

ANGEION CORP/MN  
Form 10-Q  
November 14, 2001

# U. S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## FORM 10-Q

ý **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the quarterly period ended September 30, 2001.**

OR

o **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

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

Commission file number 001-13543

## ANGEION CORPORATION

(Exact name of registrant as specified in its charter)

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Minnesota

41-1579150

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

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

(Address of principal executive offices)

Registrant's telephone number, including area code: (651) 484-4874

Indicate by check mark whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 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        No   

As of November 13, 2001, the Company had outstanding 3,556,589 shares of common stock, \$0.01 par value.

**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements****ANGEION CORPORATION AND SUBSIDIARIES****Consolidated Balance Sheets**

(unaudited, in thousands except share data)

|  | <b>September 30,<br/>2001</b> | <b>December 31,<br/>2000</b> |
|--|-------------------------------|------------------------------|
| <b>Assets</b>  |                               |                              |
| <b>Current assets:</b>   |                               |                              |
| Cash and cash equivalents  | \$ 3,052                      | \$ 6,350                     |
| Accounts receivable, net of allowance for doubtful accounts of \$232 and \$153, respectively | 4,171                         | 4,631                        |
| Inventories  | 5,197                         | 3,979                        |
| Prepaid expenses and other current assets  | 521                           | 218                          |
| <b>Total current assets</b>  | <b>12,941</b>                 | <b>15,178</b>                |
| Net non-current assets of discontinued operations  | 191                           | 236                          |
| Equipment and fixtures, net  | 1,449                         | 1,895                        |
| Intangible assets, net   | 11,507                        | 12,000                       |
| Other assets   | 329                           | 724                          |
| Goodwill, net  | 497                           | 524                          |
|  | <b>\$ 26,914</b>              | <b>\$ 30,557</b>             |
| <b>Liabilities and Shareholders' Equity</b>  |                               |                              |
| <b>Current liabilities:</b>  |                               |                              |
| Accounts payable   | \$ 794                        | \$ 812                       |
| Employee compensation  | 681                           | 549                          |
| Deferred income  | 1,021                         | 984                          |
| Warranty reserve   | 186                           | 239                          |
| Net current liabilities of discontinued operations   | 234                           | 457                          |
| Other liabilities and accrued expenses   | 1,233                         | 474                          |
| <b>Total current liabilities</b>   | <b>4,149</b>                  | <b>3,515</b>                 |
| <b>Long-term debt</b>  | <b>20,198</b>                 | <b>20,198</b>                |
| <b>Shareholders' equity:</b>   |                               |                              |

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|   |                  |                  |
|---|------------------|------------------|
| Common stock, \$.01 par value. Authorized<br>10,000,000 shares; issued and outstanding<br>3,556,589 shares in 2001 and 3,481,584 shares in 2000 | 36               | 35               |
| Additional paid-in capital  | 123,990          | 123,905          |
| Cumulative translation adjustment   | (9 )             | (9 )             |
| Accumulated deficit   | (121,450 )       | (117,087 )       |
| Total shareholders' equity  | 2,567            | 6,844            |
|   | <b>\$ 26,914</b> | <b>\$ 30,557</b> |

See accompanying notes to financial statements

## ANGEION CORPORATION AND SUBSIDIARIES

## Consolidated Statements of Operations

(unaudited, in thousands except per share amounts)

