

COMPUMED INC  
Form 10-K  
December 29, 2009

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-K**

X **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE  
ACT OF 1934**

For the fiscal year ended: **September 30, 2009**

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE  
ACT OF 1934**

For the transition period from: \_\_\_\_\_ to \_\_\_\_\_

**COMPUMED, INC.**

*(Exact name of registrant as specified in its charter)*





Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer	Accelerated filer	
Non-accelerated filer	Smaller reporting company	X

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

Yes	X	No
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As of March 31, 2009, the issuer had 25,882,643 common shares outstanding. The aggregate market value of the common shares held by non-affiliates (25,486,869) of the issuer was approximately \$4,842,505 based upon the average bid and asked prices on such date.

As of December 28, 2009, the issuer had 26,093,742 common shares outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

None.

**COMPUMED, INC.**

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**PART I**

**ITEM 1.**

**DESCRIPTION OF BUSINESS**

**GENERAL**

CompuMed has created an electronic telemedicine infrastructure to link clinical cardio-vascular data collected at the patient's point of care, such as 12-lead ECGs, provide computerized interpretation of the data and to transmit that data to cardiologists for over-read interpretations. Our key innovation in this area is the workflow technology being used to manage the inflow of data to its servers, and the routing of that data to a network of cardiologists who provide interpretations under contracts. Our services are available 7x24 and are designed to support general clinical workflows. We have specialized expertise and intellectual properties in electronic workflow, telemonitoring, imaging and analysis. Our services and products are designed to improve healthcare provider workflow and patient care, while reducing costs. We also develop imaging based diagnostic systems for the detection of certain musculoskeletal diseases such as Osteoporosis.

We are registered with the Food & Drug Administration, (FDA) and our medical devices including those used in our core products CardioGram™, OsteoGram® and OsteoCare™, are cleared by the FDA. Our products and services are reimbursable by Medicare and many private insurers.

The CardioGram is an electronic workflow and telemedicine application focused on tele-cardiology. We have been a supplier of telemedicine services for more than twenty years and have established one of the nation's largest telecommunications networks for electronic processing of electrocardiograms on a real time basis, providing ECG equipment and services to hundreds of healthcare providers throughout the U.S and performing tens of thousands of ECG interpretations annually. Using our customized electrocardiogram terminals, an electrocardiogram is acquired from a patient, digitized, transmitted in electronic form to our central computers for digital workflow processing, analyzed and received back on the electrocardiogram terminal where the electrocardiogram trace and computer interpretation are printed,- all within a few minutes. If necessary, we can provide an "overread" by a cardiologist and return the results within a short time frame, often in under an hour. We bill for this service on a per-use basis, and we sell or rent a full range of electrocardiogram machines and supplies including electrodes, recording paper, gel, and patient cables. CardioGram can also be used to manage electronic records in connection of electronic medical records and digital workflow applications.

The OsteoGram is a non-invasive diagnostic software system that has been shown in clinical studies to provide an effective and accurate bone density measurement in connection with screening for osteoporosis and assessing hip fracture risk from digital X-Rays of the hand and wrist. We believe that the OsteoGram may have significant cost advantages over other non-invasive diagnostic technologies in the marketplace. We license the OsteoGram software for license fees. Our target markets for these products are OEMs and settings where digital X-Ray infrastructure is used such as hospitals, radiology practices, imaging centers, and orthopedic office practices.

OsteoCare is a similar product to our OsteoGram but based on a self-contained peripheral unit with a dual-energy absorption X-ray technology. The Company OEMs OsteoCare form a partner. OsteoCare is useful to provide a self-contained BMD testing device in clinical point-of-care settings where a larger digital X-Ray system might not be cost-effective. We sell, lease or rent the OsteoCare system. The Company targets the OsteoCare product at

point-of-care markets such as general practices and obstetric-gynecology practices.

We were incorporated in the State of Delaware on July 21, 1986.

**SIGNIFICANT EVENTS FOR THE FISCAL YEAR AND EVENTS SUBSEQUENT TO THE CLOSE OF THE FISCAL YEAR**

*Telecardiology Services*

CompuMed's historical customer base for its telecardiology services has been the correctional healthcare segment. During 2009, we were able to leverage the significant investments to expand our telecardiology and telemedicine platform supporting our CardioGram into new market segments. While much of the revenue impact from some of these new markets remains ahead of us, we established key new initial customer relationships in significant new markets. These include, (i) a new Fortune 50 customer in the occupational healthcare segment of our market, which we are now using to build a case study for the use and clinical effectiveness of our telecardiology product in the occupational healthcare marketplace, (ii) the continued expansion into the rural health market and (iii) the launch of

a new point-of-care initiative aimed at pediatric cardiovascular disease screening in Florida with the University of Miami. These activities have allowed the Company to develop its capabilities to deliver services in primary care settings in addition to the institutional settings that have formed our core business to date.

Frost and Sullivan, US ECG and Cardiac Monitoring Products and Services Markets, 2006, estimates the overall market size for ECG services in clinical care settings will exceed \$1 billion in 2010. Additionally trends towards telemedicine use in support of diagnosis and treatment of disease, including cardiovascular disease, appear to be accelerating due to recent push from the federal government, healthcare reform and cost reductions. We believe that we might be at a key strategic inflection point in the marketplace acceptance of our telemedicine services in the broader point of care clinical market, and believe we might have the opportunity to move the Company into a position of leadership in providing telecardiology services to primary care patients, including to patients directly at home. Currently our products have been used principally in institutional settings within certain niches, but some of our activities during the year in pediatrics, rural and occupational healthcare have allowed us to test both technology and reimbursements for this primary care targets.

Telemedicine and health information technology adoption are expected to be among the top 10 healthcare trends of the coming year, according to a report by PricewaterhouseCoopers, a top 10 Health Industry Issues in 2010: Squeezing The Juice Out Of Healthcare: December 2009. They forecast that the healthcare industry might rely on improved broadband connectivity and greater integration of healthcare technologies to further growth of the telemedicine market. Meanwhile, alternative care models could gain greater precedence over traditional in-office patient care. And, to qualify for federal incentives, more hospitals and healthcare providers will also embrace electronic health record systems. The No. 1 trend of 2010 is likely to be providers' efforts to reduce healthcare costs, according to the report. PricewaterhouseCoopers also predicts there will be greater adaptation to new healthcare regulations, and fraud and abuse recovery.

These types of telemedicine technologies are also gaining in acceptance because they help reduce cost of healthcare. According to market research firm Parks Associates, the total digital home health market in the US could grow at an average annual rate of 36% and turn into a \$2.1 billion industry in 2012. According to Parks, the rapid expansion of wellness monitoring programs and online patient-physician messaging services might partly drive this growth. In another study conducted by Penn, State University (C. Cruise, M Lee, Physical Medicine and Rehabilitation Clinics of North America, Volume 16, Issue 1, pages 267-284), remote home health monitoring for a single group of diabetes patients cut costs for hospital care by 69%. A Veterans Administration study (Dibya Sarkar, Broadband Could Be Health Boom For Seniors, Government Health IT, December 9, 2005) of remote monitoring of patients showed a 40% cut in emergency room visits and another study by the Kaufman Foundation (Better Health Care Together Robert Litan, Vital Signs via Broadband: Remote health Monitoring transmits savings, enhances lives, October 2008) forecasted that 30% of all hospital, out-patient and drug expenses could be saved from remote monitoring for the chronically ill.

The Company responded to these trends by planning an aggressive move into primary care markets. During the months immediately subsequent the close of the fiscal year, we have been engaged in detailed business planning towards the market launch of consumer facing initiatives in calendar 2010 (eHealth initiative), which could include patient home monitoring and screening. We have also engaged into significant strategic discussion with possible joint venture partners that would accelerate and capitalize this market entry. We have not yet entered into any material joint ventures in this area, but the process of negotiation is on-going and we remain committed to including such strategic relationships as part of our market entry in the primary care markets. Partially to provide capitalization for the activities in support of its eHealth initiatives, and related joint ventures, the Company entered into an agreement with Bathgate Capital Partners, LLC to effect the private placement of up to 1,500,000 shares of the Company common stock at a price of \$0.12 per share. The Company plans to close the private placement by January 31, 2010.

Our pediatric project in Florida has successfully validated our technology in primary care. We have also been able to experiment with our partners on the delivery of reimbursable procedures. Based on the experience in Florida, we are

making plans to expand our pediatric effort to California and eventually nationwide. The American Academy of Pediatrics, (AAP) and the American Heart Association (AHA), based on findings from the Congenital Cardiac Defects Committee, issued a recommendation that children with certain risk factors should have selective screening through ECGs before being prescribed ADHD drugs due to potential adverse cardiac effects of psychotropic medications in children. The Company believes that, as a result of the recommendation, demand may grow for specialized pediatric cardiology over-reads of ECGs by pediatricians and mental health professionals. According to the AHA, there are more than 2.5 million children and teens in the US taking stimulants to control their ADHD.

Additionally, demand for this type of screening is growing from school settings engaged in athletics. According to Science Daily (2008 -- <http://www.sciencedaily.com/releases/2008/07/080703203243.htm>), one young competitive athlete dies every three days from an unrecognized cardiovascular disorder in the US. In the majority of cases, the athletes appear healthy and there is no previous clinical sign of heart problems. The clinical usefulness of pre-screening programs to identify people at high risk has been hotly debated but consensus appears to be emerging that there should be some kind of pre-screening program involving electrocardiogram (ECG). We are currently negotiating with educational healthcare providers to begin running this type of screening as a natural extension of our pediatric program.

We cannot, however, offer assurance that any of these strategies, joint venture or market expansions will be successful in growing the business or that our products will ultimately prove to be effective in these new markets.

During the fiscal year the majority of our significant State correctional contracts came due for renewal. The Company succeeded to renew 100% of its contracts and in most cases was able to increase the number of facilities or patients under contract.

Our correctional customers responded to the fiscal pressures on their budget by eliminating wide screening of patients, and limiting use of our services to at-risk patients. This trend depressed revenue throughout the year, but was partially offset by the increase in overall customers under contracts.

We are currently providing ECG over-read services to 975 institutions, nationwide and have performed tests on over 75,000 patients totaling over 100,000 tests.

#### *Skeletal Health Business*

Market acceptance of this product has been limited by the fact that the OsteoGram software is a bolt-on to other Digital Radiology (DR) or equivalent systems. While such systems are normally present in large facilities, many of the smaller physician's practices that appear most interested in providing bone density screening to their patients typically do not own such systems, or in many cases do not even own x-ray equipment. As a result, we have not been able to deploy OsteoGram for the point-of-care opportunity and OsteoGram is principally focused in OEM markets where DR technologies are present such as hospitals, surgery centers, larger orthopedic practices and imaging centers. Recognizing this, the Company has altered its marketing effort of the OsteoGram to focus on larger facilities with existing DR/CT systems, and is looking at its alternate product OsteoCare to address the point-of-care needs of the larger number of smaller physician practices.

OsteoGram continues to have limited acceptance at this time. In the US there is a tendency by the physician community to look at RA, the technology on which OsteoGram is based, as a lesser technology than DXA, the prevalent approach to bone densitometry. While this appears to be a perception, it has made sales, especially in the US, difficult. In overseas markets, the bias towards DXA is less pronounced and the Company has invested effort towards developing credible international channels and clearing the path towards a greater presence internationally. In order to overcome this perception, and to expand its ability to operate in international markets, the Company has been investigating strategic alliances with one or more large third parties that could add large company resources to our OsteoGram marketing efforts. It is too early to indicate the form and structure of such a relationship and there can be no guarantees that such a relationship can be found or executed. Additionally, the Company with its OEMs has worked aggressively to clear the product for sale in China. This effort resulted in the Chinese State Food & Drug Administration clearing the OsteoGram for sale in China on June 6, 2008.

While the Company continues to address a worldwide market for its skeletal health products. The Company has focused marketing effort in China where demand has been increasing. The Company believes that Osteoporosis affects more than 200 million people worldwide and is especially prevalent in China, where the traditional diet lacks

calcium. According to China's most recent national census, about 100 million Chinese citizens suffer from the disease in various stages. During the fiscal year, a large scale study led and presented by renowned osteoporosis researcher Dr. Jianhua Wang at the recent 6th International Conference on Bone and Mineral Research in Hohhot, China specifically affirmed the precision and accuracy of CompuMed's OsteoGram system for low cost osteoporosis screening. Dr. Wang's presentation titled "Study on Measurement of Phalangeal Bone Density by Radiographic Absorptiometry" presented extremely precise results when performing short-term repeated tests with CompuMed's OsteoGram system. In addition, the study outcome was highly correlated to China's popular osteoporosis normal database, confirming the high

accuracy of OsteoGram. Radiographic absorptiometry (RA) is a technique for bone mass measurement from radiographs of peripheral sites, most commonly the hand or heel. This was one of the largest and most thorough studies ever performed to study the value of RA in measuring bone mineral density. We believe that the results further confirmed that the OsteoGram is an effective and efficient alternative to costly DXA systems.

In July 2008, CompuMed announced that the Company had received approval from China's State Food and Drug Administration (SFDA) to sell the OsteoGram system and therefore work with Chinese OEMs to penetrate the Chinese market for osteoporosis screening.

The Company has continued to grow the number of units placed in China, principally through its distribution partners in China. While encouraging as a trend, the volume of units is still small in comparison to the total market potentials. Recognizing the potential importance of certain overseas markets such as China, and the fact that the Company might need to expand its marketing and R&D effort in those markets beyond what it has the resources to accomplish alone, the Company is exploring entering into a joint venture or other strategic relationship with potential strategic partners to expand its international market reach. Currently the products are marketed in China through its master distributor, Rayco, a unit of Carestream Health.

The marketplace for OsteoCare in the US was negatively impacted by the refusal by some private insurance providers to reimburse physicians for peripheral testing. We are currently working with those physicians and those private reimbursers to reconsider those policies. However, there can be no assurances that those decisions will be reconsidered or that we will not have negative impact. Furthermore, the uncertainty associated with healthcare reform and continued cutting of reimbursements associated with imaging devices in general has affected the entire medical imaging business.

## **ELECTROCARDIOGRAM SERVICES**

### **GENERAL**

ECG and cardiac monitoring services are among the most powerful tools physicians have in diagnosing heart ailments. According to the Centers for Disease Control (CDC)/National Center for Health Statistics (NCHS), Centers for Disease Control and Prevention, National Center for Health Statistics, Health, United States, 2008, for persons born in the United States, the probability at birth that they will die of some form of cardiovascular disease (CVD) is 47 percent. As of 2007 in the United States, forms of CVD remain the number one cause of death for men and women alike, and the number three cause of death for children under the age of 15. Additionally, 3 to 4 people on average die every few minutes in the US from varying forms of CVD, equal approximately 2,600 US lives daily.

The term CVD includes several different types of cardiovascular disorders, including high blood pressure, stroke, and coronary heart disease, which include heart attacks (myocardial infarction). Congestive heart failure and congenital heart defects are also forms of CVD. Recent statistics published by the American Heart Association show that CVD affects approximately 64.4 million Americans. The financial burden for CVD was estimated at \$368.4 billion in 2007, up from \$351 billion in 2006, an increase of 5 percent in one year alone. Of this, \$226.7 billion consisted of healthcare expenditures, with the remaining \$141.7 billion attributed to indirect costs, such as lost productivity. With risk factors such as obesity, high cholesterol, and sedentary lifestyles steadily increasing, the prevalence of CVD, demand for ECG, and cardiac monitoring services is poised to increase.

The market for ECG and cardiac event monitoring includes resting ECG services, Stress ECG Services, Holter monitoring services, cardiac event monitoring services, and pacemaker monitoring services. Each aspect of this market plays an integral role in helping physicians reach accurate and timely diagnoses of various forms of CVD, and

to help physicians monitor patient health after measures are taken to correct ailments. Currently CompuMed is addressing only the resting ECG segment but it is exploring entering additional modalities to widen its market. According to a Frost & Sullivan report (Frost & Sullivan, North American home health care and disease management markets for remote patient monitoring, June 2009), the total U.S. market for ECG and cardiac monitoring services was estimated at approximately \$3.5 billion in 2007. Due to a decline in reimbursement rate for services in most segments, this overall market size is estimated at essentially the same point it was in 2005. Frost & Sullivan forecasts that, increasing demand for services in response to new technologies, increasing pacemaker implantation, aging population, and increased incidence of CVD should outpace the negative impact decreasing reimbursements are expected to have on the market going forward. In 2011, Frost & Sullivan expects the market to reach slightly above \$3.7 billion, growing at an estimated CAGR of 2.3 percent over the period 2007 to 2011.

## **THE IMPORTANCE OF ECG OVER-READS IN CLINICAL PRACTICE**

While the training and board examinations required of cardiologists ensure expert ECG interpretation skills, the majority of ECGs are interpreted in primary care settings by non-cardiologists. At one time, this was not understood as a problem. However, as our understanding of the heart increases daily, so does the difficulty of accurately interpreting ECGs. Today, according to medical literature, more than 400 diagnostic statements can be made on the basis of a 12-lead ECG. In 2005 the American Heart Association (AHA) and the American College of Cardiology (ACC) put forward a joint statement under which they recommend that every ECG should be interpreted by a Cardiologist or an ECG-trained physician. The only board certification meeting this standard is Cardiology. This was evidenced by an ACC/AHA study where physicians were tested in ECG interpretation. Of the physicians that were tested,

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70% of all non-Internal Medicine specialists failed

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49% of all Internal Medicine specialists failed

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Up to 30% of all computerized interpretations failed.

We believe that interpreting ECG correctly is a particularly important matter, since 11% of ECG interpretation errors are associated with morbidity and mortality. Liability for the provider is also high. According to the American Academy of Family Physicians, missed "myocardial infarction (MI) is the leading cause of litigation against family physicians. More malpractice dollars are awarded for missed myocardial infarctions than for any other single diagnosis." Studies and court records show that failure to diagnose cardiac conditions is a problem in all primary care settings. One study published in the American Journal of Medicine found "that 2% of emergency doctor's patients with MI were sent home mistakenly, most commonly related to problems in physician use of the ECG."

