VASOMEDICAL INC
Form 10-Q
April 14, 2005

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 February 28, 2005

[ ] 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

Number of Shares Outstanding of Common Stock, $.001 Par Value, at April 14, 2005 58,552,688

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the 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 [ ]
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Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X]
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ITEM 1 - FINANCIAL STATEMENTS

Vasomedical, Inc. and Subsidiaries

CONSOLIDATED CONDENSED BALANCE SHEETS

ASSETS	February 28, 2005 (unaudited)
CURRENT ASSETS	
Cash and cash equivalents	$1,228,727
Certificates of deposit and treasury bills	2,764,154
Accounts receivable, net of an allowance for doubtful accounts of $520,914 at February 28, 2005 and $699,203 at May 31, 2004	1,589,381
Inventories	3,613,082
Other current assets	436,636
Total current assets	9,631,980
PROPERTY AND EQUIPMENT, net of accumulated depreciation of $2,559,660 at February 28, 2005 and $ 2,378,576 at May 31, 2004	2,265,307
DEFERRED INCOME TAXES	14,582,000
OTHER ASSETS	318,597
	$26,797,884

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LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES	
Accounts payable and accrued expenses	$2,307,044
Current maturities of long-term debt and notes payable	145,164
Sales tax payable	228,761
Deferred revenues	1,646,918
Accrued warranty and customer support expenses	105,583
Accrued professional fees	114,817
Accrued commissions	105,998
Total current liabilities	4,654,285
LONG-TERM DEBT	985,089
ACCRUED WARRANTY COSTS	17,250
DEFERRED REVENUES	876,677
OTHER LIABILITIES	100,750
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; 58,552,688 and 58,419,356 shares at February 28, 2005 and May 31, 2004, respectively, issued and outstanding	58,552
Additional paid-in capital	51,450,639
Accumulated deficit	(31,345,358)
Total stockholders' equity	20,163,833
	$26,797,884
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The accompanying notes are an integral part of these condensed statements.

Vasomedical, Inc. and Subsidiaries

CONSOLIDATED CONDENSED STATEMENTS OF EARNINGS
(unaudited)

	Nine Months Ended		Thr
	February 28, 2005	February 29, 2004	February 2005
Revenues			
Equipment sales	$8,629,026	$14,147,248	$2,131,
Equipment rentals and services	2,618,393	2,132,323	832,
	11,247,419	16,279,571	2,964,
Cost of sales and services			
Cost of sales, equipment	3,034,836	4,616,671	831,
Cost of equipment rentals and services	965,413	948,427	332,

	4,000,249	5,565,098	1,164,
Gross Profit	7,247,170	10,714,473	1,799,
Expenses			
Selling, general and administrative	9,088,858	9,217,836	2,947,
Research and development	2,521,321	2,996,970	863,
Provision for doubtful accounts	135,156	1,147,011	2,
Interest expense and financing costs	84,971	101,335	25,
Interest and other income, net	(51,795)	(115,102)	(20,
	11,778,511	13,348,050	3,818,
LOSS BEFORE INCOME TAXES	(4,531,341)	(2,633,577)	(2,018,
Income tax expense, net	(29,661)	(30,000)	(7,
NET LOSS	$(4,561,002)	$(2,663,577)	$(2,026,
Net loss per common share			
- basic	$(0.08)	$(0.05)	$(0
- diluted	$(0.08)	$(0.05)	$(0
Weighted average common shares outstanding			
- basic	58,545,850	57,847,004	58,552,
- diluted	58,545,850	57,847,004	58,552,

The accompanying notes are an integral part of these condensed statements.

Vasomedical, Inc. and Subsidiaries

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

	Shares	Amount	Additional Paid-in Capital	Accumulate Deficit
Balance at June 1, 2004	58,419,356	$58,419	$51,320,106	$(26,784,
Exercise of stock options	133,332	133	130,533	
Net loss				(4,561,
Balance at February 28, 2005	58,552,688	$58,552	$51,450,639	$(31,345,

The accompanying notes are an integral part of this condensed statement.

Vasomedical, Inc. and Subsidiaries

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(unaudited)

	Nine mont
	February 28, 2005
Cash flows from operating activities	
Net loss	$(4,561,002)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities	
Depreciation and amortization	433,177
Provision for doubtful accounts	178,289
Allowance for inventory write-off	71,908
Changes in operating assets and liabilities	
Accounts receivable	3,754,183
Financing receivables, net	--
Inventories	(1,372,541)
Other current assets	(164,123)
Other assets	(50,530)
Accounts payable, accrued expenses and other current liabilities	(1,296,234)
Other liabilities	(400,099)
	1,154,030
Net cash (used in) provided by operating activities	(3,406,972)
Cash flows from investing activities	
Purchase of property and equipment	(177,340)
Purchase of certificates of deposit and treasury bills	(1,583,614)
Net cash used in investing activities	(1,760,954)
Cash flows from financing activities	
Proceeds from notes	--
Payments on notes	(99,062)
Proceeds from exercise of options and warrants	130,666
Net cash provided by financing activities	31,604
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(5,136,322)
Cash and cash equivalents - beginning of period	6,365,049
Cash and cash equivalents - end of period	$1,228,727
Non-cash investing and financing activities were as follows:	
Inventories transferred to (from) property and equipment, attributable to operating leases, net	$61,299

The accompanying notes are an integral part of these condensed statements.

Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (unaudited)
February 28, 2005

NOTE A - BASIS OF PRESENTATION

The consolidated condensed balance sheet as of February 28, 2005, and the related consolidated condensed statements of earnings for the nine and three-month periods ended February 28, 2005 and February 29, 2004, changes in stockholders' equity for the nine-month period ended February 28, 2005, and cash flows for the nine- month periods ended February 28, 2005 and February 29, 2004, have been prepared by Vasomedical, Inc. and Subsidiaries (the "Company") without audit. In the opinion of management, all adjustments (which include only normal, recurring accrual adjustments) necessary to present fairly the financial position and results of operations as of February 28, 2005, and for all periods presented have been made.

Certain information and footnote disclosures, normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted. These financial statements should be read in conjunction with the financial statements and notes thereto included in the Annual Report on Form 10-K for the year ended May 31, 2004. Results of operations for the periods ended February 28, 2005 and February 29, 2004 are not necessarily indicative of the operating results expected or reported for the full year.

We believe that our cash flow from operations together with our current cash reserves will be sufficient to fund our business plan and projected capital requirements through at least July 2005. Although we have incurred significant losses during the last three fiscal years, we believe that the Company is positioned for long-term growth. Our long-term growth is largely dependent upon the successful commercialization of EECP(R) therapy into the congestive heart failure ("CHF") indication which depends in part on results from the Prospective Evaluation of EECP in Congestive Heart Failure ("PEECH(TM)") clinical trial being sufficient to promote adoption of the therapy in CHF. As more fully discussed in Note K "SUBSEQUENT EVENT", PEECH results were disclosed on March 8, 2005. Our long-term ability to achieve profitable operations is further dependent on successfully completing additional debt or equity financing to provide marketing funds necessary to launch EECP therapy in the congestive heart failure market and to bridge the period between completion of the PEECH clinical trial and a congestive heart failure national reimbursement coverage decision by the Centers for Medicare and Medicaid Services (CMS). While we are currently seeking to raise such capital through public or private equity or debt financings, there is no assurance we will be successful in these efforts. Future capital funding, if available, may result in dilution to current shareholders.

Reclassifications

Certain reclassifications have been made to the prior years' amounts to conform with the current year's presentation.