|  | Three Months Ended |          | Nine Months Ended |           |
|--|--------------------|----------|-------------------|-----------|
|  | September 30,      |          | September 30,     |           |
|  | 2001               | 2000     | 2001              | 2000      |
| <b>Revenues</b>                        |                    |          |                   |           |
| Equipment and supply sales             | \$ 3,349           | \$ 3,446 | \$ 10,368         | \$ 10,995 |
| Service revenue                        | 659                | 622      | 1,925             | 1,839     |
|  | 4,008              | 4,068    | 12,293            | 12,834    |
| <b>Cost of goods sold</b>              |                    |          |                   |           |
| Cost of equipment and supplies         | 2,231              | 2,473    | 6,768             | 8,061     |
| Cost of service revenue                | 104                | 122      | 331               | 385       |
|  | 2,335              | 2,595    | 7,099             | 8,446     |
| <b>Gross margin</b>                    | 1,673              | 1,473    | 5,194             | 4,388     |
| <b>Operating expenses:</b>             |                    |          |                   |           |
| Selling and marketing                  | 1,284              | 1,187    | 3,766             | 3,551     |
| General and administrative             | 966                | 680      | 2,263             | 2,036     |
| Research and development               | 441                | 425      | 1,204             | 1,243     |
| Amortization of intangibles            | 276                | 294      | 924               | 873       |
|  | 2,967              | 2,586    | 8,157             | 7,703     |
| <b>Operating loss</b>                  | (1,294 )           | (1,113 ) | (2,963 )          | (3,315 )  |
| <b>Other income (expense):</b>         |                    |          |                   |           |
| Interest income                        | 29                 | 134      | 160               | 350       |
| Interest expense                       | (511 )             | (511 )   | (1,531 )          | (1,595 )  |
| <b>Loss before taxes</b>               | (1,776 )           | (1,490 ) | (4,334 )          | (4,560 )  |
| Provision for taxes                    | -                  | -        | -                 | -         |
| <b>Loss from continuing operations</b> | (1,776 )           | (1,490 ) | (4,334 )          | (4,560 )  |

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|   |             |             |             |            |
|---|-------------|-------------|-------------|------------|
| <b>Income (loss) from discontinued operations, net of taxes</b> | -           | 22          | (29 )       | 11,085     |
| <b>Net income (loss)</b>  | \$ (1,776 ) | \$ (1,468 ) | \$ (4,363 ) | \$ 6,525   |
| <b>Net income (loss) per share - basic and diluted</b>          |             |             |             |            |
| Continuing operations   | \$ (0.50 )  | \$ (0.43 )  | \$ (1.24 )  | \$ (1.25 ) |
| Discontinued operations   | -           | 0.01        | (0.01 )     | 3.04       |
| Net income (loss)   | (0.50 )     | (0.42 )     | (1.25 )     | 1.79       |
| <b>Weighted average common shares outstanding</b>               |             |             |             |            |
| Basic and diluted   | 3,543       | 3,466       | 3,502       | 3,645      |

See accompanying notes to financial statements

## ANGEION CORPORATION AND SUBSIDIARIES

**Consolidated Statements of Cash Flows**  
(unaudited, in thousands)

|  | Nine Months Ended |           |
|--|-------------------|-----------|
|  | 2001              | 2000      |
| <b>Cash Flows From Operating Activities:</b>   |                   |           |
| Net income (loss)  | \$ (4,363 )       | \$ 6,525  |
| Adjustments to reconcile net income (loss) to net cash flows used in operating activities: |                   |           |
| (Income) loss from discontinued operations   | 29                | (11,085 ) |
| Depreciation and amortization  | 1,428             | 1,377     |
| Changes in operating assets and liabilities:   |                   |           |
| Accounts receivable  | 460               | 832       |
| Inventory  | (1,218 )          | 682       |
| Prepaid expenses and other current assets  | 92                | 257       |
| Accounts payable   | (18 )             | (272 )    |
| Employee compensation  | 132               | (130 )    |
| Other liabilities and accrued expenses   | 815               | 395       |
| Net cash used in continuing operations   | (2,643 )          | (1,419 )  |
| Net cash used in discontinued operations   | (252 )            | (3,076 )  |
| Net cash used in operating activities  | (2,895 )          | (4,495 )  |
| <b>Cash Flows From Investing Activities:</b>   |                   |           |
| Purchase of equipment and fixtures   | (58 )             | (256 )    |
| Investment in proprietary software   | (404 )            | (559 )    |
| Acquisition of operating assets  | -                 | (468 )    |
| Net cash used in continuing operations   | (462 )            | (1,283 )  |
| Net cash provided by discontinued operations   | 45                | 9,293     |
| Net cash provided by (used in) investing activities  | (417 )            | 8,010     |
| <b>Cash Flows From Financing Activities:</b>   |                   |           |
| Borrowings under bank line of credit   | -                 | 6,927     |
| Payments under bank line of credit   | -                 | (6,927 )  |
| Proceeds from stock transactions   | 14                | 24        |
| Net cash provided by financing activities  | 14                | 24        |