We believe that expert ECG interpretation can significantly reduce the risk of these kinds of mistakes for many cardiac conditions.

## **COMPUMED PROVIDES EXPERT OVER-READS TO POINT OF CARE SETTINGS THAT DO NOT HAVE ACCESS TO CARDIOLOGISTS**

CardioGram affords healthcare providers an opportunity to have an ECG over-read by a cardiologist, decreasing the risk of interpretation errors and its ensuing liability. The CardioGram is an electronic workflow and telemedicine application focused on tele-cardiology. We have been a supplier of telemedicine services for more than twenty years and have established one of the nation's largest telecommunications networks for electronic processing of electrocardiograms on a real time basis, providing ECG equipment and services to hundreds of healthcare providers throughout the U.S and performing tens of thousand ECG interpretations annually. Using our customized electrocardiogram terminals, an electrocardiogram is acquired from a patient, digitized, transmitted in electronic form to our central computers for digital workflow processing, analyzed and received back on the electrocardiogram terminal where the electrocardiogram trace and computer interpretation are printed- all within a few minutes. When requested by our customers, we can provide an "over-read" by a cardiologist and return the results within a short time frame, often in under an hour. We bill for this service on a per-use basis, and we sell or rent a full range of electrocardiogram machines and supplies including electrodes, recording paper, gel, and patient cables. With recently introduced options the CardioGram can also be used to manage electronic records in connection of electronic medical

records and digital workflow applications.

It is possible, although unlikely, that despite the certifications and qualifications of our cardiologists that provide over-reads under contract for our customers, an error might be made or an over-read might lead to an erroneous treatment recommendation or diagnosis on the part of our cardiologists. Our contract cardiologists perform their over-reads services with us under their own medical license and are generally responsible for any malpractice that might ensue from their services. However it is possible that the Company might be held liable for our cardiologists mistakes in some circumstances. For this reason the Company maintains a liability insurance policy to cover such claims. There is some risk, however, that the Company might receive a claim of this type, and that the claim might result into a liability for the Company in excess of what might be covered by our insurance policy. Such a claim could put the Company at risk. However in the history of the Company spanning multiple decades of offering such services, there has never been a successful malpractice claim against the Company. As a result management, believes that this risk is small.

## MARKETING - ELECTROCARDIOGRAM SERVICES

CompuMed's historical customer base for its telecardiology services has been the correctional healthcare segment. During 2009, we were able to leverage the significant investments to expand our telecardiology and telemedicine platform supporting our CardioGram into new market segments. While much of the revenue impact from some of these new markets remains ahead of us, we established key new initial customer relationships in significant new markets. These include, (i) a new Fortune 50 customer in the occupational healthcare segment of our market, which we are now using to build a case study for the use and clinical effectiveness of our telecardiology product in the occupational healthcare marketplace, (ii) the continued expansion into the rural health market and (iii) the launch of a new point-of-care initiative aimed at pediatric cardiovascular disease screening in Florida with the University of Miami. These activities have allowed the Company to develop its capabilities to deliver services in primary care settings in addition to the institutional settings that have formed our core business to date.

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Pediatrics, (AAP) and the American Heart Association (AHA), based on findings from the Congenital Cardiac Defects Committee, issued a recommendation that children with certain risk factors should have selective screening through ECGs before being prescribed ADHD drugs due to potential adverse cardiac effects of psychotropic medications in children. The Company believes that, as a result of the recommendation, demand may grow for specialized pediatric cardiology over-reads of ECGs by pediatricians and mental health professionals. According to the AHA, there are more than 2.5 million children and teens in the US taking stimulants to control their ADHD.

Additionally, demand for this type of screening is growing from school settings engaged in athletics. According to Science Daily (2008 -- <http://www.sciencedaily.com/releases/2008/07/080703203243.htm>), one young competitive athlete dies every three days from an unrecognized cardiovascular disorder in the US. In the majority of cases, the athletes appear healthy and there is no previous clinical sign of heart problems. The clinical usefulness of pre-screening programs to identify people at high risk has been hotly debated but consensus appears to be emerging that there should be some kind of pre-screening program involving electrocardiogram (ECG). We are currently negotiating with educational healthcare providers to begin running this type of screening as a natural extension of our pediatric program.

We cannot, however, offer assurance that any of these strategies, joint venture or market expansions will be successful in growing the business or that our products will ultimately prove to be effective in these new markets.

During fiscal year 2009, the majority of our significant state correctional contracts came due for renewal. The Company succeeded to renew 100% of its contracts and in most cases was able to increase the number of facilities or patients under contract.

Our correctional customers responded to the fiscal pressures on their budget by eliminating wide screening of patients, and limiting use of our services to at-risk patients. This trend depressed revenue throughout the year, but was partially offset by the increase in overall customers under contracts.

We are currently providing ECG over-read services to 975 institutions, nationwide and have performed tests on over 75,000 patients totaling over 100,000 tests.

## **COMPETITION - ELECTROCARDIOGRAM SERVICES**

We compete with multiple companies in the ECG services markets, some of which have considerably more experience and financial resources. Many of our competitors are regional in nature. Amongst national competitors we compete with Biomedical Systems, Inc., a clinical research organization which offers various monitoring and over-reads services including ECG and Holter monitoring.

In the drug discovery clinical marketplace there are many companies that offer ECG interpretations services, new drug discovery and new drug applications. Most notable is eResearch Technologies, a large public clinical research corporation. As our focus is the point-of-care market, we have not directly competed with clinical research organizations that service the pharmaceutical sectors, and in fact have successfully provided services to clinical research organizations in that sector. It is possible that such organizations, including eResearch Technologies might change their focus and chose to enter our point-of-care market, in which case we would be direct competitors. Additionally if we chose to target this sector directly we would be competing directly with eResearch and its peers.

We also compete with the suppliers of self-interpreting ECG equipment. Although self-interpreting ECG equipment is widely available, our customers have historically preferred the optional feature of automatically sending their ECG results to one of our cardiologists for an over-read when the results are abnormal and when emergencies arise. We believe that this 24/7 over-read feature is a key advantage that enables us to market our services in segments of the

market where physicians or specialists may not be available on a routine basis. We could lose customers who choose to receive services from a competitor or who purchase a self-interpretive machine and no longer need our ECG interpretations. If we were to lose existing customers, they may be difficult to replace, and that could have a material adverse impact on our operations and financial condition.

We estimate that our centralized electrocardiogram analyses constitute less than 1% of the total number of electrocardiograms taken each year in the U.S.

We compete on the basis of service, ease-of-use, and price. Our existing and potential competitors consist principally of companies that have substantially greater financial, technical, marketing, distribution and other resources, greater current market penetration and longer-standing relationships with customers than us. We believe

that our ability to compete successfully depends on a number of factors, both within and outside of our control, including the price, quality and performance of our products and those of our competitors. Other factors affecting our ability to compete include the timing and success of our new product introductions, the development of technical innovations, the number and nature of our competitors in a given market, and general market and economic conditions. We may not be able to compete successfully in the future.

## **SKELETAL HEALTH PRODUCTS**

### **GENERAL**

The Company's OsteoGram product is a non-invasive diagnostic system that has been shown in clinical studies to provide an effective and accurate bone density measurement in connection with screening for osteoporosis and assessing hip fracture risk. We believe that the OsteoGram may have significant cost advantages over other technologies in the marketplace. Our target markets for these products are hospitals, radiology practices, imaging centers, and general OB/GYN and orthopedic office practices. The product is on its third generation and is offered on the market worldwide either directly by the Company or through approved distributors and Original Equipment Manufacturers (OEMs).

According to the Bone Health and Osteoporosis report from the U.S. Surgeon General, (Department of Health and Human Services, Bone Health and Osteoporosis, A report of the Surgeon General, 2004), fractures due to bone disease are common, costly and often become a chronic burden on individuals and society. A white woman over the age of 50 has more than a 40 percent chance of suffering a fracture sometime during the rest of her life (Cummings and Melton 2002). Fractures can have devastating consequences for both the individuals who suffer them and their family members. Hip fractures are associated with increased risk of mortality; the risk of mortality is 2.8 to 4 times greater among hip fracture patients during the first 3 months after the fracture than comparable risk among individuals of similar age who live in the community and do not suffer a fracture .

Despite the devastating impact of bone disease, and Medicare's stated desire to test more at-risk patients, the Centers for Medicare and Medicaid services recently enacted significant cuts in the reimbursement for central DXA, or dual energy X-ray absorptiometry, a technology which widely used in the United States to perform bone mineral density testing. As a result there have been trends in the marketplace of significant slowing of sales of central DXA systems and the number of centers offering central DXA services appears to be shrinking. Approved reimbursement for alternative screening technologies such as the Company's OsteoGram product was left unchanged. However, there is no guarantee that reimbursements for alternative procedures will remain unchanged in the future.

In part because of the changing Medicare reimbursement posture is making the economics of owning and operating a DXA facility less attractive, our market research suggests that there may be a new and growing demand for peripheral bone density measurement machines that can perform the test at point-of-care, in a small physician practice and on an inexpensive desktop device. As a result, we have engaged during the quarter in an aggressive test marketing effort to validate the notion that a point-of-care unit could enhance our product offering and receive favorable market acceptance.

The OsteoGram is a medical image processing software system that enables healthcare providers to screen, diagnose and monitor osteoporosis using digital hand images from filmless x-ray equipment or conventional, film-based x-rays. Osteoporosis is diagnosed by measuring bone mineral density. A low bone mineral density is indicative of the disease. The OsteoGram is based on a bone mass measurement technique called radiographic absorptiometry, which was cited

in the 2004 Surgeon General's report on bone disease. Radiographic absorptiometry uses a conventional x-ray of the hand, scanned at high resolution, to measure bone density. The radiographic absorptiometry technique not only measures bone mass, but also the cortical thickness of bones. Recent studies affirm the importance of cortical thickness as an additional measure of bone strength and overall fracture risk. Several prominent pharmaceutical manufacturers are developing products that will strengthen cortical bone. Cortical bone is the outer shell that gives bone strength, much like the hollow tubes from which bicycles are constructed. Our technology has the capability to measure bone mineral density in both cortical and trabecular bone. Dual energy X-ray absorptiometry, or DXA, is considered the "Gold Standard" of bone mineral density measurement because of its long history of clinical trials and the aggressive lobbying by industry organizations but it has difficulty differentiating between cortical and trabecular bone.

In May 1999, we received clearance from the United States Food and Drug Administration, or FDA, to market an automated version of the OsteoGram software for use as a stand-alone product by physicians. In 2004 we launched the Digital Imaging and Communications in Medicine, or DICOM, a digital version of the product. Using digital or film-based x-ray equipment, two posterior-anterior views of the left-hand fingers are taken with an aluminum alloy reference wedge in each exposure. The calibration wedge is used to adjust for any differences among x-ray equipment, exposures and other variables. In the case of the film-based version of the OsteoGram, the developed film is scanned with a high-resolution desktop scanner, and the OsteoGram software analysis program rapidly produces an accurate and precise bone mineral density report. With a filmless x-ray system the digital image is captured on a workstation for analysis. We developed the DICOM-compliant version of the OsteoGram for use on filmless systems, which have become a high growth segment in the medical imaging market. DICOM is the industry-consortium established information standard that allows the new generation of digital medical imaging equipment to interconnect.

Market acceptance of this product has been limited by the fact that the OsteoGram software is a bolt-on to other Digital Radiology (DR) or equivalent systems. While such systems are normally present in large facilities, many of the smaller physician's practices that appear most interested in providing bone density screening to their patients typically do not own such systems, or in many cases do not even own x-ray equipment. As a result we have not been able to deploy OsteoGram for the point-of-care opportunity and OsteoGram is principally focused in OEM markets where DR technologies are present such as hospitals, surgery centers, larger orthopedic practices and imaging centers. Recognizing this, the Company has altered its marketing effort of the OsteoGram to focus on larger facilities with existing DR/CT systems, and is looking at its alternate product OsteoCare to address the point-of-care needs of the larger number of smaller physician practices.

OsteoGram continues to have limited acceptance at this time. In the US there is a tendency by the physician community to look at RA, the technology on which OsteoGram is based, as a lesser technology than DXA, the prevalent approach to bone densitometry. While this appears to be a perception, it has made sales, especially in the US, difficult. In overseas markets the bias towards DXA is less pronounced and the Company has invested effort towards developing credible international channels and clearing the path towards a greater presence internationally. In order to overcome this perception, and to expand its ability to operate in international markets, the Company has begun investigating strategic alliances with one or more large third parties that could add large company resources to our OsteoGram marketing efforts. It is too early to indicate the form and structure of such a relationship and there can be no guarantees that such a relationship can be found or executed. Additionally, the Company with its OEMs has worked aggressively to clear the product for sale in China. This effort resulted in the Chinese State Food & Drug Administration clearing the OsteoGram for sale in China on June 6, 2008.

We continue to believe a new market demand may also be developing from certain digital mammography providers interested in adding the OsteoGram as a complementary screening test on their own full field digital mammography equipments. We are pursuing strategies to align with market-leading partners and integrate our product into its digital mammography platform or mammography management/networking software. To date, however, these discussions have not resulted in new OEM relationships or materials sales. There can be no guarantees we will succeed in establishing such new alignments, relationships or sales. During the year, we installed prototypes at major hospitals and the dual use system is now in clinical use.

We have to date performed integration tests that have proven the technical feasibility of using the full field digital mammography machine as input to OsteoGram. One of our OEMs, FujiFilm Medical USA has begun installing the dual use machine at key hospital settings. Our progress in entering for the release of such a combined product is, however, hampered by market trends occurring in mammography industry. High volume imaging centers are reluctant to disrupt their workflow to provide a second test on the same machine, instead focusing on high volume mammography screens. While the Company believes that there would be advantages to medium sized organizations to provide both BMD and mammography testing on the same machine, the market for such product has yet to mature. The Company is exploring the option of joint ventures in this area to evangelize and possibly accelerate the market. There can be no assurances, however, that we will be successful in accomplishing such a linkage or in building such a

business relationship with any such partners and that this strategy will be successful in the marketplace. Commercially launching such an integrated product may also involve obtaining further regulatory approvals, including possibly receiving an FDA 510(k) clearance, which we may not be able to obtain.

## **STRATEGIC RELATIONSHIPS**

The Company continues to work closely with its network of OEM distributors for the OsteoGram. We believe that our network of digital equipment partners, which now includes Rayco (CareStream China), CareStream Health (previously Kodak Health Group), Swissray International and FujiFilm Medical USA. Our principal challenge however, remains to help these partners be effective in the marketplace with our products, and help them acquire the specialized knowledge necessary to market our products effectively in their clinical markets. We continue to be engaged in multiple significant initiatives with our partners to help them build effective sales channels, target specific clinical customers, build reference sites, and create market awareness. The US market has continued to be challenging for the OsteoGram product, as the market has been slow to emerge. Additionally, we believe that the initiatives discussed above in **Recent Events** could potentially provide additional support to our partners in the marketplace. There can be no guarantees, however, that we will ultimately be successful in increasing our revenues.

During the year, we also begun working directly with point-of-care sales organizations to market the OsteoGram. We entered into a distribution agreement with TI-BA Enterprises, one of the nation's largest distributors of X-Ray systems to the clinical point-of-care market.

Based on an agreement signed in 2008 with OSI Systems, the Company has launched a further skeletal health diagnostic technology, initiative under the brand OsteoCare, targeting primary care physicians in the US.

The marketplace for OsteoCare during the year was however negatively impacted by the refusal by some private insurance providers to reimburse physicians for peripheral testing. We are currently working with those physicians and those private reimbursers to reconsider those policies. However, there can be no assurances that those decisions will be reconsidered or that we will not have negative impact by those policies. Furthermore, the uncertainty associated with healthcare reform and continued cutting of reimbursements associated with imaging devices in general has affected the entire medical imaging business.

Some of the installations for OsteoCare during the year are highly visible reference sites. These are generating valuable case studies that we can use to further promote the products. We placed an OsteoCare unit at the University of Pennsylvania Medical Center and are currently negotiating the expansion of that site to multiple units.

The Company is constantly re-evaluating its success metrics for the OsteoCare program and plans on reviewing its inventory available for trial on a quarter-to-quarter basis and based on its cash flow.

## **RESEARCH AND DEVELOPMENT**

We have moderated our R&D investment in the core product and aligned some of our R&D to the response of the market, including the reduction of our US R&D effort in favor of R&D in support of China. Currently, we believe that majority of the R&D for our Skeletal Health business is completed and we are reducing our effort in this area.

## **COMPETITION-OSTEOGRAM & OSTEOCARE**

Bone mineral density measurements are the primary methods used to assist physicians in detecting osteoporosis. Bone mineral density is measured by passing x-ray beams or ultrasound through bone and determining how much energy the bone absorbs.

*Dual energy x-ray absorptiometry (DXA)* is currently the mostly widely used osteoporosis detection technology, with a worldwide installed base in 2003 exceeding 16,000 units according to Frost & Sullivan. The DXA market is divided into axial or central machines, which are designed to measure bone mass and density at a variety of skeletal sites, primarily the hip and spine, and peripheral machines, which measure bone mass and density at appendicular sites such as forearm, hand or heel.

The leading manufacturers of whole-body DXA scanners include General Electric's Lunar Division U.S. and Hologic, Inc. U.S., which together command most of the worldwide DXA market. The leading manufacturers of peripheral DXA machines are General Electric, Hologic. Whole body DXA products typically cost from \$50,000-\$130,000 and require specially trained technicians, who must be licensed in most states, and who are not available on a 24-hour, 7 days a week basis.