NOTE B IMPACT OF NEW ACCOUNTING PRONOUNCEMENTS

In December 2004, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 153 ("SFAS No. 153"), "Exchanges of Non-monetary Assets an

amendment of APB Opinion No. 29". SFAS No. 153 amends Opinion 29 to eliminate the exception for non-monetary exchanges of similar productive assets and replaces it with a general exception for exchanges of non-monetary assets that do not have commercial substance. A non- monetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective for fiscal periods after June 15, 2005. The Company does not expect the adoption of SFAS No. 153 to have a material impact on the Company's consolidated financial statements.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123(R) ("SFAS No. 123(R)"), "Accounting for Stock-Based Compensation". SFAS No. 123(R) establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. This Statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS No. 123(R) requires that the fair value of such equity instruments be recognized as expense in the historical financial statements as services are performed. Prior to SFAS No. 123(R), only certain pro-forma disclosures of fair value were required. SFAS No. 123(R) shall be effective for the Company as of the beginning of the first interim reporting period that begins after June 15, 2005. The adoption of this new accounting pronouncement is expected to have a

material impact on the financial statements of the Company commencing with the quarter ending November 30, 2005.

In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151 ("SFAS No. 151"), Inventory Costs, an amendment of ARB No. 43, Chapter 4. The amendments made by SFAS No. 151 will improve financial reporting by clarifying that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and by requiring the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Earlier application is permitted for inventory costs incurred during fiscal years beginning after November 24, 2004. The Company is currently evaluating the impact of adoption of SFAS No. 151 on its financial position and results of operations.

In December 2003, the SEC issued Staff Accounting Bulletin (SAB) No. 104, "Revenue Recognition" (SAB No. 104), which codifies, revises and rescinds certain sections of SAB No. 101, "Revenue Recognition in Financial Statements", in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The changes noted in SAB No. 104 did not have a material effect on the Company's financial position or results of operations.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150 ("SFAS No. 150"), "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." This statement establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. In accordance with the standard, financial instruments that embody obligations for the issuer are required to be classified as liabilities. This Statement shall be effective for financial instruments entered

into or modified after May 31, 2003, and otherwise shall be effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 has not had a material impact on the Company's financial position and results of operations.

In April 2003, the FASB issued Statement of Financial Accounting Standards No. 149 ("SFAS No. 149"), "Amendment of Statement No. 133 on Derivative Instruments and Hedging Activities," which amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003, except for the provisions that were cleared by the FASB in prior pronouncements. The adoption of SFAS No. 149 has not had a material impact on the Company's financial position and results of operations.

In January 2003, the FASB issued FASB Interpretation No. 46 "Consolidation of Variable Interest Entities" ("FIN 46"), as interpreted by FIN 46R. In general, a variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. A variable interest entity often holds financial assets, including loans or receivables, real estate or other property. A variable interest entity may be essentially passive or it may engage in activities on behalf of another company. Until now, a company generally has included another entity in its consolidated financial statements only if it controlled the entity through voting interests. FIN 46 changes that by requiring a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. FIN 46's consolidation requirements apply immediately to variable interest entities created or acquired after January 31, 2003. The consolidation requirements apply to older entities in the first interim period beginning after June 15, 2003. Certain of the disclosure requirements apply in all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. The Company adopted FIN 46 effective January 31, 2003. The adoption of FIN 46 did not have a material impact on the Company's financial position or results of operations.

In November 2002, the Emerging Issues Task Force, ("EITF") reached a consensus opinion on, "Revenue Arrangements with Multiple Deliverables", "(EITF 00-21)". That consensus provides that revenue arrangements with multiple deliverables should be divided into separate units of accounting if certain criteria are met. The consideration of the arrangement should be allocated to the separate units of accounting based on their relative fair values, with different provisions if the fair value is contingent on delivery of specified items or performance conditions. Applicable revenue criteria should be considered separately for each separate unit of accounting. EITF 00-21 is effective for revenue arrangements entered into in fiscal periods beginning

after June 15, 2003. Effective September 1, 2003, the Company prospectively adopted the provisions of EITF 00-21.

NOTE C STOCK-BASED COMPENSATION

The Company has five stock-based employee compensation plans. The Company

accounts for stock-based compensation using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations ("APB No. 25") and has adopted the disclosure provisions of Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No. 123." Under APB No. 25, when the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized. Accordingly, no compensation expense has been recognized in the consolidated financial statements in connection with employee stock option grants.

On October 28, 2004 the shareholders approved the 2004 Stock Option/Stock Issuance Plan and authorized the issuance of 2,500,000 shares.

During the nine-month period ended February 28, 2005, the Board of Directors granted non-qualified stock options under the 1997 Stock Option Plan, the 1999 Stock Option Plan and the 2004 Stock Option/Stock Issuance Plan to 9 directors, 4 officers, and 37 employees to purchase an aggregate of 2,428,000 shares of common stock, at exercise prices ranging from $0.95 to $1.19 per share, which represented the fair market value of the underlying common stock at the time of the respective grants. These options vest immediately, or over three-year and four-year periods, and expire five years and ten years from the date of grant.

During the nine-month period ended February 28, 2005, options to purchase 133,332 shares of common stock were exercised at an exercise price of $0.98 per share, aggregating $130,666 of proceeds to the Company. During the nine-month period ended February 28, 2005, options to purchase 474,166 shares of common stock at an exercise price of $0.91 - $3.96 were cancelled.

The following table illustrates the effect on net loss and loss per share had the Company applied the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," to stock-based employee compensation.

	Nine Months Ended		Three
	February 28, 2005	February 29, 2004	February 28, 2005
Net loss, as reported	$(4,561,002)	$(2,663,577)	$(2,026,849)
Deduct: Total stock-based employee compensation expense determined under fair value-based method for all awards	(888,075)	(1,080,817)	(234,549)
Pro forma net loss	$(5,449,077)	$(3,744,394)	$(2,261,398)
Loss per share:			
Basic - as reported	$(0.08)	$(0.05)	$(0.03)
Diluted - as reported	$(0.08)	$(0.05)	$(0.03)
Basic - pro forma	$(0.09)	$(0.06)	$(0.04)
Diluted - pro forma	$(0.09)	$(0.06)	$(0.04)

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.

The fair value of the Company's stock-based awards was estimated assuming the following weighted- average assumptions for the nine months ended February 28, 2005:

Expected life (years)	5
Expected volatility	82%
Risk-free interest rate	4.4%
Expected dividend yield	0.0%

NOTE D - EARNINGS (LOSS) PER COMMON SHARE

Basic earnings (loss) per share is based on the weighted average number of common shares outstanding without consideration of potential common shares. Diluted earnings (loss) per share is based on the weighted number of common and potential 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. For the nine-month and three-month periods ended February 28, 2005 options and warrants to purchase 6,832,253 of common stock were excluded from the computation of diluted earnings per share because the effect of their inclusion would be antidilutive. Similarly, for the nine-month and three-month periods ended February 29, 2004, options and warrants to purchase 6,745,086 were excluded from the computation of diluted earnings per share due to their antidilutive effect.

The following table sets forth the computation of basic and diluted earnings (loss) per common share:

	Nine Months Ended	Thr

	February 28, 2005	February 29, 2004	February 2005
Numerator:			
Basic and diluted net loss	$(4,561,002)	$(2,663,577)	$(2,026,
Denominator:			
Basic - weighted average common shares	58,545,850	57,847,004	58,552,
Stock options	--	--	
Warrants	--	--	
Diluted - weighted average common shares	58,545,850	57,847,004	58,552,
Basic and diluted loss per common share	$(0.08)	$(0.05)	$(0.

NOTE E - INVENTORIES

Inventories consist of the following:

	February 28, 2005	May 2
Raw materials	$1,133,485	
Work in process	1,291,609	
Finished goods	1,187,988	
	$3,613,082	$2

At February 28, 2005 and May 31, 2004, the Company has recorded reserves for obsolete inventory of $472,000 and $399,000, respectively.

NOTE F - LONG-TERM DEBT

The following table sets forth the computation of long-term debt:

	February 28, 2005	May 2
Facility loans (a)	$983,257	$
Term loans (b)	146,996	
	1,130,253	
Less current portion	(145,164)	

	$985,089	$

(a) The Company purchased its headquarters and warehouse facility and secured notes of $641,667 and $500,000, respectively, under two programs sponsored by New York State. These notes, which bear interest at 7.8% and 6%, respectively, are payable in monthly installments consisting of principal and interest payments over fifteen- year terms, expiring in September 2016 and January 2017, respectively, and are secured by the building.

