributor agreement	-
Stock based compensation	5,314
Changes in operating assets and liabilities:	
Accounts receivable	(163,836
Inventories	(193,041
Other current assets	(76,377
Accounts payable, accrued expenses and other current liabilities	318,546
Other liabilities	105,518
	37,754
Net cash provided by operating activities	(512,217
Cash flows provided by (used in) investing activities	
Proceeds from the building sale	-
Expenses paid for sale of building	-
Purchases of fixed assets	(1,379
Net cash provided by (used in) investing activities	(1,379

Cash flows provided by (used in) financing activities	
Payments on long term debt and notes payable	-
Proceeds from Securities Purchase agreement	-
Expenses paid in relation to Securities Purchase Agreement	-
Net cash provided by financing activities	-
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(513,596
Cash and cash equivalents - beginning of period	2,653,999
Cash and cash equivalents - end of period	$ 2,140,403

Non-cash investing and financing activities were as follows:	
Inventories transferred to property and equipment, attributable to operating leases, net	$ 19,274
Common stock issued for distribution agreement	$ -
Supplemental Disclosures	
Interest paid	$ -
Income taxes paid	$ 665

The accompanying notes are an integral part of these consolidated condensed financial statements

Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (unaudited)
August 31, 2008

NOTE A - ORGANIZATION AND PLAN OF OPERATIONS

Vasomedical, Inc. was incorporated in Delaware in July 1987. Unless the context requires otherwise, all references to "we", "our", "us", "Company", "registrant", "Vasomedical" or "management" refer to Vasomedical Inc. and its subsidiaries. Since 1995, we have been primarily engaged in designing, manufacturing, marketing and supporting EECP(R) enhanced external counterpulsation systems based on our unique proprietary technology currently indicated for use in cases of stable or unstable angina (i.e., chest pain), congestive heart failure (CHF), acute myocardial infarction (i.e., heart attack, (MI)) and cardiogenic shock. The EECP(R) therapy system is a non-invasive, outpatient therapy for the treatment of diseases of the cardiovascular system. The therapy serves to increase circulation in areas of the heart with less than adequate blood supply and helps to restore systemic vascular function. The therapy also increases blood flow and oxygen supply to the heart muscle and other organs and decreases the heart's workload and need for oxygen, while also improving function of the endothelium, the lining of blood vessels throughout the body, lessening resistance to blood flow. We provide hospitals, clinics and physician private practices with EECP(R) equipment, treatment guidance, and a staff training and equipment maintenance program designed to provide optimal patient outcomes. EECP(R) is a registered trademark for our enhanced external counterpulsation therapy and systems. For more information, visit www.vasomedical.com.

We have Food and Drug Administration (FDA) clearance to market our EECP(R) therapy for use in the treatment of stable and unstable angina, congestive heart

failure, acute myocardial infarction, and cardiogenic shock, however, our current marketing efforts are limited to the treatment of chronic stable angina and congestive heart failure. Medicare and other third-party payers currently reimburse for the treatment of angina pectoris patients with moderate to severe symptoms who are refractory to medications and not candidates for invasive procedures, including patients with serious co-morbidities, such as heart failure, diabetes, and peripheral vascular disease. Patients with primary diagnoses of heart failure, diabetes, and peripheral vascular disease are also reimbursed under the same criteria, provided the primary indication for treatment with EECP(R) therapy is angina symptoms.

During the last several years we incurred operating losses. We have attempted to achieve profitability by reducing operating costs and halting the trend of declining revenue, and to reduce cash usage through bringing our cost structure more into alignment with current revenues. By engaging in restructurings during March 2007 and April 2007, the Company has substantially reduced personnel and spending on sales, marketing and development projects. In addition, during the first quarter of fiscal year 2008, we raised additional capital through a private equity financing and by the sale of our facility under a leaseback agreement.

- On June 21, 2007, we entered into a Securities Purchase Agreement with Kerns Manufacturing Corp. (Kerns). Concurrently with our entry into the Securities Purchase Agreement, we also entered into a Distribution Agreement and a Supplier Agreement with Living Data Technology Corporation (Living Data), an affiliate of Kerns.

  We sold to Kerns, pursuant to the Securities Purchase Agreement, 21,428,572 shares of our common stock at $.07 per share for an aggregate of $1,500,000, as well as a five-year warrant to purchase 4,285,714 shares of our common stock at an initial exercise price of $.08 per share (the Warrant). The agreement further provided for the appointment to our Board of Directors of two representatives of Kerns. In furtherance thereof, Jun Ma and Simon Srybnik, Chairman of both Kerns and Living Data, have been appointed members of our Board of Directors. Pursuant to the Distribution Agreement, we have become the exclusive distributor in the United States of the AngioNew ECP systems manufactured by Living Data. As additional consideration for such agreement, we agreed to issue an additional 6,990,840 shares of our common stock to Living Data. Pursuant to the Supplier Agreement, Living Data now is the exclusive supplier to us of the ECP therapy systems that we market under the registered trademark EECP(R). The Distribution Agreement and the Supplier Agreement each have an initial term extending through May 31, 2012.

  Pursuant to a Registration Rights Agreement, we granted to Kerns and Living Data, subject to certain restrictions, "piggyback registration rights" covering the shares sold to Kerns as well as the shares issuable upon exercise of the Warrant and the shares issued to Living Data.

- On August 15, 2007, we sold our facility under a five-year leaseback agreement for $1.4 million. The net proceeds from the sale were

approximately $425,000, after payment in full of the two secured notes on our facility, brokers fees, closing costs, and the opening of a certificate of deposit in accordance with the provisions of the new lease.

NOTE B - STOCK-BASED COMPENSATION

As of June 1, 2006, the Company adopted Statement of Financial Standards No. 123 (revised 2004), Share-Based Payment ("SFAS No. 123 (R)"), which is a revision of SFAS No. 123. SFAS No. 123 (R) supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and amends FASB Statement No. 95, Statement of Cash Flows.

Generally, the approach to accounting for share-based payments in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. Pro forma disclosure of the fair value of share-based payments is no longer an alternative to financial statement recognition.

During the three-month period ended August 31, 2008, the Board of Directors did not grant any non-qualified stock options.

During the three-month period ended August 31, 2008, the Company's Board of Directors granted 150,000 shares of common stock to one employee of the Company having a fair market value of $0.08 per share at the time of the respective grant, but was not issued until the second quarter of fiscal 2009.

Stock-based compensation expense recognized under SFAS 123(R) was $5,314 and $61,786 for the three months ended August 31, 2008 and 2007, respectively. For purposes of estimating the fair value of each option on the date of grant, the Company utilized the Black-Scholes option-pricing model. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

Equity instruments issued to non-employees in exchange for goods, fees and services are accounted for under the fair value-based method of SFAS No. 123(R).

The fair value of the Company's stock-based awards was estimated assuming the following weighted-average assumptions:

Expected life (years)	5
Expected volatility	93%
Risk-free interest rate	5%
Expected dividend yield	0%

NOTE C -LOSS PER COMMON SHARE

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

	Three months ended August	
	2008	20
Numerator:		
Net loss	$ (549,971)	$ (1
Denominator:		
Basic - weighted average common shares	93,768,004	87,74
Stock options		
Warrants		
Diluted - weighted average common shares	93,768,004	87,74
Loss per share - basic	$ (0.01)	$
- diluted	$ (0.01)	$

Options and warrants, in accordance with the following table, were excluded from the computation of diluted loss per share for the three months ended August 31, 2008 and 2007, because the effect of their inclusion would be antidilutive.

	Three months ended August 31,	
	2008	2007
Options	5,460,210	5,996,710
Warrants	6,540,252	6,540,252
	12,000,462	12,536,962

Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (unaudited)
August 31, 2008

NOTE D - INVENTORIES, NET

Inventories, net of reserves consist of the following:

	August 31, 2008	May 31, 2008
Raw materials	$ 947,759	$ 936,035
Work in process	491,602	603,925
Finished goods	387,084	112,718

	$ 1,826,445	$ 1,652,678

At August 31, 2008 and May 31, 2008, the Company had reserves for excess and obsolete inventory of $581,725 and $594,042, respectively.

NOTE E - PROPERTY AND EQUIPMENT

Property and equipment is summarized as follows:

	August 31, 2008	May 31, 2008
Office, laboratory and other equipment	$ 1,230,771	$ 1,368,170
EECP(R) systems under operating leases or under loan for clinical trials	738,674	719,401
Furniture and fixtures	148,165	148,165
	2,117,610	2,235,736
Less: accumulated depreciation	2,057,558	2,178,566
Property and equipment - net	$ 60,052	$ 57,170

Depreciation expense amounted to $17,772 and $58,734 for the three-month periods ended August 31, 2008 and 2007, respectively.