We experience extensive competition for the OsteoGram from companies that offer DXA machines, primarily because they are considered the "Gold Standard" for measuring bone mineral density and have a large installed base worldwide. We compete by offering cost effective testing and a product with a unique digital format. The

OsteoGram was developed to enhance the use of existing radiological equipment for generating bone mineral density reports comparable to tests performed on the expensive, dedicated DXA equipment generally found in hospitals and specialty practices. The OsteoGram test is reimbursed by Medicare and many medical insurance plans.

Other competition for the OsteoGram comes from less accurate ultrasound and other peripheral devices. Our competition also uses single-energy x-ray absorptiometry, quantitative computed tomography, quantitative ultrasound, and radiographic absorptiometry. All radiographic techniques in use today have been validated through extensive clinical studies and are currently approved in the U.S. for Medicare reimbursement. We employ the radiographic absorptiometry technology because we believe it offers a combination of accuracy, ease of use and relative low cost.

*Quantitative Computed Tomography.* Quantitative computed tomography (QCT) utilizes existing computed tomography, CT or CAT scanners that have been upgraded with specialized software, while peripheral quantitative computed tomography (pQCT) utilizes specialized peripheral computed tomography equipment. Quantitative computed tomography and peripheral quantitative computed tomography are expensive to perform and require a high degree of expertise to operate properly. In addition, the radiation dose of quantitative computed tomography is remarkably high compared to the OsteoGram(R) process.

*Quantitative Ultrasound.* Quantitative ultrasound (QUS) bone densitometers were introduced in the early 1990s, and they are widely available. General Electric Lunar and Hologic are leaders in the ultrasound market segment; however, the market also includes numerous regional manufacturers. We believe that there are now approximately 10,000 quantitative ultrasound machines installed worldwide. Quantitative ultrasound has U.S. FDA clearance for screening in the U.S., but unlike the OsteoGram(R), is not recommended by the National Osteoporosis Foundation for diagnosis.

To our knowledge, the only manufacturer using radiographic absorptiometry, other than us, is Alara, Inc. U.S. In 2000, the FDA approved Alara's self-contained, tabletop system that performs digital radiographic absorptiometry of the hand. We believe Alara is currently focused on developing computed radiography systems.

Our existing and potential competitors consist principally of companies that have substantially greater financial, technical, marketing, distribution and other resources, greater current market penetration and longer-standing relationships with customers than us. We believe that our ability to compete successfully depends on a number of factors, both within and outside of our control, including the price, quality and performance our products and those of our competitors. Other factors include the timing and success of our new product introductions and our competitors, the development of technical innovations, the number and nature of our competitors in a given market, and general market and economic conditions. We may not be able to compete successfully in the future.

## **ASSEMBLY, REPAIR AND CUSTOMER SERVICE**

We repair and maintain most of the electrocardiographs rented, leased or sold to our customers. All repair and assembly operations are conducted at our headquarters in Los Angeles. Our internal customer service staff handles customer equipment and training problems, and our customer service department handles initial installation and set-up, usually over the telephone.

## **GOVERNMENT REGULATION**

The Centers for Medicare and Medicaid Services approve diagnostic tests for reimbursement by Medicare. The OsteoGram is approved for reimbursement by Medicare as a centralized laboratory test and as a stand-alone system. Government regulations may change at any time and Medicare reimbursement for the OsteoGram test, as well as for other bone mineral density tests, may be withdrawn or reduced. Furthermore, other forms of testing for bone mineral density as an indicator of osteoporosis have been or may be approved for reimbursement, which may reduce our market share or profit margins for these services.

Our OsteoGram test and automated software have been cleared by FDA for use and sale. In addition, the OsteoGram is approved for use in a number of other countries, including the People's Republic of China and the European Union through the award of a CE Mark. ECG testing is FDA cleared and Medicare approved.

There can be no guarantees that the Company will obtain and in the future maintain all the necessary regulatory approvals in each jurisdiction it is doing business in. Loss of such regulatory approvals could have a material adverse effect on our business.

## **PATENTS AND PROPRIETARY RIGHTS**

The U.S. Patent and Trademark Office awarded us our first OsteoGram patent in June 2001 with a duration of 20 years. The patent covers twenty aspects of method and apparatus for determining bone mineral density. In April 2004 we were awarded a second patent with a duration of 20 years, which includes twenty-four claims covering image processing and bone segmentation technology.

In November 2005 we filed the final action on our patent application to protect our intellectual property rights relating to the integration of the OsteoGram with mammography equipment. We believe a strong market exists for coupling mammography and bone mineral density testing onto a single platform. Women often do not get tested for osteoporosis, since the disease is silent in nature and testing is inconvenient. Women do, however, get frequent mammograms. Coupling the two tests is a winning combination for patients, imaging centers and digital imaging manufacturers. This action remains pending.

In October 2007 the Company was issued a US Patent for a Method, code, and system for assaying joint deformity. We believe that the claims underlying these patents have implication in the quantification and measurement of joint disease such as Arthritis. We have been approached by parties associated with pharmaceutical drug discovery and are exploring options to leverage our software and our intellectual properties in this area for a possible joint venture or other business relationship designed to couple our technology with new drugs being introduced in the Arthritis area. This could lead to new products as well as new distribution channels and revenue streams. However, there can be no guarantee at this time that such relationship can be made or that it would be successful.

The Company has a number of other active applications under prosecution as well as multiple foreign applications of its US patents. The Company continues to pursue aggressively new patents, however, it has recently begun a review of pending applications that remain unissued. The Company might abandon, combine or restructure applications that might be proving to be too costly or time-consuming in relationship to their potential benefit or for which significant objections from the patent examiners makes the likelihood of final issuance unlikely. The Company is evaluating the foreign jurisdictions in which the patents were filed and chose not to prosecute in certain foreign jurisdictions that might be duplicative, (e.g. not prosecute in individual European countries if already covered by the European Patent Office application) due to their maintenance costs. In fiscal year 2008, the Company elected to abandon some of the applications relating to its DICOM Patent application for OsteoGram, which remained unissued due to significant objections by the patent examiners citing significant prior art. The Company believes that this decision is not material to its ability to protect its intellectual properties. As a result of this decision, the Company wrote off capitalized expenses incurred in connection with this patent.

The OsteoGram trademark has been our registered trademark since July 2, 2002. We filed and were awarded trademark protection for the OsteoClick, our remote, pay-per-use system utilizing the OsteoGram software positioned on a central server.

## **EMPLOYEES**

As of September 30, 2009, we had 10 full-time and 1 part-time employees, in addition to our network of independent sales representatives and distributors. None of our employees are represented by a labor union and we have experienced no work stoppages. We consider our relations with our employees to be good. We also retain consultants from time to time when necessary. Independent cardiologists are retained for electrocardiogram "overreads" on a

per-procedure basis.

## **INSURANCE**

We maintain liability insurance on our current products and are not aware of any claims based on the use or failure of our products that are expected to have material adverse effect on our operations or financial condition. Claims made in the future with respect to our products may not be successfully defended or our insurance may not be sufficient. Furthermore, liability insurance may not continue to be available to us on acceptable terms.

## **ITEM 1A.**

### **RISK FACTORS**

Not applicable.

## **ITEM 1B.**

### **UNRESOLVED STAFF COMMENTS**

Not applicable.

**ITEM 2.**

**DESCRIPTION OF PROPERTY**

The Company's corporate office, computer center and warehouse facilities are located in an office building located at 5777 West Century Boulevard, Los Angeles, CA 90045. This 10,949 square foot facility is leased through February 2013 at a monthly rent of \$13,686 for the first year, with a 3% increase in the ensuing lease years, plus certain operating expenses.

**ITEM 3.**

**LEGAL PROCEEDINGS**

None.

**ITEM 4.**

**SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.

**PART II****ITEM 5.****MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND PURCHASE OF EQUITY SECURITIES**

Our common stock is currently quoted on the over-the-counter bulletin board under the symbol "CMPD.OB". Prior to December 1, 1999, our common stock was listed on the NASDAQ National Market System. The following table sets forth the range of high and low bid prices for our common stock during the periods indicated. The prices set forth below represent inter-dealer prices, which do not include retail mark-ups and markdowns, or any commission to the broker-dealer, and may not necessarily represent actual transactions.

Year Ending September 30, 2009

Quarter Ended:	Common Stock	
	High	Low
December 31, 2008	\$ 0.25	\$ 0.12
March 31, 2009	\$ 0.22	\$ 0.13
June 30, 2009	\$ 0.25	\$ 0.12
September 30, 2009	\$ 0.18	\$ 0.09

Year Ending September 30, 2008

Quarter Ended:	Common Stock	
	High	Low
December 31, 2007	\$ 0.55	\$ 0.45
March 31, 2008	\$ 0.50	\$ 0.28
June 30, 2008	\$ 0.37	\$ 0.21
September 30, 2008	\$ 0.39	\$ 0.22

As of September 30, 2009, there were approximately 479 record holders of our common stock, which does not include common stock held in "nominee" or "street" name.

**DIVIDENDS**

On March 14, 2007, we closed a private placement of our securities to an institutional investor pursuant to the Securities Purchase Agreement. We sold to the investor 4,167 Units at a price of \$480 per Unit resulting in total proceeds of \$2,000,000. Each Unit consisted of 1 share of our Class D Preferred Stock as well as 1,000 Common Stock Purchase Warrants with an exercise price of \$0.30 per share. Pursuant to the Agreement, we issued all 4,167

shares of the authorized Class D Preferred Stock. Each share of Class D Preferred Stock is convertible at any time into 2,000 shares of common stock. The holder of each issued and outstanding share of Class D Preferred Stock will be entitled to receive a dividend in respect of each such share at the rate per share of \$9.60 per annum, payable on each of the first, second, third, and fourth anniversaries of March 12, 2007, commencing March 12, 2008. Dividend payments to each holder will be made in shares of our common stock valued at the average Market Price over 20 trading days, as defined in the Certificate of Designation. In the event the dividends may not lawfully be paid by the issuance of our common stock and may be lawfully paid in cash, the dividends will be paid in cash. The Company issued a total of 332,274 shares of common stock in lieu of cash to pay for dividends due March 2008 and 2009. In the event of any liquidation, dissolution or winding-up, either voluntarily or involuntarily, the holders of shares of the Class D Preferred Stock then issued and outstanding will be entitled to be paid out of our assets available for distribution to its stockholders, whether from capital, surplus or earnings, before any payment shall be made to the holders of shares of our common stock or upon any other series of our Preferred Stock with a liquidation preference subordinate to the liquidation preference of Class D Preferred Stock, an amount per share equal to \$480 plus the dollar amount equal to all unpaid and accrued dividends and interest thereon. In addition, a merger or consolidation with or into any other corporation, or a sale, lease, exchange, or transfer of all or any part of our assets will be deemed a liquidation event unless no assets are distributed in respect of any class of our capital stock in connection with, or as a result of, such merger or consolidation.

## **STOCK OPTION PLANS**

### **2003 STOCK INCENTIVE PLAN**

Options generally become exercisable at a rate of 33% of the shares subject to an option one year after its grant. The remaining shares generally become exercisable over an additional 24 months. The duration of options may not exceed ten years. Options are generally non-assignable, except in the case of death and may be exercised only while the optionee is employed by us or, in certain cases, within three months after termination of employment or six months after death or disability. The purchase price and number of shares of common stock that may be purchased upon exercise of options are subject to adjustment in certain cases, including stock splits, recapitalizations and reorganizations.

Both the amount of options granted and to whom they are granted, are determined by the Board of Directors with the recommendation of the Compensation Committee, at their discretion. There are no specific criteria, performance formulas or measures applicable to the determination of the amount of options to be granted and to whom these options are to be granted.

### **2006 STOCK INCENTIVE PLAN**

There are 12,500,000 shares of common stock available for issuance under the 2006 Stock Incentive Plan. Options generally become exercisable at a rate of 33% of the shares subject to an option one year after its grant. The remaining shares generally become exercisable over an additional 24 months. The duration of the options may not exceed ten years, and in the case of an incentive stock option granted to a 10% stockholder, shall not exceed five years. Options are generally non-assignable, except in the case of death and may be exercised only while the optionee is employed by us or, in certain cases, within twelve months after death or disability. The purchase price and number of shares of common stock that may be purchased upon exercise of options are subject to adjustment in certain cases including stock splits, recapitalizations and reorganizations.

Both the amount of options granted and to whom they are granted, is determined by the Board of Directors with the recommendation of the Compensation Committee, at their discretion. There are no specific criteria, performance formulas or measures applicable to the determination of the amount of options to be granted and to whom these options are to be granted.

## **ITEM 6.**

### **SELECTED FINANCIAL DATA**

Not applicable.

## **ITEM 7.**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis compares our results of operations for the year ended September 30, 2009 to the same period in 2008. This discussion and analysis should be read in conjunction with the consolidated financial statements and notes thereto.

#### **CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS**

This Report on Form 10-K contains forward-looking statements, including, without limitation, statements concerning our possible or assumed future results of operations. These statements are preceded by, followed by or include the words "believes," "could," "expects," "intends" "anticipates," or similar expressions. Our actual results could differ materially from those anticipated in the forward-looking statements for many reasons including, but not limited to, product and service demand and acceptance, changes in technology, ability to raise capital, the availability of appropriate acquisition candidates and/or business partnerships, economic conditions, the impact of competition and pricing, capacity and supply constraints or difficulties, government regulation and other risks described in this report. Although we believe the expectations reflected in the forward-looking statements are reasonable, they relate only to events as of the date on which the statements are made, and our future results, levels of activity, performance or achievements may not meet these expectations. We do not intend to update any of the forward-looking statements after the date of this document to conform these statements to actual results or to changes in our expectations, except as required by law.

## RESULTS OF OPERATIONS

### FISCAL YEAR ENDED SEPTEMBER 30, 2009 AS COMPARED TO 2008

Total revenues for fiscal 2009 were \$2,048,000 as compared to \$2,153,000 in fiscal 2008, a decrease of 4.9%. This decrease was due to a decline in ECG sales and services offset by increase of the Osteocare product lines.

ECG services revenue, which consists of ECG processing, equipment rental, overread and maintenance, during fiscal 2009, decreased by 6.3% to \$1,762,000 from \$1,880,000 in fiscal 2008, due to lower ECG processing and over-reads volume at certain Department of Corrections sites in response to their state budget cuts, partially offset by an overall increase of sites under contracts.

ECG product and supplies sales decreased by 25.9% in fiscal 2009 to \$117,000 from \$158,000 in fiscal 2008, due to some State Department of Corrections delaying certain capital purchases to stay within their state budgets during the global economic downturn.

OsteoGram revenues increased by 47.0% in fiscal 2009 to \$169,000 from \$115,000 in fiscal 2008, due to continued growth of our sales activities in China.

Cost of ECG services decreased by 16.2% to \$676,000 in fiscal 2009 compared to \$807,000 in fiscal 2008 and cost of goods sold for ECG for fiscal 2009 decreased by 22.2% to \$77,000 from \$99,000 in fiscal 2008. Both of these costs decreased as a result of the decrease in ECG sales and services mentioned above.

Cost of goods sold for OsteoGram decreased by 75.0% during fiscal 2009 to \$1,000 from \$4,000 of fiscal 2008, due to the purchase of special packing labels that were required by our OEM partners for regulatory purposes in fiscal 2008 and no longer required for fiscal 2009.

Selling expenses decreased by 7.3% for fiscal 2009 to \$344,000 from \$371,000 of fiscal 2008. The decrease was partially due to a retroactive commission paid in fiscal 2008 and partially due to discontinued regulatory service and sales force related to the OsteoGram as cost containment measures.

General and administrative expenses in fiscal 2009 decreased by 43.3% to \$957,000 from \$1,689,000 due principally to continued implementation of cost reductions, increased efficiency of our operation stemming from improvement in systems and technologies made last year and a one-time legal and stock-based compensation expense pursuant to the Agreement entered with Boston Avenue Capital, LLC on February 15, 2008 and due to an overall expense reduction in the Company.

Research and development costs for fiscal 2009 decreased by 89.8% to \$43,000 from \$421,000 in fiscal 2008 due to the effect of cost reductions stemming from the re-alignment of R&D priorities and the completion of certain product development efforts.

The Company recorded \$96,000 and \$393,000 of stock based compensation in fiscal years 2009 and 2008, respectively. The significant decrease in fiscal 2009 was due to the accelerated vesting of the stock options of the Board of Directors who resigned on February 15, 2008.

Interest income and dividends decreased by 97.1% to \$1,000 in fiscal 2009 from \$34,000 in fiscal 2008, due to the sell-off of certain marketable securities to comply with the Company's investment policy and to fund our working capital.

Interest expense decreased for fiscal 2009 by 5.7% to \$50,000 from \$53,000 in fiscal 2008, mostly due to pay-off on certain capital lease obligations.

The Company's net loss decreased by 82.9% to \$253,000 in fiscal 2009 from \$1,478,000 in fiscal 2008. The decrease was due the cost cutting measures that the Company implemented starting in the first quarter of fiscal 2009.

### **FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES**

At September 30, 2009, we had approximately \$208,000 in cash and marketable securities, as compared to a balance of \$406,000 at September 30, 2008, a net decrease of \$198,000 or 48.8%, due to loss in operations and investment in capital assets.

During fiscal year 2009, purchases of property and equipment decreased to \$2,000 from \$179,000 for fiscal 2008. The decrease was due to delaying orders from certain State Departments of Corrections in response to their budget cuts.

We have historically used existing cash and readily available marketable securities balances to fund operating losses and capital expenditures. We also have raised funds through the sale of common and preferred stock issuances and proceeds from the exercise of stock options and warrants. The proceeds from the exercise of stock options were \$98,000 for fiscal 2008 and none in fiscal 2009.

In December 2009, the Company entered into an agreement with Bathgate Capital Partners, LLC to effect the private placement of up to 1,500,000 shares of the Company common stock at a price of \$0.12 per share. The Company plans to close the private placement by January 31, 2010. The proceeds of the private placement will be used for working capital.

