

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

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-QSB/A**

(Amended Quarterly Report)

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

**For the quarterly period ended April 30, 2006**

**OR**

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

**For the transition period from                      to                      .**

**Commission file number 001-13543**

**Angeion Corporation**

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

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

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

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

(Address of principal executive offices)

**(651) 484-4874**

(Issuer's telephone number, including area code)

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

Yes

No

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

Yes  No

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

Yes  No

The Company had 3,623,352 shares of common stock, \$0.10 par value, outstanding as of June 5, 2006.

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**EXPLANATORY STATEMENT**

This Form 10-QSB/A amends and restates the Company's Form 10-QSB for the quarter ended April 30, 2006, initially filed with the Securities and Exchange Commission (the SEC) on June 14, 2006 (the Original Filing), and is being filed to reflect the restatement of the financial statements and other financial information of the Company for the second fiscal 2006 quarter and six months ended April 30, 2006.

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

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

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

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

Therefore, the Company has:

- Increased the provision for tax from continuing operations by \$80,000 and \$174,000 for the three and six months ended April 30, 2006, respectively,
- Increased tax expense related to discontinued operations by \$97,000 for both periods ended April 30, 2006, and
- Decreased goodwill by \$328,000, decreased intangible assets by \$77,000, decreased other current liabilities and accrued expenses by \$7,000 and decreased deferred income tax liabilities by \$128,000 as of April 30, 2006.

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

In addition to the adjustments discussed above, this restatement includes adjustments for the reclassification of bonus expenses previously included in general and administrative expenses to other statement of operations expense captions to properly classify bonus expense to the salary of the employee who earned the bonus and the Company's revision of certain discontinued operating cash flows to a

financing cash flow. We refer to these as Other Adjustments, which were immaterial, individually and in the aggregate, to the previously issued financial statements.

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

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## PART I - FINANCIAL INFORMATION

**Item 1. Financial Statements.**

## ANGEION CORPORATION AND SUBSIDIARIES

## Consolidated Balance Sheets

April 30, 2006 and October 31, 2005

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

	Restated April 30, 2006	October 31, 2005
<b>Assets</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 2,957	\$ 1,072
Cash restricted for discontinued operations	200	400
Accounts receivable, net of allowance for doubtful accounts of \$165 and \$210, respectively	4,319	4,100
Inventories	4,840	3,455
Prepaid expenses and other current assets	210	280
Current assets of discontinued operations	1,500	700
<b>Total current assets</b>	<b>14,026</b>	<b>10,007</b>
Property and equipment, net of accumulated depreciation of \$1,724 and \$1,598, respectively	1,105	1,035
Intangible assets, net	5,015	5,498
Goodwill		328
<b>Total Assets</b>	<b>\$ 20,146</b>	<b>\$ 16,868</b>
<b>Liabilities and Shareholders Equity</b>		
<b>Current liabilities:</b>		
Accounts payable	\$ 2,369	\$ 1,184
Employee compensation	1,232	1,166
Advance payments from customers	1,165	
Deferred income	917	871
Warranty reserve	213	175
Other current liabilities and accrued expenses	411	366
Current liabilities of discontinued operations	725	517
<b>Total current liabilities</b>	<b>7,032</b>	<b>4,279</b>
<b>Long-term liabilities:</b>		
Long-term deferred income	509	319
Deferred income taxes	211	337
Total long-term liabilities	720	656
<b>Total Liabilities</b>	<b>7,752</b>	<b>4,935</b>
<b>Shareholders equity:</b>		
Common stock, \$0.10 par value, authorized 25,000,000 shares, issued and outstanding, 3,623,352 shares in 2006 and 3,609,325 shares in 2005	362	361
Additional paid-in capital	17,825	17,589
Deferred compensation	(78)	(14)
Accumulated deficit	(5,715)	(6,003)
Total shareholders equity	12,394	11,933
<b>Total Liabilities and Shareholders Equity</b>	<b>\$ 20,146</b>	<b>\$ 16,868</b>

See accompanying notes to consolidated financial statements.



## ANGEION CORPORATION AND SUBSIDIARIES

## Consolidated Statements of Operations

(unaudited, in thousands except per share amounts)

	Three Months Ended April 30, Restated 2006		Six Months Ended April 30, Restated 2006	
	2005		2005	
<b>Revenues</b>				
Equipment and supply sales	\$ 6,564	\$ 5,367	\$ 12,811	\$ 9,652
Service revenue	648	665	1,334	1,410
	7,212	6,032	14,145	11,062
<b>Cost of goods sold</b>				
Cost of equipment and supplies	3,584	2,918	6,865	5,514
Cost of service revenue	99	126	222	227
	3,683	3,044	7,087	5,741
<b>Gross margin</b>	3,529	2,988	7,058	5,321
<b>Operating expenses:</b>				
Selling and marketing	1,852	1,858	3,805	3,565
General and administrative	806	614	1,519	1,278
Research and development	571	559	1,054	1,037
Amortization of intangibles	203	203	406	406
	3,432	3,234	6,784	6,286
<b>Operating income (loss)</b>	97	(246 )	274	(965 )
Interest income	19	8	28	16
<b>Income (loss) before taxes</b>	116	(238 )	302	(949 )
Provision for taxes	85		185	
<b>Income (loss) from continuing operations</b>	31	(238 )	117	(949 )
<b>Gain from discontinued operations, net of \$103 for income taxes</b>	175		171	
<b>Net income (loss)</b>	\$ 206	\$ (238 )	\$ 288	\$ (949 )
<b>Earnings (loss) per share - basic</b>				
Continuing operations	\$ 0.01	\$ (0.07 )	\$ 0.03	\$ (0.26 )
Discontinued operations	0.05		0.05	
Net income (loss)	\$ 0.06	\$ (0.07 )	\$ 0.08	\$ (0.26 )
<b>Earnings (loss) per share - diluted</b>				
Continuing operations	\$ 0.01	\$ (0.07 )	\$ 0.03	\$ (0.26 )
Discontinued operations	0.04		0.05	
Net income (loss)	\$ 0.05	\$ (0.07 )	\$ 0.08	\$ (0.26 )
<b>Weighted average common shares outstanding</b>				
<b>Basic</b>	3,619	3,606	3,615	3,605
<b>Diluted</b>	3,760	3,606	3,714	3,605

See accompanying notes to consolidated financial statements.