(b) In fiscal years 2003 and 2004, the Company financed the cost and implementation of a management information system and secured several notes, aggregating approximately $305,219. The notes, which bear interest at rates ranging from 7.5% through 12.5%, are payable in monthly installments consisting of principal and interest payments over four-year terms, expiring at various times between August and October 2006.

NOTE G - DEFERRED REVENUES

The Company records revenue on extended service contracts ratably over the term of the related warranty contracts. Effective September 1, 2003, the Company prospectively adopted the provisions of EITF 00-21. Upon adoption of the provisions of EITF 00-21, the Company began to defer revenue related to EECP system sales for the fair value of in-service and training to the period when the services are rendered and for warranty obligations ratably over the service period, which is generally one year. The changes in the Company's deferred revenues are as follows:

	Nine Months Ended		Thr
	February 28, 2005	February 29, 2004	February 2005
Deferred Revenue at the beginning of the period	$2,846,451	$1,709,551	$2,773
ADDITIONS			
Deferred extended service contracts	1,473,022	1,392,588	428
Deferred in-service and training	147,500	215,000	30
Deferred warranty obligations	630,000	650,000	132
RECOGNIZED AS REVENUE			
Deferred extended service contracts	(1,395,461)	(1,066,682)	(512
Deferred in-service and training	(230,000)	(157,500)	(60
Deferred warranty obligations	(947,917)	(183,333)	(269
Deferred revenue at end of period	2,523,595	2,559,624	2,523
Less: current portion	(1,646,918)	(1,601,037)	(1,646
Long-term deferred revenue at end of period	$876,677	$958,587	$876

NOTE H - WARRANTY COSTS

Equipment sold is generally covered by a warranty period of one year. Effective September 1, 2003, the Company adopted the provisions of EITF 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables" on a

Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (unaudited)
February 28, 2005

prospective basis. Under EITF 00-21, for certain arrangements, a portion of the overall system price attributable to the first year warranty service is deferred and recognized as revenue over the service period. As such, the Company no longer accrues estimated warranty costs upon delivery but rather recognizes warranty and related service costs as incurred. Prior to September 1, 2003, the Company accrued a warranty reserve for estimated costs to provide warranty services when the equipment sale is recognized. The factors affecting the Company's warranty liability included the number of units sold and historical and anticipated rates of claims and costs per claim. The warranty provision resulting from transactions prior to September 1, 2003 will be reduced in future periods for material and labor costs incurred as related product is serviced during the warranty period or when the warranty period elapses. A review of warranty obligations is performed regularly to determine the adequacy of the reserve. Based on the outcome of this review, revisions to the estimated warranty liability are recorded as appropriate.

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

	Nine Months Ended		Thre
	February 28, 2005	February 29, 2004	February 2005
Warranty liability at the beginning of the period	$244,917	$788,000	$154,
Expense for new warranties issued	-	164,000	
Warranty amortization	(122,084)	(602,000)	(31,
Warranty liability at end of period	122,833	350,000	122,
Less: Current portion	(105,583)	(241,000)	(105,
Long-term warranty liability at end of period	$17,250	$109,000	$17,

NOTE I - INCOME TAXES

During the nine-months ended February 28, 2005 and February 29, 2004, we recorded a provision for state income taxes of $29,661 and $30,000, respectively.

As of February 28, 2005, the Company had recorded deferred tax assets of $14,582,000 net of a $3,444,520 valuation allowance related to the anticipated recovery of tax loss carryforwards. The amount of the deferred tax assets considered realizable could be reduced in the future if estimates of future taxable income during the carryforward period are lower than projected. Ultimate realization of the deferred tax assets is dependent upon material improvements over present levels of consolidated pre-tax losses in order for us to generate sufficient taxable income prior to the expiration of the tax loss carryforwards. Management believes that the Company is positioned for long-term growth despite the financial results achieved through February 28, 2005, and that based upon the weight of available evidence, that it is "more likely than not" that the net deferred tax assets will be realized. The "more likely than not" standard is subjective, and is based upon management's estimate of a greater than 50% probability that its long range business plan can be realized.

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's estimates are largely dependent upon achieving considerable growth in revenue and profits resulting from the successful commercialization of EECP therapy into the congestive heart failure indication, which Management believes will enable the Company to reverse the current trend of increasing losses and generate pre-tax income in excess of over $42 million over the next seven years in order to fully utilize all of the deferred tax assets. Such future estimates of future taxable income 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. Certain critical assumptions associated with the Company's estimates include:

-- that the results from the PEECH clinical trial, as disclosed in Note K "SUBSEQUENT EVENT", as well as other cllinical evidence are sufficiently positive for the PEECH clinical trial to be published in a peer review journal and enable the EECP therapy to obtain approval for a national Medicare reimbursement coverage policy plus other third-party payer reimbursement policies specific to the congestive heart failure indication;

-- that the reimbursement coverage will be both broad enough in terms of coverage language and at an amount adequate to enable successful commercialization of EECP therapy into the congestive heart failure indication and enable the Company to achieve material growth in revenue and profits;

-- that the EECP therapy will be accepted by the medical community as an adjunctive therapy for the treatment of patients suffering from congestive heart failure; and

-- that we will be able to secure additional financing to provide sufficient funds to market EECP therapy in the congestive heart failure indication.

Additional uncertainties that could cause actual results to differ materially are the following:

-- the effect of the dramatic changes taking place in the healthcare environment;

-- the impact of competitive procedures and products and their pricing;

-- other medical insurance reimbursement policies;

-- there can be no assurance that we will be able to raise additional capital necessary to implement our business plan;

-- unexpected manufacturing problems;

-- unforeseen difficulties and delays in the conduct of clinical trials, peer review publications 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;

-- the recent history of declining revenues and profits; and

-- the risk factors reported from time to time in the Company's SEC reports.

Factors considered by Management in making its assumptions and included in the long-term business plan are the following:

-- FDA clearance to market EECP therapy in congestive heart failure;

-- independent market research indicates that the patient population potentially eligible for EECP therapy in congestive heart failure market is larger than the current refractory angina patient population and when the two patient populations are combined the total market opportunity for EECP therapy will be more than double;

-- many physician practices have told Management that they do not have a sufficient number of patients to economically justify adoption of the procedure with the current reimbursement coverage for refractory angina. The increased market size resulting from the addition of CHF patients should improve the economic model for the physician practice;

-- positive clinical evidence from the PEECH clinical trial that was recently concluded as disclosed in Note K "SUBSEQUENT EVENT", plus other smaller clinical trials and the IEPR patient registry that demonstrates the clinical effectiveness of EECP therapy in the treatment of congestive heart failure to medical providers, payers and regulators.

-- the PEECH clinical trial was completed this fiscal year as planned and the summary results of the trial were disclosed in March 2005;

-- the Company intends to have the results of the PEECH trial published in a peer review journal, which is an important step necessary to support an application to CMS to expand reimbursement coverage of EECP therapy to include CHF patients;

-- the Company sustained a period of profitability in fiscal years 2000, 2001 and 2002 with profits before income taxes of $1,290,916, $5,237,242 and $4,240,106, respectively; and

-- management continues to believe that the Company will be able to raise sufficient funds to enable it to execute its business plan.

While Management believes that they will be able to execute the Company's business plan over the longer term and the Company will be able to utilize its tax loss carryforwards, the exact timing of its return to profitability is uncertain, subject to significant management judgments and estimates and dependent on a variety of external factors including: market conditions at that time, the reception of the EECP therapy by the medical professionals and payers and the timing of a Medicare reimbursement decision. It is possible that significant tax loss carryforwards from fiscal years 2005, 2006 and 2007 may

expire before the Company is able to use them. As a result of these uncertainties, beginning in fiscal 2004, the Company began to provide a valuation reserve for all additional tax loss carryforwards that were generated by current operating losses. Management reviews this policy on a quarterly basis and believes that the above valuation reserve is appropriate under the current circumstances.