NOTE F - DEFERRED REVENUE

The changes in the Company's deferred revenues are as follows:

	Three Months Ended August 31,	
	2008	2007
Deferred revenue at the beginning of the period	$ 1,618,053	$ 1,7
Additions:		
Deferred extended service contracts	446,834	4
Deferred in-service and training	17,500	
Deferred service arrangements	600	
Deferred service arrangement obligations	52,500	
Recognized as revenue:		
Deferred extended service contracts	(410,126)	(5
Deferred in-service and training	(12,500)	
Deferred service arrangements	(600)	
Deferred service arrangement obligations	(49,579)	(
Deferred revenue at end of period	1,662,682	1,6
Less: current portion	1,151,556	1,2
Long-term deferred revenue at end of period	$ 511,126	$ 3

NOTE G - SALE-LEASEBACK

In August 2007, the Company sold its warehouse and corporate facility for $1,400,000. Under the agreement, the Company is leasing back the property from the purchaser over a period of five years. The Company is accounting for the leaseback as an operating lease. The gain of $266,226 realized in this transaction has been deferred and is being amortized to income ratably over the term of the lease. At August 31, 2008, the unamortized deferred gain of $208,544 is shown as "Deferred gain on sale of building" in the Company's consolidated condensed balance sheet. The short-term portion of $53,245 is shown in current liabilities and the long-term portion of $155,299 is in long-term liabilities. The amount recognized as a gain in the first quarter of fiscal 2008 was $13,311.

NOTE H - WARRANTY LIABILITY

The changes in the Company's product warranty liability are as follows:

	August 31, 2008	August 31,
Warranty liability at the beginning of the period	$ 17,250	$ 15,7
Expense for new warranties issued	18,000	9,0
Warranty claims	(11,750)	(9,5
Warranty liability at the end of the year	23,500	15,2
Long-term warranty liability at the end of the year	$ -	$

NOTE I - RELATED-PARTY TRANSACTIONS

On June 21, 2007, we entered into a Securities Purchase Agreement with Kerns. Concurrently with our entry into the Securities Purchase Agreement, we also entered into a Distribution Agreement and a Supplier Agreement with Living Data, an affiliate of Kerns.

We sold to Kerns, pursuant to the Securities Purchase Agreement, 21,428,572 shares of our common stock at $.07 per share for an aggregate of $1,500,000, as well a five-year warrant to purchase 4,285,714 shares of our common stock at an initial exercise price of $.08 per share (the "Warrant"). The agreement further provided for the appointment to our Board of Directors of two representatives of Kerns. In furtherance thereof, Jun Ma and Simon Srybnik, Chairman of both Kerns and Living Data, have been appointed members of our Board of Directors. Pursuant to the Distribution Agreement, we have become the exclusive distributor in the United States of the AngioNew ECP systems manufactured by Living Data. As additional consideration for such agreement, we agreed to issue an additional 6,990,840 shares of our common stock to Living Data. Pursuant to the Supplier Agreement, Living Data now is the exclusive supplier to us of the ECP therapy systems that we market under the registered trademark EECP(R). The Distribution Agreement and the Supplier Agreement each have an initial term extending through May 31, 2012.

Pursuant to a Registration Rights Agreement, we granted to Kerns and Living

Data, subject to certain restrictions, "piggyback registration rights" covering the shares sold to Kerns as well as the shares issuable upon exercise of the Warrant and the shares issued to Living Data.

On July 10, 2007, the Board of Directors appointed Behnam Movaseghi, Treasurer and Chief Financial Officer of Kerns Manufacturing Corporation, to our Board of Directors.

As affiliates of Living Data and Kerns, Mr. Ma, Mr. Movaseghi and Mr. Srybnik have each been directly involved in the transactions between Living Data or Kerns, on the one hand, and the Company, on the other hand, with respect to the Securities Purchase Agreement, the Distribution Agreement and the Supplier Agreement, as well as providing consulting services to the Company without compensation.

During the three-month period ended August 31, 2008, the Company purchased ECP therapy systems under the Supplier Agreement for $75,000 from Living Data. In addition, Living Data purchased $3,162 worth of ECP therapy system components from the Company.

During the three-month period ended August 31, 2008, Living Data assigned to the Company all of its rights and interests under its Distributorship Agreement with a corporation organized and existing under the laws of the People's Republic of China that manufactures Ambulatory Blood Pressure Monitors, Ambulatory ECG Recorders and Holter & ABPM Combiner Recorders, for $20,000 payable to Living Data based on certain terms and conditions. The Company has also agreed to pay to Living Data 5% of the selling price or 5% of the cost of all goods sold (whichever is higher), and 5% of the cost of all goods transferred but not sold under the Assignment Agreement to Living Data based on sales of this equipment. The Company intends to sell these systems in the United States and other countries subject to obtaining regulatory clearance.

During the three-month period ended August 31, 2008, Living Data assigned to the Company all of its rights and interests under its Distributorship Agreement with a corporation organized and existing under the laws of the People's Republic of China that manufactures Ultrasound Scanners, for $20,000 payable to Living Data based on certain terms and conditions. The Company has also agreed to pay to Living Data 5% of the selling price or 5% of the cost of all goods sold (whichever is higher), and 5% of the cost of all goods transferred but not sold under the Assignment Agreement to Living Data based on sales of this equipment. The Company intends to sell these systems in the United States and other countries subject to obtaining regulatory clearance.

In July of 2008, the Company agreed to purchase ECP therapy systems under its Distributorship Agreement with Living Data for $360,000 payable over 18 months. The current portion of the outstanding liability as of August 31, 2008 in the amount of $240,000 is reflected in accounts payable and accrued expenses and the remaining balance of $80,000 is reflected in long-term liabilities on the accompanying balance sheet.

Further, Kerns provides the Company, free of charge, part-time use of one of its Information Technology (IT) employees as well one of their IT consultants to provide the Company with IT and database support services. In addition, a

clinical applications support specialist and a service engineer from Living Data

may be used by the Company to provide customers with clinical training and technical service. The Company was charged $2,100 for the services of the clinical applications support specialist and $1,350 for the services of the service engineer during the three-month period ended August 31, 2008.

NOTE J - INCOME TAXES

During the three-months ended August 31, 2008 and August 31, 2007, state income taxes were $3,750 and $6,296, respectively.

As of August 31, 2008, the recorded deferred tax assets were $20,001,852, reflecting a $182,500 increase during the first quarter of fiscal 2009. The deferred tax assets were offset by a valuation allowance of the same amount. Ultimate realization of any or all of the deferred tax assets is not assured, due to significant uncertainties and material assumptions associated with estimates of future taxable income during the carryforward period. The Company has concluded that, based upon the weight of available evidence, it was "more likely than not" that the net deferred tax asset would not be realized.

NOTE K - COMMITMENTS AND CONTINGENCIES

Leases

On August 15, 2007, we sold our facility under a five-year leaseback agreement. Future rental payments under the operating lease are as follows:

For the years ended:	
May 31, 2009	$ 108,122
May 31, 2010	148,488
May 31, 2011	154,427
May 31, 2012	160,604
May 31, 2013	40,541
Total	$ 612,182

Litigation

The Company is currently, and has been in the past, a party to various routine legal proceedings incident to the ordinary course of business. The Company believes that the outcome of all such pending legal proceedings in the aggregate is unlikely to have a material adverse effect on the business or consolidated condensed financial condition of the Company.

NOTE L - SUBSEQUENT EVENT

On September 9, 2008, the Company's Board of Directors granted, but have not issued as of yet, 2,025,000 shares of our common stock for fiscal 2008 compensation to the Company's board members, having a fair market value of $0.06 per share at the time of the respective grant. The total amount charged to compensation expense, for this grant, at August 31, 2008 amounted to $121,500 with the corresponding liability reflected on the balance sheet in accounts payable and accrued expenses.

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

Except for historical information contained in this report, the matters discussed are forward-looking statements that involve risks and uncertainties. When used in this report, words such as "anticipates", "believes", "could", "estimates", "expects", "may", "plans", "potential" and "intends" and similar expressions, as they relate to the Company or its management, identify forward-looking statements. Such forward-looking statements are based on the beliefs of the Company's management, as well as assumptions made by and information currently available to the Company's management. Among the factors that could cause actual results to differ materially are the following: the effect of business and economic conditions; the effect of the dramatic changes taking place in the healthcare environment; the impact of competitive procedures and products and their pricing; medical insurance reimbursement policies; unexpected manufacturing or supplier problems; unforeseen difficulties and delays in the conduct of clinical trials and other product development programs; the actions of regulatory authorities and third-party payers in the United States and overseas; uncertainties about the acceptance of a novel therapeutic modality by the medical community; and the risk factors reported from time to time in the Company's SEC reports. The Company undertakes no obligation to update forward-looking statements as a result of future events or developments.

General Overview

Vasomedical, Inc. was incorporated in Delaware in July 1987. Unless the context requires otherwise, all references to "we", "our", "us", "Company", "registrant", "Vasomedical" or "management" refer to Vasomedical, Inc. and its subsidiaries. Since 1995, we have been primarily engaged in designing, manufacturing, marketing and supporting EECP(R) enhanced external counterpulsation systems based on our unique proprietary technology currently indicated for use in cases of stable or unstable angina (i.e., chest pain), congestive heart failure (CHF), acute myocardial infarction (i.e., heart attack, (MI)) and cardiogenic shock. The EECP(R) therapy system is a non-invasive, outpatient therapy for the treatment of diseases of the cardiovascular system. The therapy serves to increase circulation in areas of the heart with less than adequate blood supply and helps to restore systemic vascular function. The therapy also increases blood flow and oxygen supply to the heart muscle and other organs and decreases the heart's workload and reduces oxygen demand, while also improving function of the endothelium, the lining of blood vessels throughout the body, lessening resistance to blood flow. We provide hospitals, clinics and physician private practices with EECP(R) equipment, treatment guidance, and a staff training and equipment maintenance program designed to provide optimal patient outcomes. EECP(R) is a registered trademark for Vasomedical's enhanced external counterpulsation therapy and systems. For more information, visit www.vasomedical.com.