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|   |    |              |    |              |
|---|----|--------------|----|--------------|
| <b>Net increase (decrease) in cash and cash equivalents</b> |    | (3,298 )     |    | 3,539        |
| <b>Cash and cash equivalents at beginning of period</b>     |    | 6,350        |    | 5,263        |
| <b>Cash and cash equivalents at end of period</b>           | \$ | <b>3,052</b> | \$ | <b>8,802</b> |
| <b>Cash paid for interest expense</b>                       | \$ | <b>757</b>   | \$ | <b>812</b>   |

See accompanying notes to financial statements



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

September 30, 2001

(Unaudited)

**1. Basis of Presentation**

The consolidated balance sheet as of September 30, 2001, the consolidated statements of operations and cash flows for the three and nine months ended September 30, 2001 and 2000, and the related information presented in these notes have been prepared by management in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X, without audit. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation of results have been included. The balance sheet at December 31, 2000 was derived from the audited financial statements as of that date. Operating results for the three and nine month periods ended September 30, 2001 are not necessarily indicative of the results that may be expected for the year ended December 31, 2001. For further information, refer to the financial statements and notes thereto included in Angeion Corporation's Annual Report on Form 10-K for the fiscal year ended December 31, 2000.

During March 2000, Angeion Corporation discontinued its historical business, the research, development, manufacturing and marketing of implantable cardioverter defibrillators ( ICD ). Consequently, the accompanying consolidated statements of operations present all activities of the ICD business under discontinued operations accounting rules. Although the last sales of ICD products were made during the second quarter of 2000, the Company continues to pursue the license or transfer of its ICD technology. As a result of the December 21, 1999 acquisition of Medical Graphics Corporation and discontinuance of the ICD business, Medical Graphics now comprises a majority of the Company's total assets and generates all of its sales. Moreover, the Company is now focusing its efforts on the markets served by and business operations of its wholly owned subsidiary, Medical Graphics Corporation, and the acquisition and development of future businesses that contribute to shareholder value.

Comprehensive income is a measure of all non-owner changes in shareholders' equity and includes such items as net income, certain foreign currency translation items, minimum pension liability adjustments and changes in the value of available-for-sale securities. For the three and nine months ended September 30, 2001 and 2000, comprehensive income (loss) for Angeion Corporation was equivalent to net income (loss) as reported.

**2. Reclassifications**

Certain amounts in Angeion's Form 10-Q for the three and nine months ended September 30, 2000 have been reclassified to conform to the 2001 presentation. These reclassifications had no effect on net income or shareholders' equity as previously reported.

**3. Net Income (Loss) Per Share**

Basic net income (loss) per share is calculated by dividing net income (loss) by the weighted-average common shares outstanding during the period. Net income (loss) per share assuming dilution reflects the potential dilution to basic net income per share that could occur upon conversion or exercise of securities, options, or other such items, to common shares using the if-converted and treasury stock methods based upon the weighted-average fair value of the Company's common shares during the period. The Company uses loss from continuing operations as the control number in determining whether these potential common shares are dilutive or antidilutive because it has reported a discontinued operation. Therefore, the same number of potential common shares used in computing the diluted per-share amount for income (loss) from continuing operations for a reporting period is used in computing all other reported diluted per-share amounts, even if these amounts are antidilutive to their respective basic per-share amounts.

**4. Other Commitments**

On December 21, 2000, as part of its strategy to leverage its core technologies and market reputation to enter the cardiac rehabilitation and disease prevention market, the Company entered into a letter of intent and term sheet with a Georgia corporation engaged in the business of developing and delivering risk assessment and lifestyle management materials and services to patients for improved cardio-vascular health. The agreement gave the Company exclusive distribution rights to a cardiac rehabilitation product for testing until July 1, 2001 in exchange for payments of \$750,000 over a six-month period. These payments may be applied, at the Company's discretion toward either the purchase of the cardiac rehabilitation products or equity in the Georgia corporation. The agreement automatically renewed by its terms and now continues on a month-to-month basis with payments of \$100,000 per month until December 31, 2001, unless notice is given 60 days prior to a proposed termination date. The letter of intent and term sheet also defines the general terms under which the Company has the right, but not the obligation, to acquire the Georgia corporation during the distribution period. The Company has \$1,045,000 of these cardiac rehabilitation products included in inventory at September 30, 2001.