## ANGEION CORPORATION AND SUBSIDIARIES

## Consolidated Statements of Cash Flows

(unaudited, in thousands)

	Six Months Ended April 30, Restated	
	2006	2005
<b>Cash Flows From Operating Activities:</b>		
Net income (loss)	\$ 288	\$ (949 )
Gain from discontinued operations	(171 )	
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	532	628
Stock-based compensation	137	
Tax benefit from stock options exercised	1	
Deferred income taxes	279	
Changes in operating assets and liabilities:		
Accounts receivable	(219 )	195
Inventories	(1,385 )	(209 )
Prepaid expenses and other current assets	70	89
Accounts payable	1,185	66
Employee compensation	66	53
Advance payments from customers	1,165	
Deferred income	236	78
Warranty reserve	38	10
Other current liabilities and accrued expenses	45	(32 )
Net cash provided by (used in) continuing operations	2,267	(71 )
Cash used in operating activities of discontinued operations	(221 )	(103 )
Net cash provided by (used in) operating activities	2,046	(174 )
<b>Cash Flows From Investing Activities:</b>		
Purchase of property and equipment	(196 )	(163 )
Net cash used in investing activities	(196 )	(163 )
<b>Cash Flows From Financing Activities:</b>		
Proceeds from issuance of common stock	35	7
Net cash provided by financing activities of continuing operations	35	7
Cash provided by (used in) financing activities of discontinued operations:		
Promissory note payment	(200 )	
Cash restricted for discontinued operations	200	
Net cash provided by financing activities	35	7
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>1,885</b>	<b>(330 )</b>
<b>Cash and cash equivalents at beginning of period</b>	<b>1,072</b>	<b>2,390</b>
<b>Cash and cash equivalents at end of period</b>	<b>\$ 2,957</b>	<b>\$ 2,060</b>

**Supplemental disclosure of non-cash investing activities:**

During the six months ended April 30, 2006, the Company decreased goodwill \$328,000 and intangible assets \$77,000 with an offsetting decrease to the deferred tax valuation allowance of \$405,000 for the usage of pre-emergence bankruptcy net operating loss carry forwards.

See accompanying notes to consolidated financial statements.



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

April 30, 2006

(Unaudited)

**1. Basis of Presentation**

The accompanying consolidated balance sheet as of April 30, 2006, the consolidated statements of operations for the three and six months ended April 30, 2006, and the consolidated statement of cash flows for the six months ended April 30, 2006 have been restated. The nature of the restatement and the effect on the financial statement line items are discussed in Note 11 to the Consolidated Financial Statements, Restatement of Quarterly Financial Statements.

The consolidated balance sheet as of April 30, 2006, the consolidated statements of operations for the three and six months ended April 30, 2006 and 2005, and the consolidated statements of cash flows for the six months ended April 30, 2006 and 2005, and the related information presented in these notes have been prepared by management in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-QSB and Rule 10-01 of Regulation S-X, without audit. Accordingly, they do not include all of the information and notes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation of results have been included. The consolidated balance sheet at October 31, 2005 was derived from the audited consolidated financial statements as of that date. Operating results for the three and six months ended April 30, 2006 are not necessarily indicative of the results that may be expected for the year ending October 31, 2006. For further information, refer to the consolidated financial statements and notes thereto included in Angeion Corporation's Annual Report on Form 10-KSB for the year ended October 31, 2005.

Comprehensive income is a measure of all non-owner changes in shareholders' equity and includes items such as net income (loss), certain foreign currency translation items, minimum pension liability adjustments and changes in the value of available-for-sale securities. For the three and six months ended April 30, 2006 and 2005, comprehensive income (loss) for Angeion Corporation was equivalent to net income (loss) as reported.

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

**2. Revenue Recognition**

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

customers and international distributors are identical. In instances when a customer order specifies final acceptance of the system, revenue is deferred until all customer acceptance criteria have been met. Estimated warranty obligations are recorded upon shipment.

Service contract revenue is based on a stated contractual rate and is deferred and recognized ratably over the service period, which is typically from one to four years. In accordance with paragraph 4, of the Emerging Issues Task Force abstract 00-21, *Revenue Arrangements with Multiple Deliverables*, the Company applies Financial Accounting Standards Board ( FASB ) Technical Bulletin No. 90-1 to service contract revenue. Revenue from installation and training services provided to domestic customers is deferred until the service has been performed. The total amount of deferred revenue was \$1,426,000 and \$1,190,000 at April 30, 2006 and October 31, 2005, respectively.