The amount of the deferred tax assets considered realizable could be reduced in the future if estimates of future taxable income during the carryforward period are reduced or if the accounting standards are changed to reflect a more stringent standard for evaluation of deferred tax assets.

The recorded deferred tax asset includes an increase to the valuation allowance of $1,536,520 during the nine-months ended February 28, 2005.

NOTE J - COMMITMENTS AND CONTINGENCIES

Employment Agreements

The approximate aggregate minimum compensation obligation under active employment agreements at February 28, 2005 are summarized as follows:

Twelve month period ended February 28,	Amount
2006	$78,125

NOTE K - SUBSEQUENT EVENT

On March 8, 2005, results of the Prospective Evaluation of EECP(R) in Congestive Heart Failure ("PEECH") trial were presented by Dr. Arthur M. Feldman, MD, PhD, Principal Investigator, in a Late Breaking Clinical Trials session of the American College of Cardiology ("ACC") Annual Scientific Session. Simultaneously, the Company announced the positive results of the trial to the public in a Press Release. The PEECH trial evaluated the efficacy of EECP therapy for the treatment of congestive heart failure ("CHF").

In designing the PEECH trial, success was demonstrated if the difference between EECP therapy combined with optimal medical therapy compared to optimal medical therapy alone achieved a p-value less than 0.025 in at least one of two pre-defined co-primary endpoints:

1. percentage of subjects with greater than or equal to 60 seconds improvement in exercise duration from baseline to six months, or

2. percentage of subjects with at least 1.25 ml/min/kg increase in peak oxygen consumption from baseline to six months.

Additional secondary endpoints were changes in exercise duration and peak oxygen consumption, changes in New York Heart Association ("NYHA") functional classification, changes in quality of life, adverse experiences and pre-defined clinical outcomes.

The study demonstrated that there were improvements in exercise duration for subjects with NYHA Class II and III symptoms of CHF who were given EECP therapy as an adjunctive therapy. Among those treated with EECP 35.4% achieved an exercise duration increase equal to or more than 60 seconds, compared with only 25.3% in the control group (p = 0.016). Peak oxygen consumption was not significantly different between the two groups at six months.

In addition, consistent with the improvement in exercise duration, symptom

status, assessed by the NYHA functional class, improved 31% in the EECP group compared to 16% in the control group (p = 0.01) and overall quality of life, as reported on the Minnesota Living with Heart Failure scale, also improved significantly. Furthermore, in exercise duration after six months the average was an increase in 25 seconds for the subjects who underwent EECP therapy, compared with a 10 second decline for patients without the EECP therapy (p = 0.01). Peak oxygen consumption was not significantly different between the two groups at six months. Additionally, EECP therapy was deemed safe and well tolerated in this group of patients. The study concluded that the results suggest EECP provides adjunctive therapy in patients with NYHA Class II-III heart failure receiving optimal pharmacological therapy.

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 "anticipated", "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. (the "Company"), incorporated in Delaware in July 1987, is primarily engaged in designing, manufacturing, marketing and supporting EECP(R) external counterpulsation systems based on our proprietary technology currently indicated for use in cases of stable or unstable angina (i.e., chest pain), cardiogenic shock, acute myocardial infarction (i.e., heart attack) and congestive heart failure ("CHF"). EECP therapy is currently marketed for chronic stable angina. We are also actively engaged in research to determine the potential benefits of EECP therapy in the management of CHF. EECP 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 may restore systemic vascular function. We provide hospitals, clinics and private practices with EECP equipment, treatment guidance, and a staff training and maintenance program designed to provide improved patient outcomes. EECP is a registered trademark for Vasomedical's enhanced external counterpulsation systems.

Medicare and numerous other commercial third-party payers currently

reimburse for EECP therapy in the treatment of refractory angina. The Medicare reimbursement rate in the continental United States for a full course of 35 one-hour treatments ranges from $3,955 to $7,216. Although Medicare has not modified its national coverage policy for EECP therapy to specifically include CHF patients, we believe, based upon data published from the International EECP Patient Registry ("IEPR"), that there exists a significant subset of patients with CHF that also have disabling angina that qualify for Medicare reimbursement under its present coverage policy. However reimbursement for CHF as a primary indication is not covered under national coverage policy.

Critical Accounting Policies

Financial Reporting Release No. 60, which was released by the Securities and Exchange Commission, or 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 A of the Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended May 31, 2004 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

We recognize 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 systems in the period in which we deliver the system to the customer. Revenue from the sale of our EECP systems to international markets is recognized upon shipment, during the period in which we deliver 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 direct EECP 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. Effective September 1, 2003, we adopted the provisions of Emerging Issues Task Force, or EITF, Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables", ("EITF 00-21"), on a prospective basis. 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 our multiple-element arrangements are generally

comprised of the following elements that would qualify as separate units of accounting: system sales, in-service support consisting of equipment set-up and training provided at the customers facilities and warranty service for system sales generally covered by a warranty period of one year. 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 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 EECP system sales;

i) when delivery and acceptance occurs based on delivery and acceptance documentation received from independent shipping companies or customers,
ii) for in-service and training following documented completion of the training, and
iii) for warranty service ratably over the service period, which is generally one year. In-service and training generally occurs within three weeks of shipment and our return policy states that no returns will be accepted after in-service and training has been completed.

We recognized deferred revenues of $230,000 and $60,000 related to in-service training and $947,917 and $269,166 related to warranty service during the nine-month and three-month periods ended February 28, 2005, respectively. In addition, following the adoption of the provisions of EITF 00-21 beginning September 1, 2003 we began to defer revenue that had previously been recorded at the time of sale. Previously, in accordance with Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements," we accrued costs associated with these arrangements as warranty expense in the period the system was delivered and accepted. During the nine-month and three-month periods ended February 28, 2005, we deferred $147,500 and $30,000 related to in-service training and $630,000 and $132,500 related to warranty service, respectively. The amount related to in-service training is recognized as revenue at the time the in-service training is completed and the amount related to warranty service is recognized as service revenue ratably over the related service period, which is generally one year. Costs associated with the provision of in-service training and warranty service, including salaries, benefits, travel, spare parts and equipment, are recognized in cost of sales as incurred.

We also recognize revenue generated from servicing EECP systems that are no longer covered by a warranty agreement, or by providing sites with additional training, in the period that these services are provided. Revenue related to future commitments under separately priced extended warranty agreements on the EECP system are deferred and recognized ratably over the service period, generally ranging from one year to four years. Deferred revenues recognized related to extended warranty agreements that have been invoiced to customers prior to the performance of these services, were $1,395,461 and $1,066,682 for the nine-month periods ended February 28, 2005 and February 29, 2004, respectively, and $512,015 and $399,109 for the three-month periods ended February 28, 2005 and February 29, 2004, respectively. 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 balance sheets.

We have also entered into lease agreements for our EECP 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 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 February 28, 2005.

Accounts Receivable, net

Our accounts receivable, net 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 outstanding longer than the contractual payment terms are considered past due. Estimates are used in determining our allowance for doubtful accounts based on our historical collections experience, current trends, credit policy and a percentage of our accounts receivable by aging category. In determining these percentages, we look at historical write-offs of our receivables. We also look at the credit quality of its customer base as well as changes in our credit policies. We continuously monitor collections and payments from its customers. While credit losses have historically been within expectations and the provisions established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past.