**5. Litigation**

On November 1, 2001, the Company entered into a settlement agreement that resolved all outstanding litigation with U.S. Bank National Association, as Trustee for the holders of the Company's 7-1/2% Senior Convertible Notes due 2003. Under the settlement, the Company paid the Trustee \$300,000 subsequent to September 30, 2001 and has been released from all claims asserted in the complaint. In turn, the Trustee has been released from all counterclaims asserted by the Company. The lawsuit had been brought by the Trustee in September 1999, and alleged that certain actions by the Company violated the terms of the Indenture and required prepayment of amounts due under the Indenture.

**6. New Accounting Pronouncements**

In July 2001, the FASB issued Statement No. 141, *Business Combinations*, and Statement No. 142, *Goodwill and Other Intangible Assets*. Statement 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001 as well as all purchase method business combinations completed after June 30, 2001. Statement 141 also specifies criteria that intangible assets acquired in a purchase method business combination must meet to be recognized and reported apart from goodwill, noting that any purchase price allocable to an assembled workforce may not be accounted for separately. Statement 142 will require that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually in accordance with the provisions of Statement 142. Statement 142 will also require that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*.

The Company is required to adopt the provisions of Statement 141 immediately, and Statement 142 effective January 1, 2002. Furthermore, goodwill and intangible assets determined to have an indefinite useful life acquired in a purchase business combination completed after June 30, 2001, but before Statement 142 is adopted in full, will not be amortized, but will continue to be evaluated for impairment in accordance with the appropriate pre-Statement 142 accounting literature. Goodwill and intangible assets acquired in business combinations completed before July 1, 2001 will continue to be amortized and tested for impairment in accordance with the appropriate pre-Statement 142 accounting literature prior to the full adoption of Statement 142.

Statement 141 will require, upon adoption of Statement 142, that the Company evaluate its existing intangible assets and goodwill that were acquired in a prior purchase business combination, and to make any necessary reclassifications in order to conform with the new criteria in Statement 141 for recognition apart from goodwill. Upon adoption of Statement 142, the Company will be required to reassess the useful lives and residual values of all intangible assets acquired, and make any necessary amortization period adjustments by the end of the first interim period after adoption. In addition, to the extent an intangible asset is identified as having an indefinite useful life, the Company will be required to test the intangible asset for impairment in accordance with the provisions of Statement 142 within the first interim period. Any impairment loss will be measured as of the date of adoption and recognized as the cumulative effect of a change in accounting principle in the first interim period.

In connection with Statement 142's transitional impairment evaluation, the Statement requires the Company to perform an assessment of whether there is an indication that goodwill is impaired as of the date of adoption. To accomplish this, the Company must identify its reporting units and determine the carrying value of each reporting unit by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units as of the date of adoption. The Company has up to six months from the date of adoption to determine the fair value of each reporting unit and compare it to the carrying amount of the reporting unit. To the extent the carrying amount of a reporting unit exceeds the fair value of the reporting unit, an indication exists that the reporting unit goodwill may be impaired and the Company must perform the second step of the transitional impairment test. In the second step, the Company must compare the implied fair value of the reporting unit goodwill with the carrying amount of the reporting unit goodwill, both of which would be measured as of the date of adoption. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit to all of the assets (recognized and unrecognized) and liabilities of the reporting unit in a manner similar to a purchase price allocation, in accordance with Statement 141. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill. This second step is required to be completed as soon as possible, but no later than the end of the year of adoption. Any transitional impairment loss will be recognized as the cumulative effect of a change in accounting principle in the Company's statement of operations.