We intend to pursue additional joint ventures, research and/or sub-contractor agreements relating to the execution of our business plan. Additionally, we may seek partners and acquisition candidates of businesses that are complementary to our own. These investments would be subject to our obtaining financing through issuance of debt or other securities. An acquisition may result in increased indebtedness or additional dilution to stockholders.

## **OPERATIONS**

A portion of the Company's available capital is currently invested in money market accounts. As of September 30, 2009, the Company's investments in marketable securities were valued at \$111,000.

The Company has incurred recurring losses of \$253,000 and \$1,478,000 in fiscal years ended September 30, 2009 and 2008, respectively, resulting in aggregate losses of \$1,731,000 over that two-year period. The net loss before non-cash expenses (depreciation and amortization, loss on disposal of property and equipment and stock-based compensation) amounted to \$3,000. The net cash used by operating activities amounted to \$76,000. Significant components of the difference included a \$6,000 increase in accounts receivable, which was related to the delayed payment from certain state department of corrections due to their budget crisis and an \$88,000 decrease in accounts payable. This decrease was related to legal expenses incurred in connection to the process of a strategic transaction during fiscal 2008. The remaining difference in working capital was related to changes in various current assets and liability balances.

The Company anticipates that its cash flow from operations, available cash and marketable securities will be sufficient to meet its anticipated financial needs for at least the next 12 months assuming that no significant downturn in its business occurs. There can be no guarantee that the Company will achieve this result and the Company may need to raise additional capital in the future or draw down in its available credit line. Such sources of financing might not be available on reasonable terms or at all. Failure to raise capital needed could adversely impact the Company's business, operating results and liquidity. If additional funds were raised through the issuance of equity securities, the percentage of ownership of existing stockholders would then be reduced. Furthermore, these equity securities might have rights, preferences or privileges senior to the Company's common stock. The Company's common stock is currently quoted on the over-the-counter bulletin board, which will make it more difficult to raise funds through the issuance of equity securities. These additional sources of financing may not be available on acceptable terms, if at all.

Our primary capital resource commitments at September 30, 2009 consist of capital and operating lease commitments, primarily for computer equipment, electrocardiogram terminals and for our corporate office facility.

Additionally we are exploring joint ventures, acquisitions and other forms of strategic transactions, which might cause us to require additional capital. The Company plans to make use of its existing credit facility for such transactions.

However there is no guarantee that the Company will be able to enter in such a transaction or that it would be at terms consistent with the available credit facility.

## **FINANCING ACTIVITIES**

On March 14, 2007, we closed a private placement of our securities with Boston Avenue Capital, LLC pursuant to the Securities Purchase Agreement. We sold to the investor 4,167 Units at a price of \$480 per Unit resulting in total proceeds of \$2,000,000. Each Unit consisted of 1 share of our Class D Preferred Stock as well as 1,000 Common Stock Purchase Warrants with an exercise price of \$0.30 per share. Pursuant to the Agreement, we issued all 4,167

shares of the authorized Class D Preferred Stock. Each share of Class D Preferred Stock is convertible at any time into 2,000 shares of common stock. The holder of each issued and outstanding share of Class D Preferred Stock will be entitled to receive a dividend in respect of each such share at the rate per share of \$9.60 per annum, payable on each of the first, second, third, and fourth anniversaries of March 12, 2007, commencing March 12, 2008. Dividend payments to each holder will be made in shares of our common stock valued at the average Market Price over 20 trading days, as defined in the Certificate of Designation. In the event the dividends may not lawfully be paid by the issuance of our common stock and may be lawfully paid in cash, the dividends will be paid in cash. The Company issued a total of 332,274 shares of common stock in lieu of cash to pay for dividends due March 2008 and 2009. In the event of any liquidation, dissolution or winding-up, either voluntarily or involuntarily, the holders of shares of the Class D Preferred Stock then issued and outstanding will be entitled to be paid out of our assets available for distribution to its stockholders, whether from capital, surplus or earnings, before any payment shall be made to the holders of shares of our common stock or upon any other series of our Preferred Stock with a liquidation preference subordinate to the liquidation preference of Class D Preferred Stock, an amount per share equal to \$480 plus the dollar amount equal to all unpaid and accrued dividends and interest thereon. In addition, a merger or consolidation with or into any other corporation, or a sale, lease, exchange, or transfer of all or any part of our assets will be deemed a liquidation event unless no assets are distributed in respect of any class of our capital stock in connection with, or as a result of, such merger or consolidation.

The Class D Preferred Stock has the same voting rights as our common stock except that each share of Class D Preferred Stock is entitled to 2,000 votes for each vote allowed for a share of common stock, however such amount will be proportionally adjusted in the event of a reverse or forward split of our common stock.

On February 15, 2008, the Company entered into a revolving line of credit agreement (the "Credit Agreement") between the Company, as Borrower, and Boston Avenue Capital, LLC, an Oklahoma limited liability company, as Lender (the "Lender" or "BAC"). The Credit Agreement provided for a new revolving line of credit facility in an aggregate principal amount of up to \$4 million. The revolving line of credit matured on December 31, 2017. Advances under the revolving line of credit bore interest at the current three-month London Interbank Offered Rate (LIBOR), payable quarterly in arrears for the prior fiscal quarter on the fifth business day of each January, April, July and October, commencing on April 7, 2008. The Credit Agreement also provided that unused amounts up to the total commitment bore interest at a rate of one percent (1%) per annum, compounded annually on the first business day of each calendar year. Under the Credit Agreement, the Lender provided the Company a letter of credit issued by JP Morgan Chase NA in an amount at all times equal to the amount of (i) \$4,000,000 less (ii) the aggregate amount of advances then outstanding under the revolving line of credit. Advances under the revolving line of credit were unsecured senior obligations of the Company.

The Credit Agreement contained customary representations and warranties of the Company. Availability under the new revolving line of credit was subject to certain conditions, including (i) certain covenants relating to the composition of the Board of Directors of the Company, (ii) that the members of the Board of Directors of the Company unanimously approve any advance, (iii) that there not be any undisclosed material liabilities at the time of an advance, and (iv) that the Lender shall have consented (in its sole discretion) in the event that an advance is requested and, at the time of the request for the advance, the Company or any of its officers, directors, employees, shareholders or affiliates is a party to any pending legal proceedings related to the Company or its affiliates.

The February 15, 2008 revolving line of credit facility could be prepaid at any time in whole or in part without premium or penalty, other than payment of the 1% commitment interest on unused advances if the commitment is not terminated.

The Credit Agreement also included certain customary events of default including, but not limited to: failure to pay principal or interest when due (subject to grace period); any representation or warranty proving to have been materially incorrect when made or confirmed; failure to perform or observe covenants set forth in the Credit

Agreement; and bankruptcy and insolvency defaults.

On December 16, 2008, the Company entered into an amended revolving line of credit agreement (the Amended Credit Agreement ) between the Company, as Borrower, and Boston Avenue Capital, LLC, an Oklahoma limited liability company, as Lender (the Lender or BAC ). The Amended Credit Agreement amends the original credit agreement entered into between Borrower and Lender dated February 15, 2008 (the Original Credit Agreement ).

The Amended Credit Agreement provides a credit facility in an aggregate principal amount of up to \$4 million. Advances under the revolving line of credit shall bear interest at the current three-month London Interbank Offered Rate (LIBOR), payable quarterly in arrears for the prior fiscal quarter on the fifth business day of each January, April, July and October commencing after the first advance. The Amended Credit Agreement provides that unused amounts up to the total commitment shall bear interest at a rate of one percent (1%) per annum, compounded annually on the first business day of each calendar year, if the letter of credit is held by a third party. In this Amended Credit Agreement, BAC provided the Company a promissory note in lieu of a third party letter of credit. This will eliminate the 1% interest bearing on the unused amount. The Amended Credit Agreement matures on December 31, 2010.

The Amended Credit Agreement terminates the 16,000,000 warrants (the Original Warrants ) issued to BAC as consideration for the Original Credit Agreement. The Original Warrants were granted i) at a variable price based on the trading of the stock price and ii) regardless of whether an advance was made under the Original Credit Agreement. Under the Amended Credit Agreement, the Company will issue 16,000,000 warrants (the New Warrants ) to BAC for a purchase price of \$5,000 only if, and after, an advance of funds under the Amended Credit Agreement occurs. The strike price of the New Warrants is fixed at two dollars (\$2.00) each. The New Warrants may only be issued upon shareholder approval, which the Company must use its best efforts to obtain before the second anniversary of any advance.

The Amended Credit Agreement contains customary representations and warranties of the Company. Availability under the new revolving line of credit is subject to certain conditions, including (i) that the existing board members of the Company and other directors approved by the Lender comprise all of the directors of the Company, (ii) that the members of the board of directors of the Company unanimously approve any advance, (iii) that there not be any undisclosed material liabilities at the time of an advance, and (iv) that the Lender shall have consented (in its sole discretion) in the event that an advance is requested and, at the time of the request for the advance, the Company or any of its officers, directors, employees, shareholders or affiliates is a party to any pending legal proceedings related to the Company or its affiliates.

Advances under the Amended Credit Agreement may be prepaid at any time in whole or in part without premium or penalty. The Amended Credit Agreement also includes certain customary events of default including, but not limited to failure to pay principal or interest when due (subject to grace period); any representation or warranty proving to have been materially incorrect when made or confirmed; failure to perform or observe covenants set for the in the Amended Credits Agreement; and bankruptcy and insolvency defaults.

On November 4, 2008, the Board of Directors of the Company approved the Amended Credit Agreement, with Mr. Chuck Gillman, the manager of BAC, abstaining.

As of September 30, 2009, there was no draw made against the line of credit.

## **MATERIAL TRENDS AND UNCERTAINTIES**

The marketplace acceptance of peripheral densitometry equipment is still limited, and subject to complex scientific, clinical, reimbursement and policy-making factors which are constantly evolving. It is difficult to predict if any of these factors will create material barriers to our ability to expand the OsteoGram or OsteoCare business. Additionally, these factors are different in various foreign markets. The overall business is also competitive and a number of competitive technologies are emerging that may hinder the acceptance of our product in the marketplace. We are investing heavily to help our channel partners develop the expertise to position and sell our products effectively, however, we have not yet seen material results from that effort and there are no guarantees that we will.

Our ECG business is very competitive and we rely significantly on certain contracts with individual state governments. While we successfully renewed all contracts in 2009 that came due for expiration, many customers reserve the rights to cancel such contract under a broad base of options. A loss of some of these contracts could be material for the Company. Additionally, it is possible that competitive pressures may force us to lower our prices, which could adversely effect our overall revenues as well as our gross profits. Additionally many of our customers have responded to the current financial and economic crisis by reducing their volume of use to high-risk patients. If this trend should continue we might experience a downturn of our volume of business, which might not be offset by an increase of revenue from other sources.

We are also potentially vulnerable by fiscal and budget crisis on the part of the States that are our principal customers. The Company receives significant revenues from the States of California, Illinois, New York and Florida and any significant budget problems in those states could adversely affect us.

Our services are regulated by both Federal and State regulators. Many policies relating to telemedicine regulatory and licensing oversight are evolving often on a state-by-state basis. We might be forced to change or cease offering certain services if some of the regulatory or licensing landscape changes. This could have a material effect on our business.

If our revenues should be impacted materially by some of these negative trends, we might have to draw on our credit line or seek equity capital to meet short-term liquidity needs. Both of those events might be dilutive to our shareholders. Additionally we might not meet all the conditions and criteria to effect a drawdown on the credit facility or to be able to secure suitable equity funding from an investor. In such an event, the Company might be forced to significantly reduce its operations or abandon some or all of its activities.

### **OFF-BALANCE SHEET ARRANGEMENTS**

None

### **CRITICAL ACCOUNTING POLICIES**

Our discussion and analysis of our financial condition and results of operations, including the discussion on liquidity and capital resources, are based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we re-evaluate our estimates and judgments, particularly those related to the determination of the estimated recoverable amounts of trade accounts receivable, impairment of long-lived assets, deferred tax valuation allowance and valuation of stock options. We believe the following critical accounting policies require our more significant judgment and estimates used in the preparation of the financial statements.

We maintain an allowance for doubtful accounts for estimated losses that may arise if any of our customers are unable to make required payments. Management specifically analyzes the age of customer balances, historical bad debt experience, customer credit-worthiness, and changes in customer payment terms when making estimates of the collectibility of our trade accounts receivable balances. If we determine that the financial condition of any of our customers has deteriorated, whether due to customer specific or general economic issues, increases in the allowance may be made. Accounts receivable are written off when all collection attempts have failed.

We have a significant amount of property, equipment and intangible assets, including patents. In accordance with guidance issued by the Financial Accounting Standards Board ("FASB"), we review our long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. Recoverability of long-lived and amortizable intangible assets to be held and used is measured by a comparison of the carrying amount of an asset to the future operating cash flows expected to be generated by the asset. If these assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying value of the assets exceeds their fair value.

ECG sales and services revenue is recognized in accordance with SAB 104 as the following criteria have been met: (1) persuasive evidence of an arrangement exists, (2) the product has been delivered or the services have been rendered, (3) the fee is fixed or determinable, and (4) collectibility of the fee is reasonably assured.

ECG services are comprised of ECG processing, over-read, rental and maintenance. ECG processing and over-read revenue is recognized monthly on a per-usage basis after the services are performed. Equipment rental and maintenance revenue is recognized monthly over the terms of the customer's agreement.

ECG product and supplies sales revenue is recognized upon shipment of the products and passage of title to the customer.

OsteoGram software revenue is recognized in accordance with guidance issued by the FASB as the following criteria have been met: (1) persuasive evidence of an arrangement exists, (2) the software has been delivered, (3) the fee is fixed or determinable, and (4) collectibility of the fee is probable. OsteoGram PCS revenue is recognized in

accordance with guidance issued by the FASB as the following criteria have been met: (1) the PCS is part of the initial license (software) fee, (2) the PCS period is for one year, (3) the estimated cost of providing the PCS is immaterial, (4) we do not offer upgrades and enhancements during the PCS arrangement. Our policy is to accrue all estimated costs of providing the PCS services.

Income taxes are accounted for under the asset and liability method. Under this method, to the extent that we believe that the deferred tax asset is not likely to be recovered, a valuation allowance is provided. In making this determination, we consider estimated future taxable income and taxable timing differences expected to reverse in the future. Actual results may differ from those estimates.

Commencing October 1, 2006, we implemented changes that the FASB issued related to the accounting for employee stock options, on a modified-prospective basis, to recognize share-based compensation for employee stock option awards in our statements of operations. We account for the issuance of stock, stock options and warrants for services based on the estimated fair value of options and warrants using the Black-Scholes pricing model. This model's calculations include the exercise price, the market price of shares on grant date, weighted average assumptions for risk-free interest rates, expected life of the option or warrant, expected volatility of our stock and expected dividend yield. The amounts recorded in the financial statements for share-based expense could vary significantly based on the subjective assumptions used in the pricing model.

## **RECENT ACCOUNTING PRONOUNCEMENTS**

On September 30, 2009, we adopted changes issued by the FASB to the authoritative hierarchy of GAAP. These changes establish the FASB Accounting Standards Codification™ (Codification) as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. The FASB will no longer issue new standards in the form of Statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts; instead the FASB will issue Accounting Standards Updates (ASU). ASUs will not be authoritative in their own right as they will only serve to update the Codification. These changes and the Codification itself do not change GAAP. Other than the manner in which new accounting guidance is referenced, the adoption of these changes had no impact on our financial statements.

On July 1, 2009, we adopted changes issued by the FASB to accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued, otherwise known as subsequent events. Specifically, these changes set forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. The adoption of these changes had no impact on our financial statements as management already followed a similar approach prior to the adoption of this new guidance.

On June 30, 2009, we adopted changes issued by the FASB to fair value disclosures of financial instruments. These changes require a publicly traded company to include disclosures about the fair value of its financial instruments whenever it issues summarized financial information for interim reporting periods. Such disclosures include the fair value of all financial instruments, for which it is practicable to estimate that value, whether recognized or not recognized in the statement of financial position; the related carrying amount of these financial instruments; and the method(s) and significant assumptions used to estimate the fair value. Other than the required disclosures, the adoption of these changes had no impact on our financial statements.

On June 30, 2009, we adopted changes issued by the FASB to fair value accounting. These changes provide additional guidance for estimating fair value when the volume and level of activity for an asset or liability have significantly decreased and includes guidance for identifying circumstances that indicate a transaction is not orderly. This guidance is necessary to maintain the overall objective of fair value measurements, which is, that fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date under current market conditions. The adoption of these changes had no impact on our financial statements.

On June 30, 2009, we adopted changes issued by the FASB to the recognition and presentation of other-than-temporary impairments. These changes amend existing other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities. The adoption of these changes had no impact on our financial statements.

The FASB issued guidance in December 2007 relating to accounting for business combinations. While retaining the fundamental requirements of accounting for business combinations, including that the purchase method be used for all business combinations and for an acquirer to be identified for each business combination, these changes define the acquirer as the entity that obtains control of one or more businesses in the business combination and establishes the acquisition date as the date that the acquirer achieves control instead of the date that the consideration is transferred. These changes require an acquirer in a business combination, including business combinations achieved in stages (step acquisition), to recognize the assets acquired, liabilities assumed, and any non-controlling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exceptions. This guidance also requires the recognition of assets acquired and liabilities assumed arising from certain contractual contingencies as of the acquisition date, measured at their acquisition-date fair values. Additionally, these changes require acquisition-related costs to be expensed in the period in which the costs are incurred and the services are received instead of including such costs as part of the acquisition price. The Company will adopt this guidance effective October 1, 2009 and the impact on the financial statements will be dependent on future acquisitions.