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

### 3. New Accounting Pronouncements

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

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

#### 4. Stock Based Compensation

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

(In thousands, except for per share amounts)	Three Months Ended April 30 Restated		Six Months Ended April 30 Restated	
	2006	2005	2006	2005
<b>Net income (loss)</b>				
As reported	\$ 206	\$ (238 )	\$ 288	\$ (949 )
Add: Stock-based employee compensation expense included in reported net income (loss), net of related tax effects	51		86	
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(25 )	(21 )	(28 )	(42 )
Pro forma	\$ 232	\$ (259 )	\$ 346	\$ (991 )
<b>Net income (loss) per share basic</b>				
As reported	\$ 0.06	\$ (0.07 )	\$ 0.08	\$ (0.26 )
Pro forma	\$ 0.06	\$ (0.07 )	\$ 0.10	\$ (0.27 )
<b>Net income (loss) per share diluted</b>				
As reported	\$ 0.05	\$ (0.07 )	\$ 0.08	\$ (0.26 )
Pro forma	\$ 0.06	\$ (0.07 )	\$ 0.09	\$ (0.27 )

The above table reflects the acceleration of vesting for 31,200 options during the quarter ended April 30, 2006 due to the achievement of performance-based milestones. As further described below, this increased stock-based compensation expense during the three and six months ended April 30, 2006. The above pro forma net income for the three and six months ended April 30, 2006 includes \$37,000 of fair value based stock compensation expense that was accelerated due to meeting these performance milestones.

#### Variable Stock Option Grants

The Company has granted to its employees 78,000 options with an exercise price of \$2.00 that vest at increasing rates as the Company's common stock trades for increasing prices for 20 of 30 consecutive days. Notwithstanding the performance vesting schedule, these options may be exercised in full beginning October 1, 2009. The options will become exercisable earlier if the Company's stock trades at the following prices for 20 of 30 consecutive trading days.

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

Because the vesting for these grants is dependent on achieving these common stock price milestones, the Company has accounted for unvested option grants using variable accounting in accordance with APB No. 25. Accordingly, the Company determines the intrinsic value of unvested variable option grants at each balance sheet date and records the changes in intrinsic value as deferred compensation. During the three months ended April 30, 2006, the Company's stock traded at or above \$4.50 per share for more than 20 of 30 consecutive trading days and therefore 31,200, or 40% of these options have vested. Upon vesting, the options are considered fixed plan awards with no further adjustment to the aggregate intrinsic value. In addition, all previously recorded deferred compensation expense is charged to earnings upon vesting. Although no options vest until October 1, 2009 or until the Company's stock trades at the prices listed in the above table for 20 of 30 consecutive days, these outstanding options are nevertheless deemed to have intrinsic value because the closing price of the Company's stock at April 30 and January 31, 2006 was \$4.80 and \$4.23 per share, respectively. Stock based compensation expense associated with these variable options was \$81,000 and \$137,000 for the three and six months ended April 30, 2006, respectively. These amounts include the intrinsic value of the unvested options for the three and six months ended at April 30 2006, respectively, pro-rated from their grant date to the time-based vesting date of October 1, 2009 and the intrinsic value of options that vested during the second quarter of 2006 based on achieving certain stock price levels described above. The compensation expense for the vested options was based on \$4.87 per share, which was the closing price of the Company's stock on the day these options vested. As of April 30, 2006, the Company has recorded deferred compensation of \$78,000 relating to these unvested variable stock options.

## 5. Inventories

Inventories consisted of the following at April 30, 2006 and October 31, 2005:

(In thousands)	2006	2005
Raw materials	\$ 1,744	\$ 1,304
Work-in-progress	604	186
Finished goods	2,492	1,965
	\$ 4,840	\$ 3,455

## 6. Intangible Assets and Goodwill

Intangible assets consisted of the following at April 30, 2006 and October 31, 2005:

(In thousands)	<b>Restated 2006</b>	<b>2005</b>
<b>Intangible assets:</b>		
Developed technology	\$ 6,900	\$ 6,900
Trade name (unamortized)	923	1,000
	7,823	7,900
Amortization - developed technology	(2,808	) (2,402
	\$ 5,015	\$ 5,498

Amortization expense was \$406,000 for each of the six-month periods ended April 30, 2006 and 2005.

Intangible assets are being amortized using the straight-line method over the estimated useful lives of the assets that range from three to ten years. If the Company utilizes pre-emergence bankruptcy net operating loss carryforwards ( NOLs ), the Company will sequentially reduce the cost of goodwill, trade name and developed technology until the net carrying cost of these assets is zero. To the extent that utilization of these NOLs reduces the cost of developed technology, future amortization expense will be reduced. Estimated amortization expense for the remainder of fiscal year 2006 and for each of the succeeding years based on the intangible assets as of April 30, 2006, which does not reflect the possible reduction discussed above, is as follows:

(In thousands)	<b>Amortization</b>
Six months ending October 31, 2006	\$ 406
2007	779
2008	779
2009	778
2010	450
Thereafter	900
	\$ 4,092

Goodwill and Trade name consisted of the following at April 30, 2006 and October 31, 2005:

(In thousands)	<b>Goodwill</b>	<b>Trade Name</b>
Balance at October 31, 2005	\$ 328	\$ 1,000
Reduction in balance due to utilization of pre-emergence bankruptcy NOL (restated)	(328	) (77
Balance at April 30, 2006 (restated)	\$	\$ 923

## 7. Warranty Reserve

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

remaining months of warranty coverage. The warranty reserve adjustment reflects the Company's historical warranty experience based on type of equipment. Warranty activity for the six months ended April 30, 2006 and 2005 was as follows:

(In thousands)	2006	2005
Balance, beginning of period	\$ 175	\$ 155
Warranty provisions	198	141
Warranty claims	(160)	(131)
Balance, end of period	\$ 213	\$ 165