Inventories, net

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

Deferred Revenues

We record revenue on extended service contracts ratably over the term of the related warranty contracts. Effective September 1, 2003, we prospectively adopted the provisions of EITF 00-21. Upon adoption of the provisions of EITF 00-21 effective September 1, 2003, we began to defer revenue related to EECP system sales for the fair value of in-service and 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. Effective September 1, 2003, we adopted the provisions of EITF 00-21 on a prospective basis. Under EITF 00-21, for certain arrangements, a portion of the overall system price attributable to the first year warranty service is deferred and recognized as revenue over the service period. As such, we no longer accrue warranty costs upon delivery but rather recognize warranty and related service costs as incurred. Prior to September 1, 2003, we accrued a warranty reserve for estimated costs to provide warranty services when the equipment sale was recognized. The factors affecting our warranty liability included the number of units sold and historical and anticipated rates of claims and costs per claim. The warranty provision resulting from transactions prior to September 1, 2003, will be reduced in future periods for material and labor costs incurred as related product is returned during the warranty period or when the warranty period elapses.

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 change, 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 our long range business plan can be realized.

Deferred tax liabilities and assets are classified as current or non-current based on the classification of the related asset or liability for financial reporting. A deferred tax liability or asset 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 we recorded relates primarily to the realization of net operating loss carryforwards, of which the allocation of the current portion, if any, reflects the expected utilization of such net operating losses in next twelve months. Such allocation is based our internal financial forecast and may be subject to revision based upon actual results.

Stock Compensation

We have five stock-based employee compensation plans. We account for stock-based compensation using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to

Employees," and related Interpretations ("APB No. 25") and have adopted the disclosure provisions of Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No. 123." Under APB No. 25, when the exercise price of our employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized. Accordingly, no compensation expense has been recognized in the consolidated financial statements in connection with employee stock option grants.

Pro forma compensation expense may not be indicative of future disclosures because it does not take into effect pro forma compensation expense related to grants before 1995. For purposes of estimating the fair value of each option on the date of grant, we 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 our 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 our 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.

Recently Issued Accounting Standards

In December 2004, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 153 ("SFAS No. 153"), "Exchanges of Non-monetary Assets an amendment of APB Opinion No. 29". SFAS No. 153 amends Opinion 29 to eliminate the exception for non-monetary exchanges of similar productive assets and replaces it with a general exception for exchanges of non-monetary assets that do not have commercial substance. A non- monetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective for fiscal periods after June 15, 2005. The Company does not expect the adoption of SFAS No. 153 to have a material impact on the Company's consolidated financial statements.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123(R) ("SFAS No. 123(R)"), "Accounting for Stock-Based Compensation". SFAS No. 123(R) establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. This Statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS No. 123(R) requires that the fair value of such equity instruments be recognized as expense in the historical financial statements as services are performed. Prior to SFAS No. 123(R), only certain pro-forma disclosures of fair value were required. SFAS No. 123(R) shall be effective for the Company as of the beginning of the first interim reporting period that begins after June 15, 2005. The adoption of this new accounting pronouncement is expected to have a material impact on the financial statements of the Company commencing with the quarter ending November 30, 2005.

In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151 ("SFAS No. 151"), Inventory Costs, an amendment of ARB No. 43, Chapter 4. The amendments made by SFAS No. 151 will improve financial reporting by clarifying that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and by requiring the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Earlier application is permitted for inventory costs incurred during fiscal years beginning after November 24, 2004. The Company is currently evaluating the impact of adoption of SFAS No. 151 on its financial position and results of operations.

In December 2003, the SEC issued Staff Accounting Bulletin (SAB) No. 104, "Revenue Recognition" (SAB No. 104), which codifies, revises and rescinds certain sections of SAB No. 101, "Revenue Recognition in Financial Statements", in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The changes noted in SAB No. 104 did not have a material effect on our financial position or results of operations.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150 ("SFAS No. 150"), "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." This statement establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. In accordance with the standard, financial instruments that embody obligations for the issuer are required to be classified as liabilities. This Statement shall be effective for financial instruments entered into or modified after May 31, 2003, and otherwise shall be effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 has not had a material impact on our financial position and results of operations.

In April 2003, the FASB issued Statement of Financial Accounting Standards No. 149 ("SFAS No. 149"), "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," which amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003, except for the provisions that were cleared by the FASB in prior pronouncements. The adoption of SFAS No. 149 has not had a material impact on our financial position and results of operations.

In January 2003, the FASB issued FASB Interpretation No. 46 "Consolidation of Variable Interest Entities" ("FIN 46"), as interpreted by FIN 46R. In general, a variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. A variable interest entity often holds financial assets, including loans or receivables, real estate or other property. A variable interest entity may be essentially passive or it may engage in activities on behalf of another company. Until now, a company generally has included another entity in its consolidated financial statements only if it controlled the entity through voting interests. FIN 46 changes that by requiring a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. FIN 46's consolidation requirements apply immediately to variable interest entities created or acquired after January 31, 2003. The consolidation requirements apply to older entities in the first

interim period beginning after June 15, 2003. Certain of the disclosure requirements apply in all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. We adopted FIN 46 effective January 31, 2003. The adoption of FIN 46 did not have a material impact on our financial position or results of operations.

In November 2002, the Emerging Issues Task Force, ("EITF") reached a consensus opinion on, "Revenue Arrangements with Multiple Deliverables", "(EITF 00-21)". That consensus provides that revenue arrangements with multiple deliverables should be divided into separate units of accounting if certain criteria are met. The consideration of the arrangement should be allocated to the separate units of accounting based on their relative fair values, with different provisions if the fair value is contingent on delivery of specified items or performance conditions. Applicable revenue criteria should be considered separately for each separate unit of accounting. EITF 00-21 is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. Effective September 1, 2003, we prospectively adopted the provisions of EITF 00-21.

Results of Operations

Three Months Ended February 28, 2005 and February 29, 2004

Net revenues from sales, leases and service of our external counterpulsation systems ("EECP" systems) for the three-month periods ended February 28, 2005 and February 29, 2004, were $2,964,328 and $5,949,910, respectively, which represented a decline of $2,985,582 or 50%. We reported a net loss of $2,026,849 compared to a net loss of $310,041 for the three-month periods ended February 28, 2005 and February 29, 2004, respectively. Our net loss per common share was $0.03 for the three-month period ended February 28, 2005 compared to a net loss of $0.01 for the three-month period February 29, 2004.

Revenues

Revenues from equipment sales declined approximately 59% to $2,131,567 for the three-month period ended February 28, 2005 as compared to $5,185,388 for the same period for the prior year. The decline in equipment sales is due primarily to a 63% decline in domestic units shipped and a 10% decline in the average sales prices of new EECP systems sold in the domestic market.

We believe the decline in domestic units shipped reflects weakened demand in the refractory angina market as existing capacity is more fully utilized, coupled with increased competition from surgical procedures, mainly the use of drug-eluting stents. We anticipate that demand for EECP systems will remain soft until an expansion of the current Centers for Medicare and Medicaid Services ("CMS") national reimbursement policy for use of EECP therapy to treat congestive heart failure patients is obtained. In addition, average domestic selling prices continue to decline reflecting the impact in the market of lower priced competitive products. We continue to believe that our EECP systems currently sell at a significant price premium to competitive products reflecting the clinical efficacy and superior quality of the EECP system plus the many

value added services offered by us. However, we anticipate that this current trend of declining prices will continue in the immediate future as our competition attempts to capture greater market share through pricing discounts. Lastly, we continue to reorganize certain territory responsibilities in our sales department due to recently vacant and/or unproductive territories, and recently completed the restructuring of a major independent distributor territory to direct sales.

Our revenue from the sale of EECP systems to international distributors in the third quarter of fiscal 2005 decreased approximately 49% to $145,000 compared to $286,500 in same period of the prior year reflecting decreased volume.

The above decline in revenue from equipment sales was partially offset by a 9% increase in revenue from equipment rental and services for the three month period ended February 28, 2005, from the same three-month period in the prior year. Revenue from equipment rental and services represented 28% of total revenue in the third quarter of fiscal 2005 compared to 13% in the third quarter of fiscal 2004. The increase in both absolute amounts and percentage of total revenue resulted primarily from an increase of $126,960, or approximately 20%, in service related revenue from $640,690 to $767,650 for the three-month periods ended February 29, 2004 and February 28, 2005, respectively. The higher service revenue reflects an increase in service, spare parts and consumables as a result of the continued growth of the installed base of EECP systems plus greater marketing focus on the sale of extended service contracts. Rental revenue decreased approximately 53% from $107,915 for the three-month period ended February 29, 2004 to $50,379 for the three-month period ended February 28, 2005, reflecting the deferral of $37,098 in rental revenue due to use of the installment method of revenue recognition for one customer.

