

ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/  
Form 10-K405  
March 30, 2001

SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549

FORM 10-K

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

DECEMBER 31, 2000  
(FOR THE FISCAL YEAR ENDED)

1-9731  
(COMMISSION FILE NUMBER)

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

ARRHYTHMIA RESEARCH TECHNOLOGY, INC.  
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE  
(STATE OR OTHER JURISDICTION OF  
INCORPORATION OF ORGANIZATION)

72-0925679  
(IRS EMPLOYER IDENTIFICATION  
NUMBER)

1101 SOUTH CAPITAL OF TEXAS HIGHWAY  
BUILDING G, SUITE 200  
AUSTIN, TEXAS  
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

78746  
(ZIP CODE)

(512) 347-9640  
(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

SECURITIES REGISTERED PURSUANT TO SECTION 12 (b) OF THE ACT:

COMMON STOCK, \$.01 PAR VALUE  
(TITLE OF EACH CLASS)

AMERICAN STOCK EXCHANGE  
(NAME OF EACH EXCHANGE ON WHICH REGISTERED)

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT

NONE

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes /X/ No / /

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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. /X/

On March 1, 2001, there were 3,072,120 shares of the registrant's common stock outstanding, par value \$.01, which is the only class of common or voting stock of the registrant. As of March 1, 2001, the aggregate market value of the voting stock of the registrant held by non-affiliates was

# Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

\$4,388,540 based upon the closing price of the shares of common stock on the American Stock Exchange.

## PART I

### ITEM 1. BUSINESS

#### BACKGROUND

Arrhythmia Research Technology, Inc. ("ART" or the "Company") was incorporated under the laws of the State of Louisiana in 1981 and reincorporated under the laws of the State of Delaware in 1987. ART is engaged in the sales and licensing of computerized medical instruments, which acquire data and analyze electrical impulses of the heart to detect and aid in the treatment of potentially lethal arrhythmias. ART's product line includes signal-averaging electrocardiographic (SAECG) equipment comprised of the Tri-Pac, the 1200 EPX(TM), the LP-Pac Q(TM), and the PREDICTOR(R) 7. Additionally, ART was the exclusive distributor of CardioMapp(TM) and CardioLab for Prucka Engineering Inc.'s electrophysiology products through December 31, 1996. Pursuant to a sales commission agreement for CardioLab systems, ART received commissions in 1999 and 1998. In 2000, ART received \$1,000,000 from Prucka Engineering Inc., now owned by GE Marquette Medical Systems Inc., ("GE/Prucka") as payment to terminate the sales commission agreement as of January 1, 2000. The sales commission agreement had been scheduled to expire on December 31, 2002.

ART's wholly owned subsidiary, Micron Products, Inc. ("Micron"), is a manufacturer and distributor of silver/silver chloride-plated sensor elements ("sensors") used in the manufacture of disposable electrodes constituting a part of ECG diagnostic and monitoring instruments. Micron also acts as a distributor of metal snap fasteners ("snaps"), another component used in the manufacture of disposable electrodes. In 1997, Micron acquired the rights to an electrode assembly machine, which it now manufactures and sells or leases to its sensor and snap customers. Micron was incorporated in the State of Massachusetts in 1972 and is located in Fitchburg, Massachusetts.

The following table sets forth for the periods specified, the revenue derived from the products of ART and its subsidiary Micron (collectively the "Company"):

	YEARS ENDED DECEMBER 31,					
	2000		1999		1998	
	\$	%	\$	%	\$	%
Sensors & Snaps.....	8,342,252	88	9,534,569	92	8,444,870	99
Polymers.....	64,788	-	183,839	2	-	-
CardioLab & CardioMapp.....	1,000,000	11	384,598	4	485,331	5
SAECG equipment.....	114,823	1	276,578	2	429,300	5
K-3 CathLab	-	-	-	-	1,095	-
<b>Total.....</b>	<b>\$ 9,521,863</b>	<b>100</b>	<b>\$ 10,379,584</b>	<b>100</b>	<b>\$ 9,360,596</b>	<b>100</b>

The Company believes that recent pronouncements in the fields of cardiology and electrophysiology, such as those related the Multicenter Unsustained Tachycardia Trial (MUSTT), will create an increased demand for

ART's patented and proprietary technology. To the extent new legislation or regulations, if any, are enacted or adopted in the future relating to ART's business, including greater third-party coverage and reimbursement, the Company also believes this would have a significant impact on demand for ART's product line.

2

#### RECENT DEVELOPMENTS

##### REORGANIZATION OF AUSTIN OPERATIONS

Early in 2000, the direct sales and administrative staff involved in the marketing and manufacture of ART's product lines were substantially reduced. The remaining personnel, supplemented by key Micron managers and contract programmers, were assigned to upgrade ART's signal-averaging products. The new software is expected to make ART's products more competitive in 2001 and the Company will be in a better position to generate sales and licensing revenues as the demand for electrocardiographic technology grows.

##### TERMINATION OF GE/PRUCKA COMMISSION AGREEMENT

As reported in the second quarter of 2000, the Company received \$1,000,000 of revenue attributed to the termination of a commission agreement with GE/Prucka. The commission agreement covering sales of CardioLab systems was scheduled to expire on December 31, 2002, however, GE/Prucka negotiated to buy out the remainder of the contract with no further obligations to either party. This lump sum payment has all been included in the sales of CardioLab and CardioMapp for 2000. The Company will not realize additional revenues or costs related to CardioLab products in future periods.

##### PURCHASE OF TREASURY STOCK

Purchases of treasury stock were 265,040 shares in 2000 compared to 153,891 in 1999. Periodically, the Board of Directors authorizes the purchase of the Company's common stock based on the amount of cash not required for operations or capital expenditures, the market price of ART's common stock and the availability of the stock for sale. The Board of Directors expects to continue this policy in the year 2001.

#### DESCRIPTION OF BUSINESS

##### SIGNAL-AVERAGING ELECTROCARDIOGRAPHIC (SAECG) PRODUCTS

Sudden cardiac death afflicts over 400,000 individuals in the United States alone each year. As described in an Expert Consensus on Signal-Averaged Electrocardiography published in the Journal of the American College of Cardiology (Vol. 27, No. 1, 1996), these occurrences are due to sustained ventricular tachycardia (abnormally rapid heartbeat) or ventricular fibrillation (very fast, completely irregular heartbeat), which severely affect the capability of the heart's pumping chambers or ventricles. Ventricular arrhythmia's are distinguished from arrhythmia's affecting the atrium (the non-pumping chambers of the heart), which generally are not life threatening. The majority of ventricular arrhythmias occur in patients who have survived a prior heart attack or have significant coronary artery disease. However, individuals with primary electrical disturbances of the heart comprise an additional subset of patients. Thus, various techniques have evolved to detect and treat individuals at risk of the development of sustained ventricular arrhythmias which may cause marked interference with the proper functioning of blood circulation, resulting, in some cases, in sudden cardiac death.

By analyzing the electrical signals from the hearts of animal and human survivors of heart attacks, researchers have found that, in contrast to the relatively discrete, narrow high amplitude signals recorded from normal subjects, low amplitude, high frequency signals persisted well after the heartbeats were recorded in approximately 20% to 25% of heart attack survivors. These latter signals became known as "late potentials." Since directly recorded late potentials had been documented in subjects with malignant ventricular arrhythmias, the hypothesis arose that late potentials would be recorded in subjects with, or at risk of, sustained ventricular arrhythmias. After successful surgical treatment of ventricular arrhythmias, these late potential signals disappeared, which indicated an association between these abnormal signals and the underlying condition.

Signal-averaged surface (non-invasive) electrocardiography has become well established as a means of evaluating and diagnosing those individuals at risk for potentially lethal ventricular arrhythmias as documented by the Expert Consensus on SAECG (noted above). The steps involved in obtaining a SAECG include: recording, digitization, averaging, amplification, and filtering. Conventional surface electrocardiography generally cannot detect late potentials. A major limitation stems from the inability to isolate the low amplitude signals. Amplification of the standard electrocardiogram to detect late potentials results in contamination by coincident electrical noise. The SAECG processes enable late potentials to be

3

amplified and enhanced, while eliminating undesired electrical noise. At the 1996 AHA Sessions, a significant study showed that SAECG could be an effective diagnostic tool for patients with coronary heart disease (CHD) even before they have had a heart attack. Patients with CHD approximate 15.0 million. An SAECG study involving 458 patients who had an acute myocardial infarction was published in the American Heart Journal in 1997. In the absence of late potentials, the probability of having no arrhythmic event was 99% in the first year, and 96% in five years. On the other hand, the presence of late potentials found in the SAECG represents the strongest single predictor of future arrhythmic risk in patients after a first acute myocardial infarction, with a 4.6-fold increase in the risk of sudden death or sustained ventricular tachycardia. The results of research presented at a meeting at the 1999 American College of Cardiology indicate that T-wave alternans and late potential seem to be independent predictors for ventricular tachyarrhythmias in patients with post-myocardial infarctions. Although T-wave alternans had a higher sensitivity, late potentials had a higher specificity. It was concluded that a combination of both tests could identify high-risk patients more accurately.

#### 1200 EPX

The 1200 EPX is a specialized high resolution ECG system used to detect late potentials, which cannot be detected by conventional surface ECG instruments. The 1200 EPX is used in conjunction with an MS-DOS based personal computer utilizing the patented Simson bi-directional Butterworth filtering technique. The 1200 EPX acquires, digitizes, averages and filters the cardiac signals providing late potential analysis with its time domain and frequency-domain analysis software. ART has the rights to the use of the Simson bi-directional Butterworth filtering technique for the detection of late potentials in the terminal portion of the QRS cycle. This method was pioneered by Michael Simson, MD, and has been built into each 1200 EPX. Hard copy reports are generated using laser jet printers. See "EPSoft (TM) Software Library" for post-processing applications available for the 1200 EPX. In 2000, a substantial portion of surplus 1200 EPX inventory was sold to a large

medical products distributor. Any revenue to ART will be recognized on the resale of these units to the extent the distributor is able to market this product.

LP-PAC Q

The LP-Pac Q is a low-cost signal-averaging kit for MS-DOS based personal computers which consists of a "smart" SAECG pre-amplifier/patient cable, lead wires, a data acquisition system (DAS) card to receive ECG signals in real-time, time domain late-potential analysis software and an isolation safety transformer. The LP-Pac Q uses the patented Simson bi-directional Butterworth filtering technique, the recognized standard for the detection of late potentials, and provides results which are substantially equivalent to the 1200 EPX. All software modules for the 1200 EPX are also available for the LP-Pac Q, with the exception of Heart Rate Variability analysis. See "EPSoft(TM) Software Library".

TRI-PAC AND PREDICTOR(R) 7

The TRI-PAC is a system which performs resting ECG, signal averaged ECG and stress ECG's using the same data acquisition device. The acquisition device developed by NORAV Medical Ltd. is combined with Predictor(R) 7 software which is a Windows version of signal averaging programs used to record and analyze cardiac late potentials. Predictor(R) 7 consists of a computer, digitizing hardware, programmable amplifiers, QSR detection hardware/firmware and preamplifiers that can be attached to a windows compliant printer to produce a hard copy of the signal averaged test.

EPSOFT(TM) SOFTWARE LIBRARY

The primary thrust in software development efforts since mid-1997, has been the conversion and development of DOS-based products into the Windows 95 environment.

The Company believes ART's research and development staff has developed breakthrough digital signal processing techniques to enhance the overall analytical power of the SAECG test. Two such developments are the IntraSpect(TM) and Early Potential Analysis software packages. IntraSpect(TM), which is protected by a United States patent, permits visualization and quantification of electrical fragmentation within the entire QRS complex (entire ventricular depolarization cycle), using individual-lead Acceleration Spectrum Analysis (ASA). Hence, micropotential detection is no longer limited to the 'late potential' region. Furthermore, patients with conduction delay problems (i.e. "bundle branch block") can have SAECG analysis performed on them. This covers 25% of a patient population, which previously could not be analyzed with SAECG.

The Early Potential Analysis software has been designed specifically for P wave-triggered SAECG acquisition and analysis and is used as a research tool in assessing patients at risk for atrial fibrillation and flutter. ART continues to offer other optional post-processing signal averaging software packages for the 1200 EPX and LP-Pac Q, including Cal-ABS(TM) Plus software for individual lead time domain analysis; and Heart Rate Variability (HRV) software for the 1200 EPX. These

4

optional signal-averaging software packages are not approved by the FDA and are for research purposes, not clinical diagnosis.

ART also offers the PREDICTOR Heart Rate Variability ECG software

## Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

("PREDICTOR HRVECG"), which is marketed under a 510(k) granted by the FDA in 1989. PREDICTOR HRVECG provides time and frequency domain mathematical tools for the non-invasive assessment of R wave to R wave in sequential QRS complexes. PREDICTOR HRVECG can be used alone or in conjunction with a PREDICTOR(R) 7, and the LP-Pac Q signal-averaging systems.

Software upgrades are provided at no charge to customers of ART with systems under warranty. Sales of post-processing software products were not material to the Company's business in 2000.

### SENSORS AND SNAPS

#### SILVER/SILVER CHLORIDE-PLATED SENSOR ELEMENTS

Micron is a manufacturer and distributor of silver/silver chloride-plated sensor elements for use in the manufacture of disposable electrodes for ECG diagnostic, monitoring and related instrumentation.

The disposable electrode has proven to be more accurate and reliable than the reusable electrodes available in the market. Additionally, disposable electrodes are faster and easier to use as compared to reusable electrodes, which require cleaning after each use. As a result, the disposable electrode has replaced the reusable electrode in many applications. A disposable electrode generally consists of an adhesive for attachment to the patient's body, a gel to insure maximum signal acquisition, a conductor or snap for attachment to the transfer wires and the sensor element. The type of sensor element manufactured by Micron consists of a molded plastic substrate plated with a silver/silver chloride surface, which is a highly sensitive conductor of electrical signals. Silver/silver chloride-plated disposable electrodes are utilized in coronary care units and for other monitoring purposes. In most of these ECG procedures, up to ten electrodes are used and after each test, all such electrodes are discarded.