## 8. Net Income (Loss) per Share

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

Shares used in the earnings per share computations for the three and six months ended April 30, 2006 and 2005 are as follows:

(In thousands)	Three Months Ended April 30		Six Months Ended April 30	
	2006	2005	2006	2005
Weighted average common shares outstanding basic	3,619	3,606	3,615	3,605
Dilutive effect of stock options	141		99	
Weighted average common shares outstanding diluted	3,760	3,606	3,714	3,605

The dilutive effect of stock options in the above table excludes all options for which the exercise price was higher than the closing market price of \$4.80 per share as of April 30, 2006. The number of option shares excluded from the calculation was 362,800 for the three and six months ended April 30, 2006. As a result of the net loss, there were no dilutive common shares outstanding for the three and six months ended April 30, 2005, and accordingly, 482,800 were excluded from the calculation.

The Company had warrants outstanding at April 30, 2006 and 2005 to purchase 179,480, and 179,481 shares, respectively, of its common stock that were considered antidilutive and therefore not considered to have been exercised.

## 9. Discontinued Operations and Related Litigation

On April 12, 2006, Angeion Corporation and Medmarc Casualty Insurance Company ( Medmarc ) agreed to a settlement that resolved all matters with respect to the pending lawsuit between the parties related to the recovery of insurance proceeds for a claim associated with the Company's former ICD business. Medmarc agreed to make a single payment to the Company on or prior to June 11, 2006, and each party agreed to dismiss with prejudice all claims against the other in the pending lawsuit. On June 9, 2006, the Company received the settlement payment.



The Company has recorded the total amount due from Medmarc as current assets of discontinued operations at April 30, 2006. The Company recorded an increase to this receivable of \$804,000 during the second quarter of 2006.

The current liabilities of discontinued operations at April 30, 2006 include the following items:

- 1) The legal fees due under the contingency fee agreement with the Company's counsel;
- 2) The remaining \$200,000 payment due under the June 30, 2005 ELA Medical settlement agreement; and
- 3) All unpaid miscellaneous expenses due as of April 30, 2006.

As a result of the settlement with Medmarc, the Company recorded additional discontinued operating expenses of \$526,000 for the quarter ended April 30, 2006, primarily reflecting contingent legal fees related to the settlement. The adjustments to both current assets and current liabilities of discontinued operations resulted in a net gain of \$175,000 from discontinued operations for the quarter ended April 30, 2006. The Company expects that the only expense for discontinued operations in the future will be the purchase of product liability insurance for as long as the Company believes it necessary to cover ICDs that remain implanted in patients. The current policy for product liability insurance covering ICDs expires in July 2006.

See Note 11 to the Consolidated Financial Statements, Restatement of Quarterly Financial Statements, for revisions associated with the presentation of cash flows from discontinued operations.

#### **10. Income Taxes (Restated)**

The Company has recorded a provision for taxes from continuing operations of \$85,000 and \$185,000 for the three and six months ended April 30, 2006, respectively. The Company has also allocated \$103,000 of the provision for taxes to discontinued operations for the three and six months ended April 30, 2006. The provision for taxes has been calculated and presented in the statement of operations as if the Company's earnings were fully taxable. The amount of income taxes payable is determined after utilizing the Company's pre-emergence bankruptcy NOLs. Under American Institute of Certified Public Accountants Statement of Position 90-7, *Financial Reporting by Entities in Reorganization Under the Bankruptcy Code* (SOP 90-7), the tax benefit for the utilization of these loss carry forwards must be recognized as a reduction of intangibles rather than a reduction of the provision for taxes in the statement of operations. See Note 11 to the Consolidated Financial Statements, Restatement of Quarterly Financial Statements, for further details.

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

The Company has recorded a full valuation allowance against its net deferred tax asset, excluding the effect of deferred tax liability which is unable to be used as a source of income against these deferred

tax assets, based on its belief that it is more likely than not that the asset will not be realized in the future. This determination was made in a prior fiscal year and is still applicable for the second quarter of 2006. The Company will continue to assess the need for a full valuation allowance in future quarters. The Company has recognized a deferred tax liability of \$211,000 as of April 30, 2006 related to an indefinite lived intangible that is being amortized for tax purposes. Under SOP 90-7, a substantial portion of any future reversal of the valuation allowance will first reduce any intangible assets and then be credited directly to additional paid-in capital. After the exhaustion of pre-emergence bankruptcy NOLs, approximately \$2.3 million of the valuation allowance is related to post-bankruptcy NOLs and would be available to reduce the provision for taxes in the statement of operations.

#### **11. Restatement of Quarterly Financial Statements**

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

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

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

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

- (1) The Company has increased the provision for taxes from continuing operations by \$80,000 and \$174,000 for the three and six months ended April 30, 2006, respectively, increased tax expense related to discontinued operations by \$97,000 for both periods ended April 30, 2006, and decreased goodwill by \$328,000, decreased intangible assets by \$77,000, decreased other current liabilities and accrued expenses by \$7,000 and decreased deferred income tax liabilities by \$128,000 as of April 30, 2006 to properly account for income taxes.
- (2) The Company has reclassified \$136,000 and \$196,000, for the three and six-month periods ended April 30, 2006, respectively, of bonus expenses previously included in general and administrative expenses to other statement of operations expense captions to properly classify bonus expense to the salary of the employee who earned the bonus.
- (3) The Company revised the presentation of operating and financing cash flows attributable to discontinued operations for the six months ended April 30, 2006. The revision reflects the restriction of \$200,000 of cash and the fiscal 2006 payment on the promissory note to ELA Medical as financing activities, rather than operating activities as previously reported.