As of the date of adoption, the Company expects to have unamortized goodwill in the amount of \$487,000, unamortized identifiable intangible assets in the amount of \$11,346,000, both of which will be subject to the transition provisions of Statements 141 and 142. Amortization expense related to goodwill was \$37,000 and \$27,000 for the year ended December 31, 2000 and the nine months ended September 30, 2001, respectively. Because of the extensive effort needed to comply with adopting Statements 141 and 142, it is not practicable to reasonably estimate the impact of adopting these Statements on the Company's financial statements at the date of this report, including whether it will be required to recognize any transitional impairment losses as the cumulative effect of a change in accounting principle.

In August 2001, the Financial Accounting Standards Board approved SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS No. 144 addresses the financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of. However, this statement retains the fundamental provisions of SFAS No. 121 for (a) recognition and measurement of the impairment of long-lived assets to be held and used and (b) measurement of long-lived assets to be disposed of by sale.

SFAS No. 144 also supersedes the accounting and reporting provisions of APB Opinion No. 30, Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions for the disposal of a segment of a business. However, this Statement retains the requirement of APB No. 30 to report discontinued operations separately from continuing operations and extends that reporting to a component of an entity that either has been disposed of or is classified as held for sale. This statement also amends ARB No. 51, Consolidated Financial Statements to eliminate the exception to consolidation for a temporarily controlled subsidiary. The Company is required and plans to adopt the provisions of SFAS No. 144 in the first quarter of fiscal 2003.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**Forward-Looking Statements**

Statements included in this Quarterly Report on Form 10-Q that are not historical or current facts are forward-looking statements made pursuant to the safe harbor provision of the Private Securities Litigation Reform Act of 1995. The words believe, expect, will, can, estimate, anticipate and similar expressions are intended to identify forward-looking statements. Forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially, including the factors set forth in the Section entitled "Certain Risk Factors" in Part I, Item 1, "Business" of the Company's Form 10-K for the year ended December 31, 2000 as well as others not now anticipated. Various forward-looking statements have been made in this Quarterly Report on Form 10-Q and may also be made in other Angeion reports filed under the Securities Exchange Act of 1934, in its press releases and in other documents. In addition, from time to time, the Company through its management may make oral forward-looking statements. The Company undertakes no obligation to update any forward-looking statement.

**Overview**

Angeion, through its Medical Graphics Corporation subsidiary, develops, manufactures and markets non-invasive cardiorespiratory diagnostic systems and related software for the management and improvement of cardiorespiratory health under the MedGraphics trade name. The primary MedGraphics products include pulmonary function and cardiopulmonary exercise testing systems. Traditionally, Medical Graphics' revenue has been generated from this area.

On December 13, 2000, the Company announced that it intended to focus a significant portion of its resources on the cardiac rehabilitation and disease prevention markets, which are a logical extension of its core diagnostic systems business. This will add a much larger consumer focused market to the Company's business and if successful, will lessen its dependence on one-time sales of capital equipment to large medical facilities. Angeion stated that new product offerings would build on the Company's core exercise stress testing technologies including expert system software products and its AeroSport metabolic analyzer products.

As part of its strategy, the Company entered into a letter of intent and term sheet with a Georgia corporation engaged in the business of developing and delivering risk assessment and lifestyle management materials and services to patients for improved cardiovascular health. See Note 4, "Other Commitments" in this Form 10-Q.

On January 16, 2001, the Company announced that Medical Graphics was adding the Personal Digital Coach™ to its cardiorespiratory products. The Personal Digital Coach™ is a proprietary device that provides verbal feedback to the user regarding exercise intensity. The Company will market this new product to the cardiac rehabilitation, fitness club and weight-loss industries through rights obtained under an exclusive OEM distribution agreement with a third party.

During the third quarter 2001, the Company completed the branding strategy for its new product and continued to develop the related packaging and marketing materials. In addition, the Company began selling its new product, the New Leaf™ Personal Exercise System that includes the Personal Digital Coach, in conjunction with selected early-adopting customers, initially cardiac rehabilitation centers and fitness clubs.

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Moreover, the Company is continuing to develop and refine its marketing plans while at the same time expanding its customer base.