In addition to the traditional ECG tests, disposable electrodes incorporating Micron's sensor elements are used in connection with stress and "Holter" tests. The Holter test utilizes a portable ECG heart-monitoring device that is worn by a patient for up to 24 hours during the patient's normal activity and is designed to record data from the patient's heart. The stress test monitors the human heart during rest followed by exercise and again at rest. Both the Holter and stress tests employ silver/silver chloride disposable electrodes.

#### METAL SNAP FASTENERS

Metal snap fasteners are used to attach the disposable electrode to the lead wires of an ECG machine. Micron purchases the metal snap fasteners for resale from a supplier and performs additional quality control tests, repackaging and inventory stocking for its customers who can purchase the snaps along with Micron sensors.

#### HIGH SPEED ELECTRODE ASSEMBLY MACHINE

Pursuant to an asset purchase agreement, dated March 5, 1997, Micron acquired from Newmark, Inc. substantially all its assets used in the business of manufacturing, assembling, marketing, leasing and selling medical stud and eyelet application machines. At the same time it entered into the asset purchase agreement, Micron executed a manufacturing agreement with Newmark pursuant to which Newmark would continue to manufacture and service the machines on behalf of Micron for a period of one year for a specified price. The manufacturing of the machines was taken over by Micron at the start of 2000. Electrode assembly machines provide Micron with a complimentary product, which it can lease or sell to existing sensor and snap customers.

POLYMER OPERATION

During 1999 the Company had a trial polymer operation utilizing some existing equipment, which resulted in approximately \$184,000 of sales in 1999 and sales of \$65,000 in 2000, prior to the discontinuation of this operation. The Company decided not to pursue the operation so as not to deviate from the core business and has sold all existing polymer equipment.

The following table shows the revenues derived from the products of Micron for the years ended December 31:

	2000	%	1999	%	1998	%
Sensors.....	\$ 6,827,178	81	\$ 7,583,530	78	\$ 6,817,112	81
Snaps.....	1,389,432	17	1,797,008	18	1,514,521	18
Snap Machines.....	125,642	2	154,031	2	113,237	1
Polymer.....	64,788	-	183,839	2	-	-
Total.....	\$ 8,407,040	100	\$ 9,718,408	100	\$ 8,444,870	100

ENVIRONMENTAL REGULATION

Like many industrial processes, the Micron manufacturing process utilizes hazardous and non-hazardous chemicals, the treatment and disposal of which are subject to federal and state regulation. Since its inception, Micron has expended significant funds to train its personnel, install waste treatment and recovery equipment and to retain an independent environmental consulting firm to constantly review, monitor and upgrade its air and waste water treatment activities. As a result, Micron believes that the operation of its manufacturing facility is in compliance with currently applicable safety, health and environmental laws and regulations.

GROUNDWATER

During September 1992, as a requirement for obtaining a mortgage to repurchase its Fitchburg, Massachusetts manufacturing facility, Micron performed an environmental site assessment, including an analysis of groundwater samples for the presence of certain petroleum-based products, metals and solvents. The site assessment indicated levels of petroleum products and metals in excess of the maximum allowable standards. Micron filed a release report and a Preliminary Assessment and Interim Site Classification form with the Massachusetts Department of Environmental Protection ("DEP"). The DEP classified the site as a disposal site within the meaning of the Massachusetts Oil and Hazardous Material Release Prevention and Response Act and identified Micron as a potentially responsible party with liability.

On January 21, 1993, Micron filed its Phase I Limited Site Investigation and Waiver Application ("Application"). The Application identified several potential off-site sources for the discharge and demonstrated that none of the types of chemicals found on the property are used in the Micron manufacturing process. On February 18, 1993, the DEP classified the site as a non-priority disposal site and granted Micron's waiver application with the

## Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

stipulation that Micron evaluate the upgradient off-site sources which may have caused the contamination.

During 1999, a Method 3 Risk Characterization was performed demonstrating that a condition of "No-Significant Risk" exists at the site. Based on this and prior work characterizing the source and extent of the contamination, a Downgradient Property Status Submittal and a Notice of Activity and Limitation Use (AUL) on the part of the property were filed. The completion of the Phase II and Response Action Outcome was filed on February 28, 2000. The Phase II report included a Massachusetts Contingency Plan (MCP) Method 3 Risk Characterization and Response Action Outcome Statement that demonstrated a condition of "No Significant Risk" at the site. The site has been closed out under the MCP and is now awaiting a mandatory audit by the DEP.

### ATTORNEY GENERAL OF MASSACHUSETTS INVESTIGATION

In response to an anonymous phone call, all Micron records related to its wastewater treatment operation and expenses were subpoenaed by the Attorney General of Massachusetts for investigation in 1997. In 2000, the Company received notification by the Attorney General's office that the investigation had been concluded with no adverse action.

6

### GENERAL

#### CUSTOMERS AND SALES

ART historically has sold its electrocardiographic products to hospitals where purchasing decisions are typically made on the advice of physicians affiliated with such hospitals. The electrocardiographic products are also marketed to individual physicians and clinics. ART's sales cycle, with respect to hospitals, which generally commences at the time a hospital issues a request for proposal and ends upon submission of a purchase order, may take up to nine months. The sales cycle with respect to physicians and clinics is significantly shorter, typically 30 to 60 days.

Micron manufactures its sensor elements against specific customer purchase orders, some in accordance with supply agreements between Micron and the electrode manufacturers. There are approximately 40 significant manufacturers of silver/silver chloride-plated disposable electrodes worldwide. Micron sells its sensor elements to most of these manufacturers. During the year ended December 31, 2000, three major customers accounted for 36%, 25% and 14% of net sales of Micron. Sales backlog is not material to Micron's business.

The following table sets forth, for the periods indicated, the approximate consolidated revenues and percentages of revenues derived from the sales of the Company's products in its geographic markets:

	REVENUES FOR THE YEARS ENDED DECEMBER			
	2000	%	1999	%
United States.....	\$ 2,422,711	29	\$ 3,349,427	32
Europe.....	2,987,559	35	2,951,797	28
Canada, Mexico & South America.....	2,840,434	33	3,679,873	36
Pacific Rim.....	248,343	3	315,256	3
Other.....	22,816	-	83,231	1



Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

Sub Total.....	\$	8,521,863	100	\$	10,379,584	100
		=====	===		=====	===
GE/Prucka termination payment.....		1,000,000				
		-----				
Total.....	\$	9,521,863				
		=====				

The lower percentage of U.S. sales in 2000 reflects the transfer of a major Micron customer who closed a U.S. plant and moved its volume to Canada. In 1999, the U.S. plant had approximately \$526,000 in United States sales that were transferred to its Canadian plant. In late 2000, another major Micron customer announced its intentions to also transfer production from a U.S. plant to a Canadian plant.

INSTALLATION AND SERVICE

ELECTROCARDIOGRAPHIC

WARRANTY AND MAINTENANCE. ART provides a one-year warranty, which covers parts and labor for all of its SAECG software and hardware products. Customers may renew the warranty annually at a cost of approximately \$1,000 to \$2,700 depending on the service level and type of system.

SENSORS AND SNAPS

Micron sells its sensors and snaps to original equipment manufacturers of disposable electrodes that assemble the finished product. Micron sales, manufacturing and customer service personnel provide the electrode manufacturers with technical support as a value added service.

7

PRODUCT SUPPLIERS AND MANUFACTURING

ELECTROCARDIOGRAPHIC

ART currently has limited manufacturing capabilities for its signal averaging products and relies upon established inventories to fill current sales orders. When additional units are required, ART plans to sub-contract the basic unit production and perform final assembly and quality control testing in-house.

SENSORS AND SNAPS

Micron manufactures its sensor elements at its Fitchburg, Massachusetts facility employing a proprietary non-patented multi-step process. The raw materials used by Micron in its sensors are (1) plastic resins used to mold the substrates and (2) silver/silver chloride chemical solutions for plating the molded plastic substrates. Both the plastic used by Micron and the silver/silver chloride solutions are in adequate supply. Fluctuations in the price of silver are contractually passed on to customers.

Micron's medical snap fasteners are currently manufactured by Newmark, Inc. and Scovill Fasteners Inc. Micron buys the snaps in bulk, performs additional quality control tests, repackages and stocks inventory for its customers who can purchase the snaps along with Micron sensors.

MARKETING AND COMPETITION

## Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

ART engages independent sales representatives and distributors of medical instruments in various regions throughout the United States and foreign distributors to market all of ART's products. Sales representatives, who are paid on a commission basis, are generally responsible for identifying customers and demonstrating products in their respective geographic markets. ART has arrangements with foreign as well as domestic distributors who sell ART's products in most of the significant foreign markets.

### SAECG PRODUCTS

ART's marketing efforts with respect to SAECG products have focused primarily on those hospitals with an electrophysiology laboratory and electrophysiologists with the ability to apply the late potential test in a clinical environment. ART believes that this market segment is a relatively small percentage of the potential market for signal-averaging instruments. In the United States there are approximately 9,000 cardiologists certified by the American Board of Internal Medicine. ART markets its SAECG products at regional and national trade shows in the United States and Europe.

ART is aware of certain other companies, which have developed or are developing technologies and products, which are competitive with ART's products. Other technologies or products, which are functionally similar to ART's signal-averaging products, are currently available from a number of competitors, including Del Mar Avionics, Marquette Electronics, Inc., and Agilent Technologies. Most are well established, have substantially greater financial and other resources and have established reputations for success in the development, sale and service of products. ART believes that its competitive advantage is based on a number of factors, including the price, ease of use, and clinical acceptance of the methodology employed in ART's signal-averaging products, as well as the patented Simson Bi-directional Butterworth filter.

### SENSORS AND SNAPS

Micron sells its sensor elements to many manufacturers of disposable silver/silver chloride ECG electrodes. Micron employs one full-time salesperson for sensors and snaps. The Company believes that it has one major competitor for sensors and that its sales of sensors greatly exceed those of its competition.

### ENGINEERING AND RESEARCH AND DEVELOPMENT

Beginning in mid-1997, ART's engineering and research and development efforts focused primarily on moving DOS software packages in the SAECG product lines into the Windows environment. ART currently employs one programmer engaged in software development and one technician for customer telephone support, warranty repairs, and limited manufacturing. For the fiscal years ended December 31, 2000, 1999, and 1998, ART had research and development expenses of approximately \$229,000, \$298,000, and \$343,000, respectively, in connection with engineering, regulatory, and research and development activities, which consisted principally of the salaries of its employees and programming consultants.

### GOVERNMENT REGULATION

Diagnostic products such as those marketed by ART are subject to an extensive regulatory clearance process by the FDA and comparable agencies in other countries. ART believes that the products currently marketed in the United States have all necessary governmental clearances required for the sale of such products in the United States and each of the countries in which its products are presently sold. The regulatory process for diagnostic devices, which sometimes includes the

requirements for pre-clinical and clinical testing, can take many years and requires the expenditure of substantial amounts of money. In the event ART seeks to market new products or significantly modify a product currently in commercial distribution, ART would be required to obtain regulatory clearance.

Federal legislation relating to medical devices could potentially cause compliance with the pre-market clearance and approval processes to be more time consuming, difficult and expensive. It is not anticipated that ART's products will be subject to special controls or regulation, but there can be no assurance that the FDA will not impose special controls or regulation.

#### THIRD-PARTY REIMBURSEMENT

Hospitals, physicians and other health care providers that purchase capital or other equipment, such as the products sold by ART, for use in furnishing care to their patients typically rely on third-party payers, principally Medicare, Medicaid, and private health insurance plans, to reimburse all or part of the costs or fees associated with the medical procedures performed with such equipment, and of the capital costs of acquiring such equipment. Cost control measures adopted by third-party payers in recent years and reductions in Medicare payments for hospital outpatient services and capital costs have had and may continue to have a significant effect on the purchasing practices of many such providers, generally causing them to be more selective in the purchase of medical equipment and to place increasing emphasis on maximizing the return on investment in new equipment.

The Medicare statute prohibits payment for any items or services that are not reasonable and necessary for the diagnosis or treatment of illness or injury. SAECG medical tests are reimbursed under Part B Medicare in all 50 states. While third-party payers generally make their own decisions regarding which items and services to cover, Medicaid and other third-party payers often apply standards similar to Medicare's in determining whether to provide coverage for a particular medical procedure.

ART is unable to predict the impact of additional legislation or regulations, if any, which may be enacted or adopted in the future relating to ART's business or the health care industry, including third-party coverage and reimbursement.

#### INSURANCE

The Company may be exposed to potential product liability claims by patients who use the Company's products. ART maintains a general liability insurance policy, which includes product liability coverage of \$1,000,000 per occurrence and \$2,000,000 per year in the aggregate. ART has also increased its umbrella policy to \$5,000,000. Micron also maintains a general liability insurance policy which includes product liability coverage of \$2,000,000. To date, there have been no asserted or threatened claims against the Company. Although Company management believes the present insurance coverage is adequate for the types of products marketed by the Company, there can be no assurance that such insurance will be sufficient to cover potential claims or that the present level of coverage will be available in the future at a reasonable cost.

ART has a directors and officers' liability insurance policy with coverage in the amount of \$3,000,000 per occurrence and \$3,000,000 per year in the aggregate.

## Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

### PATENTS AND PROPRIETARY TECHNOLOGY

#### ART

ART holds an exclusive license under the Simson Patent, which covers the signal-averaging and filtering technologies, which are utilized in the 1200 EPX, LP-Pac Q, and PREDICTOR(R) 7. The Simson Patent was issued in December 1983. ART is the assignee of three other U. S. Patents, two of which expire in July 2001 and the other in January 2002. ART holds foreign patents issued in Austria, Australia, Belgium, Canada, France, United Kingdom, Holland, Italy, Liechtenstein, Spain, Sweden, Switzerland and Germany. ART believes that patent protection is important to its business and anticipates that it will apply for additional patents or extensions as deemed appropriate.