Gross Profit

Gross profit declined to $1,799,746 or 61% of revenues for the three-month period ended February 28, 2005, compared to $4,016,735 or 68% of revenues for the three-month period ended February 29, 2004. Gross profit margin as a percentage of revenue for the three-month period ended February 28, 2005 decreased due to the lower margins from the sales of EECP systems due to reduction in average selling prices, a lower mix of used systems and higher production costs and reflecting reduced production quantities. Many of our used EECP systems carried reduced book values since they were partially amortized and as a result generated above average gross profit margins. We have limited quantities of the lower cost systems and do not anticipate a significant volume of used equipment will be sold in the future. Rental and service related margins declined slightly due to the deferral of rental revenue due to collectibility risks associated with our largest rental customer. The decline in gross profit when compared to the prior year in absolute dollars is a direct result of the lower revenue.

Gross profits are dependent on a number of factors, particularly the mix of EECP models sold and their respective average selling prices, the mix of EECP 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.

Selling, General and Administrative

Selling, general and administrative ("SG&A") expenses for the three-months ended February 28, 2005 and February 29, 2004 were $2,947,978 or 99% of revenues and $3,083,407 or 52% of revenues, respectively reflecting a decrease of $135,429 or approximately 4%. The decrease in SG&A expenditures in the third quarter of fiscal 2005 compared to fiscal 2004 resulted primarily from lower sales commissions of $307,893 associated with decreased sales revenue and lower administrative consulting of $76,425. Partially offsetting the above were increases in marketing consulting and trade show related costs $ $93,678 and $175,889, respectively.

Research and Development

Research and development ("R&D") expenses of $863,476 or 29% of revenues for the three months ended February 28, 2005, decreased by $180,119 or 17%, from the prior three months ended February 29, 2004, of $1,043,595 or 18% of revenues. The decrease reflects lower spending related to the Prospective Evaluation of EECP in Congestive Heart Failure ("PEECH(TM)") clinical trial and lower new product development costs. The patient treatment phase of the PEECH study was completed in March 2004; as a result, we have incurred lower levels of spending related to subject study activity and study management aspects of the trial. As described more fully below, we disclosed the initial results of the PEECH trial in March 2005 and expect to submit an application to the Centers for Medicare and Medicaid Services ("CMS") for a coverage decision leading to reimbursement for use of EECP therapy in treatment of CHF. Based on the above timetable we anticipate a coverage decision by CMS in early 2006.

On March 8, 2005, results of the PEECH trial were presented by Dr. Arthur M. Feldman, MD, PhD, Principal Investigator, in a Late Breaking Clinical Trials session of the American College of Cardiology ("ACC") Annual Scientific Session. Simultaneously, the Company announced the positive results of the trial to the public in a Press Release. The PEECH trial evaluated the efficacy of EECP therapy for the treatment of congestive heart failure ("CHF").

In designing the PEECH trial, success was demonstrated if the difference between EECP therapy combined with optimal medical therapy compared to optimal medical therapy alone achieved a p-value less than 0.025 in at least one of two pre-defined co-primary endpoints:

1. percentage of subjects with greater than or equal to 60 seconds improvement in exercise duration from baseline to six months, or

2. percentage of subjects with at least 1.25 ml/min/kg increase in peak oxygen consumption from baseline to six months.

Additional secondary endpoints were changes in exercise duration and peak oxygen consumption, changes in New York Heart Association ("NYHA") functional classification, changes in quality of life, adverse experiences and pre-defined clinical outcomes.

The study demonstrated that there were improvements in exercise duration for subjects with NYHA Class II and III symptoms of CHF who were given EECP therapy as an adjunctive therapy. Among those treated with EECP 35.4% achieved an exercise duration increase equal to or more than 60 seconds, compared with only 25.3% in the control group (p = 0.016). Peak oxygen consumption was not significantly different between the two groups at six months.

In addition, consistent with the improvement in exercise duration, symptom status, assessed by the NYHA functional class, improved 31% in the EECP group compared to 16% in the control group (p = 0.01) and overall quality of life, as reported on the Minnesota Living with Heart Failure scale, also improved significantly. Furthermore, in exercise duration after six months the average was an increase in 25 seconds for the subjects who underwent EECP therapy, compared with a 10 second decline for patients without the EECP therapy (p = 0.01). Peak oxygen consumption was not significantly different between the two groups at six months. Additionally, EECP therapy was deemed safe and well tolerated in this group of patients. The study concluded that the results suggest EECP provides adjunctive therapy in patients with NYHA Class II-III heart failure receiving optimal pharmacological therapy.

Provision for Doubtful Accounts

We collected funds from previously reserved accounts, which largely offset new reserve requirements. As a result, we incurred a charge to our provision for doubtful accounts during the three-month period ended February 28, 2005 of $2,200, as compared to $161,500 during the three-month period ended February 29, 2004.

Interest Expense and Financing Costs

Interest expense and financing costs decreased to $25,931 in the three-month period ended February 28, 2005, from $35,089 for the same period in the prior year. Interest expense reflects interest on loans secured to refinance the November 2000 purchase of our headquarters and warehouse facility, as well as on loans secured to finance the cost and implementation of a new management information system.

Interest and Other Income, Net

Interest and other income for the third quarters of fiscal years 2005 and 2004, was $20,968 and $6,815, respectively. The increase in interest and other income from the prior period is attributable to higher yields on invested balances, which offset the effect of lower average cash balances in the current quarter.

Income Tax Expense, Net

During the three-months ended February 28, 2005 and February 29, 2004, we recorded a provision for state income taxes of $7,978 and $10,000, respectively.

As of February 28, 2005, we had recorded deferred tax assets of $14,582,000 net of a $3,444,520 valuation allowance related to the anticipated recovery of tax loss carryforwards. The amount of the deferred tax assets considered realizable could be reduced in the future if estimates of future taxable income during the carryforward period are lower than projected. Ultimate realization of the deferred tax assets is dependent upon material improvements over present levels of consolidated pre-tax losses in order for us to generate sufficient taxable income prior to the expiration of the tax loss carryforwards. We believe that the Company is positioned for long-term growth despite the financial results achieved during fiscal years 2005, 2004 and 2003, and that based upon the weight of available evidence, that it is "more likely than not" that net

deferred tax assets will be realized. The "more likely than not" standard is subjective, and is based upon management's estimate of a greater than 50% probability that its long range business plan can be realized.

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. Our estimates are largely dependent upon achieving considerable growth in revenue

and profits resulting from the successful commercialization of EECP therapy into the congestive heart failure indication, which we believe to enable us to reverse the current trend of increasing losses and generate pre tax income in excess of $42 million over the next seven years in order to fully utilize all of the deferred tax assets. Such future estimates of future taxable income are based on our beliefs, as well as assumptions made by and information currently available to us. Certain critical assumptions associated with our estimates include:

- that the results from the PEECH clinical trial, as disclosed in the above "Research and Development" section, as well as other clinical evidence are sufficiently positive for the PEECH clinical trial to be published in a peer review journal and enable the EECP therapy to obtain approval for a national Medicare reimbursement coverage policy plus other third-party payer reimbursement policies specific to the congestive heart failure indication;

- that the reimbursement coverage will be both broad enough in terms of coverage language and at an amount adequate to enable successful commercialization of EECP therapy into the congestive heart failure indication and enable us to achieve material growth in revenue and profits;

- that the EECP therapy will be accepted by the medical community as an adjunctive therapy for the treatment of patients suffering form congestive heart failure; and

- that we will be able to secure additional financing to provide sufficient funds to market EECP therapy in the congestive heart failure indication.