The FASB issued guidance in April 2008 relating to accounting for intangible assets. These changes amend the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset in order to improve the consistency between the useful life of a recognized intangible asset outside of a business combination and the period of expected cash flows used to measure the fair value of an intangible asset in a business combination. The Company will adopt this guidance effective October 1, 2009. The adoption of this guidance is not expected to have a material impact on our financial position or results of operations.

The FASB issued guidance in December 2007 that establishes accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. This guidance defines a non-controlling interest, previously called a minority interest, as the portion of equity in a subsidiary not attributable, directly or indirectly, to a parent. These changes require, among other items, that a non-controlling interest be included in the balance sheet within equity separate from the parent's equity; consolidated net income to be reported at amounts inclusive of both the parent's and non-controlling interest's shares and, separately, the amounts of consolidated net income attributable to the parent and non-controlling interest all on the consolidated statement of operations; and if a subsidiary is deconsolidated, any retained non-controlling equity investment in the former subsidiary be measured at fair value and a gain or loss be recognized in net income based on such fair value. The Company will adopt this guidance effective October 1, 2009. The adoption of this guidance is not expected to have a material impact on our financial position or results of operations.

Effective October 1, 2008, we guidance issued by the FASB that defines fair value, establishes a framework for measuring fair value in accordance with existing GAAP and expands disclosures about fair value measurements. In February 2008, the FASB issued guidance that delayed the effective date of these changes to fiscal years and interim periods within those fiscal years beginning after November 15, 2008 for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). We elected to defer the adoption of the Standard for these non-financial assets and liabilities and are currently evaluating the impact, if any, that the deferred provisions of the Standard will have on our financial statements. The adoption of this guidance did not have an impact on our financial position or results of operations.

In December 2008, the FASB issued guidance requiring public entities to provide additional disclosures about transfers of financial assets. It also requires public entities to provide additional disclosures about their involvement with VIEs. The Company will adopt this guidance effective October 1, 2009. The adoption of this guidance is not

expected to have a material impact on our financial position or results of operations.

**ITEM 7A.**

**QUANTATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Not applicable.

**ITEM 8.**

**FINANCIAL STATEMENTS**

The financial statements are included as a separate section following the signature page to this Form 10-K.

**ITEM 9.**

**CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL MATTERS**

None

**ITEM 9A(T). CONTROLS AND PROCEDURES**

**EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES**

Our management evaluated, with the participation of our Chief Executive Officer and our Principal Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Annual Report on Form 10-K. Based on this evaluation, our Chief Executive Officer and our Principal Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 (i) is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (ii) is accumulated and communicated to our management, including our Chief Executive Officer and our Principal Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Our disclosure controls and procedures are designed to provide reasonable assurance that such information is accumulated and communicated to our management. Our disclosure controls and procedures include components of our internal control over financial reporting. Management's assessment of the effectiveness of our internal control over financial reporting is expressed at the level of reasonable assurance that the control system, no matter how well designed and operated, can provide only reasonable, but not absolute, assurance that the control system's objectives will be met.

**MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

Management is responsible for establishing and maintaining adequate internal control over financial reporting for CompuMed. CompuMed's internal control over financial reporting is a process designed under the supervision of its Chief Executive Officer and Principal Financial Officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of our financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has made a comprehensive review, evaluation, and assessment of CompuMed's internal control over financial reporting as of September 30, 2009. In making its assessment of internal control over financial reporting, management used the criteria issued by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control-Integrated Framework. Based on that assessment, management concluded that, as of September 30, 2009, CompuMed's internal control over financial reporting was effective.

This Annual Report on Form 10-K does not include an attestation report of CompuMed's independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by CompuMed's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the provision of only management's report in this Annual Report on Form 10-K.

**CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING**

There was no change in our internal control over financial reporting during fiscal 2009 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **LIMITATION ON THE EFFECTIVENESS OF CONTROLS**

Our management, including our Chief Executive Officer and Principal Financial Officer, does not expect that our disclosure controls and internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control.

The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

## **ITEM 9B.**

### **OTHER INFORMATION**

On October 28, 2005, we declared a dividend of one Common Stock Purchase Right for each outstanding share of common stock. The dividend is payable to holders of record at the close of business on August 1, 2005. Each Right entitles the registered holder to purchase shares of common stock at a purchase price of \$0.40, subject to adjustment.

Initially, the Rights will not be exercisable, certificates for the Rights will not be issued and the Rights will automatically trade with our common stock. Until the close of business on the earlier of (i) the tenth day following the public announcement that a person or group of affiliated or associated persons, together the "Acquiring Person" other than us, our subsidiary or any employee benefit plan or employee stock plan, together an "Exempt Person" has acquired, or obtained the right to acquire, beneficial ownership of 15% or more of our outstanding common stock or (ii) the tenth business day following the commencement by any person, other than an Exempt Person of, or the announcement of the intention to commence, a tender or exchange offer that would result in the ownership of 15% or more of our outstanding common stock with the earlier of such dates in clauses (i) and (ii) being called the "Distribution Date", the Rights will be evidenced, with respect to any of the common stock certificates outstanding as of August 1, 2005, by such common stock certificate, together with a copy of the Summary of Rights. On March 27, 2007, our Board of Directors approved an amendment to the Rights Agreement to modify the definition of an Acquiring Person so that it requires ownership of 35% or more of the outstanding common stock of the Company, as opposed to 15% or more, as set forth in the original Rights Agreement. A copy of that amendment is attached as Exhibit 10.17.

The Rights are not exercisable until the Distribution Date. The Rights will expire at the close of business on October 28, 2009, unless redeemed or exchanged.

The terms and conditions of the Rights are contained in a Rights Agreement between U.S. Stock Transfer Corporation and us. A copy of the Rights Agreement was filed with the Securities and Exchange Commission as an Exhibit to a Registration Statement on Form 8-A on November 2, 2005. This summary description of the Rights does not purport to be complete and is qualified in its entirety by reference to the Rights Agreement, as amended from time to time, which is incorporated in this summary description by reference.

**PART III****ITEM 10.****DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CORPORATE GOVERNANCE****EXECUTIVE OFFICERS AND DIRECTORS**

The following table sets forth certain information concerning our directors and executive officers as of September 30, 2009:

<b>NAME</b>	<b>POSITION WITH COMPANY</b>	<b>YEAR BECAME DIRECTOR</b>	<b>AGE</b>
Mark Stolper	Chairman of the Board	2008	38
Charles Gillman	Director	2008	39
Mark Crockett	Director	2008	44
Maurizio Vecchione	Interim CEO and President		48
Phuong Dang	Principal Financial Officer and Secretary		53

The terms of the Board of Directors will expire at the next annual meeting of stockholders. Our officers are elected by the Board of Directors and hold office at the will of the Board.

**BACKGROUND EXPERIENCE OF DIRECTORS AND OFFICERS**

Mark Stolper is the Chief Financial Officer of RadNet, Inc., a NASDAQ-listed leading owner and operator of medical diagnostic imaging centers. From January 2001 to July 2004, Mr. Stolper was a partner at Broadstream Capital Partners and West Coast Capital, Los Angeles-based investment banking firms focused on advising middle market companies engaged in financing and merger and acquisition transactions. Prior to joining Broadstream, Mr. Stolper was responsible for business development and mergers and acquisitions for Eastman Kodak's entertainment companies and its online image licensing business, Picture Network International. Mr. Stolper has also served as a member of Archon Capital Partners, Dillon, Read & Co., Inc., and Saratoga Partners, LLP. Mr. Stolper graduated magna cum laude from the University of Pennsylvania and received a finance degree from the Wharton School.

Mr. Crockett is managing partner of Vici Capital Partners, an activist investment, financial advisory and consulting firm, founded in 2008. Since 2005, Mr. Crockett has also been a principal of NightWatch Capital, a private investment firm. Since 1999, Mr. Crockett has been a client services director with Harvest Earnings and EHS Partners, both earnings improvement and turnaround firms. Mr. Crockett began his career as a banking and securities lawyer with Latham & Watkins before joining McKinsey & Company for several years as a strategy and M&A consultant. He then left to acquire and operate a venture-backed retail financial services company, Tax One, later selling it to a strategic buyer.

Charles Gillman is the Senior Managing Member of the Boston Avenue Capital, LLC a private investment partnership. Boston Avenue makes long-term investments after extensive due-diligence is conducted by its research staff. Boston Avenue maintains research offices in New York, Los Angeles, Tulsa, and Chennai. Mr. Gillman founded Boston Avenue Capital in 2001. Prior to 2001, Mr. Gillman served clients in a variety of industries as a strategy consultant in the New York office of McKinsey and Company. He also held positions in the investing industry. Mr. Gillman received a bachelor's degree from the Wharton School of the University of Pennsylvania in 1992. He serves on the Board of the Penn Club of New York.

Maurizio Vecchione is a Managing Partner of Synthetica Holdings, LLC, a private equity fund, and the Chairman of Synthetica (America) Ltd., a turn-around consulting firm and a management consultant retained to provide strategic advice to CompuMed. Mr. Vecchione co-founded Synthetica in September 2001 and has been managing its effort since then. He also serves as Chairman of The IDEAS Studio, a multimedia content company in the educational field and Chairman of THWAPR, Inc. (Previously Mobile Video Developent, Corp), an early stage company in wireless video technology. Both firms are clients of Synthetica. From July 2004 to September 2006 Mr. Vecchione served as CEO of Trestle Holdings, Inc, a medical imaging company for digital pathology and a company for which he orchestrated a restructuring and the sale of its operating assets. Trestle was a client of Synthetica and Mr. Vecchione's executive role there was as part of the engagement with Synthetica. From April 2003 to July 2004 Mr. Vecchione was President and CEO of Microwave Photonics, a wireless technology company he spun out of

British Telecommunications. Microware Photonics was a client of Synthetica and Mr. Vecchione's executive role there was as part of the engagement with Synthetica. Prior to joining Microware he was the founder and co-CEO of imaging rendering company ModaCAD (later Styleclick).

Ms. Dang has a degree in Accounting and been employed by us since 1990. She has served as Controller, Secretary and Principal Financial Officer since 1997. Ms. Dang has over 30 years of corporate accounting and finance experience in the healthcare field, mail order and retail stores . Prior to joining to us, she served as Accounting Manager for the Maxicare Medical Center from 1984 to 1990. From 1978 to 1984, she served as Senior Staff Accountant for Sunset House/ Gadget Tree a division of Carter Hawley Hale.

## **BOARD MEETINGS AND COMMITTEES**

Our Board of Directors held a total of three meetings during the fiscal year ended September 30, 2009. All of our Directors attended each meeting.

### **AUDIT COMMITTEE**

The Audit Committee is primarily responsible for approving the services performed by our independent auditors and reviewing reports of our external auditors regarding our accounting practices and systems of internal accounting controls. This Committee currently consists of Mr. Stolper and Mr. Crockett. The Audit Committee met three times during the fiscal year ended September 30, 2009. Mr. Stolper has been approved by our Board of Directors as the independent Audit Committee Financial Expert.

### **COMPENSATION COMMITTEE**

The Compensation Committee reviews and approves our compensation policy and has assumed responsibility for administration of our Stock Option Plans. This Committee currently consists of Mr. Stolper and Crockett. The Compensation Committee met one time during the fiscal year ended September 30, 2009.

## **COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT**

Section 16(a) of the Exchange Act, as amended, requires our executive officers, directors and persons who beneficially own more than 10% of our common stock to file reports of their beneficial ownership and changes in ownership (Forms 3, 4 and 5, and any amendment thereto) with the SEC. Executive officers, directors, and greater-than-ten percent holders are required to furnish us with copies of all Section 16(a) forms they file. Based on our review of the activity of our officers and directors for the fiscal year ended September 30, 2008, we believe Forms 3, 4 or 5 were timely filed.

## **CODE OF ETHICS**

We have adopted a Code of Ethics that applies to our principal executive officer and principal financial officer. A copy of the Code of Ethics is available on our website at <http://www.compumed.net/info/index.html>. We intend to disclose any amendment or waiver to the Code of Ethics on our website at <http://www.compumed.net/info/index.html>. We will provide to any person without charge, upon written request to our above address, a copy of such code of ethics.

**ITEM 11.****EXECUTIVE COMPENSATION**

The following table shows for the fiscal year ended September 30, 2009 certain compensation information for our principal executive officer, principal financial officer. Other than our principal executive and principal financial officers serving during fiscal year 2009, we had no other reportable executive officers for the period.

**SUMMARY COMPENSATION TABLE**

Name and Principal Year	Salary (\$) <sup>(1)</sup>	Bonus (\$)	Awards (\$)	Non-Equity <sup>(2)</sup>		Compensation (\$)	All Other Compensation (\$)	Total (\$)
				Incentive	Deferred			
Maurizio Vecchione Chief Executive Officer	2009	\$ 173,000						\$ 173,000
Phuong Dang Principal Financial Officer	2009	\$ 125,000	\$ 12,000				\$ 2,000	\$ 137,000

(1)

Reflects a 5% voluntary reduction of salary.

(2)

Reflects matching Company contributions on behalf of the officer in the Company-sponsored 401(k) tax-deferred savings plan.

The following table shows the number of shares covered by exercisable and unexercisable options held by the named executive officers on September 30, 2009. There were no other outstanding equity awards as of September 30, 2009.

**Outstanding Equity Awards At Fiscal 9/30/09**

Name	Option Awards			
	Number	Number	Equity	Option

	<b>of</b>	<b>of</b>	<b>Incentive</b>	<b>Exercise</b>	<b>Expiration</b>
	<b>Securities</b>	<b>Securities</b>	<b>Plan</b>	<b>Price</b>	<b>Date</b>
	<b>Underlying</b>	<b>Underlying</b>	<b>Awards:</b>	<b>(\$)</b>	
	<b>Unexercised</b>	<b>Unexercised</b>	<b>Number</b>		
	<b>Options</b>	<b>Options</b>	<b>of</b>		
	<b>(#)</b>	<b>(#)</b>	<b>Securities</b>		
	<b>Exercisable</b>	<b>Unexercisable</b>	<b>Underlying</b>		
			<b>Unexercised</b>		
			<b>Unearned</b>		
			<b>Options</b>		
Maurizio Vecchione Chief Executive Officer From 6/01/07 To 9/30/09	170,000			\$ 0.29	5/17/2017
Phuong Dang Principal Financial Officer	20,000			\$ 0.63	1/10/2010
	35,000			\$ 0.35	12/23/2013
	35,000			\$ 0.32	12/13/2014
	45,000			\$ 0.64	12/22/2015
	125,000			\$ 0.39	8/18/2016
	83,333	41,667 <sup>(1)</sup>		\$ 0.29	5/17/2017

(1)

The remaining 41,667 shares of this option grant vest in May 17, 2010

**COMPENSATION OF DIRECTORS**

None

**EMPLOYMENT AND CONSULTING AGREEMENTS**

Effective June 1, 2007, we appointed Maurizio Vecchione to the position of Interim Chief Executive Officer. We amended our Contractor Agreement with Synthetica (America), Ltd. to provide the services of Mr. Vecchione in this capacity for consideration of \$15,000 per month and 170,000 warrants at \$0.29 per share. One third of the warrants vested on May 17, 2007, one third vested on May 17, 2008 and one third will vest on May 17, 2009. These warrants will expire on May 17, 2017. Under the terms of the Amendment, Mr. Vecchione, while part-time, will spend sufficient time at the Company to discharge the duties needed of the CEO.

On November 24, 2009, CompuMed, Inc. entered into an agreement with Mark Crockett, a director on CompuMed's Board of Directors, for the provision of certain investment banking and financial advisory services. CompuMed will compensate Mr. Crockett for his services in the form of a transaction fee tied to the value received by CompuMed upon the closing of a transaction whereby the Company's capital stock, assets or revenue streams are transferred for consideration, including, without limitation, a sale or exchange of capital stock or assets, a merger, plan of exchange or consolidation, a lease or license of assets with or without a purchase option, the formation of a joint venture, or any similar transaction. As of September 30, 2009, there was no compensation due to Mr. Crockett.

**ITEM 12.****SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS****SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS**

The following table sets forth information as of September 30, 2009 regarding shares of our common stock subject to outstanding options or authorized for issuance under our currently existing equity compensation plan.

<b>Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and</b>	<b>Weighted Average Exercise price of Outstanding Options, Warrants and Rights</b>	<b>Number of Securities Remaining and Available for Future issuance Under equity Compensation</b>
---	--	---

	<b>Rights (a)</b>	<b>(b)</b>	<b>Plans (excluding Securities Reflected in Column (a)) (c)</b>
Equity compensation plans approved by security holders	1,080,130	0.42	-0-
Equity compensation plans not approved by security holders	7,146,618	0.27	8,350,000
Total	8,226,748	0.29	8,350,000

#### **NARRATIVE DESCRIPTION OF THE 2003 STOCK INCENTIVE PLAN**

Options generally become exercisable at a rate of 33% of the shares subject to an option one year after its grant. The remaining shares generally become exercisable over an additional 24 months. The duration of options may not exceed ten years. Options are generally non-assignable, except in the case of death and may be exercised only while the optionee is employed by us or, in certain cases, within three months after termination of employment or six months after death or disability. The purchase price and number of shares of common stock that may be purchased upon exercise of options are subject to adjustment in certain cases, including stock splits, recapitalizations and reorganizations.

Both the amount of options granted and to whom they are granted, are determined by the Board of Directors with the recommendation of the Compensation Committee, at their discretion. There are no specific criteria, performance formulas or measures applicable to the determination of the amount of options to be granted and to whom these options are to be granted.

**NARRATIVE DESCRIPTION OF THE 2006 STOCK INCENTIVE PLAN**

There are 12,500,000 shares of common stock available for issuance under the 2006 Stock Incentive Plan. Options generally become exercisable at a rate of 33% of the shares subject to an option one year after its grant. The remaining shares generally become exercisable over an additional 24 months. The duration of the options may not exceed ten years, and in the case of an incentive stock option granted to a 10% stockholder, shall not exceed five years. Options are generally non-assignable, except in the case of death and may be exercised only while the optionee is employed by us or, in certain cases, within twelve months after death or disability. The purchase price and number of shares of common stock that may be purchased upon exercise of options are subject to adjustment in certain cases including stock splits, recapitalizations and reorganizations.