As part of the acquisition of substantially all the Corazonix assets in 1993, including those pertaining to high resolution ECG, ART acquired three additional patents related to time and frequency domain analysis of electrocardiogram signals. ART acquired U.S. Patent No. 5,117,833 entitled "BI-SPECTRAL FILTERING OF ELECTROCARDIOGRAM SIGNALS TO DETERMINE SELECTED QRS POTENTIALS," (the "Bi-Spec Patent") which expires in 2009. The Bi-Spec Patent, which has been licensed to Agilent Technologies, Inc. (formerly a business of Hewlett Packard Company) on a non-exclusive basis, may provide ART with a superior means of detecting late potentials. ART also acquired three additional patents, which were granted in 1990 and 1991 by the U.S. Patent Office, and cover the spectral-temporal, mapping post-processing software packages sold by ART.

United States Patent No. 5,609,158 entitled "Apparatus and Method for Predicting Cardiac Arrhythmia by Detection of Micropotentials and Analysis of all ECG Segments and Intervals," which covers a frequency domain analysis technique for SAECG data, was granted by the U.S. Patent Office in March 1997. This technique is embodied in the IntraSpect software product, and has been found to compliment the Simson methodology by increasing the overall predictive value of the

9

SAECG test. Additionally, patients with conduction delay problems (i.e., "bundle branch block") can have SAECG analysis performed on them. This includes 25% of the patient population, which previously could not be analyzed with SAECG.

Rapid technological development in the medical industry results in extensive patent filings and a rapid rate of issuance of new patents. Although the Company believes that ART's products do not and will not infringe on patents or violate proprietary rights of others, it is possible that its existing patent rights may not be valid or that infringement on existing or future patents or proprietary rights may occur. In the event that ART's products infringe patents or proprietary rights of others, ART may be required to modify the design of its products or obtain a license. There can be no assurance that ART will be able to do so in a timely manner upon acceptable terms and conditions. In addition, there can be no assurance that ART will have the financial or other resources necessary to enforce or defend a patent infringement or proprietary rights violation action. Moreover, if ART's products infringe patents or proprietary rights of others, ART could, under certain circumstances, become liable for damages, which could have a material adverse effect on ART.

ART also relies on proprietary know-how and employs various methods to protect the source codes, concepts, ideas and documentation of its proprietary software. However, such methods may not afford complete

## Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

protection and there can be no assurance that others will not independently develop such know-how or obtain access to ART's know-how or software codes, concepts, ideas and documentation. Furthermore, although ART has confidentiality agreements with its employees and appropriate vendors, there can be no assurance that such arrangements will adequately protect ART's trade secrets.

### MICRON

Micron employs a highly complex, proprietary non-patented multi-step manufacturing process for its silver/silver chloride-plated sensor elements. Key employees have executed nondisclosure and non-competition agreements. To maintain its leadership as a major supplier of sensors and snaps to the manufacturers of disposable silver/silver chloride ECG electrodes, Micron received a patent for a radiographically translucent snap that is manufactured from a flexible electrically conductive thermoplastic polymeric compound in 1995.

### EMPLOYEES

ART has three full-time employees, including one administrative and two programming personnel. Micron employs forty-four full time employees and two part-time employees, including thirteen administrative, sales and supervisory personnel, twelve quality control personnel and nineteen production personnel. None of the employees of either company are represented by a union.

### ITEM 2. PROPERTIES

ART leases approximately 1,500 square feet of new office space in Austin from an unaffiliated landlord, with monthly rental payments of \$2,657.

The manufacturing facility and offices of Micron are located in an industrial area in Fitchburg, Massachusetts. The facility consists of two buildings. The first building, which was purchased in April 1994, consists of a 22,000 square foot, six story building. The second building, which was purchased in September 1996, is a 94,000 square foot, two story building.

### ITEM 3. LEGAL PROCEEDINGS

As further discussed under Environmental Regulation, Micron has been identified as a potentially responsible party with liability by the DEP. On February 18, 1993, the site was classified as a non-priority site and Micron's waiver application was approved. As a condition of the waiver, Micron was required to prepare a five-year plan of remediation for the property. Micron has retained an environmental consulting firm, and in 1995 hired an internal consultant, to organize and implement the remediation plan and to represent Micron in its dealings with the regulatory authorities. During 2000, Micron filed its Phase II Report with the DEP. The Phase II Report included a Massachusetts Contingency Plan (MCP) Method 3 Risk Characterization and Response Action Outcome Statement that demonstrated a condition of "No Significant Risk" at the site. The site has been closed out under the MCP and is now awaiting a mandatory audit by the DEP.

In 1997, ART acquired assets from Astro-Med Inc. relating to a hemodynamics system for cardiac catheterization monitoring (Cath Lab Systems). Included as part of the purchase price of \$350,000 was a Promissory Note for \$300,000. In 1999, ART discontinued the sales of the Cath Lab Systems due to

## Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

major deficiencies in the Astro-Med products and subsequently stopped payments under the Note. In 2000, Astro-Med filed a complaint in the Rhode Island Superior Court which was removed by ART to the United States District Court in Rhode Island to have the Note enforced. ART is contesting the complaint claiming breach of obligations under the Asset Purchase Agreement.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

- a. Annual meeting of shareholders was held on December 15, 2000
- b. Paul F. Walter was elected as director of the Company at the meeting. Russell C. Chambers, E. P. Marinos, and Julius Tabin continued to serve as directors.

Paul F. Walter, MD                      2,890,663    FOR,              1,374    WITHHELD

- c. BDO Seidman, LLP, was appointed to audit the consolidated financial statements of the Company for the year ended December 31, 2000.

2,890,677    FOR,              1,360    WITHHELD

### PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

ART's Common Stock was listed on the American Stock Exchange on March 3, 1992 and trades under the ticker symbol HRT. Prior to that, ART's stock was listed on NASDAQ .

The following table sets forth, for the period indicated, the high and low closing prices per share for ART's Common Stock as quoted by the American Stock Exchange.

	HIGH	LOW
	-----	-----
Year Ended December 31, 1999		
1st Quarter.....	\$ 1 5/16	\$ 1 1/8
2nd Quarter.....	1 3/8	1 3/16
3rd Quarter.....	2 7/16	1 3/16
4th Quarter.....	2 3/8	1 3/8
Year Ended December 31, 2000		
1st Quarter.....	\$ 4 1/2	\$ 1 1/2
2nd Quarter.....	2 5/8	1 7/8
3rd Quarter.....	2 3/8	1 3/4
4th Quarter.....	2	1 7/16

As of March 1, 2001 the number of record holders of ART's common stock was estimated to be 1300. On March 1, 2001 the closing price for the common stock on the American Stock Exchange was \$1.95.

#### DIVIDEND POLICY

To date, ART has not paid any dividends on its Common Stock. The Company's long-term debt agreements contain various restrictions and conditions including restrictions regarding the payment of dividends. ART does not intend to declare any dividends in the foreseeable future, but instead intends to retain all earnings, if any, for use in the Company's business.

ITEM 6. SELECTED FINANCIAL DATA  
(IN THOUSANDS, EXCEPT PER SHARE DATA)

The selected financial data presented below for each of the years ended December 31 has been derived from the Company's audited consolidated financial statements. The data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Financial Statements, including the notes thereto, appearing elsewhere in this report.

STATEMENTS OF OPERATIONS DATA:	YEARS ENDED DECEMBER 31,			
	2000	1999	1998	1997
	----	----	----	----
Net sales	\$ 8,522	\$ 9,995	\$ 8,875	\$ 10,555
Commissions and related revenues	1,000	385	485	1,332
Total revenue	9,522	10,380	9,360	11,887
Cost of sales	5,988	6,758	6,127	7,932
Gross profit	3,534	3,622	3,233	3,955
Selling and marketing	193	393	247	499
General and administrative	2,169	2,143	2,141	2,491
Research and development	229	298	343	371
Amortization of goodwill	130	130	130	134
Write-down of assets	--	--	192	--
Income from operations	813	658	180	460
Interest and other expenses, net	(148)	(213)	(117)	(378)
Income before income taxes	665	445	63	82
Income tax expense	45	20	199	50
Net income (loss)	\$ 620	\$ 425	\$ (136)	\$ 32
Net income (loss) per share - basic	\$ .19	\$ .12	\$ (.04)	\$ .01
- diluted	\$ .18	\$ .12	\$ (.04)	\$ .01
Weighted average number of shares outstanding - basic	3,333	3,489	3,561	3,563
- diluted	3,430	3,549	3,561	3,563

BALANCE SHEET DATA:

DECEMBER 31,

Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

	2000 ----	1999 ----	1998 ----
Total assets	\$ 9,919	\$ 9,702	\$ 9,990
Long-term obligations (including current portion)	\$ 602	\$ 808	\$ 1,000
Working capital	\$ 3,671	\$ 2,174	\$ 2,282
Shareholders' equity	\$ 8,560	\$ 8,222	\$ 7,959

12

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

The following table sets forth for the periods indicated, the percentages of the net sales represented by certain items reflected in the Company's statements of operations.

	YEARS ENDED DECEMBER 31,		
	2000	1999	1998
Net sales.....	100.0%	100.0%	100.0%
Cost of sales.....	70.3	65.1	65.5
Gross profit.....	29.7	34.9	34.5
Selling and marketing.....	2.3	3.8	2.6
General and administrative.....	25.4	20.6	22.9
Research and development.....	2.7	2.9	3.7
Amortization of goodwill.....	1.5	1.3	1.4
Write-down of assets.....	-	-	2.0
Other, net.....	(1.7)	(2.0)	(1.3)
GE/Prucka lump sum termination payment.....	11.7	-	-
Income before income taxes.....	7.8	4.3	0.6
Income tax provision.....	(0.5)	(0.2)	( 2.1)
Net income (loss).....	7.3%	4.1%	(1.5%)

REVENUE

Revenues in 2000 included a \$1,000,000 lump sum payment from GE/Prucka to terminate a commission agreement for the sales of CardioLab systems. The agreement was scheduled to expire December 31, 2002. Commissions earned under the GE/Prucka agreement were approximately \$385,000 and \$485,000 in 1999 and 1998, respectively.

Excluding revenues attributed to the GE/Prucka commission agreement, the revenues from ongoing operations decreased \$1,473,132 or 15% for the year ended December 31, 2000 compared to 1999. Revenues from 2000 from the sales of Micron Products sensors and metal snaps decreased \$1,192,000 or 13% compared to 1999. Sales in 1999 related to (Y2K) concerns were abnormally high for Micron, especially at year-end. As a result, orders for sensors



## Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

dropped in the first half of 2000 but have resumed to more normal rates in the second half of 2000. Orders for metal snaps decreased approximately \$400,000 or 23% in 2000 and the lower sales volume is projected to continue due to the loss of a major customer.

Revenues for 2000 that are derived from sales of ART's SAECG equipment were \$114,823 compared to \$276,578 in 1999. During 2000, ART began marketing a new Predictor(R) Windows based software with its patented signal averaging technology. Until more of ART's proprietary software is modified and re-introduced to the cardiology and electrophysiology fields in 2001, the Company expects revenues for these ART products will not be material.

	YEARS ENDED DECEMBER 31,					
	2000	%	1999	%	1998	%
Sensors & Snaps.....	\$ 8,342,252	88	\$ 9,534,569	92	\$ 8,444,870	9
Polymers.....	64,788	-	183,839	2	-	-
CardioLab & CardioMapp.....	1,000,000	11	384,598	4	485,331	-
SAECG equipment.....	114,823	1	276,578	2	429,300	-
K-3 Cath-Lab	-	-	-	-	1,095	-
<b>Total.....</b>	<b>\$ 9,521,863</b>	<b>100</b>	<b>\$ 10,379,584</b>	<b>100</b>	<b>\$ 9,360,596</b>	<b>10</b>

### COST OF SALES

Cost of sales as a percent of revenues excluding the effect of GE/Prucka commissions and termination payment was 70.3% in 2000 compared to 67.6% in 1999. The increase as a percent of revenue was primarily due to unabsorbed fixed

13

manufacturing expenses, such as depreciation, utilities and salaried employees, associated with the lower volume of sensor sales. In 1998, cost of sales as a percent of revenues excluding GE/Prucka commissions was 69%.

### SELLING AND MARKETING

Selling and marketing expenses as a percent of sales decreased from 3.8% in 1999 to 2.3% in 2000. The decrease reflects reductions in direct sales staff and marketing support for ART products until a new generation of signal-average ECG products is available for market introduction now scheduled to commence mid-year 2001.

### GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses as a percent of sales was 25.4% in 2000 compared to 20.6% in 1999. As general and administrative expenses only increased \$26,610 in 2000 over 1999, the higher percent than 1999 is strictly a function of the lower sales in 2000. Included in expenses in 2000 are \$137,500 of severance costs related to two executives of the Company, and approximately \$120,000 of legal expenses which were incurred in connection with an environmental investigation of Micron by the Attorney General's office of Massachusetts. Micron has been informed the investigation has

## Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

concluded in 2000 with no adverse actions. These one-time costs were mostly offset by the continuing reduction in costs associated with the Austin headquarters operation.

### RESEARCH AND DEVELOPMENT

Research and development costs decreased from \$298,000 in 1999 to \$229,000 in 2000. The decrease was due to fewer full time employees engaged in ART's R&D activities, somewhat replaced by outside programming services. Ongoing research and development for Micron's products and manufacturing processes is part of its manufacturing overhead.

### INTEREST EXPENSE

Interest expense was \$91,477 in 2000 compared to \$132,919 in 1999. The Company had no bank borrowings of its credit line during 2000 and interest expense in 2000 was accrued on Bonds Payable and Long Term Debt. Bank borrowings were not required in 2000 due to approximately \$2,377,000 of cash generation from operations which included the \$1,000,000 for the termination of the GE/Prucka commission agreement, \$295,000 from the sale of a polymer extruder and \$229,000 from the refund of prior year's income taxes. Interest expense in 1998 was \$220,000.

### INCOME TAXES

For the year ended December 31, 2000, income tax as a percent of income before taxes was 6.8%, primarily due to the state tax of 9.5% on Micron's Massachusetts earnings, similar to 1999 and 1998. The low Federal income tax reflects the higher than estimated utilization of deferred tax deductions available for 2000 and future periods that generate taxable income.