## Results of Operations

Angeion Corporation recorded a net loss of \$1,776,000 for the three months ended September 30, 2001 compared to a net loss of \$1,468,000 for the same period in 2000. These amounts included no income from discontinued operations for the three months ended September 30, 2001 and income of \$22,000 from discontinued operations for 2000.

For the nine months ended September 30, 2001, the Company recorded a loss of \$4,363,000 compared to net income of \$6,525,000 for the same period in 2000. Net income for 2000 included income from discontinued operations of \$11,085,000, which is represented by a one-time gain of \$11,696,000, net of taxes, from the non-exclusive licensing of patent rights and sale of certain assets, offset by \$611,000 of discontinued operating expenses.

## Revenues

Revenues consist of product sales and service revenues. Product sales reflect sales of Medical Graphics non-invasive cardiorespiratory diagnostic systems and related software and aftermarket sales of peripherals and supplies. Service revenues reflect contract revenues from extended warranties, non-warranty service visits and training.

Total revenue decreased 1.5% to \$4,008,000 from \$4,068,000 for the three months ended September 30, 2001 and 2000, respectively. Domestic revenue decreased by 3.0% to \$2,587,000 in 2001 compared to \$2,667,000 in 2000. International revenue decreased 2.2% to \$762,000 in 2001 from \$779,000 in 2000. Service revenue increased by 5.9% to \$659,000 in 2001 from \$622,000 in 2000.

The third quarter revenue decrease of 1.5% reflects a delay of customer orders, both domestically and internationally, due primarily to the shock and uncertainty caused by the September 11, 2001 events on the East coast. While difficult to measure, there is clear indication that some customers have delayed orders that would have been received in September while others are taking a wait and see stance. Moreover, domestic customers with government funding are now permitted to obligate funds in one fiscal year and make their purchase in the next fiscal year. The Company has received a number of product orders from United States government agencies during the month of October 2001 that can be attributed to funds obligated during the government fiscal year ended September 30, 2001. The service revenue increase for the second quarter reflects the Company's continuing success in placing more emphasis on sales of extended service warranties.

For the nine months ended September 30, 2001, total revenue decreased by 4.2% to \$12,293,000 in 2001 from \$12,834,000 in 2000. Domestic revenue decreased 8.6% to \$7,623,000 in 2001 from \$8,336,000 in 2000. International revenue increased 3.2% to \$2,745,000 in 2001 from \$2,659,000 in 2000. Service revenue increased by 4.7% to \$1,925,000 in 2001 from \$1,839,000 in 2000.

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While year to date revenue for 2001 reflects the delays in customer orders experienced in September, it also continues to reflect several events occurring during the first quarter of 2000. Domestic revenue for 2000 included the carryover of 1999 software upgrade orders associated with year 2000 compliance. Moreover, the first nine months of 2000 included \$824,000 in sales from the now discontinued sleep diagnostics products. The Company's ongoing focus on rebuilding international markets has more than offset the first quarter 2001 decrease in international revenue. The year to date increase in service revenue reflects an increase in sales of extended service warranties that has offset the first quarter decrease caused by the carryover of non-warranty service calls from 1999 to 2000 due to the heavy demand and limited resources associated with installation of year 2000 upgrades late in 1999.

The Company has devoted a significant amount of its resources during the past year to developing its New Leaf Personal Exercise System for the cardiac rehabilitation, disease prevention, fitness club and weight-loss markets. Although the Company began selling its New Leaf Personal Exercise System during September 2001, revenue from the first sales of this new product was not significant for the three and nine months ended September 30, 2001.

### **Gross Margin**

Gross margin percentage increased to 41.7% of revenue for the three months ended September 30, 2001 compared to 36.2% for the same period of 2000. For the nine months ended September 30, gross margin percentage increased to 42.3% in 2001 from 34.2% in 2000. The margin increase for the third quarter reflects the results of cost reduction programs. The margin increase for the nine months ended September 30, 2001 also reflects a \$332,000 reduction in the 2000 value of sleep diagnostic product inventory in conjunction with the decision to discontinue distribution of those products. Moreover, the year-to-date margin increase also reflects the impact of cost reduction programs and discontinuance of lower margin sleep diagnostics products, partially offset by lower sales of high margin software upgrade products associated with year 2000 compliance. The Company does not expect gross margins percentages to change significantly for the balance of 2001.