Both the amount of options granted and to whom they are granted are determined by the Board of Directors with the recommendation of the Compensation Committee, at their discretion. There are no specific criteria, performance formulas or measures applicable to the determination of the amount of options to be granted and to whom these options are to be granted.

**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS**

The following table sets forth, to our knowledge, certain information concerning the beneficial ownership of the our common stock as of November 30, 2008 by: (a) each director of the Company; (b) the executive officer named in the Executive Compensation Table; (c) our directors and executive officer as a group; and (d) each person known to us who beneficially owns 5% or more of our common stock.

**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The following table sets forth certain information regarding beneficial ownership of our outstanding capital stock as of November 30, 2009 by (i) each person known by us to be the beneficial owner of more than 5% of any class of our voting securities, (ii) each of our directors, (iii) each of our executive officers and (iv) our directors and executive officers as a group. Unless otherwise indicated, the address of the beneficial owner is c/o CompuMed, Inc., 5777 W. Century Boulevard, Suite 360, Los Angeles, CA 90045.

<b>Name of Beneficial Owner</b>	<b>Common Stock <sup>(1)</sup></b>	
	<b>Number of Shares</b>	<b>%</b>
Mark Crockett		
Phuong Dang	348,888 <sup>(2)</sup>	1.3 %
Charles Gillman	12,896,774 <sup>(3)</sup>	33.4 %
Mark Stolper	666,667 <sup>(4)</sup>	2.5 %
Maurizio Vecchione	186,667 <sup>(5)</sup>	*
All officers and directors as a group	14,098,996 <sup>(6)</sup>	35.4 %

\*

Less than 1%

(1)

26,093,732 shares of common stock were outstanding as of November 30, 2009. All percentages are rounded to the nearest tenth and are based upon the number of shares outstanding on November 30, 2009. For purposes of computing the percentages of the outstanding shares owned by persons described in the table, any shares such person is deemed to own by having a right to acquire such shares by exercise or conversion are included, but shares acquirable by other persons by exercise or conversion are not included.

(2)

Includes 348,888 shares issuable within 60 days under stock options.

(3)

Includes:

a)

8,334,000 shares of common stock issuable within 60 days upon conversion of Series 2% preferred stock owned by Boston Avenue Capital, LLC.

b)

4,167,000 shares of common stock issuable within 60 days upon conversion of warrants.

c)

63,500 shares of common stock held directly by Yorktown Avenue Capital, LLC ( YAC ) and 332,274 shares held directly by Boston Avenue Capital, LLC ( BAC ). Mr. Gillman is the manager of BAC and YAC. Mr. Gillman disclaims beneficial ownership of these shares.

(4)

Includes 666,667 shares issuable within 60 days under stock options.

(5)

Includes 186,667 shares issuable within 60 days under warrants.

(6)

Includes 1,015,555 shares issuable within 60 days under stock options, 4,353,667 shares issuable within 60 days under warrants, and 8,334,000 shares issuable within 60 days upon conversion of Series 2% Preferred Stock.

## **ITEM 13.**

### **CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE**

On June 1, 2007, the Company appointed Mr. Vecchione as Interim Chief Executive Officer. Mr. Vecchione is a principal of Synthetica (America), Ltd, to which the Company paid \$173,000 and \$180,000 in consulting fees during the year ended September 30, 2009 and 2008, respectively.

On November 24, 2009, CompuMed, Inc. entered into an agreement with Mark Crockett, a director on CompuMed's Board of Directors, for the provision of certain investment banking and financial advisory services. CompuMed will compensate Mr. Crockett for his services in the form of a transaction fee tied to the value received by CompuMed upon the closing of a transaction whereby the Company's capital stock, assets or revenue streams are transferred for consideration, including, without limitation, a sale or exchange of capital stock or assets, a merger, plan of exchange or consolidation, a lease or license of assets with or without a purchase option, the formation of a joint venture, or any similar transaction. As of September 30, 2009, there was no compensation due to Mr. Crockett.

The OTC Bulletin Board, on which the Company's common stock is currently traded, does not have a requirement that a majority of the Board of Directors be independent or separate independence determination requirements. Of the Company's three current directors, two would be deemed independent, while Charles Gillman may not be. The Company believes that each member of the Company's audit committee would be deemed to be independent under the applicable rules of The NASDAQ Stock Market, and that the two members of the Company's compensation committee would be deemed independent.

## **ITEM 14.**

### **PRINCIPAL ACCOUNTANT FEES AND SERVICES**

#### **Audit Fees**

For the fiscal years ended September 30, 2009 and 2008, the aggregate fees billed for professional services rendered by Rose, Snyder and Jacobs (independent auditors) for the audits of the Company's annual financial statements and the reviews of its financial statements included in the Company's quarterly reports and filings under the Securities Act of 1933 totaled approximately \$57,900 and \$56,755, respectively.

#### **Audit-Related Fees**

For the fiscal years ended September 30, 2009 and 2008, the aggregate fees billed for professional services rendered by the Company's independent auditors for audit-related fees, which include assistance with responding to SEC comment letters, consents, and procedures performed relating to potential acquisitions, amounted to \$4,715 and

\$10,580, respectively.

**Tax Fees**

For the fiscal years ended September 30, 2009 and 2008, the aggregate fees billed by our independent auditors relating to the preparation of corporate tax returns were \$9,945 and \$6,445, respectively.

**Audit Committee Pre-Approval**

All services provided to the Company by Rose, Snyder & Jacobs as detailed above, were pre-approved by the Audit Committee and all work of said firm was performed solely by their permanent employees.

**ITEM 15.**

**EXHIBITS**

**EXHIBIT**

<b>NUMBER</b>	<b>DESCRIPTION OF EXHIBIT</b>
3.1	Certificate of Incorporation (included as Exhibit 3.1 to the Form S-1 effective May 7, 1992, and incorporated herein by reference).
3.2	Certificate of Amendment of Certificate of Incorporation (included as Exhibit 3.1a to the Form S-2/A filed June 28, 1994, and incorporated herein by reference).
3.3	Certificate of Amendment of Certificate of Incorporation (included as Exhibit 3.1b to the Form S-2/A filed November 7, 1994, and incorporated herein by reference).
3.4	Certificate of Correction of Certificate of Amendment (included as Exhibit 3.1c to the Form S-2/A filed November 7, 1995, and incorporated herein by reference).
3.5	By-Laws (included as Exhibit 3.5 to the Form 10-QSB filed February 13, 2004, and incorporated herein by reference).
3.6	Amendment to By-Laws (included as Exhibit 3.6 to the Form 10-QSB filed February 13, 2004, and incorporated herein by reference).
4.1	Certificate of Designation of Class A Preferred Stock (included as Exhibit 4.5 to the Form 10-KSB filed December 29, 1995, and incorporated herein by reference).
4.2	Certificate of Designation of Class B Preferred Stock (included as Exhibit 4.6 to the Form 10-KSB filed December 29, 1995, and incorporated herein by reference).
4.3	Certificate of Designation of Class C Preferred Stock (included as Exhibit 3.1 to the Form 8-K filed January 9, 1998, and incorporated herein by reference).
4.4	Certificate of Correction for Class C Preferred Stock (included as Exhibit 3.2 to the Form 8-K filed January 9, 1998, and incorporated herein by reference).
4.5	Rights Agreement between the Company and U.S. Stock Transfer Corporation, dated October 28, 2005 (included as Exhibit 4.1 to the Company's Form 8-A filed on November 2, 2005, and incorporated herein by reference).
4.6	Certificate of Designation for Class D 2% Convertible Preferred Stock (included as Exhibit 4.1 to the Form 8-K filed March 16, 2007, and incorporated herein by reference).
10.1	Form of Non-Qualified Stock Option Agreement (included as Exhibit 10 to the Form S-8 filed October 14, 1995, and incorporated herein by reference).
10.2	Commercial Office Lease between the Company and L.A.T. Investment Corporation, dated August 16, 1999 (included as Exhibit 10.24 to the Form 10-KSB filed December 29, 1999, and incorporated herein by reference).
10.3	Form of Stock Option Agreement (included as Exhibit 10.5 to the Form 10-QSB filed August 14, 2002, and incorporated herein by reference).
10.4	2003 Stock Incentive Plan (included as Exhibit 99.2 to the Form S-8 filed June 2, 2003, and incorporated herein by reference).
10.5	Investment Agreement between the Company and Dutchess Private Equities Fund, L.P., dated February 25, 2004 (included as Exhibit 10.9 to the Form SB-2 filed February 27, 2004, and incorporated herein by reference).
10.6	

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- Registration Rights Agreement between the Company and Dutchess Private Equities Fund, L.P., dated February 25, 2004 (included as Exhibit 10.10 to the Form SB-2 filed February 27, 2004, and incorporated herein by reference).
- 10.7 Placement Agent Agreement between the Company, Charleston Capital Securities, and Dutchess Private Equities Fund, L.P., dated February 25, 2004 (included as Exhibit 10.11 to the Form SB-2 filed February 27, 2004, and incorporated herein by reference).
- 10.8 Amendment to Commercial Office Lease between the Company and L.A.T. Investment Corporation, dated July 13, 2004 (included as Exhibit 10.6 to the Form 10-KSB filed December 29, 2004, and incorporated herein by reference).
- 10.10 Amended and Restated 2003 Stock Incentive Plan (included as Exhibit 10.1 to the Form S-8 filed April 13, 2005, and incorporated herein by reference).
- 10.11 Amendment to Commercial Office Lease between the Company and L.A.T. Investment Corporation, dated August 12, 2005 (included as Exhibit 10.6 to the Form 10-KSB filed December 27, 2005, and incorporated herein by reference).

**EXHIBIT**

<b>NUMBER</b>	<b>DESCRIPTION OF EXHIBIT</b>
10.12	2006 Stock Incentive Plan (included as Exhibit 10.1 to the Form S-8 filed August 23, 2006, and incorporated herein by reference).
10.13	Third Amendment to Commercial Office Lease between the Company and L.A.T. Investment Corporation, dated August 10, 2006 (included as Exhibit 10.14 to the Form 10-KSB filed December 29, 2006, and incorporated herein by reference).
10.14	Securities Purchase Agreement between the Company and Boston Avenue Capital, LLC, dated March 12, 2007 (included as Exhibit 10.1 to the Form 8-K filed March 12, 2007, and incorporated herein by reference).
10.15	Common Stock Purchase Warrant, dated March 12, 2007 (included as Exhibit 10.2 to the Form 8-K filed March 12, 2007, and incorporated herein by reference).
10.16	Amendment of the Rights Agreement to modify the definition of an Acquiring Person so that it requires ownership of 35% or more of the outstanding common stock of the Company opposed to 15% or more, as set forth in the original Rights Agreement (included as item 3.03 to the Form 8-K filed April 02, 2007, and incorporated herein by reference).
10.17	Appointment of Simon James and Mark Stolper as Directors pursuant to the Side Letter Agreement with Boston Avenue Capital, LLC (included as 10.1 and 10.2 to the Form-8K filed May 23, 2007, and incorporated herein by reference).
10.18	Consulting Agreement between the Company and Synthetica, LTD, dated June 7, 2007 (included as Exhibit 10.1 to the Form-8K filed June 7, 2007, and incorporated herein by reference).
10.19	Consulting Agreement between the Company and Mark Crockett, dated November 24, 2009 (included as Exhibit 99.1 to the Form-8K filed November 25, 2009, and incorporated herein by reference).
<u>23.1</u>	Consent of Independent Registered Public Accounting Firm (filed herewith).
<u>31.1</u>	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
<u>31.2</u>	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
<u>32.1</u>	Certification of Officers pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

**SIGNATURES**

In accordance with Section 13 or 15(d) of the Exchange Act, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**COMPUMED, INC.**

By: /s/ MAURIZIO VECCHIONE  
Maurizio Vecchione  
President and Chief Executive Officer

Date: December 29, 2009

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<b>Signature</b>	<b>Title</b>	<b>Date</b>
/s/ MAURIZIO VECCHIONE Maurizio Vecchione	President and Chief Executive Officer	December 29, 2009
/s/ PHUONG DANG Phuong Dang	Secretary and Principal Financial Officer	December 29, 2009
/s/ MARK STOLPER Mark Stolper	Chairman of the Board	December 29, 2009
/s/ MARK CROCKETT Mark Crockett	Director	December 29, 2009
/s/ CHARLES GILLMAN Charles Gillman	Director	December 29, 2009



**COMPUMED, INC.**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders

CompuMed, Inc.

We have audited the accompanying balance sheets of CompuMed, Inc. as of September 30, 2009 and 2008, and the related statements of operations, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of CompuMed, Inc. as of September 30, 2009 and 2008, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/Rose, Snyder & Jacobs

Rose, Snyder & Jacobs

A Corporation of Certified Public Accountants

Encino, California

December 28, 2009



**COMPUMED, INC.****BALANCE SHEET**

	<b>September 30, 2009</b>	<b>September 30, 2008</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	97,000	269,000
Investments, at fair market value	111,000	137,000
Accounts receivable, less allowance of \$14,000 (September 2009) and \$19,000 (September 2008)	293,000	282,000
Other receivables		5,000
Inventory	18,000	35,000
Prepaid expenses and other current assets	17,000	18,000
<b>TOTAL CURRENT ASSETS</b>	<b>536,000</b>	<b>746,000</b>
<b>PROPERTY AND EQUIPMENT, AT COST</b>		
Machinery and equipment	1,388,000	1,412,000
Furniture, fixtures and leasehold improvements	76,000	76,000
Equipment under capital leases	421,000	391,000
	1,885,000	1,879,000
Accumulated depreciation and amortization	(1,556,000 )	(1,457,000 )
<b>TOTAL PROPERTY AND EQUIPMENT</b>	<b>329,000</b>	<b>422,000</b>
<b>OTHER ASSETS</b>		
Patents, net of accumulated amortization of \$30,000 (September 2009) and \$20,000 (September 2008)	127,000	124,000
Other assets	15,000	18,000
<b>TOTAL OTHER ASSETS</b>	<b>142,000</b>	<b>142,000</b>
<b>TOTAL ASSETS</b>	<b>1,007,000</b>	<b>1,310,000</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	153,000	258,000

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Accrued liabilities	118,000	158,000
Unearned revenue- ECG processing	2,000	2,000
Current portion of capital lease obligations	70,000	88,000
<b>TOTAL CURRENT LIABILITIES</b>	<b>343,000</b>	<b>506,000</b>
Capital lease obligations	108,000	91,000
Commitments and Contingencies, note E		
<b>TOTAL LIABILITIES</b>	<b>451,000</b>	<b>597,000</b>
<b>STOCKHOLDERS' EQUITY</b>		
Preferred Stock, \$0.10 par value - authorized 1,000,000 shares		
Preferred Stock- Class A \$3.50 cumulative convertible voting -issued and outstanding - 8,400 shares	1,000	1,000
Preferred Stock- Class B \$3.50 cumulative convertible voting -issued and outstanding - 300 shares		
Preferred Stock- Class D 2% convertible - issued and outstanding - 4,167 shares		
Common Stock, \$0.01 par value - authorized 50,000,000 shares, issued and outstanding - 26,093,742 (September 2009) and 25,882,643 shares (September 2008)	262,000	260,000
Additional paid-in capital	36,497,000	36,363,000
Accumulated deficit	(36,204,000 )	(35,911,000 )
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>556,000</b>	<b>713,000</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>1,007,000</b>	<b>1,310,000</b>

See notes to financial statements and report of Independent Registered Public Accounting Firm.

## COMPUMED, INC.

**STATEMENTS OF OPERATIONS  
FOR THE YEARS ENDED SEPTEMBER 30,**

	<b>2009</b>	<b>2008</b>
<b>REVENUE</b>		
ECG services	1,762,000	1,880,000
ECG product and supplies sales	117,000	158,000
OsteoGram ® and Osteometer sales and services	169,000	115,000
	2,048,000	2,153,000
<b>COSTS AND EXPENSES</b>		
Costs of ECG services	676,000	807,000
Cost of goods sold-ECG	77,000	99,000
Cost of goods sold - OsteoGram ® and Osteometer	1,000	4,000
Selling expenses	344,000	371,000
Research and development	43,000	421,000
General and administrative expenses	957,000	1,689,000
Depreciation and amortization	152,000	151,000
<b>TOTAL OPERATING EXPENSES</b>	<b>2,250,000</b>	<b>3,542,000</b>
<b>OPERATING LOSS</b>	<b>(202,000 )</b>	<b>(1,389,000 )</b>
Interest income and dividends	1,000	34,000
Realized gain (loss) on marketable securities		(70,000 )
Loss on disposal of fixed asset	(2,000 )	
Interest expense	(50,000 )	(53,000 )
<b>NET LOSS</b>	<b>(253,000 )</b>	<b>(1,478,000 )</b>
Net loss per common share (basic and diluted)	(0.01 )	(0.06 )
Weighted average number of common shares outstanding	25,899,994	25,392,091

See notes to financial statements and report of Independent Registered Public Accounting Firm.

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COMPUMED, INC.

STATEMENTS OF STOCKHOLDER'S EQUITY

Series A Preferred Stock		Series B Preferred Stock		Series D Preferred Stock		Common Stock		Additional Paid-In Capital	Accumulated Deficit	Other Comprehensive Income
Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount			
400	\$ 1,000	300	\$	4,167	\$	24,939,283	\$ 250,000	\$ 35,842,000	\$ (34,393,000 )	\$ (60,000)
						821,585	9,000	89,000		(10,000)
						121,775	1,000	39,000	(40,000 )	
								393,000		
									(1,478,000 )	
400	1,000	300		4,167		25,882,643	260,000	36,363,000	(35,911,000 )	

				211,099	2,000	38,000	(40,000 )
						96,000	
							(253,000 )
400	\$ 1,000	300	\$	4,167	\$	26,093,742	\$ 262,000
						\$ 36,497,000	\$ (36,204,000 )

for the years ended September 30, 2009 and 2008 were (\$253,000) and (\$1,538,000), respectively.