### LIQUIDITY AND CAPITAL RESOURCES

The Company had working capital of \$3,671,443 at December 31, 2000 compared to \$2,173,947 at December 31, 1999. The increase of \$1,497,496 is basically the result of two events:

- (1) The receipt from GE/Prucka of a \$1,000,000 termination payment related to a commission agreement and
- (2) The classification of \$580,000 of bonds that were included in current liabilities in 1999 and now are included in long term debt. The bonds were originally scheduled to mature in May, 2000 have been renewed to mature in May 2002.

In August 1995, the Company completed a \$600,000 private bond placement. The bonds carried an 11% interest rate and the bondholders received an aggregate of 279,000 warrants to purchase ART stock at \$3.00 per share. The bond proceeds were used to help ART meet common stock repurchase commitments and to provide working capital for new product acquisitions and development. In early 2000, \$550,000 of the bonds were extended until May 31, 2002 as well as 254,980 warrants to purchase ART stock at \$1.50 per share.

During 2000, the Company had an \$800,000 line of credit with a bank that is due to expire in June 2001. This replaced a similar line, which had expired December, 1999. There were no borrowings under the line of credit in 2000. The maximum amount of borrowings under the line of credit for 1999 and 1998 was \$10,000 and \$723,000 respectively at a weighted average interest rate of 9% for both years. The Company anticipates the line of credit will be renewed in 2001.

Net cash provided by operating activities for 2000, 1999 and 1998 was

## Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

approximately \$2,377,000, \$919,000 and \$1,839,000 respectively. The major source of cash provided by operations is the net income of the Company and the significant non-cash items of depreciation and amortization.

Cash and cash equivalents were \$1,999,292 and \$455,674 at December 31, 2000 and 1999, respectively. Substantially all these funds are invested in fixed rate bank instruments that are highly liquid.

14

Net cash used in investing activities was \$255,508 in 2000, \$583,110 in 1999 and \$523,694 in 1998. The majority of these expenditures were for capital equipment at Micron's manufacturing facility in Massachusetts and the Company plans to expend approximately \$350,000 for capital equipment in 2001.

During 2000, 1999 and 1998, net cash used in financing activities totaled \$578,231, \$438,098 and \$972,320 respectively. Included in the net cash used in financing activities were purchases of treasury stock of \$502,772 in 2000, \$238,808 in 1999 and \$34,297 in 1998. In January 2000, the Company announced it had acquired in excess of five percent (5%) of its Common Stock in the belief that its stock is undervalued. The Company intends to continue this stock buy back program from time to time throughout 2001. The Company used \$75,459, \$238,567 and \$980,880, in 2000, 1999 and 1998, respectively, to pay down credit facilities and long-term debt.

### INFLATION

The Company does not believe that inflation in the United States or international markets in recent years has had a significant effect on its results of operations.

### SAFE HARBOR UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995.

Cautionary statements under the "Safe Harbor" Provisions of the Private Securities Litigation Reform Act of 1995: This Form 10-K contains certain statements of a forward-looking nature relating to future events or the future financial performance of the Company. Such forward-looking statements are only predictions and are subject to risks and uncertainties that could cause actual results or events to differ materially and adversely from the results discussed in the forward-looking statements. When used in this Form 10-K, the words or phrases "believes," "anticipates," "expects," "intends," "will likely result," "estimates," "projects" or similar expressions are intended to identify predictions and the actual events or results may differ materially from the results discussed in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, risks regarding demand for new and existing products; the success of new product development efforts; the uncertainty as to whether certain products will receive approval for sale in the United States; the Company's highly competitive industry and rapid technological change within the industry and the fact that the industry is dominated by large companies with much greater resources than the Company; and the reliance on key personnel.

The Company cautions investors and others to review the cautionary statements set forth in this Form 10-K and cautions that other factors may prove to be more important in affecting the Company's business and results of operations. These forward-looking statements speak only as of the date of this report. The Company undertakes no obligation to publicly release the results of any revisions to these forward-looking statements that may be made to reflect events or circumstances after the date of this report or to reflect the occurrence of anticipated events.

## Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

### ITEM 7A. QUANTIFICATION AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is not exposed to foreign currency exchange risk as all business is conducted based on U.S. Dollars.

15

### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT ACCOUNTANTS	17
CONSOLIDATED FINANCIAL STATEMENTS:	
Balance sheets	18
Statements of operations	19
Statements of changes in shareholders' equity	20
Statements of cash flows	21
Notes to consolidated financial statements	22-38

16

#### REPORT OF INDEPENDENT ACCOUNTANTS

To the Shareholders

Arrhythmia Research Technology, Inc.

We have audited the accompanying consolidated balance sheets of Arrhythmia Research Technology, Inc. and Subsidiary as of December 31, 2000 and 1999, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ending December 31, 2000. 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 auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes

examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 consolidated financial position of Arrhythmia Research Technology, Inc. and Subsidiary as of December 31, 2000 and 1999, and the consolidated results of their operations and their cash flows for each of the three years in the period ending December 31, 2000, in conformity with accounting principles generally accepted in the United States of America.

/s/BDO Seidman, LLP

Gardner, Massachusetts

February 16, 2001

17

ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF OPERATIONS

DECEMBER 31,	2000
-----	
ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	\$ 1,999,292
Trade and other accounts receivable, net of allowance for doubtful accounts of \$52,827 and \$83,203	1,604,141
Inventories (Note 4)	860,161
Deposits, prepaid expenses and other current assets	62,728
Income taxes recoverable	100,000
-----	
Total current assets	4,626,322
PROPERTY, PLANT AND EQUIPMENT, net (Notes 5 and 7)	3,310,958
GOODWILL, net of accumulated amortization (Note 6)	1,456,833
OTHER INTANGIBLES, net of accumulated amortization (Note 6)	48,030
DEFERRED INCOME TAXES, net (Note 8)	444,923
OTHER ASSETS	31,518
-----	

Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

Total assets		\$ 9,918,584
-----		
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current portion of capital lease obligations	\$	23,882
Current maturities of bonds payable and other long-term debt (Note 7)		178,279
Accounts payable		344,821
Accrued expenses		407,897
-----		
Total current liabilities		954,879
BONDS PAYABLE AND OTHER LONG-TERM DEBT, net of current maturities (Note 7)		399,490
CAPITAL LEASE OBLIGATIONS, net of current portion		-
DEFERRED REVENUE		4,621
-----		
Total liabilities		1,358,990
-----		
COMMITMENTS AND CONTINGENCIES (Notes 7, 9, 10 and 13):		
SHAREHOLDERS' EQUITY (Note 13):		
Preferred stock, \$1 par value; 2,000,000 shares authorized, none issued		-
Common stock, \$.01 par value; 10,000,000 shares authorized; 3,729,681 and 3,711,883 issued, respectively		37,297
Additional paid-in-capital		9,166,615
Common stock held in treasury, 563,446 and 298,406 shares at cost		(1,654,664)
Retained earnings		1,010,346
-----		
Total shareholders' equity		8,559,594
-----		
Total liabilities and shareholders' equity	\$	9,918,584

SEE ACCOMPANYING NOTES TO CONSOLIDATED FIN

18

ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF OPERATIONS

YEARS ENDED DECEMBER 31,	2000	1999
-----		
NET SALES	\$ 8,521,863	\$ 9,994,986
COMMISSIONS AND RELATED REVENUE (Note 10)	1,000,000	384,598
-----		
Total Revenue (Note 14)	9,521,863	10,379,584

Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

COST OF SALES	5,987,579	6,757,519
-----		
Gross profit	3,534,284	3,622,065
-----		
SELLING AND MARKETING	192,862	392,851
GENERAL AND ADMINISTRATIVE	2,169,217	2,142,607
RESEARCH AND DEVELOPMENT	229,659	297,568
AMORTIZATION OF GOODWILL	129,889	130,519
LOSS FROM IMPAIRMENT OF LONG-LIVED ASSETS (Note 3)	-	-
-----		
Income from operations	812,657	658,520
OTHER INCOME (EXPENSE):		
Interest expense	(91,477)	(132,919)
Other income (expense), net	(56,053)	(80,243)
-----		
Total other expense, net	(147,530)	(213,162)
-----		
INCOME BEFORE INCOME TAXES	665,127	445,358
INCOME TAX PROVISION (Note 8):		
Current	66,000	69,313
Deferred	(21,000)	(49,000)
-----		
	45,000	20,313
-----		
NET INCOME (LOSS)	\$ 620,127	\$ 425,045
-----		
NET INCOME (LOSS) PER SHARE (Note 2):		
Basic	\$ 0.19	\$ 0.12
Diluted	\$ 0.18	\$ 0.12

SEE ACCOMPANYING NOTES TO CONSOLIDATED

19

ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY  
(NOTES 9 AND 13)

	Shares	Amount	Additional Paid-in Capital	Treasury Stock	Unearned ESOP Compensati
DECEMBER 31, 1997	3,679,216	\$ 36,792	\$ 8,909,307	\$ (878,787)	\$ (82,134)
Treasury stock purchase of 28,400 shares	-	-	-	(34,297)	-

Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

ESOP payments	-	-	-	-	42,857
Net loss	-	-	-	-	-
-----					
DECEMBER 31, 1998	3,679,216	36,792	8,909,307	(913,084)	(39,277)
Issuance of common stock	32,667	327	36,986	-	-
Treasury stock purchase of 153,891 shares	-	-	-	(238,808)	-
ESOP payments	-	-	-	-	39,277
Net income	-	-	-	-	-
-----					
DECEMBER 31, 1999	3,711,883	37,119	8,946,293	(1,151,892)	-
Issuance of common stock	17,798	178	26,322	-	-
Treasury stock purchase of 265,040 shares	-	-	-	(502,772)	-
Value of warrants issued with bond renewal	-	-	194,000	-	-
Net income	-	-	-	-	-
-----					
DECEMBER 31, 2000	3,729,681	\$ 37,297	\$ 9,166,615	\$ (1,654,664)	\$ -
-----					

SEE ACCOMPANYING NOTES TO C

20

ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(NOTE 11)

YEARS ENDED DECEMBER 31,	2000	1999
-----		
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ 620,127	\$ 425,045
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Director fees paid in stock	26,500	37,313
Depreciation	771,531	693,648
Provision for doubtful accounts	(30,376)	11,011
Amortization	277,087	194,092
Loss from impairment of long-lived assets	-	-
Deferred income tax provision	(21,000)	(49,000)
Deferred revenue	(4,059)	(18,356)
Changes in assets and liabilities:		
Trade and other accounts receivable	79,333	(356,441)
Inventories	222,356	390,209
Deposits, prepaid expenses and other assets	117,379	(1,147)
Income taxes recoverable	229,408	(66,598)
Accounts payable and accrued expenses	89,071	(340,427)
-----		
Net cash provided by operating activities	2,377,357	919,349
-----		
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(246,658)	(540,713)
Other intangibles	(8,850)	(42,397)



Net cash used in investing activities	(255,508)	(583,110)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net repayments under credit facilities	-	-
Principal payments on long-term debt and capital leases	(75,459)	(238,567)
Purchase of treasury stock	(502,772)	(238,808)
Reduction of unearned ESOP compensation	-	39,277
Net cash used in financing activities	(578,231)	(438,098)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,543,618	(101,859)
CASH AND CASH EQUIVALENTS, beginning of year	455,674	557,533
CASH AND CASH EQUIVALENTS, end of year	\$ 1,999,292	\$ 455,674

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

21

ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. DESCRIPTION OF BUSINESS
 

Arrhythmia Research Technology, Inc. ("ART"), a Delaware corporation, is engaged in marketing computerized medical instruments for monitoring, analyzing and treating heart disease. Micron Products, Inc. ("Micron"), a Massachusetts corporation, a wholly-owned subsidiary of ART, is a manufacturer of silver/silver chloride-plated sensor elements, a component used in the manufacture of disposable medical electrodes designed for electrocardiograph ("ECG") and other instrumentation. Additionally, Micron also acts as a distributor of metal snap fasteners, another component used in the manufacture of disposable medical electrodes. Micron manufactures and leases high speed electrode assembly machines to its sensor and snap customers.
  
2. ACCOUNTING POLICIES
 

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of ART and Micron (collectively the "Company"). All intercompany balances and transactions

have been eliminated in consolidation.

REVENUE RECOGNITION

Revenue from product sales is recognized upon shipment of the product when independent sales representatives or distributors are responsible for installation of systems, as the title and risk of loss passes to the customer at the time of shipment. However, in cases where ART personnel are scheduled to perform this in-service/installation, the revenue is not recognized until completion of such obligations. Revenue from the sale of extended warranties is deferred and amortized ratably over the life of the warranty.

CASH AND CASH  
EQUIVALENTS

Cash and cash equivalents consist of cash on hand and on deposit in high quality financial institutions. The Company considers highly liquid investments that can be readily converted to cash at par value to be cash equivalents.

INVENTORIES

Inventories are stated at the lower of cost or market. Cost of inventories is determined by the first-in, first-out method.

CONCENTRATION OF  
CREDIT RISK

Financial instruments, which potentially expose the Company to concentrations of credit risk, as defined by SFAS No. 105, consist primarily of trade accounts receivable, cash and cash equivalents.

ART's customer base for ECG and electrophysiology products is primarily comprised of hospitals and to a much lesser extent of cardiologists and office based practitioners. Micron products are sold to manufacturers of disposable electrodes, who are typically large diversified medical product manufacturers. The Company does not generally require collateral for its sales; however, the Company believes that its terms of sale provide adequate protection against significant credit risk.

22

2. ACCOUNTING POLICIES  
(Continued)

CONCENTRATIONS OF  
CREDIT RISK  
(CONTINUED)

It is the Company's policy to place its cash and cash equivalents in high quality financial institutions. The Company does not believe significant credit risk exists with

respect to these institutions.

ADVERTISING  
EXPENSES

Advertising expenses consist primarily of costs incurred in promoting the Company's products, printed brochures and other activities. The Company expenses advertising costs as incurred. The Company's advertising expense was approximately \$16,000, \$52,000 and \$72,000 in 2000, 1999 and 1998, respectively.