### **Selling and Marketing**

Selling and marketing expenses increased 8.2% to \$1,284,000 for the three months ended September 30, 2001 from \$1,187,000 in 2000. For the nine months ended September 30, selling and marketing expenses increased 6.1% to \$3,766,000 in 2001 from \$3,551,000 in 2000. Both periods reflect increased expenses associated with the Company's focus on developing its New Leaf Personal Exercise System. The year to date increase also reflects additional costs in support of the focus on international revenue, which is somewhat offset by lower commissions due primarily to the decrease in sales of sleep diagnostics products.

### **General and Administrative**

General and administrative expenses increased by 42.1% to \$966,000 for the three months ended September 30, 2001 from \$680,000 in 2000. For the nine months ended September 30, general and administrative expenses increased 11.1% to \$2,263,000 in 2001 from \$2,036,000 in 2000. Both the quarter and nine-month periods include \$300,000 paid subsequent to September 30, 2001 as part of a settlement agreement that resolved the on-going litigation with U.S. Bank National Association, as Trustee for the holders of the Company's 7-1/2% Senior Convertible Notes. See Note Holder Litigation, Item 1. Legal Proceedings, Part II of this Form 10-Q. In addition, both periods include higher legal expenses associated with that litigation somewhat offset by lower personnel costs and shareholder communications expenses.

### **Research and Development**



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Research and development expenses for the three months ended September 30 increased by 3.8% to \$441,000 in 2001 from \$425,000 in 2000. For the nine months ended September 30, research and development expenses decreased 3.1% to \$1,204,000 in 2001 from \$1,243,000 in 2000.

The third quarter of 2001 includes an increase in engineering expenses associated with product redesign as well as the cost of software changes required by Microsoft's decision to force a change from Windows 2000 to Windows XP. Lower ongoing expenses associated with the March 2000 acquisition of AeroSport products somewhat offset these increased expenses for the quarter. Moreover, total research and development expenses for the nine months ended September 30, 2001 have been more than offset by lower on-going expenses associated with AeroSport. One of the products acquired from AeroSport has been repackaged and integrated with new software and hardware and now represents a key component in the Company's current growth initiative for the cardiac rehabilitation, disease prevention, fitness club and weight-loss markets.

Both the three and nine month periods of 2001 reflect the Company's now completed transition to a Windows98/NT/2000 platform. The expenses for 2001 also reflect development of new software and hardware platforms that address new market requirements such as the Health Insurance Portability and Accountability Act (HIPAA) of 1996 which will become a requirement in 2002 as well as ongoing replacement of older products.

### **Amortization of Intangibles**

Amortization of intangibles represents the amortization of goodwill and other intangible assets associated with acquisitions. Amortization expenses for the three months ended September 30 decreased by 6.1% to \$276,000 in 2001 from \$294,000 in 2000. For the nine months ended September 30, amortization of intangibles increased 5.8% to \$924,000 in 2001 from \$873,000 in 2000. The year to date increase reflects the acquisition of AeroSport's technology in March 2000 and the capitalization of eligible costs associated with on-going enhancement of the Company's proprietary software products.

### **Other Income (Expense)**

Interest income for the three months ended September 30 decreased to \$29,000 in 2001 from \$134,000 in 2000. Interest income for the nine months ended September 30 decreased to \$160,000 in 2001 from \$350,000 in 2000. The decrease in interest income for both periods reflects lower excess cash balances available for short-term investment as well as lower interest rates.

Interest expense was \$511,000 for the three months ended September 30, 2001 and 2000. For the nine months ended September 30, interest expense decreased to \$1,531,000 in 2001 from \$1,595,000 in 2000. The year to date decrease reflects the minimum interest charges incurred during the first quarter of 2000 for the Medical Graphics bank line of credit that expired by its terms on March 31, 2000.