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The Company has restated its balance sheet as of April 30, 2006, its statements of operations for the three and six months ended April 30, 2006 and statement of cash flows for the six months ended April 30, 2006 for the impact of the above items as follows (adjustment number corresponds with the adjustments noted above):

(In thousands)	As of April 30, 2006			As Restated
	As Previously Reported	Adjustments Amount	No.	
<b><u>Balance Sheet Data:</u></b>				
Intangible assets, net	\$ 5,092	\$ (77 )	1	\$ 5,015
Goodwill	328	(328 )	1	
Total Assets	20,551	(405 )		20,146
Other current liabilities and accrued expenses	418	(7 )	1	411
Total current liabilities	7,039	(7 )		7,032
Deferred income taxes	339	(128 )	1	211
Total long-term liabilities	848	(128 )		720
Total Liabilities	7,887	(135 )		7,752
Additional paid-in capital	17,824	1	1	17,825
Accumulated deficit	(5,444 )	(271 )	1	(5,715 )
Total shareholders equity	12,664	(270 )		12,394
Total Liabilities and Shareholders Equity	\$ 20,551	\$ (405 )		\$ 20,146

(In thousands)	Three Months Ended April 30, 2006			As Restated
	As Previously Reported	Adjustments Amount	No.	
<b><u>Statement of Operations Data:</u></b>				
Revenues:				
Equipment and supply sales	\$ 6,564	\$		\$ 6,564
Service revenue	648			648
	7,212			7,212
Cost of goods sold:				
Cost of equipment and supply sales	3,548	36	2	3,584
Cost of service revenue	99			99
	3,647	36		3,683
Gross margin	3,565	(36 )		3,529
Operating expenses:				
Selling and marketing	1,774	78	2	1,852
General and administrative	942	(136 )	2	806
Research and development	549	22	2	571
Amortization of intangibles	203			203
	3,468	(36 )		3,432
Operating income	97			97
Interest income	19			19
Income before taxes	116			116
Provision for taxes	5	80	1	85
Income from continuing operations	111	(80 )		31
Gain from discontinued operations, net of \$103 taxes	272	(97 )	1	175
Net income	\$ 383	\$ (177 )		\$ 206
Earnings per share basic				
Continuing operations	\$ 0.03	\$ (0.02 )		\$ 0.01
Discontinued operations	0.08	(0.03 )		0.05
Net Income	\$ 0.11	\$ (0.05 )		\$ 0.06
Earnings per share - diluted				
Continuing operations	\$ 0.03	\$ (0.02 )		\$ 0.01
Discontinued operations	0.07	(0.03 )		0.04
Net Income	\$ 0.10	\$ (0.05 )		\$ 0.05

(In thousands)	Six Months Ended April 30, 2006			
	As Previously Reported	Adjustments Amount	No.	As Restated
<b><u>Statement of Operations Data:</u></b>				
Revenues:				
Equipment and supply sales	\$ 12,811	\$		\$ 12,811
Service revenue	1,334			1,334
	14,145			14,145
Cost of goods sold:				
Cost of equipment and supply sales	6,810	55	2	6,865
Cost of service revenue	222			222
	7,032	55		7,087
Gross margin	7,113	(55 )		7,058
Operating expenses:				
Selling and marketing	3,697	108	2	3,805
General and administrative	1,715	(196 )	2	1,519
Research and development	1,021	33	2	1,054
Amortization of intangibles	406			406
	6,839	(55 )		6,784
Operating income	274			274
Interest income	28			28
Income before taxes	302			302
Provision for taxes	11	174	1	185
Income from continuing operations	291	(174 )		117
Gain from discontinued operations, net of \$103 taxes	268	(97 )	1	171
Net income	\$ 559	\$ (271 )		\$ 288
Earnings per share - basic				
Continuing operations	\$ 0.08	\$ (0.05 )		\$ 0.03
Discontinued operations	0.07	(0.02 )		0.05
Net Income	\$ 0.15	\$ (0.07 )		\$ 0.08
Earnings per share - diluted				
Continuing operations	\$ 0.08	\$ (0.05 )		\$ 0.03
Discontinued operations	0.07	(0.02 )		0.05
Net Income	\$ 0.15	\$ (0.07 )		\$ 0.08

(In thousands)	Six Months Ended April 30, 2006			
	As Previously Reported	Adjustments Amount	No.	As Restated
<b><u>Statement of Cash Flows Data:</u></b>				
Cash Flows From Operating Activities:				
Net income	\$ 559	\$ (271 )	1	\$ 288
Gain from discontinued operations	(268 )	97	1	(171 )
Tax benefit from stock options exercised		1	1	1
Deferred income taxes	2	277	1	279
Other current liabilities and accrued expenses	52	(7 )	1	45
Net cash provided by continuing operations	2,170	97		2,267
Restricted cash released for discontinued operations	200	(200 )	3	
Cash used in operating activities of discontinued operations	(324 )	(97 )	1	(221 )
Net cash provided by operating activities	\$ 2,046	\$		\$ 2,046
Cash Flows From Financing Activities:				
Proceeds from issuance of commons stock	35			35
Promissory note payment		(200 )	3	(200 )
Cash restricted for discontinued operations		200	3	200
Net cash provided by financing activities	\$ 35	\$		\$ 35

**Item 2. Management's Discussion and Analysis or Plan of Operation.**

**Forward-Looking Statements and Risk Factors**

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

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

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

**Overview**

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

The Company, through its Medical Graphics Corporation subsidiary, designs non-invasive diagnostic systems under the MedGraphics trade name that assist health care professionals in the prevention, early detection and cost-effective treatment of heart and lung disease. It also sells a version of some of these products under the New Leaf brand to health and fitness clubs and personal trainers to assist them in developing exercise programs to help their clients meet their personal goals. Revenues consist of equipment and supply sales and service revenues. Equipment and supply sales reflect sales of Medical Graphics' non-invasive cardiorespiratory diagnostic equipment, sales of New Leaf health and fitness products, and aftermarket sales of peripherals and supplies. Service revenues reflect revenues from extended service contracts, non-warranty service visits and additional training.