PROPERTY, PLANT  
AND EQUIPMENT

Property, plant and equipment are recorded at cost and include expenditures which substantially extend their useful lives. Depreciation on property, plant and equipment is calculated using the straight-line method over the estimated useful lives of the assets. Expenditures for maintenance and repairs are charged to earnings as incurred. When equipment is retired or sold, the resulting gain or loss is reflected in earnings.

GOODWILL

The excess of the aggregate purchase price over the fair value of net assets of businesses acquired is amortized over 20 years using the straight-line method. The Company periodically reviews goodwill of acquired businesses to assess recoverability based on future operating projections. Impairments would be recognized in operating results if a permanent diminution in value were to occur on an undiscounted basis.

OTHER INTANGIBLES

Direct costs to acquire patent technology and legal costs associated with securing and defending patents are capitalized and amortized using the straight-line method over the remaining useful life of the patents. The Company periodically reviews its patent assets to assess recoverability based on future undiscounted projected earnings from operations. Impairments are recognized in operating results when a permanent diminution in value occurs.

Certain software development costs incurred subsequent to establishment of technological feasibility are capitalized and amortized using the straight-line method over the estimated economic life of the related product, generally three years. Amortization commences when the product is available for general release. Costs to establish the technological feasibility of the product are expensed as research and development.

LONG-LIVED  
ASSETS

The Company reviews the carrying values of its long-lived and identifiable

intangible assets for possible impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable.

23

2. ACCOUNTING POLICIES  
(Continued)

INCOME TAXES

The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes," which requires recognition of deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax liabilities and assets are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse.

NET INCOME (LOSS)  
PER SHARE DATA

The Company follows the provisions of SFAS No. 128 "Earnings Per Share", which requires the Company to present its basic earnings per share and diluted earnings per share, and certain other earnings per share disclosures for each year presented. Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding. The computation of diluted earnings per share is similar to the computation of basic earnings per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. In addition, the numerator is adjusted for any changes in income or loss that would result from the assumed conversions of those potential shares.

Basic and diluted EPS computation for the years ended December 31, 2000, 1999, and 1998 are as follows:

YEARS ENDED DECEMBER 31,	2000	1999	1998
Net income (loss) available to common shareholders	\$ 620,127	\$ 425,045	\$ (136,438)

Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

Weighted average common shares outstanding	3,333,317	3,488,650	3,560,713
Basic EPS	\$ 0.19	\$ 0.12	\$ (0.04)
Diluted EPS:			
Net income (loss) available to common shareholders	\$ 620,127	\$ 425,045	\$ (136,438)
Weighted average common share outstanding	3,333,317	3,488,650	3,560,713
Assumed conversion of common shares issuable under stock option plan	97,084	60,544	-
Weighted average common and common equivalent shares outstanding	3,430,401	3,549,194	3,560,713
Diluted EPS	\$ 0.18	\$ 0.12	\$ (0.04)

24

2. ACCOUNTING POLICIES  
(Continued)

NET INCOME (LOSS)  
PER SHARE DATA  
(Continued)

The following table summarizes securities that were outstanding but not included in the calculation of diluted earnings per share because their effect would have been antidilutive:

DECEMBER 31,	2000	1999	1998
Stock options	7,000	14,000	209,000
Stock warrants	-	279,000	279,000

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted

accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates.

FAIR VALUE OF  
FINANCIAL  
INSTRUMENTS

The carrying amount reported in the balance sheets for cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate their fair value due to the immediate or short-term maturity of such instruments. The carrying amounts reported for the promissory note and bonds payable approximate fair value based on the Company's incremental borrowing rates.

COMPREHENSIVE  
INCOME

The Company follows the provisions of Statement of Financial Accounting Standards No. 130, REPORTING COMPREHENSIVE INCOME, ("SFAS No. 130") which establishes standards for reporting and display of comprehensive income, its components, and accumulated balances. Comprehensive income is defined to include all changes in equity except those resulting from investments by owners and distributions to owners. Among other disclosures, SFAS No. 130 stipulates that all items that are required to be recognized under current accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. The Company did not have any components of comprehensive income for the years ended December 31, 2000, 1999 and 1998.

INDUSTRY SEGMENTS

The Company follows the provisions of Statement of Financial Accounting Standards No. 131, "Disclosure about Segments of an Enterprise and Related Information" ("SFAS No. 131") which requires reporting of selected information about operating segments in interim financial statements issued to the public. It also establishes standards for disclosures regarding products and services, geographic areas, and major customers. SFAS No. 131 defines operating segments as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance.

2. ACCOUNTING POLICIES  
(Continued)

SHIPPING AND  
HANDLING COSTS

Shipping and handling costs include primarily freight and are classified as a cost of sales in the consolidated statements of operations.

NEW ACCOUNTING  
STANDARD NOT  
YET ADOPTED

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivatives Instruments and Hedging Activities" ("SFAS No. 133"). SFAS No. 133 requires companies to recognize all derivatives contracts as either assets or liabilities in the balance sheet and to measure them at fair value. If certain conditions are met, a derivative may be specifically designated as a hedge, the objective of which is to match the timing of gain or loss recognition on the hedging derivative with the recognition of (i) the changes in the fair value of the hedged assets or liability or (ii) the earnings effect of the hedged forecasted transaction. For a derivative not designated as a hedging instrument, the gain or loss is recognized in income in the period of change. SFAS No. 133, as amended by SFAS No. 137, is effective for all fiscal quarters of fiscal years beginning after June 15, 2000.

Historically, the Company has not entered into derivative contracts either to hedge existing risks or for speculative purposes. Accordingly, the Company does not expect adoption of the new standard to affect its financial statements.

3. ACQUISITION  
ACTIVITY

On April 14, 1997, ART acquired from Astro-Med, Inc. substantially all of the assets related to the following products (i) the basic cardiac catheterization monitoring system (the "K3-I"), (ii) the stand-alone hemodynamic analysis package (the "K3-II"), (iii) the network ready hemodynamic analysis package (the "K3-III"), and (iv) the control work station (the "K3-WI") (collectively, the "K3 Products"). The purchase price for the assets was \$350,000, with \$50,000 paid at closing and a promissory note issued in the amount of \$300,000 (see Note 7).

During the year ended December 31, 1998, the Company recorded an impairment loss on

the long-lived assets related to the Astro-Med acquisition. The impairment was the result of the K3 Products technology failing to meet competitive demands. Included in the 1998 results of operations is an impairment loss of \$192,201 which was due primarily to the reduction of the goodwill carrying value to zero. The Company also recorded a charge in 1998 of approximately \$261,000 in cost of sales for the write-down of the related inventory to its net realizable value.

4. INVENTORIES

Inventories consist of the following:

DECEMBER 31,	2000	1999
Raw materials	\$ 123,962	\$ 252,237
Work-in-process	197,254	233,966
Finished goods	538,945	596,314
Total	\$ 860,161	\$ 1,082,517

ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following:

DECEMBER 31,	Asset Lives	2000	1999
Machinery and equipment	5 to 15 years	\$ 4,481,941	\$ 4,355,011
Equipment held for lease	10 years	403,708	539,222
Building and improvements	20 years	1,856,585	1,903,221
Vehicles	3 to 5 years	28,855	28,855
Furniture and fixtures	3 to 5 years	568,825	708,804
		7,339,914	7,535,113



Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

Less accumulated depreciation	(4,028,956)	(3,699,282)
-----		
Net property, plant and equipment	\$ 3,310,958	\$ 3,835,831
-----		

The Company had \$87,770 and \$135,400 of assets under capital leases, included in machinery and equipment, at December 31, 2000 and 1999. Accumulated depreciation on these assets was \$24,868 and \$33,307 at December 31, 2000 and 1999, respectively.

EQUIPMENT  
LEASING

The Company leases attaching machines to customers under operating leases for periods of up to one year with renewable terms. The cost of the leased equipment is depreciated on a straight-line basis over ten years. Accumulated depreciation on leased equipment was \$113,936 and \$106,721 at December 31, 2000 and 1999.

6. GOODWILL AND OTHER  
INTANGIBLES

Goodwill and other intangibles consist of the following:

DECEMBER 31,	2000	1999
-----		
Goodwill	\$ 2,473,326	\$ 2,661,073
Accumulated amortization	(1,016,493)	(1,074,350)
-----		
Net goodwill	\$ 1,456,833	\$ 1,586,723
-----		
Other intangibles	\$ 606,449	\$ 597,599
Accumulated amortization	(558,419)	(474,712)
-----		
Net other intangibles	\$ 48,030	\$ 122,887
-----		

7. DEBT

Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

REVOLVING CREDIT FACILITY

The Company has available \$800,000 from a revolving credit facility with a bank, which is renewable in June 2001. The agreement provides for borrowings up to 85% of eligible accounts receivable plus 40% of raw material and finished goods inventories. There were no outstanding borrowings on the working capital line of credit as of December 31, 2000 and 1999 and no borrowings during 2000.

The agreement contains covenants that, among various matters, restrict further borrowings and security interests, merger or consolidation, acquisitions, guarantees, sales of assets other than in the normal course of business, leasing, changes in ownership and payment of dividends.

LONG-TERM DEBT

Long-term borrowings, excluding capital lease obligations, consist of:

DECEMBER 31,	2000	1999
Bonds payable	\$399,490	\$580,000
\$300,000 promissory note bearing interest at 8% per annum, payable in monthly installments of \$9,551 through May 2001, collateralized by equipment purchased.	178,279	178,279
	577,769	758,279
Less current maturities	178,279	711,464
Long-term bonds payable and debt	\$ 399,490	\$ 46,815

BONDS PAYABLE

In August 1995, the Company completed a \$600,000 private bond placement. The bonds carried an 11% interest rate and matured in May 2000. In connection with the private bond placement, ART issued an aggregate of 279,000 warrants to the bondholders to purchase ART common stock at \$3.00 per share. The warrants were exercisable upon issuance and expired in five years. The Company recorded the allocation between the detachable warrants and debt securities based on their relative fair values. The

\$202,000 related to the warrants was reported as additional paid-in capital and a discount on the bonds payable which was amortized to interest expense over the five-year term of the bonds. In 2000, the Company renewed \$550,000 of the private placement bonds for a two-year period maturing May 31, 2002. New warrants were issued to the bondholders for 254,980 shares of the Company's stock at \$1.50 per share. The warrants also expire May 31, 2002. The fair-value allocated to the warrants was \$194,000 which is reported as additional paid-in capital and a discount on the debt securities being amortized to interest expense over the two year term of the bonds. For the years 2000, 1999 and 1998, the Company recorded amortization of bond discount of \$63,490, \$46,065 and \$48,000, respectively and interest expense of \$63,250 in 2000 and \$66,000 in 1999 and 1998. The unamortized bond discount remaining as of December 31, 2000 and 1999 was \$150,510 and \$20,000, respectively.

28

ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

7. DEBT  
(Continued)

NOTE PAYABLE

On April 14, 1997, ART incurred a promissory note in the amount of \$300,000, bearing interest of 8% per annum, through the acquisition of property and equipment from a manufacturer. No payments were made during 2000 as payment of the note is being contested. The unpaid principal is included in current liabilities.

8. INCOME TAXES

The income tax provision for each of the three years in the period ended December 31, 2000 consists of the following:

	2000	1999	1998
Current:			
Federal	\$ -	\$ -	\$ -
State	66,000	69,313	115,583
Total	66,000	69,313	115,583
Deferred	(21,000)	(49,000)	84,000

---

Total income tax expense	\$ 45,000	\$ 20,313	\$ 199,583
--------------------------	-----------	-----------	------------

---

The Company's federal net operating loss ("NOL") carryforwards were approximately \$1,500,000 at December 31, 2000. During the three years ended December 31, 2000, the Company utilized approximately \$482,000, \$0 and \$137,000, of its NOL carryforwards. The NOL carryforwards expire through 2007. The use of the loss carryforwards to reduce future income tax obligations are limited in any given year due to restrictions defined in the Internal Revenue Code related to a change in ownership control.

The components of deferred income taxes were as follows as of December 31:

	2000	1999
Deferred income taxes:		
Inventories	\$ 66,164	\$ 218,560
Property, plant and equipment	61,000	124,215
Patents	288,238	294,560
Other	265,741	162,024
Net operating loss carryforwards	513,016	680,680
Valuation allowance	(749,236)	(1,056,116)
Deferred income taxes	\$ 444,923	\$ 423,923

---

ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

8. INCOME TAXES  
 (Continued)

Deferred tax assets are recognized by reducing the valuation allowance as the Company generates income, or when, in the opinion of management, significant positive evidence exists that the Company will be more likely than not to realize the tax benefits related to temporary differences which give rise to deferred tax assets.

The Company files a consolidated federal income tax return. For financial statement purposes, the actual effective consolidated tax rates have been applied to the income before income taxes when calculating the tax provision. The actual income tax provision differs from the statutory income tax rate (34%) as follows:

	2000	1999	1998
Tax provision computed at statutory rate	\$ 226,143	\$ 151,422	\$ 21,470
Increases (reductions) due to:			
Nondeductible expenses	5,358	3,850	2,034
Amortization of goodwill	39,054	39,054	39,054
State income taxes net of federal benefit	43,560	45,747	76,285
Changes in valuation allowance estimates	(306,880)	(240,172)	112,309
Other	37,765	20,412	(51,569)
Income tax expense	\$ 45,000	\$ 20,313	\$ 199,583

9. EMPLOYEE BENEFIT PLANS

Micron established an Employee Stock Ownership Plan ("ESOP") as a result of a previous plan of reorganization. The ESOP is non-contributory on the part of its participants. All employees of the Company are eligible for participation in the ESOP. The ESOP borrowed \$300,000 to purchase the Company's shares. The proceeds were used to pay creditors electing to receive cash under the ESOP plan. The shares issued by the Company to the ESOP are reflected as a reduction in shareholders' equity. The Company accounts for its ESOP in accordance with Statement of Position 76-3. Accordingly, all shares held by the ESOP, allocated or unallocated, are treated as outstanding in the earnings per share calculation. The Company has elected to recognize compensation expense based on contributions made. There are no repurchase obligations by the Company. The Company contributed and recorded compensation expense of \$0, \$39,277 and \$42,857 during the years ended December 31, 2000, 1999 and 1998, respectively.