### **Income From Discontinued Operations**

Income from discontinued operations of \$11,085,000 for the nine months ended September 30, 2000, includes a one-time gain of \$11,696,000, net of taxes, related to the non-exclusive licensing of patent rights and sale of certain assets. The gain was partially offset by \$593,000 of rental expenses associated with the building previously used for ICD products as well as other expenses of \$18,000 related to discontinued operations.

### **Liquidity and Capital Resources**

The Company had cash of \$3,052,000 and working capital of \$8,792,000 as of September 30, 2001. During the nine months ended September 30, 2001, the Company used \$2,643,000 in cash for continuing operations. The principal uses of cash included net loss before depreciation and amortization of \$2,935,000 and an increase in inventory of \$1,218,000. A \$460,000 decrease in accounts receivable, an increase of \$815,000 in other liabilities and accrued expenses and an increase in employee compensation of \$132,000 offset these uses of cash. In addition, the Company used \$252,000 in cash for discontinued operations, which included \$220,000 for rental of the facility formerly used for the Company's ICD products.

During the nine months ended September 30, 2001, the Company used \$417,000 in cash for investing activities. Cash was used to increase the Company's investment in proprietary software by \$404,000 and to purchase \$58,000 of equipment and fixtures. Cash of \$45,000 was generated from the sale of assets related to discontinued operations.

At September 30, 2001 the Company had no material commitments for capital expenditures. The Company believes that its cash flows from operations together with its existing cash will be adequate to satisfy its liquidity and capital resource needs through September 2002.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

The Company invests its cash in money market instruments or short-term investment grade securities. The Company believes that a decrease of 100 basis points in prevailing interest rates would not have an adverse effect on its net income or financial position.

The Company's product sales outside the United States are denominated in United States dollars. Accordingly, the Company believes its exposure to foreign exchange rate fluctuation is minimal.

**PART II - OTHER INFORMATION**

**Item 1. Legal Proceedings**

*Note Holder Litigation*

On November 1, 2001, the Company entered into a settlement agreement that resolved all outstanding litigation with U.S. Bank National Association, as Trustee for the holders of the Company's 7-1/2% Senior Convertible Notes due 2003. Under the settlement, the Company agreed to pay the Trustee \$300,000 and will be released from all claims asserted in the complaint. In turn, the Trustee has been released from all counterclaims asserted by the Company and has agreed to assist the Company and the note holders in their good faith negotiations to restructure the debt represented by the Senior Convertible Notes. In connection with the settlement, the parties agreed that the lawsuit would be dismissed with prejudice. The lawsuit had been brought by the Trustee in September 1999, and alleged that certain actions by the Company violated the terms of the Indenture and required prepayment of amounts due under the Indenture.

**Item 2. Changes in Securities and Use of Proceeds**

None.

**Item 3. Defaults Upon Senior Securities**

None.

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

The Company held its 2001 Annual Meeting of Shareholders on July 25, 2001. At the meeting, the shareholders of the Company took the following action:

*Election of Directors*

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The shareholders elected the following persons to serve as directors of the Company for a period of one year or until their successor is elected and qualified:

| <b>Name</b>          | <b>Votes for</b> | <b>Votes Withheld</b> |
|----------------------|------------------|-----------------------|
| Arnold A. Angeloni   | 3,144,332        | 41,086                |
| Dennis E. Evans      | 3,144,967        | 40,451                |
| James B. Hickey, Jr. | 3,139,398        | 46,020                |
| Richard E. Jahnke    | 3,143,662        | 41,756                |
| John C. Penn         | 3,144,517        | 40,901                |
| Mark W. Sheffert     | 3,144,537        | 40,881                |
| Glen Taylor          | 3,143,484        | 41,934                |

**Item 5. Other Information**

None

**Item 6. Exhibits and Reports on Form 8-K**

(a) Exhibits List

None

(b) Reports on Form 8-K

No reports on Form 8-K were filed during the three months ended September 30, 2001.

**SIGNATURES**

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

Angeion Corporation  
(Registrant)

Date: November 13, 2001

/s/ Richard E. Jahnke

Richard E. Jahnke, President and Chief Executive Officer  
(Principal Executive Officer)

Date: November 13, 2001

/s/ Dale H. Johnson

Dale H. Johnson, Chief Financial Officer