See notes to financial statements and report of Independent Registered Public Accounting Firm.

## COMPUMED, INC.

**STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED SEPTEMBER 30,**

	<b>2009</b>	<b>2008</b>
<b>OPERATING ACTIVITIES:</b>		
Net loss	(253,000 )	(1,478,000 )
Net adjustments to reconcile net loss to net cash used in operating activities:		
Realized (gain)/loss on marketable securities		70,000
Loss on disposal of property and equipment	2,000	2,000
Stock-based compensation	96,000	393,000
Depreciation and amortization	152,000	151,000
(Increase)/Decrease in accounts receivable	(6,000 )	25,000
(Increase)/Decrease in inventory and prepaid expenses	21,000	7,000
Increase/(Decrease) in accounts payable and other liabilities	(88,000 )	(22,000 )
<b>NET CASH USED IN OPERATING ACTIVITIES</b>	<b>(76,000 )</b>	<b>(852,000 )</b>
<b>CASH FLOW FROM INVESTING ACTIVITIES:</b>		
Proceeds from sale of marketable securities	26,000	954,000
Purchase of marketable securities		(607,000 )
Purchase of other asset	(14,000 )	(39,000 )
Purchase of property and equipment	(2,000 )	(179,000 )
<b>NET CASH PROVIDED BY INVESTING ACTIVITIES</b>	<b>10,000</b>	<b>129,000</b>
<b>CASH FLOW FROM FINANCING ACTIVITIES:</b>		
Proceeds from exercise of stock option		97,000
Payments on capital lease obligations	(106,000 )	(74,000 )
<b>NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES</b>	<b>(106,000 )</b>	<b>23,000</b>
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(172,000 )</b>	<b>(700,000 )</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>	<b>269,000</b>	<b>969,000</b>
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b>97,000</b>	<b>269,000</b>

SUPPLEMENTAL DISCLOSURES:

Interest paid	50,000	56,000
Disposal of property and equipment	43,000	2,000
Equipment acquired under capital lease	105,000	69,000

See notes to financial statements and report of Independent Registered Public Accounting Firm.

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**COMPUMED, INC.**

**NOTES TO FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2009 AND 2008**

**NOTE A - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Description of Business: CompuMed, Inc. (the Company) is a medical diagnostic product and services company focusing on the diagnosis, monitoring and management of several costly, high incidence diseases, particularly cardiovascular disease and osteoporosis. The Company's primary business is the development and marketing of its osteoporosis testing technology OsteoGram (R) and the computer interpretation of electrocardiograms ("ECGs"). The Company applies advanced computing, medical imaging, telecommunications and networking technologies to provide medical professionals and patients with affordable, point-of-care solutions for disease risk assessment and decision support.

**Liquidity and Capital Resources**

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. This basis of accounting contemplates the recovery of the Company's assets and the satisfaction of its liabilities in the normal course of conducting its business. The Company's ability to continue as a going concern is dependent upon various factors including, among others, its ability to reduce its operating losses and negative cash flows, and the ability to draw from our existing revolving line of credit or other sources of financing. Should we not be able to reduce our operating losses and negative cash flows, and draw or obtain funding, we may have to restructure or curtail our operations. The Company used existing cash and readily available marketable securities balances to fund operating losses and capital expenditures. The Company has raised funds from 1997 through 2009 through stock issuances and proceeds from the exercise of certain stock options and warrants.

The Company generated negative cash flows from operations and had net losses aggregating \$1,731,000 in the fiscal years ended September 30, 2009 and 2008. While the Company continued to report net loss, decreases in net cash and cash flow used in operations, the Company's net loss was down to \$253,000 in fiscal 2009 from \$1.5 million in fiscal 2008, and the net decrease in cash was down to \$172,000 from \$700,000 and net cash used in operations was down to \$76,000 from \$852,000 in prior year. The Company's cost cutting plans put into effect during the year have enabled them to reduce such large net losses and large uses of cash in operations. The Company plans to continue at their current pace of operations with hopes of bringing in more revenue or recouping revenues from certain customers who put their purchases on hold due to the budget crisis during the year. If the Company does continue at this pace, with a net decrease in cash of \$172,000, the Company has sufficient cash and investments on hand to support this. In addition, should the Company need additional funds, the Company has a \$4 million credit facility available through Boston Avenue Capital and the Company may seek additional financing through Private Placement of its common or preferred stock.

Management believes the Company will be able to generate sufficient revenue, reduce operating expenses or obtain financing in order to fund ongoing operations for at least the next twelve months. Accordingly, the financial statements do not include any adjustments to reflect the possible future effects on the recoverability or classifications of assets and liabilities that may result from the outcome of this uncertainty.

**CASH EQUIVALENTS:**

The Company considers investments in all highly liquid debt instruments with maturity of three months or less when purchased, and investments in money market accounts to be cash equivalents. Cash and cash equivalents also consist of cash on hand and demand deposit accounts.

**INVESTMENTS:**

Investments consist of money market accounts and are stated at market value based on the most recently traded price of these securities at September 30, 2009. All marketable securities are classified as available for sale at September 30, 2009 and 2008. Unrealized gains and losses, determined by the difference between historical purchase price and the market value at each balance sheet date, are recorded as a component of Accumulated Other Comprehensive Income in Stockholders' Equity. Realized gains and losses are determined by the difference between historical purchase price and gross proceeds received when the marketable securities are sold.

As of September 30, 2009, the Company's investments in marketable securities were valued at \$111,000. The Company earned \$1,000 of dividends and interest income in fiscal 2009.

**ACCOUNTS RECEIVABLE:**

The Company maintains an allowance for doubtful accounts for estimated losses that may arise if any of its customers are unable to make required payments. Management specifically analyzes the age of customer balances, historical bad debt experience, customer credit-worthiness, and changes in customer payment terms when making estimates of the collectibility of the Company's trade accounts receivable balances. If the Company determines that the financial conditions of any of its customers has deteriorated, whether due to customer specific or general economic issues, increases in the allowance may be made. Accounts receivable are written off when all collection attempts have failed.

**INVENTORY:**

Inventory consists of ECG terminals, component parts and ECG medical supplies and OsteoGram (R) hardware. Inventory, which is primarily finished goods, is stated at the lower of cost (first-in first-out method) or market.

**PROPERTY AND EQUIPMENT:**

Property and equipment are stated at cost. Depreciation and amortization are computed on the straight-line basis over 3 to 5 years. As of September 30, 2009, the property and equipment being leased to customers had a historical cost of \$1,470,000. Amortization of assets leased under capital leases is included in Depreciation and Amortization Expenses.

**REVENUE RECOGNITION:**

ECG sales and services revenue is recognized in accordance with SAB 104 when the following criteria has been met: (1) persuasive evidence of an arrangement exists, (2) the product has been delivered or the services have been rendered, (3) the fee is fixed or determinable, and (4) collectibility of the fee is reasonably assured.

ECG SERVICES are comprised of ECG processing, Over-read, Rental and Maintenance. ECG Processing and Over-read revenue is recognized monthly on a per-usage basis after the services are performed. Equipment rental and maintenance revenue is recognized monthly over the terms of the customer's agreement.

ECG PRODUCT AND SUPPLIES SALES revenue is recognized upon shipment of the products and passage of title to the customer.

OsteoGram software revenue is recognized in accordance with guidance issued by the Financial Accounting Standards Board ( FASB ) when the following criteria has been met: (1) persuasive evidence of an arrangement exists, (2) the software has been delivered, (3) the fee is fixed or determinable, and (4) collectibility of the fee is probable.

OsteoGram PCS revenue is recognized in accordance with guidance issued by the FASB as the Company met the following criteria: (1) the PCS is part of the initial license (software) fee, (2) the PCS period is for one year, (3) the estimated cost of providing the PCS is immaterial, (4) the Company does not offer upgrades and enhancements during the PCS arrangement. The Company's policy is to accrue all estimated costs of providing the PCS services.

**PATENTS:**

Patents are amortized over 15 years, starting from their approval date. The Company estimates that amortization expense related to patents will be approximately \$11,000 per year in each of the next five fiscal years.

**INCOME TAXES:**

The Company utilizes the liability method to determine the provision for income taxes, whereby deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

**PER SHARE DATA:**

The Company reports its earnings (loss) per share in accordance with guidance issued by the FASB. Basic loss per share is calculated using the net loss divided by the weighted average common shares outstanding. Shares from the assumed conversion of outstanding warrants, options and the effect of the conversion of the Class A Preferred Stock, Class B Preferred Stock and Class D Preferred Stock are omitted from the computations of diluted loss per share because the effect would be antidilutive.

Net loss	(253,000 )
Less: preferred stock dividends	(43,000 )
Net loss available to common stockholders	(296,000 )
Net loss per common share (basic and diluted)	\$ (0.01 )
Weighted average number of common shares outstanding	25,899,994

**FINANCIAL INSTRUMENTS:**

The carrying value of short-term financial instruments such as cash equivalents, accounts receivable, accounts payable, accrued liabilities and capital leases approximates their fair value based on the short-term maturities of these instruments.

**LONG-LIVED ASSETS:**

In accordance with guidance issued by the FASB, we review our long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. Recoverability of long-lived and amortizable intangible assets to be held and used is measured by a comparison of the carrying amount of an asset to the future operating cash flows expected to be generated by the asset. If these assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying value of the assets exceeds their fair value. The Company has a number of other active applications under prosecution as well as multiple foreign applications of its US patents. In the process of evaluating the applications that remain unissued, the Company abandoned, combined or restructured applications that might be proving to be too costly or time-consuming in relationship to their potential benefit. In fiscal 2008, the Company abandoned certain patent and recorded \$42,000 as impairment under depreciation and amortization in the Company's statement of operations. The Company did not record any impairment charge for long lived assets during fiscal 2009.

**USE OF ESTIMATES:**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions affecting the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**STOCK BASED COMPENSATION:**

The Company accounts for stock options in accordance with guidance issued by the FASB using the modified prospective method. Under this method, compensation cost recognized during fiscal years 2009 and 2008 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of October 1, 2006, based on the grant-date fair value estimated in accordance with guidance issued by the FASB amortized over the options' vesting period, and (b) compensation cost for all share-based payments granted subsequent to October 1, 2006, based on the grant-date fair value estimated in accordance with guidance issued by the FASB amortized on a straight-line basis over the options' vesting period. Stock-based compensation was \$96,000 and \$393,000 for the years ended September 30, 2009 and 2008, respectively.

**CONCENTRATION OF CREDIT RISK:**

Financial instruments, which potentially subject us to a concentration of risk, include cash, marketable securities and accounts receivable. Most of our customers are based in the United States at this time and we are not subject to exchange risk for accounts receivable.

The Company maintains its cash in domestic financial institutions subject to insurance coverage issued by the Federal Deposit Insurance Corporation (FDIC). Under FDIC rules, the Company is entitled to aggregate coverage as defined by Federal regulation per account type per separate legal entity per financial institution. The Company has incurred no losses as a result of any credit risk exposures.

The Company sells its products throughout the United States and in the international markets. The Company performs periodic credit evaluations of its customers' financial condition and generally does not require collateral. Credit losses have been within management's expectations. For the year ended September 30, 2009, total revenue from three customers accounted for approximately 39.9% of the Company total receivables, of which one customer accounted for 17.9% of total accounts receivable at September 30, 2009.

#### FAIR VALUE MEASUREMENTS

The Company measures its financial assets and liabilities at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., exit price) in an orderly transaction between market participants at the measurement date. Additionally, the Company is required to provide disclosure and categorize assets and liabilities measured at fair value into one of three different levels depending on the assumptions (i.e., inputs) used in the valuation. Level 1 provides the most reliable measure of fair value while Level 3 generally requires significant management judgment. Financial assets and liabilities are classified in their entirety based on the lowest level of input significant to the fair value measurement. The fair value hierarchy is defined as follows:

<b>Level Input:</b>	<b>Input Definition:</b>
Level I	Inputs are unadjusted, quoted prices for identical assets or liabilities in active markets at the measurement date.
Level II	Inputs, other than quoted prices included in Level I, that are observable for the asset or liability through corroboration with market data at the measurement date.
Level III	Unobservable inputs that reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date.

For certain of the Company's financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, accrued payroll and other expenses, the carrying amounts approximate fair value due to their short maturities.

The following table summarizes fair value measurements by level at September 30, 2009 for assets and liabilities measured at fair value on a recurring basis:

	<b>Level I</b>	<b>Level II</b>	<b>Level III</b>	<b>Total</b>
Cash and cash equivalents	\$ 97,000	\$	\$	\$ 97,000
Marketable securities	111,000			111,000
Total assets	\$ 208,000	\$	\$	\$ 208,000

**NOTE B - INCOME TAXES**

At September 30, 2009, the Company has available for federal and state income tax purposes, net operating loss carry forwards of approximately \$9 million and \$3.7 million, respectively, which expire between 2011 and 2029. The utilization of the above net operating loss carry forwards are subject to significant limitations under the tax codes due to changes in ownership and portions may expire prior to utilization. The difference between the Company's effective income tax rate and the statutory federal rate for the years ended September 30, 2009 and 2008 relates primarily to losses incurred for which no tax benefit was recognized, due to the uncertainty of its realization. The valuation allowance was approximately \$3,335,000 and \$3,235,000 at September 30, 2009 and 2008, respectively, representing an increase of \$100,000 for the year ended September 30, 2009. This increase is primarily related to increases in the Company's net operating loss carryforward for which no tax effect was recognized due to the uncertainty of its realization.

Significant components of the deferred income tax liabilities and assets as of September 30, 2009 and 2008 are as follows:

Deferred tax assets:

Net operating loss carry forwards	3,314,000	3,213,000
Other assets and liabilities	21,000	22,000
Total deferred tax assets	3,335,000	3,235,000
Valuation allowance for deferred tax assets	(3,335,000 )	(3,235,000 )
Net deferred tax assets		

Total

The Company has adopted guidance issued by the FASB that clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a recognition threshold of more likely than not and a measurement process for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. In making this assessment, a company must determine whether it is more likely than not that a tax position will be sustained upon examination, based solely on the technical merits of the position and must assume that the tax position will be examined by taxing authorities. Our policy is to include interest and penalties related to unrecognized tax benefits in income tax expense. Interest and penalties totaled \$0 for the years ended September 30, 2009 and 2008, respectively. The Company files income tax returns with the Internal Revenue Service ( IRS ) and various state jurisdictions. For jurisdictions in which tax filings are prepared, the Company is no longer subject to income tax examinations by state tax authorities for years through 2003, and by the IRS for years through 2004. The Company's net operating loss carryforwards are subject to IRS examination until they are fully utilized and such tax years are closed. Our review of prior year tax positions did not result in a material impact on the Company's financial position or results of operations.

**NOTE C - STOCKHOLDERS' EQUITY**

**CLASS A \$3.50 CUMULATIVE CONVERTIBLE VOTING PREFERRED STOCK:**

The holders of Class A Preferred Stock are entitled to receive, when and as declared by the Board of Directors, dividends at an annual rate of \$.35 per share, payable quarterly. Dividends are cumulative from the date of issuance. Total cumulated dividends not declared at September 30, 2009 amounted to \$26,000. Every two shares of the Class A Preferred Stock are presently convertible, subject to adjustment, into one share of Common Stock. In the event of any liquidation, the holders of the Class A Preferred Stock are entitled to receive \$2.00 in cash per share plus accumulated

and unpaid dividends out of assets available for distribution to stockholders, prior to any distribution to holders of Common Stock or any other stock ranking junior to the Class A Preferred Stock. The Class A Preferred Stock may be redeemed by the Company, upon 30-days' written notice, at a redemption price of \$3.85 per share. Class A Preferred Stock stockholders have the right to convert their shares into Common Stock during such 30-day period.

Shares of Class A Preferred Stock have one vote each. Shares of Class A Preferred Stock vote along with shares of Common Stock and shares of Class B Preferred Stock as a single class on all matters presented to the stockholders for action except as follows: Without the affirmative vote of the holder of a majority of the Class A Preferred Stock then outstanding, voting as a separate class, the Company may not (i) amend, alter or repeal any of the preferences or rights of the Class A Preferred Stock, (ii) authorize any reclassification of the Class A Preferred Stock, (iii) increase the authorized number of shares of Class A Preferred Stock or (iv) create any class or series of shares ranking prior to the Class A Preferred Stock as to dividends or upon liquidation. A total of 4,200 shares of Common Stock are currently issuable upon conversion of the remaining 8,400 shares of the Class A Preferred Stock.

**CLASS B \$3.50 CONVERTIBLE VOTING PREFERRED STOCK:**

In August 1994, the Company issued 52,333 shares of Class B \$3.50 Convertible Preferred Stock ("Class B Preferred Stock") in connection with the acquisition of certain property. The holders of Class B Preferred Stock are entitled to receive dividends only, when and as declared by the Board of Directors. Each share of Class B Preferred Stock is convertible, subject to adjustment, into ten shares of Common Stock. In the event of any liquidation, the holders of the Class B Preferred Stock are entitled to receive \$3.50 in cash per share plus accumulated and unpaid dividends out of assets available for distribution to stockholders, prior to any distribution to holders of Common Stock or any other stock ranking junior to the Class B Preferred Stock. Each share of Class B Preferred Stock may be redeemed by the Company, upon 30-days' written notice, at a redemption price of \$3.85 per share. Class B Preferred Stock stockholders have the right to convert their shares into Common Stock during this 30-day period.