We have FDA clearance to market our EECP(R) therapy for use in the treatment of stable and unstable angina, congestive heart failure, acute myocardial infarction, and cardiogenic shock; however, our current marketing efforts are limited to the treatment of chronic stable angina and congestive heart failure. Medicare and other third-party payers currently reimburse for the treatment of angina pectoris patients with moderate to severe symptoms who are refractory to medications and not candidates for invasive procedures. Patients with co-morbidities of heart failure, diabetes, peripheral vascular disease, etc. are also reimbursed under the same criteria, provided the primary diagnosis and indication for treatment with EECP(R) therapy is angina symptoms.

During the last several years, we incurred operating losses. We have attempted to achieve profitability by reducing operating costs and halting the trend of declining revenue, and to reduce cash usage through bringing our cost structure more into alignment with current revenues. By engaging in restructurings during March 2007 and April 2007, the Company has substantially reduced personnel and spending on sales, marketing and development projects. In addition, during the first quarter of fiscal year 2008, we raised additional

capital through a private equity financing and by the sale of our facility under a leaseback agreement. See Note A for details of these events.

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

Market Overview

Cardiovascular disease (CVD) is the leading cause of death in the world and is among the top three diseases in terms of healthcare spending in nearly every country. CVD claimed approximately 2.4 million lives in the United States in 2003 and was responsible for 1 of every 2.7 deaths, according to The American Heart Association (AHA) Heart and Stroke Statistical 2006 Update (2006 Update). Approximately 71.3 million Americans suffer from some form of cardiovascular disease. Among these, 12.0 million have coronary heart disease (CHD).

We have FDA clearance to market our EECP(R) therapy for use in the treatment of stable and unstable angina, congestive heart failure, acute myocardial infarction, and cardiogenic shock; however, our current marketing efforts are limited to the treatment of chronic stable angina and congestive heart failure. Medicare and other third-party payers currently reimburse for the treatment of angina pectoris patients with moderate to severe symptoms who are refractory to medications and not candidates for invasive procedures. Patients with co-morbidities of heart failure, diabetes, peripheral vascular disease, etc. are also reimbursed under the same criteria, provided the primary diagnosis and indication for treatment with EECP(R) therapy is refractory angina symptoms.

We will continue to educate the marketplace that EECP(R) therapy is a therapy for ischemic cardiovascular disease and that patients with a primary diagnosis of heart failure, diabetes or peripheral vascular disease are also eligible for reimbursement under the current coverage policy, provided the primary indication for treatment with EECP(R) therapy is refractory angina or angina equivalent symptoms and the patient satisfies other listed criteria. Additionally, we will continue to pursue expansion of coverage for EECP(R) therapy with Medicare and other third-party payers as evidence of its clinical utility develops.

Angina

Angina pectoris is the medical term for a recurring pain or discomfort in the chest due to coronary artery disease (CAD). Angina is a symptom of a condition called myocardial ischemia, which occurs when the heart muscle or myocardium doesn't receive sufficient blood, hence as much oxygen, as it needs. This usually happens because one or more of the heart's arteries, the blood vessels that supply blood to the heart muscle, is narrow or blocked. Insufficient blood supply to meet the need of the organ to function is called ischemia.

The cardinal symptom of stable CAD is anginal chest pain or equivalent symptoms, such as exertional dyspnea or fatigue. Angina is uncomfortable pressure, fullness, squeezing or pain, usually occurring in the center of the chest under the breastbone. The discomfort also may be felt in the neck, jaw, shoulder, back or arm. Often the patient suffers not only from the discomfort of the symptom itself but also from the accompanying limitations on activities and the associated anxiety that the symptoms may produce. Uncertainty about prognosis may be an additional source of anxiety. For some patients, the predominant symptoms may be palpitations or syncope that is caused by arrhythmias or fatigue, edema, or orthopnea caused by heart failure. Episodes of

angina occur when the heart's need for oxygen increases beyond the oxygen available from the blood nourishing the heart. Physical exertion is the most common trigger, but not the only one for angina. For example, running to catch a bus could trigger an attack of angina while walking might not. Angina may happen during exercise, periods of emotional stress, exposure to extreme cold or heat, heavy meals, alcohol consumption or cigarette smoking. Some people, such as those with a coronary artery spasm, may have angina when they are resting.

There are approximately 6.4 million angina patients in the United States and our EECP(R) therapy currently competes with other technologies in the market for approximately 100,000 to 150,000 new refractory angina patients annually who do not adequately respond to or are not amenable to medical and surgical therapy and have the potential to meet the guidelines for reimbursement of EECP(R) therapy. Most angina patients are treated with medications, including beta blockers to slow and protect the heart, and vasodilators which are often prescribed to increase blood flow to the coronary arteries. When drugs fail or inadequately correct the problem, the patients are considered unresponsive to medical therapy. Most angina patients are readily amenable to invasive

revascularization procedures such as angioplasty and coronary stent placement, as well as coronary artery bypass grafting (CABG). However, there are approximately 100,000 to 150,000 angina patients each year whose angina can not be stopped by medication and they are no longer readily amenable to palliative invasive procedures.

In February 1999, the Centers for Medicare and Medicaid Services (CMS), the federal agency that administers the Medicare program for more than 39 million beneficiaries, issued a national coverage policy for the use of external counterpulsation therapy in the treatment of refractory angina. Medicare reimbursement guidelines have a significant impact in determining the available market for EECP(R) therapy. We believe that over 65% of the patients that receive EECP(R) therapy are Medicare patients and many of the third-party payers follow Medicare guidelines, which limit reimbursement for EECP(R) therapy to patients who do not adequately respond to or are not amenable to medical therapy and are not readily amenable to invasive therapy. As a result, an important element of our strategy is to grow the market for EECP(R) therapy by expanding reimbursement coverage to include a broader range of angina patients than the current coverage policy provides and enable EECP(R) therapy to compete more with other therapies for ischemic heart disease. Please see the heading "Reimbursement" in the "Item-1 Business" section of this Form 10-KSB for a more detailed discussion of reimbursement issues.

Congestive Heart Failure (CHF)

CHF is a condition in which the heart loses its pumping capacity to supply the metabolic needs of all other organs. The condition affects both sexes and is most common in people over age 50. Symptoms include angina, shortness of breath, weakness, fatigue, swelling of the abdomen, legs and ankles, rapid or irregular heartbeat and low blood pressure. Causes range from chronic high blood pressure, heart-valve disease, heart attack, coronary artery disease, heartbeat irregularities, severe lung disease such as emphysema, congenital disease, cardiomyopathy, hyperthyroidism, severe anemia and others.

CHF is treated with medication and, sometimes, surgery on heart valves or the coronary arteries and, in certain severe cases, heart transplants. Left

ventricular assist devices (LVADs) and the use of cardiac resynchronization and implantable defibrillators are useful in selected patients with heart failure. Still, no consensus therapy currently exists for CHF and patients must currently suffer their symptoms chronically and have a reduced life expectancy.

According to the 2006 Update, in 2003 approximately 2.4 million men and 2.6 million women in the United States had CHF and about 550,000 new cases of the disease occur each year. Deaths caused by the disease increased 20.5% from 1993 to 2003. The prevalence of the disease is growing as a result of the aging of the population and the improved survival rate of people after heart attacks. Because the condition frequently entails visits to the emergency room and in-patient treatment centers, two-thirds of all hospitalizations for people over age 65 are due to CHF. The economic burden of congestive heart failure is enormous with an estimated cost to the health care system in 2005 in the United States of $29.6 billion. Congestive heart failure offers a good strategic fit with our current angina business and offers an expanded market opportunity for EECP(R) therapy. Unmet clinical needs in CHF are greater than those for angina, as there are few consensus therapies, invasive or otherwise, beyond medical management for the condition. It is noteworthy that data collected from the International EECP(R) Patient Registry(TM) (IEPR) at the University of Pittsburgh Graduate School of Public Health shows that approximately one-third of angina patients treated with EECP(R) also have a history of CHF and 70% to 80% have demonstrated positive outcomes from EECP(R) therapy.