Additional uncertainties that could cause actual results to differ materially are the following:

- the effect of the dramatic changes taking place in the healthcare environment;

- the impact of competitive procedures and products and their pricing;

- other medical insurance reimbursement policies;

- there can be no assurance that we will be able to raise additional capital necessary to implement our business plan;

- unexpected manufacturing problems;

- unforeseen difficulties and delays in the conduct of clinical trials, peer review publications 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;

-- our recent financial history of declining revenues and losses; and

-- the risk factors reported from time to time in our SEC reports.

Factors considered by us in making our assumptions and included in our long-term business plan are the following:

-- we currently have FDA clearance to market EECP therapy in congestive heart failure;

-- independent market research indicates that the patient population potentially eligible for EECP therapy in congestive heart failure market is larger than the current refractory angina patient population and when the two patient populations are combined the total market opportunity for EECP therapy will be more than double;

-- many physician practices have told us that they do not have a sufficient number of patients to economically justify adoption of the procedure with the current reimbursement coverage for refractory angina. The increased market size resulting from the addition of CHF patents should improve the economic model for the physician practice;

-- we have positive clinical evidence from the PEECH clinical trial that was recently concluded as disclosed in the above "Research and Development" section, plus other smaller clinical trials and the IEPR patient registry that demonstrates the clinical effectiveness of EECP therapy in the treatment of congestive heart failure to medical providers, payers and regulators;

-- we completed the PEECH clinical trial this fiscal year as planned and disclosed the summary results of the trial in March 2005;

-- we intend to have the results of the PEECH trial published in a peer review journal, which is an important step necessary to support an application to CMS to expand reimbursement coverage of EECP therapy to include CHF patients;

-- we sustained a period of profitability in fiscal years 2000, 2001 and 2002 with profits before income taxes of $1,290,916, $5,237,242 and $4,240,106, respectively; and

-- we continue to believe that we will be able to raise sufficient funds to enable us to execute our business plan.

While we believe that we will be able to execute our business plan over the longer term and we will be able to utilize our tax loss carryforwards, the exact timing of our return to profitability is uncertain, subject to significant management judgments and estimates and dependent on a variety of external

factors including: market conditions at that time, the reception of the EECP therapy by the medical professionals and payers and the timing of a Medicare reimbursement decision. It is possible that significant tax loss carryforwards from fiscal years 2005, 2006 and 2007 may expire before we are able to use them. As a result of these uncertainties, beginning in fiscal 2004, we began to provide a valuation reserve for all additional tax loss carryforwards that were generated by current operating losses. We review this policy on a quarterly basis and believe that the above valuation reserve is appropriate under the current circumstances.

The amount of the deferred tax assets considered realizable could be reduced in the future if estimates of future taxable income during the carryforward period are reduced or if the accounting standards are changed to reflect a more stringent standard for evaluation of deferred tax assets.

The recorded deferred tax asset includes an increase to the valuation allowance during the three months ended February 28, 2005 of $682,351.

Nine Months Ended February 28, 2005 and February 29, 2004

Net revenues from sales, leases and service of our external counterpulsation systems ("EECP" systems) for the nine-month periods ended February 28, 2005 and February 29, 2004, were $11,247,419 and $16,279,571, respectively, which represented a decline of $5,032,152 or 31%. We reported a net loss of $4,561,002 compared to $2,663,577 for the nine-month periods ended February 28, 2005 and February 29, 2004, respectively. Our net loss per common share was $0.08 for the nine-month period ended February 28, 2005, compared to a net loss of $0.05 for the nine-month period February 29, 2004.

Revenues

Revenues from equipment sales declined approximately 39% to $8,629,026 for the nine-month period ended February 28, 2005 as compared to $14,147,248 for the same period for the prior year. The decline in equipment sales is due primarily to a 34% decline in domestic units shipped, a 13% decline in the average sales prices of new EECP systems sold in the domestic market, and an unfavorable product mix reflecting a higher portion of used versus new equipment sales. Used systems earned a lower average selling price compared to new systems, and experienced a 29% decrease in average selling price when compared to used systems sold in the domestic market in the first three quarters of fiscal 2004.

We believe the decline in domestic units shipped reflects weakened demand in the refractory angina market as existing capacity is more fully utilized, coupled with increased competition from surgical procedures, mainly the use of drug-eluting stents. We anticipate that demand for EECP systems will remain soft until an expansion of the current CMS national reimbursement policy for use of EECP therapy to treat congestive heart failure patients is obtained. In addition, average domestic selling prices continue to decline reflecting the impact in the market of lower priced competitive products. We continue to believe that our EECP systems currently sell at a significant price premium to competitive products reflecting the clinical efficacy and superior quality of the EECP system plus the many value added services offered by us. However, we anticipate that this current trend of declining prices will continue in the immediate future as our competition attempts to capture greater market share through pricing discounts. In addition, we sold an unusually high percentage of used equipment, which reflected the availability of used EECP systems that had been recovered from a former customer, as well as EECP systems that had been used to treat patients in the PEECH clinical trial but were no longer required

since the treatment portion of the trial has been completed. These used systems were sold at average sales prices significantly below our new systems. Lastly, we continue to reorganize certain territory responsibilities in our sales department due to recently vacant and/or unproductive territories, and recently completed the restructuring of a major independent distributor territory to direct sales.

Our revenue from the sale of EECP systems to international distributors for the nine-month period ended February 28, 2005 decreased approximately 4% to $607,995 compared to $636,600 in same period of the prior year reflecting decreased volume of new systems, partially offset by improved average selling prices.

The above decline in revenue from equipment sales was partially offset by a 23% increase in revenue from equipment rental and services for the nine month period ended February 28, 2005, from the same nine-month period in the prior year. Revenue from equipment rental and services represented 23% of total revenue in the first three quarters of fiscal 2005 compared to 13% in the first three quarters of fiscal 2004. The increase in both absolute amounts and percentage of total revenue resulted primarily from an increase of approximately 35% in service related revenue. The higher service revenue reflects an increase in service, spare parts and consumables as a result of the continued growth of the installed base of EECP systems plus greater marketing focus on the sale of extended service contracts. Rental revenue declined approximately 26% following the termination of several short-term rental agreements partially offsetting the above.

Gross Profit

Gross profit declined to $7,247,170 or 64% of revenues for the nine-month period ended February 28, 2005, compared to $10,714,473 or 66% of revenues for the nine-month period ended February 29, 2004. Gross profit margin as a percentage of revenue for the nine-month period ended February 28, 2005, declined compared to the same period of the prior fiscal year due to reduced margins from EECP equipment sales reflecting the negative impact resulting from the reduction in average selling prices. The gross profit for rentals and services improved both in absolute amount and as a percentage of revenue reflecting increased service resulting from accessory and service contract revenue increases exceeding associated cost increases. The decline in gross profit when compared to the prior year in absolute dollars is a direct result of the lower revenue.

Gross profits are dependent on a number of factors, particularly the mix of EECP models sold and their respective average selling prices, the mix of EECP 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 nine-months

ended February 28, 2005 and February 29, 2004 were $9,088,858 or 81% of revenues and $9,217,836 or 57% of revenues, respectively reflecting a decrease of $128,978 or 1%. The decrease in SG&A expenditures in the first three quarters of fiscal 2005 compared to fiscal 2004 resulted primarily from a $445,151 decrease in administrative consulting and severance fees, $93,637 lower promotional allowances, and $67,098 lower advertising costs, partially offset by $256,670 higher market research fees and $245,272 higher trade show costs.

Research and Development

Research and development ("R&D") expenses of $2,521,321 or 22% of revenues for the nine months ended February 28, 2005, decreased by $475,649 or 16%, from the prior nine months ended February 29, 2004, of $2,996,970 or 18% of revenues. The decrease reflects lower spending related to the PEECH clinical trial, partially offset by increased expenditures for developing the new Lumenair(TM) EECP(R) Therapy System.