Total revenue for the second quarter of 2006 was \$7.2 million, an increase of 19.6% from \$6.0 million in 2005. Operating expenses for the second quarter of 2006 were \$3.4 million, an increase of 6.1% from \$3.2 million in 2005. Income from continuing operations for the three months ended April 30, 2006 was \$31,000, or \$0.01 per diluted share, compared to a loss of \$238,000, or \$0.07 per share, for the same period in 2005. Net income for the three months ended April 30, 2006 included a \$175,000 gain from discontinued operations and, therefore, was \$206,000, or \$0.05 per diluted share.

For the six months ended April 30, 2006, total revenue increased 27.9% to \$14.1 million from \$11.1 million for the same period in 2005. Operating expenses for the six months ended April 30, 2006 increased 7.9% to \$6.8 million from \$6.3 million for the same period in 2005. Income from continuing operations for the six months ended April 30, 2006 was \$117,000, or \$0.03 per diluted share, compared to a loss of \$949,000, or \$0.26 per diluted share, for the same period in 2005. The net income for the six months ended April 30, 2006 included a \$171,000 gain from discontinued operations and, therefore, was \$288,000, or \$0.08 per diluted share.

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

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

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

- The April 30, 2006 quarter marked the third consecutive profitable quarter;
- The Company achieved double-digit year-over-year revenue growth for the eighth quarter in a row. With year-over-year revenue growth for the six months ended April 30, 2006 of 27.9%, the Company's annual goal is clearly within reach. Second quarter revenue of \$7.2 million is a record revenue quarter;
- The Company is making progress in the development of new cardiorespiratory diagnostic products;
- The Company has added 64 new sites offering New Leaf active metabolic assessments since year-end;
- The New Leaf branded *EnergySmart* personalized online meal planning, tracking and calorie management system was launched in February 2006. This system is designed to help consumers from weight conscious adults and children to recreational and elite athletes properly measure and fuel their metabolism.

#### **Restatement of Financial Statements**

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

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





*the Bankruptcy Code* ( SOP 90-7 ) to the utilization of its pre-emergence bankruptcy NOL carry forwards. Angeion was in Chapter 11 Bankruptcy Reorganization from June 2002 to October 2002.

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

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

Therefore, the Company has:

- Increased the provision for taxes by \$80,000 and \$174,000 for the three and six months ended April 30, 2006, respectively,
- Increased tax expense related to discontinued operations by \$97,000 for both periods ended April 30, 2006, and
- Decreased goodwill by \$328,000, decreased intangible assets by \$77,000, decreased other current liabilities and accrued expenses by \$7,000 and decreased deferred income tax liabilities by \$128,000 as of April 30, 2006.

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

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

## Revenue

Total revenue increased by 19.6% to \$7.2 million from \$6.0 million for the three months ended April 30, 2006 and 2005, respectively. Domestic product revenue increased by 18.8% to \$5.2 million in 2006 compared to \$4.4 million in 2005. International product revenue increased 38.1% to \$1.4 million in 2006 compared to \$1.0 million in 2005. Service revenue decreased 2.6% to \$648,000 in 2006 from \$665,000 in 2005.

During the second quarter of 2006, one customer accounted for 11.5% of revenue. There were no significant customers for the same period in 2005. Due to firm orders already received, revenue from this customer is expected to exceed 10% of revenues for the third quarter of 2006.

For the six months ended April 30, total revenue increased by 27.9% to \$14.1 million from \$11.1 million for 2006 and 2005, respectively. Domestic product revenue increased by 29.1% to \$10.3 million in 2006 compared to \$7.9 million in 2005. International product revenue increased 49.5% to \$2.6 million in 2006 compared to \$1.7 million in 2005. Service revenue decreased 5.4% to \$1.3 million in 2006 from \$1.4 million in 2005.

Sales of the new Ultima PF and Ultima PFX cardiorespiratory diagnostic systems are contributing significantly to both domestic and international revenue growth. The Company continues to be pleased with customer acceptance of these new products that began shipping during April 2005. In addition, revenue from the Company's Elite Series systems has remained strong throughout the first six months of 2006 compared to 2005 as customers continue to replace their older 1085 Series equipment.

The Company was also successful in the second quarter generating more business from customers engaged in clinical research. Under these agreements, the Company sells its cardiorespiratory diagnostic systems and services to third parties conducting clinical trials at multiple sites inside and outside the United States.

Revenue from sales of the Company's New Leaf personal assessment systems has continued to increase the base from which New Leaf consumable products are made available at health and fitness clubs. The increase in this base is beginning to drive increased sales of personal metabolic assessments that drive revenue from the Company's higher margin New Leaf consumable products. For the six months ended April 30, 2006, revenue from New Leaf consumable products has more than doubled compared to the same period in 2005. The Company's New Leaf health and fitness products are continuing to contribute to domestic growth due to broadening consumer acceptance and expansion of the base.