The Company sponsors an Employee Savings and Investment Plan under Section 401(k) of the

Internal Revenue Code covering all eligible employees of the Company. Employees can contribute up to 20% of their eligible compensation or up to the maximum allowable by the IRS. The Company's matching contributions are at the discretion of management. The Company did not make any contributions for the years ended December 31, 2000, 1999 and 1998, respectively.

30

10. COMMITMENTS AND  
CONTINGENCIES

ROYALTIES

ART licenses its signal-averaging technology from an unrelated entity for a royalty fee of 4.5% of gross sales, less certain allowances for selling commissions and discounts. Costs of obtaining patents are offset against royalties due. To retain an exclusive license for the technology, ART is obligated to pay a minimum royalty of \$30,000 annually. The royalties paid were \$30,000, \$30,000 and \$35,000 for 2000, 1999 and 1998, respectively.

ELECTROPHYSIOLOGY  
PRODUCTS CONTRACT

ART and Prucka Engineering, Inc. ("Prucka"), the manufacturer of the CardioLab and CardioMapp products (the "Products") had an agreement related to ART's exclusive distribution of the Products. The agreement provided for ART to receive a 3% commission on CardioLab sales through December 31, 2002. The commissions earned for the years 1999 and 1998 were approximately \$385,000, and \$485,000, respectively. In 2000, Prucka (now owned by GE Marquette) negotiated to buy out the remainder of the agreement for \$1,000,000 with no further obligations to either party.

ENVIRONMENTAL  
GROUNDWATER

Like many industrial processes, the Micron manufacturing process utilizes hazardous and non-hazardous chemicals, the treatment and disposal of which are subject to federal and state regulation. Since its inception, Micron has expended significant funds to train its personnel, install waste treatment and recovery equipment and to retain an independent environmental consulting firm to constantly review, monitor and upgrade its air and waste water treatment activities. As a result, Micron believes that the operations of its manufacturing facility are in compliance with currently applicable safety, health and environmental laws and regulations.

Micron has been identified as a "potential responsible party" (PRP) under the Comprehensive Environmental Response and may be required to share in the cost of cleanup with respect to its Fitchburg, Massachusetts manufacturing facility. In January 1998, Micron filed information with the Massachusetts Department of Environmental Protection (DEP) to allow further subsurface investigation and a subsequent risk assessment to be performed. During 2000, Micron filed it's Phase II Report with the DEP. The Phase II Report included a Massachusetts Contingency Plan (MCP) Method 3 Risk Characterization and Response Action Outcome Statement that demonstrated a condition of "No Significant Risk" at the site. The site has been closed out under the MCP and is now awaiting a mandatory audit by the DEP. At December 31, 2000 and 1999, the consolidated balance sheets include an accrual for these costs of \$50,000.

Based on the Company's analyses and subject to the difficulty in estimating these future costs, the Company expects that any sum it may be required to pay in connection with environmental matters is not reasonably likely to exceed the amounts disclosed in an amount which would have a material adverse effect on financial condition, result of operations or liquidity.

31

ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

10. COMMITMENTS AND  
CONTINGENCIES  
(Continued)

OPERATING LEASES

The Company leases certain office space, facilities, vehicles and equipment under non-cancelable lease arrangements. Rent expense under all operating leases was approximately \$117,000, \$115,000 and \$106,000 in 2000, 1999 and 1998, respectively.

Future minimum operating lease payments as of December 31, 2000 are approximately as follows:

Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

YEAR	Operating Leases
2001	\$ 74,447
2002	36,896
2003	13,549
2004	7,491
<hr/>	
Total	\$ 132,383

11. SUPPLEMENTAL CASH FLOWS INFORMATION Cash paid for income taxes and interest for the years ended December 31 is as follows:

	2000	1999	1998
Income taxes	\$ 59,091	\$ 110,172	\$ 94,860
Interest	\$ 68,889	\$ 139,060	\$ 218,447
Non-cash activities:			
Bond discount resulting from bond and stock warrant renewal	\$ 194,000	\$ -	\$ -
Directors fees paid in stock	\$ 26,500	\$ 37,313	\$ -

12. RELATED PARTY TRANSACTIONS

The Company obtains legal services with respect to its patents from a law firm, a partner of which is a shareholder and Director of the Company. Fees for services and patent prosecution costs paid to this firm were approximately \$37,700, \$41,000 and \$3,300 for years 2000, 1999 and 1998, respectively. The amounts owed to this firm at December 31, 2000 and 1999 were approximately \$4,000 and \$31,000, respectively.

Cardio Digital Inc. ("CDI") has four shareholders who are also shareholders of the Company. Royalties paid CDI were \$6,100, \$15,700 and \$19,000 for years 2000, 1999 and 1998, respectively. The amounts owed to CDI at December 31, 2000 and 1999 were \$300 and \$5,350, respectively.



ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

12. RELATED PARTY  
 TRANSACTIONS

During the years 2000, 1999 and 1998 healthcare coverage premiums of approximately \$11,670, \$8,500 and \$8,300, respectively, were paid on behalf of a Director of the (Continued) Company in exchange for consulting services.

The Company obtains consulting services from a shareholder and Director of the Company related to acquisitions and other negotiations. No fees for services were paid to this Director for the years 2000, 1999 and 1998, respectively.

13. STOCK OPTIONS  
 OPTION PLAN

The Company has reserved 250,000 shares of its common stock for issuance to officers and key employees pursuant to an Incentive Stock Option Plan (the "Option Plan"). Under the Option Plan, options become exercisable commencing one year from the date of grant at the rate of 20% of the total granted per year and expire ten years from the date of grant. The exercise price is the fair market value of the common stock on the date of grant. The range of exercise prices was \$1.06 to \$6.00 per share for all options outstanding and granted under the Option Plan with a weighted average exercise price of \$1.63 per share and weighted average remaining life of 4.7 years. In September 1998, the Board of Directors repriced options outstanding to Directors and Officers under the Option Plan to reflect the fair market value on the effective date of \$1.06 per share.

The plan is no longer qualified for deferred tax treatment for future option grants unless amended by the Board of Directors.

Transactions under the Option Plan are summarized as follows:

	2000	1999	1998
Options outstanding at Beginning of year	107,500	110,000	163,000
Granted	-	-	-
Cancelled/expired	(56,500)	(2,500)	(53,000)

Options outstanding at end of year	51,000	107,500	110,000
Options exercised to date	4,500	2,000	2,000
Available for grant at end of year	194,500	140,500	138,000
Exercisable at end of year	51,000	102,700	95,400
Weighted-average fair value of options granted	\$ -	\$ -	\$ -

33

ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

13. STOCK OPTIONS  
(Continued)

NON-PLAN OPTIONS

During 1994, non-plan options for 144,000 shares, expiring in 2004, at an exercise price of \$3.00, were granted to eight Directors. At December 31, 2000, 90,000 options remain outstanding.

During September 1998, the Board of Directors repriced options outstanding to Directors and Officers. All options were repriced to reflect the fair market value on the effective date of \$1.06 per share.

As of December 31, 2000 the exercise price for all non-plan options outstanding was \$1.06 per share with a weighted average remaining life of 3.3 years.

Transactions relative to non-plan options are summarized as follows:

	2000	1999	1998
Options outstanding at Beginning of year	99,000	99,000	177,000
Granted	-	-	-
Cancelled/expired	(9,000)	-	(78,000)

Options outstanding at end of year	90,000	99,000	99,000
Exercisable at end of year	90,000	99,000	96,750

ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

13. STOCK OPTIONS  
(Continued)

NON-PLAN OPTIONS  
(CONTINUED)

The Company accounts for stock options at intrinsic value in accordance with Accounting Principles Board Opinion No. 25, ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES, and related interpretations. Accordingly, no compensation expense has been recognized for the plans. Had compensation cost for the Company's stock options been determined based upon the fair value at the grant date for awards under the plans consistent with the methodology prescribed under Statement of Financial Accounting Standards No. 123, ACCOUNTING FOR STOCK-BASED COMPENSATION, the Company's net income (loss) would have been adjusted to the pro forma amounts indicated below:

	2000	1999	1998
		MC	
Net income (loss) - as reported	\$ 620,127	\$ 425,045	\$ (136,438)
Net income (loss) - pro forma	\$ 614,685	\$ 414,161	\$ (269,539)
Basic income (loss) per share - as reported	\$ 0.19	\$ 0.12	\$ (0.04)
Diluted income (loss) per share - as reported	\$ 0.18	\$ 0.12	\$ (0.04)
Basic and diluted income (loss) per share - pro forma	\$ 0.18	\$ 0.12	\$ (0.08)

The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes option-pricing model. The model uses assumptions for dividend yield, expected volatility, and the risk-free interest rate.

In August 1995, warrants were issued to bondholders to purchase an aggregate of 279,000 shares of common stock at \$3.00 per share which expire five years from the date of the bond. In 2000, the warrants were extended to bondholders to purchase an aggregate of 254,980 shares of common stock at \$1.50 per share which expire May 31, 2002.

35

ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

14. INDUSTRY AND  
GEOGRAPHIC  
SEGMENTS

The Company's operations are classified into two business segments: medical electrode components and computerized medical instruments.

The following table shows sales, operating income (loss) and other financial information by industry segment as of and for the years ended December 31, 2000, 1999 and 1998:

	Medical Electrode Components	Computerized Medical Instruments	Corpor
-----			
Year ended December 31, 2000			
Sales	\$ 8,407,040	\$ 1,114,823 (A)	\$
-----			
Operating income (loss)	\$ 589,402	\$ 353,144	\$ (129,8
-----			
Capital Expenditures	\$ 246,658	\$ -	\$
Depreciation and Amortization	\$ 777,576	\$ 12,778	\$ 258,2
Identifiable assets at December 31, 2000	\$ 6,079,844	\$ 227,819	\$3,610,9
-----			
Year ended December 31, 1999			

Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

Sales	\$ 9,718,408	\$ 661,176	\$
Operating income (loss)	\$ 1,529,928	\$ (740,889)	\$ (130,5
Capital Expenditures	\$ 504,817	\$ -	\$ 35,8
Depreciation and Amortization	\$ 637,381	\$ 13,975	\$ 236,3
Identifiable assets at December 31, 1999	\$ 7,076,354	\$ 473,374	\$2,151,9
Year ended December 31, 1998			
Sales	\$ 8,444,870	\$ 915,726	\$
Operating income (loss)	\$ 1,263,650	\$ (953,764)	\$ (129,8
Capital Expenditures	\$ 453,112	\$ -	\$ 23,9
Depreciation and Amortization	\$ 650,705	\$ 27,053	\$ 204,1
Identifiable assets at December 31, 1998	\$ 6,188,950	\$ 574,019	\$3,227,1

(A) Includes a \$1,000,000 buyout of Prucka commission agreement.

36

ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

14. INDUSTRY AND GEOGRAPHIC SEGMENTS  
(Continued)
- The following table sets forth the geographic distribution of the Company's net sales:

REGION	2000	1999	1998
United States	\$ 3,422,711 (A)	\$ 3,349,427	\$ 4,898,191
Europe	2,987,559	2,951,797	2,678,710
Canada, Mexico & South America	2,840,434	3,679,873	1,557,356
Pacific Rim	248,343	315,256	173,966
Other	22,816	83,231	52,373
Net Sales	\$ 9,521,863	\$ 10,379,584	\$ 9,360,596

(A) Includes a \$1,000,000 buyout of Prucka

commission agreement.

The following table sets forth the percentage of net sales to significant customers of the medical electrode components segment in relation to total segment sales:

CUSTOMERS	2000	1999	1998
A	36%	37%	32%
B	25%	28%	15%
C	14%	11%	11%
D	-	-	25%

The only single significant customer for the computerized medical instruments segment was revenue from the Prucka commission agreement, which was terminated in 2000. For the years ended December 31, 2000, 1999 and 1998, this was 90%, 58% and 53% of computerized medical instrument net sales, respectively.

37

ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

15. QUARTERLY  
FINANCIAL DATA

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2000				
Revenues	\$ 2,543,826	\$ 2,863,091	\$ 2,108,247	\$ 2,006,699
Gross profit	867,192	1,582,495	588,157	496,440
Net income(loss)	101,731	644,842	21,933	(148,379)
Net income(loss) per share	.03	.19	.01	(.04)
1999				
Revenues	\$ 2,441,683	\$ 2,922,771	\$ 2,609,674	\$ 2,405,456
Gross profit	712,589	1,110,376	1,135,071	664,029
Net income(loss)	(1,131)	197,382	175,938	52,856
Net income(loss) per share	(.00)	.06	.05	.01

The second quarter results in 2000 include \$1,000,000 of revenue associated with the termination of a commission agreement with Prucka. During the fourth quarter of 2000, the Company determined that \$90,000 of costs related to a previous version of ART software had no future value and was charged to expense. In addition, \$106,000 of severance costs was provided for in the fourth quarter of 2000.

38

9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

DIRECTORS AND EXECUTIVE OFFICERS

The directors and executive officers of the Company are as follows:

NAME	AGE	POSITION WITH THE COMPANY
E.P. Marinos	59	Chairman of the Board of Directors, Director
Julius Tabin, Ph.D	81	Director
Paul F. Walter, MD	63	Director
Russell C. Chambers, MD	57	Director
Richard A. Campbell	58	Vice President of Finance
James E. Rouse	46	Vice President/General Manager

The Directors are divided into three classes with rotating three-year terms. Dr. Walter has been elected to serve until the 2003 annual meeting of shareholders while Dr. Chambers was elected to serve as a Director until the 2002 annual meeting of shareholders. Mr. Marinos and Dr. Tabin were elected to serve until the 2001 annual meeting of shareholders. The Company's executive officers are appointed by the Board of Directors and serve at the pleasure of the Board.

Each non-employee director receives compensation of \$1,000 per quarter. Additionally, each non-employee director receives \$500 for each meeting at which such director is present in person and \$250 for each meeting at which such director is present by telephone. Employee directors do not receive compensation.