We sponsored a pivotal, randomized clinical trial to demonstrate the efficacy of EECP(R) therapy in the most prevalent types of heart failure patients. This trial, known as PEECH(TM) (Prospective Evaluation of EECP(R) in Congestive Heart Failure), was intended to provide additional evidence of the safety and efficacy of EECP(R) therapy in the treatment of mild-to-moderate heart failure and to support our application for expansion of the Medicare national reimbursement coverage policy to include mild-to-moderate heart failure as a primary indication. The PEECH(TM) trial was a positive clinical trial, having met the statistical requirement of meeting at least one of its co-primary endpoints, a significant difference in the proportion of patients satisfying a

prespecified threshold of improvement in exercise duration. The trial also demonstrated significant improvements in favor of EECP(R) therapy on several important secondary endpoints, including exercise duration and improvement in symptom status and quality of life. Measures of change in peak oxygen consumption were not statistically significant in the overall study population, though a trend favoring EECP(R) therapy was present in early follow-up. Patients in the trial who had an ischemic etiology (i.e. pre-existing coronary artery disease), demonstrated a greater response to EECP(R) therapy than those who had an idiopathic (non-ischemic) etiology.

The preliminary results of the PEECH(TM) trial were presented at the American College of Cardiology scientific sessions in March 2005. On June 20, 2005, CMS accepted our application for expansion of reimbursement coverage of EECP(R) therapy to include patients with New York Heart Association (NYHA) Class II/III stable heart failure symptoms with an ejection fraction of less than or equal to 35% (i.e. chronic, stable, mild-to-moderate systolic heart failure as a primary indication), as well as patients with Canadian Cardiovascular Society Classification (CCSC) II (i.e. chronic, stable mild angina).

On June 23, 2005, CMS also received a request from a competing manufacturer

of external counterpulsation therapy equipment to reconsider the reimbursement coverage policy. They requested expansion of coverage to include 1) treatment of congestive heart failure, to include NYHA Class II, III with a left ventricular ejection fraction (LVEF) less than or equal to 40%, and acute heart failure; 2) treatment of stable angina to include CCSC II angina; 3) treatment of acute myocardial infarction; and 4) treatment of cardiogenic shock. On September 15, 2005, the competing manufacturer also amended their request to include NYHA Class IV heart failure.

On March 20, 2006, CMS issued their Decision Memorandum regarding this reconsideration with the opinion "that the evidence is not adequate to conclude that external counterpulsation therapy is reasonable and necessary for the treatment of:

- CCSC II angina
- Heart Failure
  - NYHA Class II/III stable heart failure symptoms with an ejection fraction of less than or equal to 35%
  - NYHA Class II/III stable heart failure symptoms with an ejection fraction of less than or equal to 40%
  - NYHA Class IV heart failure
  - Acute heart failure
- Cardiogenic shock
- Acute myocardial infarction."

They did, however, reiterate in the decision memorandum that "Current coverage as described in Section 20.20 of the Medicare National Coverage Determination (NCD) manual will remain in effect" for refractory angina patients.

On August 25, 2006 the results of the trial were initially published online by the Journal of the American College of Cardiology (JACC) and in print in its September 19, 2006 issue. JACC is the official journal of the American College of Cardiology.

In the November-December issue of the journal Congestive Heart Failure, a second report of results from the PEECH(TM) trial was published, focusing on the results of a prespecified subgroup analysis in trial patients age 65 and over. This analysis demonstrated a statistically positive response on both co-primary endpoints of the trial in patients receiving EECP(R) therapy versus those who did not, i.e. a significantly larger proportion of patients undergoing EECP(R)

therapy met or exceeded prespecified thresholds of improvement in exercise duration and peak oxygen consumption. Moreover, the patients age 65 and older who received EECP(R) therapy demonstrated the greatest differences in exercise duration, peak oxygen consumption and functional class (symptom status) compared with those who did not receive EECP(R) therapy.

These papers were submitted to CMS and we were advised to continue to gather more clinical evidence for future submission.

We will continue to educate the marketplace that EECP(R) therapy is a therapy for ischemic cardiovascular disease and that patients with a primary diagnosis of heart failure, diabetes, peripheral vascular disease, etc. are also eligible for reimbursement under the current coverage policy, provided the

primary indication for treatment with EECP(R) therapy is refractory angina or angina equivalent symptoms and the patient satisfies other listed criteria. Additionally, we will continue to pursue expansion of coverage for EECP(R) therapy with Medicare and other third-party payers as evidence of its clinical utility develops.

Critical Accounting Policies

Financial Reporting Release No. 60, which was released by the Securities and Exchange Commission, (SEC), in December 2001, requires all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. Note B of the Notes to Consolidated Condensed Financial Statements included in our Annual Report on Form 10-KSB for the year ended May 31, 2008, includes a summary of our significant accounting policies and methods used in the preparation of our financial statements. In preparing these financial statements, we have made our best estimates and judgments of certain amounts included in the financial statements, giving due consideration to materiality. The application of these accounting policies involves the exercise of judgment and use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates. Our critical accounting policies are as follows:

Revenue Recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or service has been rendered, the price is fixed or determinable and collectibility is reasonably assured. In the United States, we recognize revenue from the sale of our EECP(R) systems in the period in which we deliver the system to the customer. Revenue from the sale of our EECP(R) systems to international markets is recognized upon shipment of the product to a common carrier, as are supplies, accessories and spare parts delivered to both domestic and international customers. Returns are accepted prior to the in-service and training subject to a 10% restocking charge or for normal warranty matters, and we are not obligated for post-sale upgrades to these systems. In addition, we use the installment method to record revenue based on cash receipts in situations where the account receivable is collected over an extended period of time and in our judgment the degree of collectibility is uncertain.

In most cases, revenue from domestic EECP(R) system sales is generated from multiple-element arrangements that require judgment in the areas of customer acceptance, collectibility, the separability of units of accounting, and the fair value of individual elements. We follow the provisions of Emerging Issues Task Force, or EITF, Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables" ("EITF 00-21"). The principles and guidance outlined in EITF 00-21 provide a framework to determine (a) how the arrangement consideration should be measured (b) whether the arrangement should be divided into separate units of accounting, and (c) how the arrangement consideration should be allocated among the separate units of accounting. We determined that the domestic sale of our EECP(R) systems includes a combination of three elements that qualify as separate units of accounting:

i. EECP(R) equipment sale,
ii. provision of in-service and training support consisting of equipment set-up and training provided at the customer's facilities, and
iii. a service arrangement (usually one year), consisting of: service by factory-trained service representatives, material and labor costs, emergency and remedial service visits, software upgrades, technical phone support and preferred response times.

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

Each of these elements represent individual units of accounting as the delivered item has value to a customer on a stand-alone basis, objective and reliable evidence of fair value exists for undelivered items, and arrangements normally do not contain a general right of return relative to the delivered item. We determine fair value based on the price of the deliverable when it is sold separately or based on third-party evidence. In accordance with the guidance in EITF 00-21, we use the residual method to allocate the arrangement consideration when it does not have fair value of the EECP(R) system sale. Under the residual method, the amount of consideration allocated to the delivered item equals the total arrangement consideration less the aggregate fair value of the undelivered items. Assuming all other criteria for revenue recognition have been met, we recognize revenue for:

i. EECP(R) equipment sales, when delivery and acceptance occurs based on delivery and acceptance documentation received from independent shipping companies or customers,
ii. in-service and training, following documented completion of the training, and
iii. the service arrangement, ratably over the service period, which is generally one year.

In-service and training generally occurs within a few weeks of shipment and our return policy states that no returns will be accepted after in-service and training has been completed. The amount related to in-service and training is recognized as service revenue at the time the in-service and training is completed and the amount related to service arrangements is recognized ratably as service revenue over the related service period, which is generally one year. Costs associated with the provision of in-service and training and the service arrangement, including salaries, benefits, travel, spare parts and equipment, are recognized in cost of equipment sales as incurred.

The Company also recognizes revenue generated from servicing EECP(R) systems that are no longer covered by the service arrangement, or by providing sites with additional training, in the period that these services are provided. Revenue related to future commitments under separately priced extended service agreements on our EECP(R) system are deferred and recognized ratably over the service period, generally ranging from one year to four years. Costs associated with the provision of service and maintenance, including salaries, benefits, travel, spare parts and equipment, are recognized in cost of sales as incurred. Amounts billed in excess of revenue recognized are included as deferred revenue in the consolidated condensed balance sheets.

Revenues from the sale of EECP(R) systems through our international distributor network are generally covered by a one-year warranty period. For these customers we accrue a warranty reserve for estimated costs to provide warranty parts when the equipment sale is recognized. . The Company has also entered into lease agreements for our EECP(R) systems, generally for terms of one year or less, that are classified as operating leases. Revenues from operating leases are generally recognized, in accordance with the terms of the lease agreements, on a straight-line basis over the life of the respective leases. For certain operating leases in which payment terms are determined on a "fee-per-use" basis, revenues are recognized as incurred (i.e., as actual usage occurs). The cost of the EECP(R) system utilized under operating leases is recorded as a component of property and equipment and is amortized to cost of sales over the estimated useful life of the equipment, not to exceed five years. There were no significant minimum rental commitments on these operating leases at August 31, 2008.