Shares of Class B Preferred Stock are entitled to one vote each. Shares of Class B Preferred Stock vote as a single class on all matters presented to the stockholders for action except as follows: Without the affirmative vote of the holder of a majority of the Class B Preferred Stock then outstanding, voting as a separate class, the Company may not (i) amend, alter or repeal any of the preferences or rights of the Class B Preferred Stock, (ii) authorize any reclassification of the Class B Preferred Stock, (iii) increase the authorized number of shares of Class B Preferred Stock or (iv) create any class or series of shares ranking prior to the Class B Preferred Stock as to dividends or upon liquidation. A total of 3,000 shares of Common Stock are currently issuable upon conversion of the remaining 300 shares of Class B Preferred Stock.

**CLASS D VOTING PREFERRED STOCK:**

On March 14, 2007, the Company closed a private placement of its securities to an institutional investor pursuant to the Securities Purchase Agreement. The Company sold to the investor 4,167 Units at a price of \$480 per Unit resulting in total proceeds of \$2,000,000. Each Unit consisted of 1 share of the Company's Class D Preferred Stock as well as 1,000 Common Stock Purchase Warrants with an exercise price of \$0.30 per share. Pursuant to the Agreement, the Company issued all 4,167 shares of the authorized Class D Preferred Stock. Each share of Class D Preferred Stock is convertible at any time into 2,000 shares of the Company's common stock. The holder of each issued and outstanding share of Class D Preferred Stock will be entitled to receive a dividend in respect of each such share at the rate per share of \$9.60 per annum, payable on each of the first, second, third, and fourth anniversaries of March 12, 2007, commencing March 12, 2008. Dividend payments to each holder will be made in shares of the Company's common stock valued at the average Market Price over 20 trading days, as defined in the Certificate of Designation. In the event the dividends may not lawfully be paid by the issuance of the Company's common stock and may be lawfully paid in cash, the dividends will be paid in cash. In the event of any liquidation, dissolution or winding-up, either voluntarily or involuntarily, the holders of shares of the Class D Preferred Stock then issued and outstanding will be entitled to be paid out of the Company's assets available for distribution to its stockholders, whether from capital, surplus or earnings, before any payment shall be made to the holders of shares of the Company's common stock or upon any other series of the Company's Preferred Stock with a liquidation preference subordinate to the liquidation preference of Class D Preferred Stock, an amount per share equal to \$480 plus the dollar amount equal to all unpaid and accrued dividends and interest thereon. In addition, a merger or consolidation with or into any other corporation, or a sale, lease, exchange, or transfer of all or any part of the Company's assets will be deemed a liquidation event unless no assets are distributed in respect of any class of the Company's capital stock in connection with, or as a result

of, such merger or consolidation. The Class D Preferred Stock has the same voting rights as the Company's common stock except that each share of Class D Preferred Stock is entitled to 2,000 votes for vote allowed a share of the Company's common stock, however such amount will be proportionally adjusted in the event of a reverse or forward split of the Company's common stock.

**ISSUANCE OF COMMON STOCK - EQUITY LINE OF CREDIT**

On March 14, 2007, we closed a private placement of our securities with Boston Avenue Capital, LLC pursuant to the Securities Purchase Agreement. We sold to the investor 4,167 Units at a price of \$480 per Unit resulting in total proceeds of \$2,000,000. Each Unit consisted of 1 share of our Class D Preferred Stock as well as 1,000 Common Stock Purchase Warrants with an exercise price of \$0.30 per share. Pursuant to the Agreement, we issued all 4,167 shares of the authorized Class D Preferred Stock. Each share of Class D Preferred Stock is convertible at any time into 2,000 shares of common stock. The holder of each issued and outstanding share of Class D Preferred Stock will be entitled to receive a dividend in respect of each such share at the rate per share of \$9.60 per annum, payable on each of the first, second, third, and fourth anniversaries of March 12, 2007, commencing March 12, 2008. Dividend

payments to each holder will be made in shares of our common stock valued at the average Market Price over 20 trading days, as defined in the Certificate of Designation. In the event the dividends may not lawfully be paid by the issuance of our common stock and may be lawfully paid in cash, the dividends will be paid in cash. The Company issued a total of 332,274 shares of common stock in lieu of cash to pay for dividends due March 2008 and 2009. In the event of any liquidation, dissolution or winding-up, either voluntarily or involuntarily, the holders of shares of the Class D Preferred Stock then issued and outstanding will be entitled to be paid out of our assets available for distribution to its stockholders, whether from capital, surplus or earnings, before any payment shall be made to the holders of shares of our common stock or upon any other series of our Preferred Stock with a liquidation preference subordinate to the liquidation preference of Class D Preferred Stock, an amount per share equal to \$480 plus the dollar amount equal to all unpaid and accrued dividends and interest thereon. In addition, a merger or consolidation with or into any other corporation, or a sale, lease, exchange, or transfer of all or any part of our assets will be deemed a liquidation event unless no assets are distributed in respect of any class of our capital stock in connection with, or as a result of, such merger or consolidation.

The Class D Preferred Stock has the same voting rights as our common stock except that each share of Class D Preferred Stock is entitled to 2,000 votes for vote allowed a share of common stock, however such amount will be proportionally adjusted in the event of a reverse or forward split of our common stock.

On February 15, 2008, the Company entered into a revolving line of credit agreement (the "Credit Agreement") between the Company, as Borrower, and Boston Avenue Capital, LLC, an Oklahoma limited liability company, as Lender (the "Lender" or "BAC"). The Credit Agreement provided for a new revolving line of credit facility in an aggregate principal amount of up to \$4 million. The revolving line of credit matured on December 31, 2017. Advances under the revolving line of credit bore interest at the current three-month London Interbank Offered Rate (LIBOR), payable quarterly in arrears for the prior fiscal quarter on the fifth business day of each January, April, July and October, commencing on April 7, 2008. The Credit Agreement also provided that unused amounts up to the total commitment bore interest at a rate of one percent (1%) per annum, compounded annually on the first business day of each calendar year. Under the Credit Agreement, the Lender provided the Company a letter of credit issued by JP Morgan Chase NA in an amount at all times equal to the amount of (i) \$4,000,000 less (ii) the aggregate amount of advances then outstanding under the revolving line of credit. Advances under the revolving line of credit were unsecured senior obligations of the Company.

The Credit Agreement contained customary representations and warranties of the Company. Availability under the new revolving line of credit is subject to certain conditions, including (i) certain covenants relating to the composition of the Board of Directors of the Company, (ii) that the members of the Board of Directors of the Company unanimously approve any advance, (iii) that there not be any undisclosed material liabilities at the time of an advance, and (iv) that the Lender shall have consented (in its sole discretion) in the event that an advance is requested and, at the time of the request for the advance, the Company or any of its officers, directors, employees, shareholders or affiliates is a party to any pending legal proceedings related to the Company or its affiliates.

The February 15, 2008 revolving line of credit facility could be prepaid at any time in whole or in part without premium or penalty, other than payment of the 1% commitment interest on unused advances if the commitment is not terminated.

The Credit Agreement also included certain customary events of default including, but not limited to: failure to pay principal or interest when due (subject to grace period); any representation or warranty proving to have been materially incorrect when made or confirmed; failure to perform or observe covenants set forth in the Credit Agreement; and bankruptcy and insolvency defaults.

On December 16, 2008, the Company entered into an amended revolving line of credit agreement (the Amended Credit Agreement ) between the Company, as Borrower, and Boston Avenue Capital, LLC, an Oklahoma limited liability company, as Lender (the Lender or BAC ). The Amended Credit Agreement amends the original credit agreement entered into between Borrower and Lender dated February 15, 2008 (the Original Credit Agreement ).

The Amended Credit Agreement provides a credit facility in an aggregate principal amount of up to \$4 million. Advances under the revolving line of credit shall bear interest at the current three-month London Interbank Offered Rate (LIBOR), payable quarterly in arrears for the prior fiscal quarter on the fifth business day of each January, April, July and October commencing after the first advance. The Amended Credit Agreement provides that unused amounts up to the total commitment shall bear interest at a rate of one percent (1%) per annum, compounded annually on the first business day of each calendar year, if the letter of credit is held by a third party. In this

Amended Credit Agreement, BAC provided the Company a promissory note in lieu of a third party letter of credit. This will eliminate the 1% interest bearing on the unused amount. The Amended Credit Agreement matures on December 31, 2010.

The Amended Credit Agreement terminates the 16,000,000 warrants (the Original Warrants ) issued to BAC as consideration for the Original Credit Agreement. The Original Warrants were granted i) at a variable price based on the trading of the stock price and ii) regardless of whether an advance was made under the Original Credit Agreement. Under the Amended Credit Agreement, the Company will issue 16,000,000 warrants (the New Warrants ) to BAC for a purchase price of \$5,000 only if, and after, an advance of funds under the Amended Credit Agreement occurs. The strike price of the New Warrants is fixed at two dollars (\$2.00) each. The New Warrants may only be issued upon shareholder approval which the Company must use its best efforts to obtain before the second anniversary of any advance.

The Amended Credit Agreement contains customary representations and warranties of the Company. Availability under the new revolving line of credit is subject to certain conditions, including (i) that the existing board members of the Company and other directors approved by the Lender comprise all of the directors of the Company, (ii) that the members of the board of directors of the Company unanimously approve any advance, (iii) that there not be any undisclosed material liabilities a the time of an advance, and (iv) that the Lender shall have consented (in its sole discretion) in the event that an advance is requested and, at the time of the request for the advance, the Company or any of its officers, directors, employees, shareholders or affiliates is a party to any pending legal proceedings related to the Company or its affiliates.

Advances under the Amended Credit Agreement may be prepaid at any time in whole or in part without premium or penalty. The Amended Credit Agreement also includes certain customary events of default including, but not limited to: Failure to pay principal or interest when due (subject to grace period); any representation or warranty proving to have been materially incorrect when made or confirmed; failure to perform or observe covenants set for the in the Amended Credits Agreement; and bankruptcy and insolvency defaults.

On November 4, 2008, the Board of Directors of the Company approved the Amended Credit Agreement, with Mr. Chuck Gillman, the manager of BAC, abstaining.

As of September 30, 2009, there was no draw made against the line of credit.

#### **NOTE D - STOCK OPTIONS AND WARRANTS**

The Company has adopted two non-stockholder approved stock incentive plans, the 2003 Stock Incentive Plan (the "2003 Plan") and the 2006 Stock Incentive Plan (the "2006 Plan"), and two stockholder approved stock options plans, the 1992 Stock Option Plan ("1992 Plan") and the 2002 Stock Option Plan (the "2002 Plan") (collectively, the "Plans"). The 1992 Plan expired in March 2002 and the 2002 Plan was suspended on the effective date of the 2003 Plan in June 2003. Awards are outstanding under the Plans, but awards may be granted in the future only under the 2003 Plan and the 2006 Plan. The 2003 Plan provides for the granting of options, stock awards and other forms of equity compensation to key employees, officers and certain individuals. Only nonqualified options may be granted under the 2003 Plan. The 2006 Plan provides for the granting of options and stock awards to any officer, director, employee and certain individuals. Both nonqualified and incentive options may be granted under the 2006 Plan. The 2003 plan authorized 6.5 million shares, while the 2006 plan authorized 12.5 million shares.

Options granted under the Plans generally become exercisable at a rate of 33% of the shares subject to an option one year after the date of grant and the remaining shares generally become exercisable over an additional 24 months. The duration of options may not exceed ten years beyond the date of grant.

In addition to options issued pursuant to these Plans, the Company has granted non-qualified stock options to certain members of the Board of Directors, management and consultants. Such options have been granted with exercise prices equal to the market prices of the common stock at the date of grant and are for a term of ten years.

The Company did not grant any options during fiscal year 2009 and 2008.

The expected stock volatility rates are based on the historical stock volatility of the Company's common stock. The risk free interest rates are based on the U.S. Treasury yield curve in effect at the time of the grant for periods corresponding to the expected life of the option. The Company has opted to use the simplified method as allowed by guidance issued by the FASB for estimating our expected term to arrive at a term in between the vesting period and

the contractual term. The Company uses the simplified method because the unvested options are forfeited at termination and the vested options are forfeited in 90 days if not exercised.

A summary of the stock option activity, and related information for the years ended September 30 follows:

	2009		2008	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Options outstanding, beginning of period	8,748,248	0.30	11,237,414	0.29
Options exercised			(785,767 )	0.12
Options granted				
Options forfeited/canceled	(521,500 )	0.50	(1,703,399 )	0.30
Options outstanding, end of period	8,226,748	0.29	8,748,248	0.30
Options exercisable, end of period	7,738,416	0.29	7,514,920	0.30

The aggregate intrinsic value of the options outstanding and of the options exercisable at September 30, 2009 is \$46,904.

The following summarizes information concerning stock options outstanding at September 30, 2009:

	Shares	Exercise Price	Weighted Average Exercise price	Weighted Average Remaining Contractual Life
Outstanding as of 09/30/2009	8,226,748	\$0.0800 - \$0.9500	\$0.29	5.77
Vested	7,738,416	\$0.0800 - \$0.9500	\$0.29	5.65
Unvested	488,332	\$0.2900 - \$0.2900	\$0.29	7.63
Exercisable as of 09/30/2009	7,738,416	\$0.0800 - \$0.9500	\$0.29	5.65

There were no options exercised during fiscal year 2009. As for fiscal 2008, the intrinsic value of the options exercised was approximately \$200,000.

As of September 30, 2009, the total unrecognized fair value compensation costs relating to unvested stock options was \$36,000, which is to be recognized over a remaining of approximately 1 year.

There were 5,168,118 warrants outstanding at a weighted average exercise price of \$0.28 and exercisable on a weighted average term of 3 years.

**NOTE E - COMMITMENTS AND CONTINGENCIES**

The Company has capital leases for machinery and equipment that expire in 2013. On March 1, 2008, the Company entered into a new lease with LAT Investment. Under the new lease, the Company moved the corporate office and computer center from its prior 9,496 square feet on the building's twelfth floor to the new space consisting of 10,949 square feet on the building's third floor. The lease term is five years with the option to renew for an additional five-year term. The monthly rent under the new lease is \$13,686 for the first year, with 3% increase in the ensuing lease years, plus certain operating expenses. The following is a summary as of September 30, 2009 of future minimum lease payments together with the present value of the net minimum lease payments on capital leases:

<b>Year ending September 30</b>	<b>Capital Lease</b>	<b>Operating Leases</b>
2010	93,000	178,000
2011	67,000	176,000
2012	45,000	174,000
2013	18,000	71,000
	223,000	599,000
Less amount representing interest	45,000	
Net minimum lease payment	178,000	
Less current portion	70,000	
Present value of net minimum payment, less current portion	108,000	

During the year ended September 30, 2009, the Company entered into a capital lease obligation for equipment at the cost of \$105,000. These obligations bear an average interest rate of 16.7% and a monthly payment of \$1,000 and mature between July 2012 and August 2013. The range of interest rates on capital leases outstanding as of September 30, 2009 was 11.93% to 17.32%.

Rental expense under operating leases was \$166,000 and \$162,000 in fiscal years 2009 and 2008, respectively.

### **LITIGATION**

From time to time the Company is involved in litigation and threatened litigation arising in the ordinary course of business. The Company is not aware of any material unsettled litigation.

### **NOTE F - SAVINGS AND RETIREMENT PLANS**

The Company has a Savings and Retirement Plan (the "Plan") under which every full-time salaried employee who is 18 years of age or older may contribute up to 100% of his or her eligible annual salary to the Plan. For an employee contribution of up to but not exceeding 6% of the employee's annual salary the Company makes a matching contribution of \$0.25 for every \$1.00 of the employee's contribution. The Company's contributions are 100% vested after 36 months of contributions to the Plan. Benefits are payable under the Plan upon termination of a participant's employment with the Company or at retirement. The Plan meets the requirements of Section 401(k) of the Internal Revenue Code. The Company's matching contribution, which was charged to expense, was \$9,000 and \$11,000 for fiscal 2009 and 2008, respectively.

### **NOTE G - RELATED PARTY TRANSACTIONS**

On June 1, 2007, the Company appointed Mr. Vecchione as Interim Chief Executive Officer. Mr. Vecchione is a principal of Synthetica (America), Ltd, to which the Company paid \$173,000 and \$180,000 in consulting fees during the year ended September 30, 2009 and 2008, respectively.

On November 24, 2009, CompuMed, Inc. entered into an agreement with Mark Crockett, a director on CompuMed's Board of Directors, for the provision of certain investment banking and financial advisory services. CompuMed will compensate Mr. Crockett for his services in the form of a transaction fee tied to the value received by CompuMed upon the closing of a transaction whereby the Company's capital stock, assets or revenue streams are transferred for consideration, including, without limitation, a sale or exchange of capital stock or assets, a merger, plan of exchange or consolidation, a lease or license of assets with or without a purchase option, the formation of a joint venture, or any

similar transaction. As of September 30, 2009, there was no compensation due to Mr. Crockett.

On March 11, 2009, the Company recorded \$45,000 payable to BAC, of which \$40,000 was related to interest on the \$4 million third party line of credit and \$5,000 related to fees reimbursed to BAC due to the cancellation of warrants to purchase 16 million shares of the Company's common stock, pursuant to the Amended Credit Agreement. As of September 30, 2009, the Company owed BAC \$31,000 relating to these amounts.

#### **NOTE H SUBSEQUENT EVENTS**

On Nov 6, 2009, the Company granted an aggregate of 600,000 shares of warrants and options, of which 300,000 warrants were issued to the Chief Executive Officer, 100,000 shares of options to the Principal Financial Officer, and the remaining to certain key employees and a consultant.

In December 2009, the Company entered into an agreement with Bathgate Capital Partners, LLC to effect the private placement of up to 1,500,000 shares of the Company's common stock at a price of \$0.12 per share. The Company plans to close the private placement by January 31, 2010. The proceeds of the private placement will be used for working capital.

The Company has evaluated subsequent events through December 28, 2009, the date the financial statements were issued.