Provision for Doubtful Accounts

During the nine-month period ended February 28, 2005, we charged $135,156 to our provision for doubtful accounts as compared to $1,147,011 during the nine-month period ended February 29, 2004. The decrease was due primarily to a $680,000 provision made in the prior fiscal period associated with the write-off of all funds due from a major customer that ceased operations in December 2003.

Interest Expense and Financing Costs

Interest expense and financing costs decreased to $84,971 in the nine-month period ended February 28, 2005, from $101,335 for the same period in the prior year. Interest expense reflects interest on loans secured to refinance the November 2000 purchase of our headquarters and warehouse facility, as well as on loans secured to finance the cost and implementation of a new management information system.

Interest and Other Income, Net

Interest and other income for the first three quarters of 2005 and 2004, was $51,795 and $115,102, respectively. The decrease in interest and other income from the prior period is the direct result of the absence of interest income related to certain equipment sold under sales-type leases incurred in fiscal 2004 and lower miscellaneous customer payments, partially offset by higher interest income due to improved yields.

Income Tax Expense, Net

During the nine-months ended February 28, 2005 and February 29, 2004, we recorded a provision for state income taxes of $29,661 and $30,000, respectively.

As of February 28, 2005, we had recorded deferred tax assets of $14,582,000 net of a $3,444,520 valuation allowance related to the anticipated recovery of tax loss carryforwards. The amount of the deferred tax assets considered

realizable could be reduced in the future if estimates of future taxable income during the carryforward period are reduced. Ultimate realization of the deferred tax assets is dependent upon our generating sufficient taxable income prior to the expiration of the tax loss carryforwards. We believe that the Company is positioned for long-term growth despite the financial results achieved during fiscal years 2005, 2004 and 2003, and that based upon the weight of available evidence, that it is "more likely than not" that net deferred tax assets will be realized. The "more likely than not" standard is subjective, and is based upon management's estimate of a greater than 50% probability that its long range business plan can be realized.

Ultimate realization of any or all of the deferred tax assets is not assured, due to significant uncertainties associated with estimates of future taxable income during the carryforward period. Our estimates are largely dependent upon achieving considerable growth resulting from the successful commercialization of EECP therapy into the congestive heart failure indication. Such future estimates of future taxable income are based on our beliefs, as well as assumptions made by and information currently available to us. (See "Income Tax Expense, Net" in the "Three Months Ended February 28, 2005 and February 29, 2004" section of this "Management's Discussion and Analysis of Financial Condition and Results of Operation").

The recorded deferred tax asset and increase to the valuation allowance during the nine months ended February 28, 2005 was $1,536,520.

Liquidity and Capital Resources

We believe that our cash flow from operations together with our current cash reserves will be sufficient to fund our business plan and projected capital requirements through at least July 2005. Although we have incurred significant losses during the last three fiscal years, we believe that the Company is positioned for long-term growth. Our long-term growth is largely dependent upon the successful commercialization of EECP therapy into the congestive heart failure indication, which depends in part upon the acceptance of the results of the PEECH clinical trial by the medical community as being sufficient to promote the adoption of the therapy in CHF. Our long-term ability to achieve profitable operations is further dependent on successfully completing additional debt or equity financing to provide marketing funds necessary to launch EECP therapy in the congestive heart failure market and to bridge the period between completion of the PEECH clinical trial and a congestive heart failure national reimbursement coverage decision by CMS. While we are currently seeking to raise such capital through public or private equity or debt financings, there is no

assurance we will be successful in these efforts. Future capital funding, if available, may result in dilution to current shareholders.

We have financed our operations in fiscal 2005 and 2004 primarily from working capital and operating results. At February 28, 2005, we had a cash and cash equivalents balance of $1,228,727 and working capital of $4,977,695 as compared to a cash and cash equivalents balance of $6,365,049 and working capital of $9,771,870 at May 31, 2004. Our cash balances decreased $5,136,322 in the nine-month period compared to May 31, 2004, primarily due to $3,406,972 used

in operating activities and $1,760,954 used in investing activities.

The decrease in cash provided by our operating activities during the first three quarters of fiscal year 2005 resulted primarily from the net loss of $4,561,002 less adjustments to reconcile net loss to net cash used in operating activities of $1,154,030. Changes in our operating assets and liabilities provided cash of $470,656. The changes in the asset components primarily reflect an increase in inventory of $1,372,541 plus higher other current assets of $164,123, primarily prepaid insurance premiums offset by a $3,754,183 reduction in accounts receivable due to the decreased revenue. The changes in our operating liability components reflect a reduction in accounts payable and accrued liabilities of $1,296,234 and other liabilities totaling $400,099. Non-cash adjustments for depreciation, amortization, allowance for doubtful accounts and allowance for inventory write-offs of $683,374 partially offset the above.

Net accounts receivable were 14% of revenues for the nine-month period ended February 28, 2005, compared to 34% at the end of the nine-month period ended February 29, 2004, and accounts receivable turnover improved to 5.4 times as of February 28, 2005, as compared to 3.6 times as of February 29, 2004. 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 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. If in our judgment the degree of collectibility is uncertain at the time of shipment, we use the installment sales method and record revenue based on cash receipt. During the first three quarters of fiscal 2005 and 2004, approximately 2% and 3%, respectively, of revenues were generated from sales in which initial payment terms were greater than 90 days, we offered no sales- type leases and 6% and 0% of revenues reflect cash receipts from installment sales. 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 program. As we are creating a new market for EECP 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 $1,760,954 during the nine-month period ended February 28, 2005. The principal use of cash was for the purchase of short-term certificates of deposit and treasury bills totaling $1,583,614 to improve the yield on our unused cash balances. All of our certificates of deposit have original maturities of greater than three months and mature in less than twelve months. Additionally, we used $177,340 in cash primarily for the purchase of equipment to be used in the manufacture of our EECP systems.

Our financing activities provided net cash of $31,604 during the nine-month period ended February 28, 2005, reflecting $130,666 received from the exercise of stock options less payments on our outstanding notes and loans totaling $99,062.

We cancelled our line of credit in August 2004 and do not currently have an available line of credit.

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

The following table presents our expected cash requirements for contractual obligations outstanding as of February 28, 2005.

	Total	Due as of 2/28/06	Due as of 2/28/07 and 2/29/08	Due as of 2/28/09 and 2/28/10
Long-Term Debt	$1,130,253	$145,164	$182,968	$143,622
Operating Leases	99,835	74,918	24,917	--
Litigation Settlement	233,750	133,000	100,750	--
Employment Agreements	78,125	78,125	--	--
Total Contractual Cash Obligations	$1,541,963	$431,207	$308,635	$143,622

Effects of Inflation

We believe that inflation and changing prices over the past three years have not had a significant impact on our revenue or on our results of operations.

ITEM 3 - QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to certain financial market risks, including changes in interest rates. All of our revenue, expenses and capital spending are transacted in US dollars. Our exposure to market risk for changes in interest rates relates primarily to its cash and cash equivalent balances and the line of credit agreement. The majority of our investments are in short-term instruments and subject to fluctuations in US interest rates. Due to the nature of our short-term investments, we believe that there is no material risk exposure.

ITEM 4 - 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 February 28, 2005, 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 February 28, 2005 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.

Vasomedical, Inc. and Subisidiaries

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 AND REPORTS ON FORM 8-K:

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.

Reports on Form 8-K

The Registrant filed a Report on Form 8-K dated January 13, 2005 to report an event under Items 2.02 and 9.01.

The Registrant filed a Report on Form 8-K dated January 26, 2005 to report

an event under Item 8.01.

Vasomedical, Inc. and Subsidiaries

In accordance with to 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/ Thomas Glover
Thomas Glover
Chief Executive Officer and Director
(Principal Executive Officer)

/s/ Thomas W. Fry
Thomas W. Fry
Chief Financial Officer (Principal Financial and Accounting Officer)

Date: April 14, 2005