E.P. (LOU) MARINOS was appointed President and Chief Executive Officer of the Company in March 1995 and resigned in May, 1997. Mr. Marinos, until he resigned, also served in the capacity of Chief Financial Officer and Chief Operating Officer since joining the Company in May, 1994. Prior to joining the Company Mr. Marinos held senior executive management or Director positions with Intermedics, Inc., Carbon Implants, Inc., Bio-International,

## Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

Inc. and Endeveco, Inc. He was also a senior partner with Deloitte & Touche. Mr. Marinos is presently Chairman of the Board of Midcoast Interstate Transmission, Inc. and President and Chief Executive Officer of Kansas Pipeline Co. Mr. Marinos was appointed Chairman of the Board of Directors of ART in July, 2000 and has been a director of the Company since March, 1996.

JULIUS TABIN, PH.D. has been a director of the Company since its inception. Since 1949, Dr. Tabin has been a partner in the law firm of Fitch, Even, Tabin & Flannery.

PAUL F. WALTER, MD. has been a director of the Company since its inception. Dr. Walter is a Professor of Medicine at Emory University where he has been on the faculty since 1971.

RUSSELL C. CHAMBERS, MD. has been a director of the Company since its inception and served as the Company's Chairman of the Board until August 1990. For more than the past five years, Dr. Chambers has been primarily engaged in the management of his personal investments.

RICHARD A. CAMPBELL was appointed Vice President of Finance of the Company in June, 2000.

JAMES E. ROUSE WAS appointed Vice President/General Manager of the Company in December, 2000.

39

### ITEM 11. EXECUTIVE COMPENSATION

The following tables set forth certain information concerning compensation of and stock options held by the Company's President and Chief Executive Officer and the President of the Company's subsidiary, Micron:

SUMMARY COMPENSATION TABLE

NAME AND PRINCIPAL POSITION	ANNUAL COMPENSATION				LONG-TERM AWARD
	YEAR	SALARY	BONUS	OPTIONS	STOCK OPTION (SH)
Anthony A. Cetrone, President, Micron Products Inc. (1)	2000	\$ 66,353	-	-	-
Nancy C. Arnold, President Arrhythmia Research Technology, Inc (2)	2000	\$ 72,188	-	-	-
Anthony A. Cetrone, President, Micron Products Inc.	1999	\$110,000	15,651	-	-
Nancy C. Arnold, President, Arrhythmia Research Technology, Inc.	1999	\$ 82,500	500	-	-
Anthony A. Cetrone, President, Micron Products Inc.	1998	\$ 98,000	5,282	-	-



Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

Sidney M. Barbanel, President and Chief Executive Officer

1998 \$ 70,833 - - -

(1) Mr. Cetrone retired from the Company and resigned his position as Chairman of the Board and Chief Executive Officer of the Company in July, 2000. The Company has not named a replacement Chief Executive Officer for the Company and the Board of Directors has served in this capacity since the resignation of Mr. Cetrone. The Company has an arrangement to compensate directors for time spent on these responsibilities. No amounts were paid in 2000.

(2) Ms. Arnold terminated her employment with the Company in November, 2000.

OPTION GRANTS IN LAST FISCAL YEAR

There were no options granted during fiscal year 2000.

40

AGGREGATED OPTION EXERCISES AND FISCAL YEAR-END OPTIONS VALUES TABLE

The realized value of aggregated option exercises during 2000 and the value of unexercised in-the-money options at December 31, 2000 held by the Named Executive Officers are shown in the following table:

OPTION EXERCISES AND FISCAL YEAR-END OPTION VALUES

NAME	SHARES ACQUIRED ON EXERCISE	VALUE REALIZED (MARKET PRICE AT EXERCISE LESS EXERCISE PRICE)	NUMBER OF UNEXERCISED OPTIONS HELD AT DECEMBER 31, 2000		EXERCISE
			EXERCISABLE	UNEXERCISABLE	
E. P. Marinos	-	\$ -	42,000	-	\$ 23

(1) Calculated on the basis of the closing price per share for the Common Stock on the American Stock Exchange of \$1.625 on December 31, 2000.

REPORT OF THE COMPENSATION COMMITTEE

The following report of the Compensation Committee (the "Committee" ), as well as the Performance Table set forth herein, are not soliciting materials, are not deemed filed with the Securities and Exchange Commission (the "SEC") and are not incorporated by reference in any filing of the Company under the Securities Act of 1933, as amended (the "Securities Act"), or the Securities Exchange Act of 1934, as amended (the "Exchange Act"), whether made before or after the date of this Form 10-K and irrespective of any general incorporation language in any such filing.

The Compensation Committee is responsible for establishing and reviewing the Company's executive compensation policies, advising the full Board of Directors on all compensation matters and administering the Company's stock

option plans. The Committee relating to compensation of the President and Chief Executive Officer are reviewed and approved by the other non-employee Directors.

#### COMPENSATION POLICY

The Company's executive compensation policies are designed to foster the Company's business goals of achieving profitable growth and premium returns to Stockholders. The principal objectives of these policies are as follows: (1) to attract, motivate and retain executives of outstanding ability and character; (2) to provide rewards that are closely related to the performance of the Company and the individual executive by placing a portion of compensation at risk; and (3) to align the interests of executives and Stockholders through long-term, equity-based incentives and programs to encourage and reward stock ownership.

This report discusses the manner in which base salaries, short-term incentive compensation and long-term, equity-based incentives for the Company's President and Chief Executive Officer and other executive officers were determined for the 2000 fiscal year.

#### EXECUTIVE COMPENSATION

The key components of executive compensation are base salary, short-term incentive compensation and long-term, equity-based incentives. Base salaries are generally targeted to be competitive with the average salaries paid at other companies of similar size and complexity both within and outside the medical device distribution and manufacturing industries.

#### BASE SALARY

Salary level targets are established so that the Company can attract and retain the most qualified employees. The Compensation Committee approves the individual salaries of executive officers. In determining an executive officer's salary, the Compensation Committee considers, but does not assign specific weights to, the following factors: internal factors involving the executive's level of responsibility, experience, individual performance, and equity issues relating to pay for other Company executives, as well as external factors involving competitive positioning, overall corporate performance, and general economic conditions. No specific formula is applied to determine the weight of each factor.

41

#### INCENTIVE COMPENSATION PROGRAM

The Company maintains an incentive compensation program for substantially all officers and executives designed to reward such individuals for their contributions to corporate and individual objectives. In the past, the programs have provided additional compensation based on performance and profits of those operations for which the various executives have responsibility. No bonuses were earned by any executive officers named in the Summary Compensation Table, in 2000.

#### LONG-TERM INCENTIVE COMPENSATION

The Company also grants stock options and other equity incentives in order to link compensation to the Company's long-term growth and performance and to increases in Stockholder value. The Committee has broad discretion to establish the terms of such grants. The Company grants awards to designated employees upon commencement of employment or following a significant change

## Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

in an employee's responsibility or title. Awards are based on guidelines relating to the employee's position in the Company which are set by the Committee, as well as the employee's current performance and anticipated future contributions. The Committee also considers the amount and terms of stock options previously granted to each of the employees. The Committee individually evaluates these factors with respect to each executive and then the Committee reaches a consensus on the appropriate award. During fiscal year 2000, the Committee did not recommend the grant of any options to any Executive Officers.

### COMPENSATION OF PRESIDENT AND CHIEF EXECUTIVE OFFICER

Anthony A. Cetrone served as President and Chief Executive Officer of the Company until November, 1999, however, he continued as Chairman of the Board and Chief Operating Officer of Micron. Mr. Cetrone retired from the Company and resigned his position as Chairman of the Board and Chief Operating Officer of the Company in July, 2000. Prior to his retirement, his annual rate of base compensation was \$110,000. Nancy C. Arnold was named President in November, 1999. Ms. Arnold served as President and General Counsel until she terminated her employment with the Company in November, 2000. Prior to her termination, her annual rate of compensation was \$82,500.

This report on executive compensation is made by and on behalf of the Company's Compensation Committee.

Russell C. Chambers, M.D.

### STOCK PERFORMANCE INFORMATION

The following Performance Table compares the Company's cumulative total shareholder return on its Common Stock for a five-year period (from December 31, 1995 to December 31, 2000), with the cumulative total return of the Standard & Poor's 500 Stock Index ("S&P 500") (which does not include the Company), and the Standard & Poor's Medical Products and Supplies Stock Index (which includes the Company) ("S&P Med"). Dividend reinvestment has been assumed. The Performance Table assumes \$100 invested in December 31, 1995 in the Company's Common Stock, S&P 500, and S&P Med.

	CUMULATIVE TOTAL			
	12/95	12/96	12/97	12/00
ARRHYTHMIA RESEARCH TECHNOLOGY, INC.	100.00	58.82	36.76	3
S & P 500	100.00	122.96	163.98	21
S & P HEALTH CARE (MEDICAL PRODUCTS & SUPPLIES)	100.00	114.77	143.09	20

### COMPLIANCE WITH SECTION 16(a) OF THE SECURITIES EXCHANGE ACT

Based solely upon the Company's review of the copies of such forms it has received, the Company believes that all its officers, directors and greater than ten percent beneficial owners complied with the filing requirements applicable to them pursuant to Section 16(a) of the Securities Exchange Act during 2000.

STOCK OPTIONS

1987 INCENTIVE STOCK OPTION PLAN

In 1987, the Company adopted a stock option plan (the "Option Plan") pursuant to which 250,000 shares of Common Stock have been reserved for issuance to officers and other key employees and to certain other persons who are employed or engaged by the Company. Options are designated as "incentive stock options" within the meaning of the Internal Revenue Code of 1986, as amended. The purpose of the Option Plan is to encourage stock ownership by persons instrumental to the success of the Company, in order to give them a greater personal interest in the Company's business. The exercise price of any stock option granted to an eligible employee may not be less than 100% of the fair market value of the shares underlying such option on the date of grant, unless such employee owns more than 10% of the outstanding Common Stock, in which case the exercise price of any incentive stock option may not be less than 110% of such fair market value. The term of each option and the manner in which it may be exercised is determined by the Board of Directors provided that no option may be exercisable more than 10 years after the date of grant and, in the case of a stock option granted to an eligible employee owning more than 10% of the Common Stock, no more than five years. Generally, options become exercisable one year from the date of grant and each year thereafter at a rate of 20% per year. Options are not transferable, except upon death of the option holder. The 1987 ISO Plan has expired.

Options to purchase an aggregate of 229,000 shares of Common Stock at an exercise price of \$2.25 to \$6.50 per share have been granted under the Option Plan to twenty current and former employees. Of these, options for 4,500 shares were exercised and options to purchase 141,500 shares granted to eleven former employees were canceled due to termination of employment or death of the employees. In September 1998, the Board of Directors adjusted the exercise price of the options granted to the Directors and officers of the company to reflect the current fair market value of the stock, which was \$1.06. During the years ended December 31, 2000 and 1999, no options were granted. During the year ended December 31, 2000, options to purchase 2,500 shares were exercised and options to purchase 54,000 shares were cancelled due to retirement or termination of employment.

OTHER OPTIONS

In addition, options to purchase an aggregate of 518,450 shares of Common Stock have been granted at exercise prices ranging from \$2.00 to \$4.00; such options were not granted under the Option Plan. At December 31, 2000, options for 55,251 shares have been exercised and options for 302,700 shares have been terminated/forfeited.

In October 1994, options for 144,000 shares, expiring in 2004, at an exercise price of \$3.00, were granted to eight Directors. The shares were immediately exercisable. Options for 72,000 shares have been terminated or forfeited.

In November 1995, options to purchase 29,000 shares, expiring in 2005, at an exercise price of \$3.00, were granted to two Officers and Directors of the Company. All options were forfeited upon the resignations of both Officers and Directors.

In September 1998, the Board of Directors adjusted the exercise price of the options granted to the Directors and Officers of the Company to reflect the current market value of the stock, which was \$1.06 per share.

# Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

## MEDICAL CONSULTANTS

From time to time, the Company consults with medical advisors who report on advances in technology and on developments in their respective fields. During 2000, 1999 and 1998, the Company used consultants on a specific project basis. Amounts paid to consultants during 2000, 1999 and 1998 were not material.

43

## ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth information as of March 1, 2001 based on information obtained from the persons named below, with respect to the beneficial ownership of shares of Common Stock by (i) each person known by the Company to be the owner of more than five percent of the outstanding shares of Common Stock, (ii) each director of the Company and (iii) all officers and directors as a group.

NAME OF BENEFICIAL OWNER (4)	BENEFICIAL OWNERSHIP (1)	
	NUMBER	PERCENT
Russell C. Chambers, M.D. (2)	487,691	15.39
Julius Tabin, Ph.D.	138,824	4.38
Paul F. Walter, M.D.	82,055	2.59
E.P. Marinos	60,426	1.91
All officers and directors as a group (3)	821,587	25.93

- Unless otherwise noted, each person has sole voting and investment power with respect to the shares of Common Stock beneficially owned.
- Excludes Company shares owned by two trusts of which Dr. Chambers' son and Dr. Chambers' wife have a beneficial interest. Dr. Chambers is neither a beneficiary of trustee of the two trusts and disclaims any beneficial ownership of the common stock held by the trusts. Includes 2,500 shares over which Dr. Chambers has voting power pursuant to an agreement, 12,500 shares held as custodian for his son and 2,500 shares held as custodian for a niece.
- Includes 52,591 shares held by the Micron Employee Stock Ownership Plan over which an Officer of the Company has power as Trustee.
- Includes options to purchase shares of Common Stock, all of which are exercisable at December 31, 2000, as follows:

NAME	NUMBER
E.P. Marinos	42,000
Russell C. Chambers, M.D.	18,000
Julius Tabin	18,000
Paul F. Walter, M.D.	18,000

	-----
Total.....	96,000
	=====

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

To date, all transactions between the Company and its officers, directors, or their affiliates have been approved or ratified by a majority of the directors who did not have an interest in, and who were not employed by the Company at the time of, such transaction. The Company's Board of Directors adopted resolutions providing that any transaction between the Company and its officers, directors or their affiliates must be approved by a majority of the Board of Directors who do not have an interest in, and who are not employed by the Company at the time of, such transaction. The Company believes that all transactions entered into with affiliates of the Company were on terms no less favorable than could have been obtained from unaffiliated third parties.