Service revenue decreased \$17,000 or 2.6% during the second quarter of 2006 compared to the same quarter in 2005 due to the relatively aggressive pace that customers are replacing older equipment with the Company's new models, thereby reducing revenue from extended service contracts and non-warranty service visits on older equipment. The second quarter decrease is somewhat less than the 7.9% decrease experienced during the first quarter of 2006. The Company believes that this negative revenue trend will continue to decline and eventually turn positive when new equipment sold in the past 12 months becomes eligible for new extended service contracts.

#### **Gross Margin**

Gross margin percentage for the three months ended April 30, 2006 of 48.9% of revenue was comparable to 49.5% for the same period in 2005. For the six months ended April 30, 2006, gross margin percentage increased to 49.9% from 48.1% for the same period in 2005. The overall gross margin percentage for the second quarter of 2006 decreased due to product mix. The product mix in the third quarter of 2006 is expected to be similar.

#### **Selling and Marketing**

Selling and marketing expenses for the three months ended April 30, 2006 of \$1.9 million were unchanged compared to the same period in 2005. For the six months ended April 30, 2006, selling and marketing expenses increased by 6.7% to \$3.8 million compared to \$3.6 million for the same period in 2005.

Second quarter 2006 selling and marketing expenses reflect a \$62,000 or 19.3% decrease in commission costs due to lower commissionable revenue and lower costs for related incentive programs. In addition, trade show expenses for the second quarter of 2006 were \$29,000 lower compared to the same period in 2005. Decreases in commission expenses and trade show costs were offset by a \$29,000 increase in costs associated with equipment demonstrations to potential customers.

For the six months ended April 30, 2006, commission expenses were \$75,000 or 13.3% higher compared to the same period of 2006 primarily due to the 42% increase in domestic sales for the first

quarter of 2006. In addition, increases in expenses for travel, trade shows and equipment demonstrations contributed to the 3.7% overall increase in selling and marketing expenses for the six months ended April 30, 2006.

#### **General and Administrative**

General and administrative expenses for the three months ended April 30, 2006 increased by \$192,000 or 31.3% to \$806,000 compared to \$614,000 for the same period in 2005. For the six months ended April 30, 2006, general and administrative expenses increased by \$241,000 or 18.9% to \$1.5 million compared to \$1.3 million for the same period in 2005.

General and administrative expenses included \$81,000 and \$137,000 for the three and six months ended April 30, 2006, respectively, for stock-based compensation associated with variable options compared to no expense in this area for 2005 for either period. These stock-based compensation expenses were non-cash expenses. The Company marks-to-market the intrinsic value of its unvested variable options on a quarterly basis. In addition, the Company was required to expense the full amount of intrinsic value for an aggregate of 40% of the outstanding options that vested during the second quarter. These vested options will now be excluded from future variable option accounting. See Note 4 to the Consolidated Financial Statements, Stock-Based Compensation, in this Form 10-QSB/A for additional discussion of variable options.

In addition, there was a \$61,000 increase in general and administrative expenses due to a \$12,000 decrease in the provision for doubtful accounts for the six months ended April 30, 2006 compared to a \$73,000 decrease in the provision for doubtful accounts for the same period in 2005. Legal expense decreases of \$35,000 and \$40,000 for the three and six months of 2006 compared to the same periods of 2005 somewhat offset these decreases.

General and administrative expenses also included \$19,000 in consulting expenses associated with Sarbanes-Oxley compliance costs for the second quarter of 2006 compared to \$21,300 for the same period in 2005. For the six months ended April 30, general and administrative expenses included \$34,000 for Sarbanes-Oxley compliance costs in 2006 compared to \$52,800 for the same period in 2005.

#### **Research and Development**

Research and development expenses for the three months ended April 30, 2006 increased \$12,000 or by 2.1% to \$571,000 from \$559,000 for the same period in 2005. For the six months ended April 30, 2006, research and development expenses increased \$17,000 or 1.6% to \$1.1 million compared to \$1.0 million for the same period in 2005.

The Company is currently working on new products intended for use by international markets and asthma, allergy and primary care physicians. These new products are planned for release late in 2006 or early 2007. In addition, the Company is also implementing new designs and new components for use in its existing systems that have lower costs and are more efficient in the manufacturing process.

#### **Amortization of Intangibles**

Amortization of developed technology was \$203,000 for each of the three month periods ended April 30, 2006 and 2005 and \$406,000 for each of the six-month periods ended April 30, 2006 and 2005. As further described in Note 6 above, as the Company utilizes pre-emergence bankruptcy net operating loss carry forwards, the Company will sequentially reduce the cost of trade names and developed

technology until the net carrying cost is zero. To the extent that utilization of these NOLs reduces the cost of developed technology, future amortization expense will be reduced.

#### **Provision for Taxes**

The Company is required to present the provision for taxes for 2006 as if it were fully taxable in accordance with SOP 90-7. The Company has utilized its pre-emergence bankruptcy NOLs in the calculation of its income taxes payable but is required to pay only U.S. and State Alternative Minimum Taxes ( AMT ) because it has substantial federal net operating loss carry forwards. The tax benefit for using pre-emergence bankruptcy NOLs has been recorded as a reduction of goodwill and intangible assets in the three and six months ended April 30, 2006. See Note 11 to the Consolidated Financial Statements, Restatement of Financial Statements, in this Form 10-QSB/A for additional discussion of the accounting for income taxes and the use of pre-emergence bankruptcy NOLs.