Accounts Receivable, net

The Company's accounts receivable are due from customers engaged in the provision of medical services. Credit is extended based on evaluation of a customer's financial condition and, generally, collateral is not required. Accounts receivable are generally due 30 to 90 days from shipment and are stated at amounts due from customers net of allowances for doubtful accounts, returns, term discounts and other allowances. Accounts that remain outstanding longer than the contractual payment terms are considered past due. Estimates are used in determining the allowance for doubtful accounts based on the Company's historical collections experience, current trends, credit policy and a percentage of its accounts receivable by aging category. In determining these

percentages, we look at historical write-offs of our receivables. The Company also looks at the credit quality of its customer base as well as changes in its credit policies. The Company continuously monitors collections and payments from our customers. While credit losses have historically been within expectations and the provisions established, the Company cannot guarantee that it will continue to experience the same credit loss rates that it has in the past.

Inventories, net

The Company values inventory at the lower of cost or estimated market, cost being determined on a first-in, first-out basis. The Company often places EECP(R) systems at various field locations for demonstration, training, evaluation, and other similar purposes at no charge. The cost of these EECP(R) systems is transferred to property and equipment and is amortized over the next two to five years. The Company records the cost of refurbished components of EECP(R) systems and critical components at cost plus the cost of refurbishment. The Company regularly reviews inventory quantities on hand, particularly raw materials and components, and records a provision for excess and obsolete inventory based primarily on existing and anticipated design and engineering changes to its products as well as forecasts of future product demand.

We have adopted the provisions of Statement of Financial Accounting Standards No. 151, "Inventory Costs", on a prospective basis. The statement clarifies that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and requires the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. As a result of adopting SFAS No. 151, we absorbed approximately $36,000 more in fixed production overhead into inventory during the first quarter of fiscal year 2009 as compared to the same period in fiscal 2008.

Deferred Revenues

The Company records revenue on extended service contracts ratably over the term of the related contract period. In accordance with the provisions of EITF 00-21, we began to defer revenue related to EECP(R) system sales for the fair value of installation and in-service training to the period when the services are rendered and for warranty obligations ratably over the service period, which is generally one year.

Warranty Costs

Equipment sold is generally covered by a warranty period of one year. Under the provisions of EITF 00-21, for certain arrangements, a portion of the overall system price attributable to the first year service arrangement is deferred and recognized as revenue over the service period. As such, we do not accrue warranty costs upon delivery but we rather recognize warranty and related service costs as incurred.

Equipment sold to international customers through our distributor network is generally covered by a one-year warranty period. For these customers the Company accrues a warranty reserve for estimated costs of providing a parts only warranty when the equipment sale is recognized.

The factors affecting our warranty liability included the number of units sold and historical and anticipated rates of claims and costs per claim.

Net Loss per Common Share

Basic loss per share is based on the weighted average number of common shares outstanding without consideration of potential common stock. Diluted loss per share is based on the weighted number of common and potential dilutive common shares outstanding. The calculation takes into account the shares that may be issued upon the exercise of stock options and warrants, reduced by the shares that may be repurchased with the funds received from the exercise, based on the average price during the period.

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Income Taxes

Deferred income taxes are recognized for temporary differences between financial statement and income tax bases of assets and liabilities and loss carryforwards for which income tax benefits are expected to be realized in future years. A valuation allowance is established, when necessary, to reduce deferred tax assets to the amount expected to be realized. In estimating future tax consequences, we generally consider all expected future events other than an enactment of changes in the tax laws or rates. The deferred tax asset is continually evaluated for realizability. To the extent our judgment regarding the realization of the deferred tax assets changes, an adjustment to the allowance is recorded, with an offsetting increase or decrease, as appropriate, in income tax expense. Such adjustments are recorded in the period in which our estimate as to the realizability of the asset changed that it is "more likely than not" that all of the deferred tax assets will be realized. The "more likely than not" standard is subjective, and is based upon our estimate of a greater than 50% probability that the deferred tax asset will be realized.

Deferred tax assets and liabilities are classified as current or non-current based on the classification of the related asset or liability for financial reporting. A deferred tax asset or liability that is not related to an asset or liability for financial reporting, including deferred tax assets related to carryforwards, are classified according to the expected reversal date of the temporary difference. The deferred tax asset the Company previously recorded, and then reversed fully in fiscal 2006, related primarily to the realization of net operating loss carryforwards, of which the allocation of the current portion, if any, reflected the expected utilization of such net operating losses for the following twelve months. Such allocation was based on the Company's internal financial forecast and may be subject to revision based upon actual results.

Stock-based Employee Compensation

In December 2004, the FASB issued Statement of Financial Standards No. 123 (revised 2004), Share-Based Payment ("SFAS No. 123 (R)"), which is a revision of SFAS No. 123. SFAS No. 123 (R) supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and amends FASB Statement No. 95, Statement of Cash Flows. Generally, the approach to accounting for share-based payments in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees including grants of employee stock options, to be recognized in the financial statements based on their fair values. Pro forma disclosure of the fair value of share-based payments is no longer an alternative to financial statement recognition. The Company has five stock-based employee compensation plans.

As new stock options are issued by the Company this may have a material effect on its quarterly and annual financial statements, in the form of additional compensation expense. It is not possible to precisely determine the expense impact of adoption since a portion of the ultimate expense that is recorded will likely relate to awards that have not yet been granted. The expense associated with these future awards can only be determined based on factors such as the price for the Company's common stock, volatility of the Company's stock price and risk free interest rates as measured at the grant date.

For purposes of estimating the fair value of each option on the date of grant, the Company utilizes the Black-Scholes option-pricing model.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable measure of the fair value of its employee stock options.

Equity instruments issued to non-employees in exchange for goods, fees and services are accounted for under the fair value-based method of SFAS No. 123 (R).

Recently Issued Accounting Pronouncements Not Yet Effective

Statements of Financial Accounting Standards (SFAS):

SFAS No. 141 (R), "Business Combinations" -- retains the fundamental requirements in Statement 141 that the acquisition method of accounting (which Statement 141 called the purchase method) be used for all business combinations and for an acquirer to be identified for each business combination. This Statement defines the acquirer as the entity that obtains control of one or more businesses in the business combination and establishes the acquisition date as the date that the acquirer achieves control.

- replaces Statement 141's cost-allocation process and requires an acquirer to recognize the assets acquired, the liabilities assumed,

and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date,

- o requires the acquirer in a business combination achieved in stages (sometimes referred to as a step acquisition) to recognize the identifiable assets and liabilities, as well as the noncontrolling interest in the acquiree, at the full amounts of their fair values,
- o requires that an acquirer evaluate new information and measure a liability at the higher of its acquisition-date fair value or the amount that would be recognized if applying Statement 5, then measuring an asset at the lower of its acquisition-date fair value or the best estimate of its future settlement amount,
- o requires the acquirer to recognize contingent consideration at the acquisition date, measured at its fair value at that date.

Effective for fiscal years beginning after December 15, 2008

SFAS 157, "Fair Value Measurements" -- defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, where the Board previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Earlier application is encouraged, provided that the reporting entity has not yet issued financial statements for that fiscal year, including financial statements for an interim period within that fiscal year.

SFAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities--including an amendment of FASB Statement No. 115" -- permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement is expected to expand the use of fair value measurement, which is consistent with the Board's long-term measurement objectives for accounting for financial instruments. This Statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007, and interim periods within those fiscal years. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of FASB Statement No. 157, "Fair Value Measurements".

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SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements" -- changes the way the consolidated income statement is presented. It requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure, on the face of the consolidated statement of income, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. Previously, net income attributable to the noncontrolling interest generally was reported as an expense or other deduction in arriving at consolidated net income. It also was often presented in combination with other financial statement amounts. Effective for fiscal years beginning after December 15, 2008.

SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities - an Amendment of FASB Statement 133 -- enhances required disclosures regarding derivatives and hedging activities, including enhanced disclosures regarding how: (a) an entity uses derivative instruments; (b) derivative instruments and related hedged items are accounted for under FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities; and (c) derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. Specifically, Statement SFAS No. 161 requires:

- Disclosure of the objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation;
- Disclosure of the fair values of derivative instruments and their gains and losses in a tabular format;
- Disclosure of information about credit-risk-related contingent features; and
- Cross-reference from the derivative footnote to other footnotes in which derivative-related information is disclosed.

Effective for fiscal years and interim periods beginning after November 15, 2008. Early application is encouraged. The Company does not expect that SFAS No. 161 will have any significant effect on future financial statements.

SFAS No. 163, "Accounting for Financial Guarantee Insurance Contracts" -- clarifies how SFAS No. 60, "Accounting and Reporting by Insurance Enterprises", applies to financial guarantee insurance contracts issued by insurance enterprises, including the recognition and measurement of premium revenue and claim liabilities. It also requires expanded disclosures about financial guarantee insurance contracts. SFAS No. 163 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and all interim periods within those fiscal years, except for disclosures about the insurance enterprise's risk-management activities, which are effective the first period beginning after May 23, 2008.

FASB Staff Positions (FSP):

FSP APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)" -- clarifies that convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) are not addressed by paragraph 12 of APB Opinion No. 14, Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants. Additionally, this FSP specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years.