In May 1983, ART entered into an agreement with Cardiodigital Industries, Inc., a Texas corporation ("CDI"), pursuant to which ART granted an exclusive license to CDI to use the technology covered by the Simson Patent in connection with research and development of signal-averaging devices. In consideration for the license, CDI provided \$175,000 of financing and granted ART an option to acquire any technology developed by CDI on an exclusive basis at a price of either \$1,250,000 or a royalty fee of \$150 per cardiac signal-averaging device sold by ART, up to a maximum of \$1,250,000. ART exercised its option to purchase such technology at the fee of \$150 per signal-averaging device sold by ART. Dr. Julius Tabin, is a director of ART and a shareholder of CDI. In addition, the estate of G. Russell Chambers (Dr. Chambers' father), is a principal shareholder of CDI. Royalty fees paid for the years ended December 31, 2000, 1999 and 1998 were \$6,100, \$15,700 and \$19,000, respectively.

Dr. Julius Tabin, a member of the law firm of Fitch, Even, Tabin & Flannery, the Company's patent counsel, has been a director of the Company since its inception and he and other members of the firm are shareholders of the Company. For the years ended December 31, 2000, 1999 and 1998, the law firm billed the Company approximately \$19,300, \$40,638 and \$3,286, respectively, for legal services rendered and patent prosecution costs. The amounts owed to the firm at December 31, 2000, 1999 and 1998 were approximately \$4,000, \$31,000, and \$18,000, respectively.

Dr. Russell C. Chambers, a director and shareholder of the Company, is engaged as a consultant to the Company. For the years ended December 31, 2000, 1999 and 1998, health insurance premiums paid on Dr. Chambers behalf amounted to approximately \$11,670, \$8,500, and \$8,300, respectively.

The Company obtains consulting services, with respect to acquisitions and other negotiations, from Mr. E. P. Marinos, a shareholder and Director of the Company. No fees for services were paid to this Director for years 2000, 1999 and 1998, respectively. The amounts owed to the Director were approximately \$4,275, \$0, and \$0 for December 31, 2000, 1999 and 1998, respectively.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) List of documents filed as a part of this report:

(1) All Financial Statements

See index to financial statements on page 16 for a list of all financial statements filed as part of this report.

(2) Financial Statement Schedules

(A) Schedule II

All schedules for which provision is made in Regulation S-X of the Securities and Exchange Commission not included here are omitted as the required information is inapplicable or the information is presented in the financial statements or related notes.

(3) Exhibits

The following exhibits, required by Item 601 of Regulation S-K are submitted herewith:

DESCRIPTION OF EXHIBITS

10.34	Asset Purchase Agreement, dated March 5, 1997, between Micron Products, Inc. and
10.35	Manufacturing Agreement, dated March 5, 1997, between Micron Products, Inc. and N
10.36	Asset Purchase Agreement, dated April 14, 1997, between Arrhythmia Research Techno
	and Astro-Med, Inc.....
10.37	Manufacturing Agreement, dated April 14, 1997, between Arrhythmia Research Techno
	Astro-Med, Inc.....
10.38	Software Conversion Agreement, dated April 21, 1997, between Arrhythmia Research
	Inc. and Softheart, Inc. ....
10.39	License Agreement, dated April 21, 1997, between Arrhythmia Research Technology,
	Softheart, Inc. ....

(b) Reports filed in the fourth quarter on Form 8-K:

None

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ARRHYTHMIA RESEARCH TECHNOLOGY, INC.

Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

BY: /s/ E. P. Marinos

-----  
 E. P. Marinos  
 Chairman of the Board of Arrhythmia Research Technology, Inc.  
 and Acting Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

SIGNATURE	CAPACITY
-----	
/s/ E. P. Marinos ----- E. P. Marinos	Chairman of the Board and Acting Chief Executive Officer
/s/ Russell C. Chambers ----- Russell C. Chambers	Director
/s/ Julius Tabin ----- Julius Tabin	Director
/s/ Paul F. Walter ----- Paul F. Walter	Director

EXHIBIT INDEX

EXHIBIT NUMBER	DESCRIPTION OF EXHIBIT
-----	
3.0	Articles of Incorporation.....
3.1	By-laws.....
3.2	Certificate of Agreement of Merger of Arrhythmia Research Technology, Inc., a Louisiana Corporation, and Arrhythmia Research Technology, Inc., a Delaware Corporation.....
3.3	Articles of Merger of Arrhythmia Research Technology, Inc., a Louisiana Corporation and Arrhythmia Research Technology, Inc., a Delaware corporation.....
4.0	Form of Certificate evidencing shares of the Company's Common Stock.....
4.1	Form of Non-plan Options to purchase Company Common Stock.....
4.2	Form of Options to purchase Company Common Stock under the 1987 Incentive Stock Option Plan.....
4.3	Form of Underwriter's Warrant.....
4.4	Bond Indenture and Bond Form.....
4.5	Form of Option for E.P. (Lou) Marinos under 1995 Key Employees Stock Option Plan.....
4.6	Form of Option for Anthony A. Cetrone under 1995 Key Employees Stock Option Plan.....



Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

10.0	Distribution Agreement by and between Prucka Engineering, Inc. and ART, dated November 1989.....
10.1	Amendment to Distribution Agreement dated November 20, 1989.....
10.2	Lockup Agreement.....
10.3	Manufacturing Agreement by and between ART and Mortara Instrument, Inc. dated March 1989.....
10.4	Amendment to Manufacturing agreement dated June 15, 1987.....
10.5	Letter agreement by and between ART and Mortara Instrument, Inc. dated October 26, 1989.....
10.6	Letter agreement by and between ART and Mortara Instrument, Inc. dated February 21, 1990.....
10.7	Letter agreement by and between ART and Mortara Instrument, Inc. dated February 21, 1990.....
10.8	Letter agreement by and between ART and Mortara Instrument, Inc. dated July 31, 1990.....
10.9	License Agreement dated November 15, 1981 by and between University Patents, Inc., and ART.....
10.10	Amendment to License Agreement dated June 1, 1985.....
10.11	License of Cardiac Signal Average and Base Technology by ART to Cardiodigital Industries, Inc. to ART.....
10.12	Grant of Option to Acquire Exclusive License for Use of Signal Averaging Technology by Cardiodigital Industries, Inc. to ART.....
10.13	Agreement and Plan of Merger executed by ART and Arrhythmia Research Technology, Inc. and Louisiana corporation.....
10.14	Settlement Agreement, dated February 23, 1990, by and among Baylor College of Medicine, Methodist Hospital Foundation and The Methodist Hospital and Matthew W. Prucka, De Systems Inc., Prucka Engineering, Inc., Dr. Christopher Wyndham and Arrhythmia Research Technology, Inc.....
10.15	Form of Employment Agreement dated June 1, 1991, by and between the Company and Dr. Christopher Wyndham.....
10.16	Amendment No. 2 to License Agreement between ART and University Patents, Inc. dated December 14, 1991.....
10.17	O E M Agreement by and between Vascor Medical Corporation, Vascomed and ART dated December 14, 1991.....
10.18	Amendment to O E M Agreement dated December 14, 1991.....
10.19	O E M agreement by and between Professional Catheter Corporation and ART dated September 1991.....
10.20	Distribution Agreement by and between Prucka Engineering, Inc. and ART, dated May 1992.....
10.21	Employment Agreement, dated November 24, 1992, between the Company and Anthony A. Tucker.....
10.22	Asset Purchase Agreement, dated February 17, 1993, by and among Hubbard, Thurman, Tucker & Harris, L.L.P. and ART.....
	48
10.23	Agreement and Plan of Merger, dated November 25, 1992, among Arrhythmia Research Technology, Inc., ART Merger Subsidiary II, Inc., Micron Products Inc. and Micron Medical Products Inc.....
10.24	Merger Agreement, dated November 25, 1992, between ART Merger Subsidiary II, Inc. and Micron Products Inc.....
10.25	Asset Purchase Agreement, dated July 9, 1993, between Arrhythmia Research Technology, Inc. and Corazonix Corporation.....
10.26	Amendment to Asset Purchase Agreement, dated November 5, 1993, between Arrhythmia Research Technology, Inc. and Corazonix Corporation.....
10.27	Manufacturing and Equipment Lease Agreement, dated November 5, 1993, between Arrhythmia Research Technology, Inc. and Corazonix Corporation.....
10.28	Letter of Intent dated September 28, 1993, between Arrhythmia Research Technology, Inc. and Mr. John Curley, L. P.....
10.29	Letter of Intent, dated September 28, 1993 by and between Arrhythmia Research Technology, Inc. and Mr. John Curley and Mr. Thomas Krug.....
10.30	Agreement by and between Arrhythmia Research Technology, Inc. and Prucka Engineering, Inc. dated August 1994.....
10.31	First and Second Amendments to Manufacturing and Equipment Lease, dated August 31, 1994 and October 6, 1994, respectively, between Arrhythmia Research Technology, Inc. and Corazonix Corporation.....
10.32	Agreement and Modification of Second Amendment to Manufacturing and Equipment Lease Agreement, dated November 4, 1994, between Arrhythmia Research Technology, Inc. and Corazonix Corporation.....

Edgar Filing: ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/ - Form 10-K405

10.33 Employment Agreement, dated March 1, 1996, between the Company and E. P. Marinoss..  
 10.34 Asset Purchase Agreement, dated March 5, 1997, between Micron Products, Inc. and N  
 10.35 Manufacturing Agreement, dated March 5, 1997, between Micron Products, Inc. and Ne  
 10.36 Asset Purchase Agreement, dated April 14, 1997, between Arrhythmia Research Techno  
 Astro-Med, Inc.  
 10.37 Manufacturing Agreement, dated April 14, 1997, between Arrhythmia Research Technol  
 Astro-Med, Inc.  
 10.38 Software Conversion Agreement, dated April 21, 1997, between Arrhythmia Research T  
 and Softheart, Inc.  
 10.39 License Agreement, dated April 21, 1997, between Arrhythmia Research Technology, I  
 Softheart, Inc.  
 22.0 Subsidiaries.....  
 28.0 1987 Incentive Stock Option Plan.....  
 28.1 Option Agreement, dated March 18, 1991, between the Company and Julius Tabin.....  
 28.2 Option Agreement, dated March 18, 1991, between the Company and Robert A. Simms...  
 28.3 Option Agreement, dated March 18, 1991, between the Company and Tom Podl.....  
 28.4 Option Agreement, dated March 18, 1991, between the Company and Paul F. Walter....  
 28.5 Option Agreement, dated March 18, 1991 between the Company and Russell C. Chambers  
 28.6 Option Agreement, dated August 21, 1990, between the Company and Robert A. Simms..  
 28.7 Option Agreement, dated March 8, 1993, between the Company and Anthony A. Cetrone..  
 28.8 Option Agreement, dated March 8, 1993, between the Company and Wayne Schroeder. .  
 28.9 Merger Agreement, dated December 26, 1993, between Micron Products Inc. and Micron  
 Products Inc.....  
 28.10 Articles of Merger of Parent and Subsidiary.....  
 28.11 Consent Judgment signed by Arrhythmia Research Technology, Inc. and Corazonix Corp  
 entered on November 15, 1993.....

- (A) Incorporated herein by reference from a Registration Statement on Form S-18 as fil  
 Commission in April 1988, Registration Statement No. 33-20945-FW.
- (B) Incorporated herein by reference from a Form 10-K as filed with the Commission in
- (C) Incorporated herein by reference from a Registration Statement on Form S-1 as file  
 Commission in August 1990, Registration Statement No. 33-36607.
- (D) Incorporated herein by reference from a Form 10-K as filed with the Commission in
- (E) Incorporated by reference from Form 8-K as filed with the Commission on December 1
- (F) Incorporated herein by reference from a Form 10-K as filed with the Commission in
- (G) Incorporated by reference from Form 8-K as filed with the Commission on July 15, 1
- (H) Incorporated by reference from Form 8-K as filed with the Commission on November 2
- (I) Incorporated by reference from Form 8-K as filed with the Commission of June 30, 1
- (J) Incorporated by reference from Form 8-K-A as filed with the Commission of July 10,
- (K) Incorporated by reference from Form 8-K as filed with the Commission September 29,
- (L) Incorporated by reference from Form 10-K as filed with the Commission in March 199
- (M) Incorporated by reference from Form 10-K as filed with the Commission in March 199

ARRHYTHMIA RESEARCH TECHNOLOGY, INC.  
 AND SUBSIDIARY  
 SCHEDULE II

REPORT OF INDEPENDENT ACCOUNTANTS ON SCHEDULE

To the Shareholders  
 Arrhythmia Research Technology, Inc.

The audits referred to in our report dated February 16, 2001 relating to the consolidated financial statements of Arrhythmia Research Technology, Inc. and Subsidiary, which is contained in Item 8 of this form 10-K included the audit of the financial statements schedule for the years ended December 31, 2000, 1999 and 1998 listed in Item 14 (a) (2). This financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on this financial statement schedule based on our audits.

In our opinion such financial statement schedule presents fairly, in all material respects, the information set forth therein for the years ended December 31, 2000, 1999 and 1998.

Gardner, Massachusetts  
 February 16, 2001

/s/ BDO Seidman LLP  
 -----

51

ARRHYTHMIA RESEARCH TECHNOLOGY, INC.  
 AND SUBSIDIARY  
 SCHEDULE II

VALUATION AND QUALIFYING ACCOUNTS

	Balance at Beginning of Period	Charged to Costs and Expenses	Deducti
-----			
ALLOWANCE FOR DOUBTFUL ACCOUNTS:			
2000	\$ 83,203	\$ 56,918	\$ 87,
-----			
1999	\$ 72,192	\$ 48,375	\$ 37,
-----			
1998	\$ 61,318	\$ 21,518	\$ 10,
-----			
ALLOWANCE FOR SLOW-MOVING INVENTORIES:			
2000	\$ 458,500	\$ 24,433	\$332,
-----			
1999	\$1,022,835	\$ -	\$564,
-----			
1998	\$ 820,610	\$ 202,225	\$