#### **Discontinued Operations**

The net gain from discontinued operations of \$171,000 for the six months ended April 30, 2006 reflects the net difference after recording the agreed upon insurance recovery and the associated legal fees that were contingent upon the recovery together with other additional consulting fees and miscellaneous litigation expenses. The Company has allocated \$103,000 of the provision for taxes to discontinued operations for the three and six-month periods ended April 30, 2006. See Note 9 to the Consolidated Financial Statements, Discontinued Operations and Related Litigation, in this Form 10-QSB for additional discussion of the litigation settlement with Medmarc.

#### **Liquidity and Capital Resources**

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

The Company had cash and cash equivalents of \$3.2 million, including \$200,000 of cash restricted for discontinued operations, and working capital of \$7.0 million as of April 30, 2006. During the six months ended April 30, 2006, the Company generated \$2.3 million in cash from continuing operations in part because its net income of \$288,000 included non-cash expenses of \$532,000 for depreciation and amortization, \$137,000 for stock-based compensation and \$279,000 of deferred income taxes. Equal increases of \$1.2 million for advance payments from customers and accounts payable together with an increase of \$236,000 in deferred income all contributed to the generation of cash. Advance payments from customers are associated with orders for equipment received from a new customer. Cash was used for increases of \$1.4 million and \$219,000 in inventories and accounts receivable, respectively. The increases in both inventories and accounts payable are necessary to support the new customer's order for equipment intended for use in clinical research.

The Company used \$221,000 in cash for operating activities of discontinued operations, which included legal fees and consulting expenses and other expenses related to the ELA Medical settlement and Medmarc litigation. On June 9, 2006, the Company received the settlement payment from Medmarc for the insurance recovery related to expenses associated with previously discontinued ICD products. See Note 9 to the Consolidated Financial Statements, Discontinued Operations and Related Litigation, in this Form 10-QSB/A for additional discussion.

During the six months ended April 30, 2006, the Company used \$196,000 in cash for the purchase of property and equipment. The Company has no material commitments for capital expenditures for fiscal year 2006.

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

The Company believes that its liquidity and capital resource needs for fiscal year 2006 will be met through its current cash and cash equivalents and cash flows from operations.

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

#### *(a) Evaluation of Disclosure Controls and Procedures*

Management, with the participation of the Company's chief executive officer, Rodney A. Young, and chief financial officer, Dale H. Johnson, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures, as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934, as of April 30, 2006. In this evaluation, the Company originally concluded that its disclosure controls and procedures were effective as of April 30, 2006, as disclosed in the Company's Form 10-QSB filed on June 14, 2006.

In connection with the restatement, management, under the direction of its chief executive officer and chief financial officer, reevaluated the disclosure controls and procedures and due to the identification of a material weakness in internal control over financial reporting related to the Company's accounting for income taxes, as described below, concluded that the Company's disclosure controls and procedures were not effective as of April 30, 2006.

The material weakness in internal control over financial reporting related to the Company's accounting for income taxes. Specifically, the Company did not have, and through its engagement of third party outside advisers did not acquire, adequate technical expertise to effectively oversee and review the Company's accounting for the utilization of pre-emergence bankruptcy NOL carry forwards in accordance with AICPA Statement of Position 90-7, *Financial Reporting by Entities in Reorganization under the Bankruptcy Code*. As a result, the Company restated the financial information included in the first three quarters of the year ended October 31, 2006, including the three and six months ended April 30, 2006, as included herein, to correct a material error in accounting for income taxes.

Due to this material weakness in internal control over financial reporting, the Company performed other procedures related to the presentation of income taxes and the use of pre-emergence bankruptcy NOL carry forwards in preparing its restated consolidated financial statements as of and for the three and six months ended April 30, 2006 to ensure that these consolidated financial statements were presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles.

*(b) Changes in Internal Control over Financial Reporting*

There was no change in the Company's internal control over financial reporting during the quarter ended April 30, 2006 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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

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**PART II - OTHER INFORMATION**

**Item 1. Legal Proceedings.**

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

As disclosed in Item 3 of the Form 10-KSB for the year ended October 31, 2005, the Company is involved in a lawsuit brought by Medmarc Casualty Insurance Company in United States District Court for the District of Minnesota involving a claim for indemnification by ELA Medical and the Company's claim for insurance coverage from Medmarc in the matter Medmarc Casualty Insurance Company v. Angeion Corporation, ELA Medical, Inc. and ELA Medical SA.

The following material developments in that matter have occurred since the filing of the Form 10-KSB:

On January 20, 2006, the Company and Medmarc argued summary judgment motions in United States District Court on issues of confirming Medmarc's responsibility to reimburse the Company for its \$1.4 million settlement with ELA and its legal fees paid in defending the lawsuit. As reported by Angeion in its Form 10-QSB for the quarter ended January 31, 2006, the Court granted, in large part, Angeion's motion for summary judgment in the pending lawsuit.

Subsequent to the Court's ruling, on April 12, 2006, Angeion and Medmarc agreed to a confidential settlement that resolves all matters with respect to the pending lawsuit. Under the terms of the settlement, Medmarc agreed to make a single payment to Angeion on or prior to June 11, 2006, and each party agreed to dismiss with prejudice all claims against the other in the pending lawsuit.

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

*Recent Sales of Unregistered Securities*

The Company had no unregistered sales of equity securities during the three months ended April 30, 2006.

*Small Business Issuer Purchases of Equity Securities*

The Company did not purchase any equity securities during the three months ended April 30, 2006.

**Item 3. Defaults Upon Senior Securities.**

None

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

None

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**Item 5. Other Information.**

None

**Item 6. Exhibits.**

(a) The following exhibits are included herein:

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

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

Angeion Corporation  
(Registrant)

Date: January 29, 2007

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

Date: January 29, 2007

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

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