FSP FAS 133-1 and FIN 45-4, "Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161" -- amends FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, to require disclosures by sellers of credit derivatives, including credit derivatives embedded in a hybrid instrument. This FSP also amends FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of

Others, to require an additional disclosure about the current status of the payment/performance risk of a guarantee. Further, this FSP clarifies the Board's intent about the effective date of FASB Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities. This FSP is effective for reporting periods ending after November 15, 2008.

FSP FAS 140-3, "Accounting for Transfers of Financial Assets and Repurchase Financing Transactions" -- amends FASB Statement 140 to state that a transferor and transferee shall not separately account for a transfer of a financial asset and a related repurchase financing unless (a) the two transactions have a valid and distinct business or economic purpose for being entered into separately and (b) the repurchase financing does not result in the initial transferor regaining control over the financial asset. This FSP is effective for financial statements issued for fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. Earlier application is not permitted.

FSP FAS 142-3, "Determination of the Useful Life of Intangible Assets" -- amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, Goodwill and Other Intangible Assets. Paragraph 11(d) of Statement 142 precluded an entity from using its own assumptions about renewal or extension of an arrangement where there is likely to be substantial cost or material modifications. This FSP amends paragraph 11(d) of Statement 142 so that an entity will use its own assumptions about renewal or extension of an arrangement, adjusted for the entity-specific factors in paragraph 11 of Statement 142, even when there is likely to be substantial cost or material modifications. Therefore, in determining the useful life of the asset for amortization purposes, an entity shall consider the period of expected cash flows used to measure the fair value of the recognized intangible asset, adjusted for the entity-specific factors including, but are not limited to, the entity's expected use of the asset and the entity's historical experience in renewing or extending similar arrangements. This FSP shall be effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited.

FSP FAS 157-1, "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13" -- amends SFAS No. 157, "Fair Value Measurements", to exclude SFAS No. 13, "Accounting for Leases", and other accounting pronouncements that address fair value measurements for purposes of lease classification or measurement under Statement 13. However, this scope exception does not apply to assets acquired and liabilities assumed in a business combination that are required to be measured at fair value under SFAS No. 141, "Business Combinations", or No. 141 (revised 2007), "Business Combinations", regardless of whether those assets and liabilities are related to leases.

FSP FAS 157-2, "Effective Date of FASB Statement No. 157" -- delays the effective date of SFAS No. 157, "Fair Value Measurements", for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The delay is intended to allow the Board and constituents additional time to consider the effect of various implementation issues that have arisen, or that may arise, from the application of SFAS No. 157. This FSP defers the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items

within the scope of this FSP.

FSP SOP 07-1-1, -- indefinitely delays the effective date of AICPA Statement of Position 07-1, "Clarification of the Scope of the Audit and Accounting Guide Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies."

FSP EITF 03-6-1, -- "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities." This FSP provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating

securities and shall be included in the computation of earnings per share pursuant to the two-class method. The FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. Upon adoption, a company is required to retrospectively adjust its earnings per share data (including any amounts related to interim periods, summaries of earnings and selected financial data) to conform with the provisions in this FSP. Early application of this FSP is prohibited.

EITF Consensuses (EITF):

EITF Issue No. 07-1, "Accounting for Collaborative Arrangements " -- when entities enter into arrangements to participate in a joint operating activity a collaborative arrangement may provide that one participant has sole or primary responsibility for certain activities or that two or more participants have shared responsibility for certain activities. Participants should evaluate whether an arrangement is a collaborative arrangement at the inception of the arrangement based on the facts and circumstances present at that time. Revenue generated and costs incurred by participants from transactions with parties should be reported gross or net on the appropriate line item in each participant's respective financial statements depending on the nature of the participation. Disclosures should include information about the nature and purpose of its collaborative arrangements, the entity's rights and obligations under the collaborative arrangements, the accounting policy for collaborative arrangements, and the income statement classification and amounts attributable to transactions arising from the collaborative arrangement. Effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years.

EITF Issue No. 07-5, " Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock" -- This Issue addresses the determination of whether an instrument (or an embedded feature) is indexed to an entity's own stock, which is the first part of the scope exception in paragraph 11(a) of Statement 133. If an instrument (or an embedded feature) that has the characteristics of a derivative instrument under paragraphs 6-9 of Statement 133 is indexed to an entity's own stock, it is still necessary to evaluate whether it is classified in stockholders' equity (or would be classified in stockholders' equity if it were a freestanding instrument). For example, a net-cash-settled stock purchase warrant may be indexed to an entity's own stock, but it is not classified in stockholders' equity. Other applicable authoritative accounting literature, including Issues 00-19 and 05-2, provides guidance for determining whether an instrument (or an embedded feature) is classified in stockholders' equity (or would be classified in stockholders' equity if it were a freestanding instrument). This Issue does not address that second part of the

scope exception in paragraph 11(a) of Statement 133. Entities are required to apply the guidance in this issue to fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. Earlier application by an entity that has previously adopted an alternative accounting policy is not permitted.

EITF Issue No. 08-3, "Accounting by Lessees for Maintenance Deposits" -- The objective of this Issue is to clarify how a lessee shall account for a maintenance deposit under an arrangement accounted for as a lease. This Issue applies to the lessee's accounting for maintenance deposits paid by a lessee under an arrangement accounted for as a lease that are refunded only if the lessee performs specified maintenance activities. Maintenance deposits within the scope of this Issue shall be accounted for as a deposit asset. Lessees shall continue to evaluate whether it is probable that an amount on deposit will be returned to reimburse the costs of the maintenance activities incurred by the lessee. When an amount on deposit is less than probable of being returned, it shall be recognized as additional expense. When the underlying maintenance is performed, the maintenance costs shall be expensed or capitalized in accordance with the lessee's maintenance accounting policy. This Issue is effective for financial statements issued for fiscal years beginning after December 15, 2008, including interim periods within those fiscal years. Earlier application by an entity that has previously adopted an alternative accounting policy is not permitted.

EITF Issue No. 08-5, "Issuer's Accounting for Liabilities Measured at Fair Value with a Third-Party Credit Enhancement" -- This issue discusses the application of fair value to liabilities issued with an inseparable contractual third-party credit enhancement (e.g., a guarantee). In applying the fair value option to liabilities, the question arises as to whether the liability and the

third-party enhancement should be accounted for as: (a) one unit of accounting, which would result in the third-party guarantee being taken into consideration in determining the fair value of the liability, or (b) two separate units of accounting, which would not result in the third-party guarantee being taken into consideration in determining the fair value of the liability.

The EITF concluded that the scope of this issue applies to a liability that is issued with an inseparable third-party credit enhancement that is measured or disclosed at fair value, except a liability with a guarantee provided by the government or government agencies.

The final consensus requires that an entity: (a) apply the guidance in this issue prospectively to its first reporting period beginning on or after December 15, 2008; (b) recognize the effect of the change prospectively, with the effect of initially applying the guidance in this issue included in the change in fair value in the period of adoption, and (c) include in the period of adoption disclosure of -- (1) the existence of any third-party credit enhancement on any issued liability that is within the scope of this issue, (2) the valuation technique(s) used to measure the fair value of issued liabilities within the scope of this issue, and (3) any changes from valuation techniques used in prior periods to measure liabilities within the scope of this issue. Early adoption is permitted.

EITF Issue No. 08-6, "Equity Method Investment Accounting Considerations" -- The purpose of this issue is to resolve several accounting issues that arise

in applying the equity method of accounting. Most of these issues arise or become more prevalent upon the effective date of FASB Statement No. 141 (Revised 2007), "Business Combinations", and (or) FASB Statement No. 160, "Noncontrolling Interests in Consolidated Financial Statements." This is because the literature that is being replaced or amended by Statements 141R and 160 have been used by analogy in addressing certain aspects of applying the equity method of accounting, which raises the question as to whether these aspects of applying the equity method of accounting should change upon the effective date of Statements 141R and 160 (which for calendar year-end companies is January 1, 2009). The specific issues raised with Issue 08-6 include:

Issue 1: How the initial carrying value of an equity method investment should be determined. In other words, should the initial carrying value of an equity method investment be determined as if the equity method investment were any other acquired asset or should it be determined as if the equity method investment were a business combination? For example, should transaction costs be capitalized or expensed?

Issue 2: How the difference between the investor's carrying value, as determined in Issue 1, and the underlying equity of the investee should be allocated to the underlying assets and liabilities of the investee. In other words, should the allocation method used be wholly consistent with the acquisition method included in Statement 141R or should it be only partially consistent with the acquisition method included in Statement 141R? For example, should the allocation to contingent assets and liabilities be consistent with the model used in Statement 141R to account for contingent assets and liabilities or should the allocation to contingent assets and liabilities be consistent with FASB Statement No. 5, Accounting for Contingencies , and other generally accepted accounting principles?

Issue 3: How an impairment assessment of an underlying indefinite-lived intangible asset of an equity method investment should be performed. In other words, should the underlying indefinite-lived intangible asset be tested annually and as part of an other-than-temporary impairment test, or only as part of an other-than-temporary impairment test?

Issue 4: How should an equity method investee's issuance of shares should be accounted for?

Issue 5: How should a change in an investment from the equity method to the cost method be accounted for?

The EITF concluded on these issues:

Issue 1: A cost accumulation model should be used to determine the initial carrying value of an equity method investment. That is, the initial carrying value would include transaction costs.

Issue 2: No additional guidance will be provided.

Issue 3: Only an other-than-temporary impairment test should be performed on the overall investment. There should not be a separate impairment test for the underlying indefinite-lived intangible assets.

Issue 4: The equity method investee's issuance of shares should be accounted for as the sale of a proportionate share of the investment, which would result in a gain or loss in income in many situations.

Issue 5: No gain or loss should be recognized when changing the method of accounting for an investment from the equity method to the cost method of accounting.

The guidance in this issue should be applied to transactions that occur in fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Early adoption is not permitted for entities that have previously adopted an alternative accounting policy.

EITF Issue No. 08-7, "Accounting for Defensive Intangible Assets" -- This issue discusses the accounting for defensive intangible assets. A defensive intangible asset, for purposes of this issue, includes all acquired intangible assets that the acquirer does not intend to actively use, but intend to hold to prevent its competitors from obtaining access to the asset. The following questions have arisen in regards to these assets:

Issue 1: Should the acquired defensive intangible asset by accounted for separately or as part of another related intangible asset (recognized or unrecognized) of the acquirer?

Issue 2: How should the useful life of the acquired intangible asset be determined if it is accounted for as a separate asset?

The EITF concluded on these issues:

Issue 1: The value of an acquired defensive intangible asset should be separately accounted for.

Issue 2: The date at which the defensive asset is expected to be "effectively abandoned" should be used to determine the length of its useful life. In effect, the amortization period would be the period of time over which the defensive intangible asset is expected to provide defensive value to the entity. This accounting includes in-process R&D defensive intangible assets.

The guidance in this issue should be applied prospectively to intangible assets acquired on or after the beginning of the first annual reporting period beginning on or after December 15, 2008.

EITF Issue No. 08-8, "Accounting for an Instrument (or an Embedded Feature) with a Settlement Amount That Is Based on the Stock of an Entity's Consolidated Subsidiary " -- Paragraph 11(a) of FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities," provides for a contract issued or held by a reporting entity that satisfies the following two conditions to not be considered a derivative financial instrument for purposes of that statement: (a) the contract is indexed to the entity's own stock and (b) the contract is classified in stockholders' equity. When the instrument (or embedded feature) under consideration is one whose "payoff to the counterparty is based, in whole or in part, on the stock of a consolidated subsidiary," the question arises as to whether such an instrument (or embedded feature) should be considered indexed to the entity's own stock. Certain aspects of this question have been dealt with in the past by the EITF. For example, EITF Issue No. 00-6, "Accounting for Freestanding Derivative Financial Instruments Indexed to, and Potentially Settled in, the Stock of a Consolidated Subsidiary," indicates that freestanding instruments issued by the parent whose payoff is based in whole or in part on the stock of a consolidated subsidiary is not indexed to the parent's own stock (i.e., it would not satisfy the first of the two conditions in paragraph 11(a) of Statement 133). In addition, EITF Issue No. 99-1, "Accounting for Debt

Convertible into the Stock of a Consolidated Subsidiary," indicates that debt issued by a parent or subsidiary that is convertible into the subsidiary's own stock can qualify for the scope exception in paragraph 11(a). Many believe that

the conclusions in Issues 99-1 and 00-6 are inherently inconsistent. This inherent inconsistency is expected to become magnified upon the effective date of FASB Statement No. 160, "Noncontrolling Interests in Consolidated Financial Statements." This is due to Statement 160 requiring the classification of the noncontrolling interest in a subsidiary within equity in the consolidated financial statements. Prior to the effective date of Statement 160, the noncontrolling (or minority) interest is most often reflected in the mezzanine of the balance sheet between liabilities and equity. Upon the change in the classification of the noncontrolling interest, it is expected that more instruments will qualify for the second of the two conditions included in paragraph 11(a) of Statement 133 (i.e., the contract is classified in stockholders' equity). This will, in turn, place additional attention or prominence on the evaluation of whether the instrument (or embedded feature) should be considered indexed to the entity's own stock (i.e., whether the instrument qualifies for the first of the two conditions included in paragraph 11(a) of Statement 133). As such, this issue was added to the EITF's agenda to address:

Issue 1: Whether instruments within the scope of Issue 08-8 should or should not be precluded from being considered indexed to the entity's own stock for purposes of the consolidated financial statements

Issue 2: Whether the instrument should be classified as: (a) a component of the noncontrolling interest reflected in the stockholders' equity section of the consolidated balance sheet, or (b) a component of the controlling interest reflected in the stockholders' equity section of the consolidated balance sheet.

The EITF concluded on these issues:

Issue 1: An instrument within the scope of this issue is not precluded from being considered indexed to the entity's own stock for purposes of the consolidated financial statements of the parent. For purposes of determining whether the instrument is, in fact, indexed to the entity's own stock, the guidance in EITF Issue No. 07-5, "Determining Whether an Instrument (or an Embedded Feature) Is Indexed to an Entity's Own Stock," should be considered. Issue 07-5 and other applicable literature (e.g., EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock ") should be referred to for purposes of determining the classification of the instrument.

Issue 2: The presentation within stockholders' equity of an equity-classified instrument within the scope of this issue is not dependent on whether the instrument was issued by the parent or subsidiary. In other words, such an instrument should be presented as a component of the noncontrolling interest reflected in the stockholders' equity section of the consolidated balance sheet if the instrument was issued by either the parent or the subsidiary. If, however, the instrument was issued by the parent and it goes unexercised, the carrying amount of the instrument would be reclassified from the noncontrolling interest to the controlling

interest at that time. Note: The guidance in this issue is not applicable to instruments within the scope of and accounted for in accordance with FASB Statement No. 123 (Revised 2004), "Share-Based Payment," and EITF Issue No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods, or Services." However, once an instrument ceases to be accounted for in accordance with Statement 123R or Issue 96-18, the guidance in this issue is applicable to that instrument.

The consensus requires that an entity: (a) apply the guidance in this issue for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2008; (b) apply the guidance to outstanding instruments as of the beginning of the fiscal year in which this issue is adopted; (c) use the fair value of an outstanding contract that was previously classified as a derivative

asset or liability as its net carrying amount at the date of adoption; (d) reclassify the net carrying amount of the outstanding contracts to noncontrolling interest at the date of adoption; and (e) provide any transition disclosure required by paragraphs 17 and 18 of FASB Statement No. 154, "Accounting Changes and Error Corrections." Early adoption is not permitted.

Results of Operations

Three Months Ended August 31, 2008 and 2007

Net revenue from sales, leases and service of our EECP(R) systems for the three months ended August 31, 2008 and 2007, was $1,311,721 and $1,340,076, respectively, which represented a decrease of $28,355, or 2%. We reported a net loss attributable to common stockholders of $549,971 and $18,786 for the first quarter of fiscal 2009 and 2008, respectively. The increase in the net loss was primarily due to increases in our operating expenses from the comparative prior period. Our net loss per diluted common share was $0.01 for the three-month period ended August 31, 2008 compared to a net loss of $0.00 per diluted common share for the three-month period ended August 31, 2007.

Revenues

Revenue from equipment sales increased approximately 33% to $656,469 for the three-month period ended August 31, 2008 as compared to $493,268 for the same period in the prior year. The increase in equipment sales is due primarily to a 40% increase in the number of equipment shipments offset slightly by a decrease in the average blended per unit sale price. The 40% increase in the number of units sold reflects a 50% increase in new unit sales, both domestically and internationally, decreased minimally by the number of used unit models sold from the prior fiscal quarter.

We believe the decline in the sales price per unit reflects weakened demand in the refractory angina market as existing capacity is more fully utilized, coupled with increased direct and indirect competition. We anticipate that demand for EECP(R) systems will remain soft unless there is greater clinical acceptance for the use of EECP(R) therapy in treating patients with angina or angina equivalent symptoms who meet the current reimbursement guidelines or an expansion of the current CMS national reimbursement policy to include some or all Class II & III heart failure patients. Patients with angina or angina equivalent symptoms eligible for reimbursement under current policies include

many with serious comorbidities, such as heart failure, diabetes, peripheral vascular disease and/or others. Despite this, many cardiology clinicians appear to be waiting for approval of reimbursement coverage for heart failure as a primary indication before they will move forward with the treatment of ischemic heart failure patients with angina equivalent symptoms. Reluctance to bill for ischemic heart failure patients under the current coverage guidelines, and failure to get or maintain adequate reimbursement coverage for angina and heart failure would adversely affect our business prospects. We anticipate that a prevailing trend of declining prices will continue in the immediate future as our competition attempts to capture greater market share through pricing discounts. The average price of new systems sales declined by 22% which was mainly due to increased competition, in the first quarter of fiscal 2009 compared to the same three-month period in the prior year and the average sales price of used systems declined 11% in the first quarter of fiscal 2009. We continue to reorganize certain territory responsibilities in our sales department due to vacant and/or unproductive territories.

Our revenue from the sale of EECP(R) systems and related products to international distributors in the first quarter of fiscal 2009 increased approximately 103% to $315,984 compared to $155,991 in the same three-month period in the prior year reflecting increased sales volume.

Our revenue from equipment rental and services decreased 23% to $655,225 in the first quarter of fiscal 2009 from $846,808 in the first quarter of fiscal year 2008. Revenue from equipment rental and services represented 50% of total revenue in the first quarter of fiscal 2009 and 63% in the same quarter of fiscal 2008. The decrease in revenue generated from equipment rentals and services is due to a decrease in the service business, with respect to service contract sales, and service related income generated from units not under contract, as well as, a decrease in accessories and service parts shipped compared to the same quarter of the prior fiscal year.

Gross Profit

Gross profit declined to $500,562, or 38% of revenues, for the first quarter of fiscal 2009 compared to $684,739, or 51% of revenues, for the same quarter of fiscal 2008. The decrease in the gross profit margin as a percentage of revenue for the first quarter of fiscal 2009 compared to the same quarter of the prior fiscal year was mainly due to lower revenue generated from equipment rentals and services due to a decrease in the service business, with respect to service contract sales, and service related income generated from units not under contract, as well as, a decrease in accessories and service parts shipped of $169,000, or 24%. The decline in gross profit related to equipment sales, when compared to the same three-month period in the prior year in absolute dollars is principally due to the lower sales price per unit from the first quarter of fiscal 2008.

In addition, gross profits are dependent on a number of factors, particularly the mix of EECP(R) models sold domestically and internationally and their respective average selling prices, the mix of EECP(R) units sold, rented or placed during the period, the ongoing costs of servicing such units, and certain fixed period costs, including facilities, payroll and insurance. Gross profit margins are generally less on non-domestic business due to the use of distributors resulting in lower selling prices. Consequently, the gross profit realized during the current period may not be indicative of future margins.

Selling, General and Administrative

Selling, general and administrative ("SG&A") expenses for the first quarter of fiscal 2009 and 2008 were $943,759, or 72% of revenues, and $558,156, or 42% of revenues, respectively, reflecting a increase of $385,603 or approximately 69%. The increase in SG&A expenditures in the first quarter of fiscal 2009 resulted primarily from increased direct expenditures of $66,078 due to increased sales personnel and associated costs including travel, offset by decreases in other sales related costs. Marketing expenses increased $56,202 due to increased expenditures in personnel and their associated costs in the marketing and clinical application support areas, plus higher market research, product promotion, advertising, and trade show expenses. Administrative expenses increased $263,323 as a result of increased expenditures in professional fees related to accounting, legal and consulting services, corporate expenses, and directors' compensation offset slightly by decreases in insurance expenses and other miscellaneous administrative expenses.

During the first quarter of fiscal 2009, there was no change in the Company's provision for doubtful accounts compared to the first quarter of fiscal 2008 when the Company reversed a provision for doubtful accounts of $25,246.

Research and Development

Research and development ("R&D") expenses of $132,347, or 10% of revenues, for the first quarter of fiscal 2009 decreased by $6,828, or 10%, from $139,175, or 10% of revenues, for the first quarter of fiscal 2008. The decrease is primarily attributable to a decrease in product development spending, offset by an increase in regulatory affairs expenses related to obtaining regulatory clearance for the ambulatory ECG recorders and Holter ABPM combination recorders and ultrasound scanners.

Interest Expense and Financing Costs

The Company had no interest expense and financing costs for the first quarter of fiscal 2009 compared to $16,666 for the same quarter in the prior year. Interest expense primarily reflects interest on loans secured to refinance the November 2000 purchase of the Company's headquarters and warehouse facility. The decrease is a direct result of the sale-leaseback agreements for the Company's headquarters and warehouse facility, which occurred during the first quarter of fiscal 2008.

Interest and Other Income, Net

Interest and other income for the first quarter of 2009 and 2008, were $16,012 and $12,331, respectively. Interest income reflects interest earned on the Company's cash balances.

Recognition of Deferred Gain on Sale of Building

The Recognition of Deferred Gain on Sale of Building for the first quarter of 2009 and 2008, were $13,311 and $4,437, respectively. The gain resulted from the Company's sale-leaseback of its facility. See Note G.

Income Tax Expense, Net

During the first quarters of fiscal 2009 and 2008 we recorded a provision for income taxes of $3,750 and $6,296, respectively.

As of August 31, 2008, the recorded deferred tax assets were $20,001,852, reflecting an increase of $182,500 during the first quarter of fiscal 2009, which was offset by a valuation allowance of the same amount.

Ultimate realization of any or all of the deferred tax assets is not assured due to significant uncertainties and material assumptions associated with estimates of future taxable income during the carryforward period. In November 2005, we concluded that, based upon the weight of available evidence, it was "more likely than not" that the net deferred tax asset would not be realized and increased the valuation allowance to bring the net deferred tax asset carrying value to zero.

Liquidity and Capital Resources

Cash and Cash Flow

We have financed our operations primarily from working capital, a private equity financing, and by the sale of our facility under a leaseback agreement. At August 31, 2008, we had cash and cash equivalents of $2,140,403 and working capital of $2,436,625 compared to cash and cash equivalents of $2,653,999 and working capital of $2,851,901 at May 31, 2008.

Cash used in operating activities was $512,217 during the first quarter of fiscal 2009, which consisted of a net cash loss after adjustments of $503,027 and cash used by operating assets and liabilities of $9,190. The changes in the accounts balances primarily reflects increases in inventory of $193,041, accounts receivable of $163,836, and other current assets of $76,377, which were primarily offset by an increase in accounts payable, accrued expenses, and other current liabilities of $318,546. Net accounts receivable were 67% of revenues for the three-month period ended August 31, 2008, as compared to 54% for the three-month period ended August 31, 2007, and accounts receivable turnover decreased to 6.5 times as of August 31, 2008, as compared to 7.8 times as of August 31, 2007.

Standard payment terms on our domestic equipment sales are generally net 30 to 90 days from shipment and do not contain "right of return" provisions. We have historically offered a variety of extended payment terms, including sales-type leases, in certain situations and to certain customers in order to expand the market for our EECP(R) therapy system products in the US and internationally. Such extended payment terms were offered in lieu of price concessions, in competitive situations, when opening new markets or geographies and for repeat customers. Extended payment terms cover a variety of negotiated terms, including payment in full - net 120, net 180 days or some fixed or variable monthly payment amount for a six to twelve month period followed by a balloon payment, if applicable. During the three-month periods ended August 31, 2008 and August 31, 2007, there were no revenues generated from sales in which initial payment terms were greater than 90 days and we offered no sales-type leases during either period. In general, reserves are calculated on a formula

basis considering factors such as the aging of the receivables, time past due,

and the customer's credit history and their current financial status. In most instances where reserves are required, or accounts are ultimately written-off, customers have been unable to successfully implement their EECP(R) therapy program. As we are creating a new market for the EECP(R) therapy and recognizing the challenges that some customers may encounter, we have opted, at times, on a customer-by-customer basis, to recover our equipment instead of pursuing other legal remedies, which has resulted in our recording of a reserve or a write-off.

Investing activities used net cash of $1,379 for the purchase of fixed assets during the three-month period ended August 31, 2008.

The Company had no financing activities during the three-month period ended August 31, 2008.

The following table presents the Company's expected cash requirements for contractual obligations outstanding as of August 31, 2008.

	Total	Due thru 9/1/2008 and 8/31/2009	Due thru 9/1/2009 and 8/31/2011	Due thru 9/1/2011 and 8/31/2013	Due Thereafter
Operating Leases	$ 612,182	$ 144,163	$ 305,856	$ 162,163	$ -
Other long-term liabilities	320,000	240,000	80,000	-	-
Total Contractual Cash Obligations	$ 932,182	$ 384,163	$ 385,856	$ 162,163	$ -

Liquidity

During the first quarter of fiscal 2008, events took place, that allowed us to raise additional capital through a private equity financing and by the sale of our facility under a leaseback agreement. See Note A for details of these events.

Based on our current operations and the amounts received from the transactions described in Note A, we believe that we have sufficient working capital to continue our operations through at least the next twelve months.

Effects of Inflation

We believe that inflation and changing prices over the past year have had a significant impact on our revenue or on our results of operations.

ITEM 3 - CONTROLS AND PROCEDURES

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of August 31, 2008, our disclosure controls and procedures are effective to provide reasonable assurances that such disclosure controls and

procedures satisfy their objectives and that the information required to be disclosed by us in the reports we file under the Exchange Act is recorded, processed, summarized and reported within the required time periods. There were no changes during the fiscal quarter ended August 31, 2008 in our internal controls or in other factors that could have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS:

None.

ITEM 2 - UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS:
None

ITEM 3 - DEFAULTS UPON SENIOR SECURITIES:

None

ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5 - OTHER INFORMATION:

None

ITEM 6 - EXHIBITS

Exhibits

31 Certifications pursuant to Rules 13a-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32 Certifications pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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.

VASOMEDICAL, INC.

By: /s/ John C.K Hui

John C.K. Hui
President and Chief Executive Officer

(Principal Executive Officer)

/s/ Tricia Efstathiou

Tricia Efstathiou
Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: October 15, 2008