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RECOM MANAGED SYSTEMS INC DE/
Form 10QSB
November 14, 2003

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2003

Commission File Number 33-11795

RECOM MANAGED SYSTEMS, INC.

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

Delaware

87-0441351

(State or other jurisdiction of
incorporation or organization)

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

4705 Laurel Canyon Boulevard, Suite 203
Studio City, California 91607

(Address of principal executive offices)

(818) 432-4560

(Registrant's telephone number including area code)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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.

[X] Yes [] No

As of October 31, 2003, the Registrant had 32,169,125 shares of common stock, \$.001 par value.

Transitional Small Business Disclosure format: Yes [] No [X]

INDEX

	Page No.
Part I: Financial Information	
Item 1. Financial Statements:	
Unaudited Balance Sheet - as of September 30, 2003	3
Unaudited Statements of Operations - Three and Nine Months Ended September 30, 2002 and 2003.....	4
Unaudited Statements of Cash Flows - Nine Months Ended September 30, 2002 and 2003	5
Notes to Consolidated Financial Statements.....	6 - 11
Item 2. Management's Plan of Operation.....	11
Item 3. Controls and Procedures.....	12
Part II: Other Information.....	13
Item 1. Legal Proceedings.....	13
Item 2. Change in Securities.....	13
Item 3. Defaults Upon Senior Securities.....	13
Item 4. Submission of Matters to a Vote of Security Holders.....	14
Item 5. Other Information.....	14
Item 6. Exhibits and Reports on Form 8-K.....	14
Signatures	14

RECOM MANAGED SYSTEMS, INC.
 (A DEVELOPMENT STAGE COMPANY)
 BALANCE SHEET
 SEPTEMBER 30, 2003
 (UNAUDITED)

ASSETS

CURRENT ASSETS

Cash	\$ 2,980
EQUIPMENT AND LEASEHOLD IMPROVEMENTS, net of accumulated depreciation of \$43,251	152,156
TECHNOLOGY, net of accumulated amortization of \$2,600	5,200

TOTAL ASSETS	\$ 160,336
	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES

Accounts Payable and Other Liabilities	\$ 617,914

TOTAL LIABILITIES	617,914

STOCKHOLDERS' EQUITY

Common Stock	32,154
Additional paid-in capital	4,377,617
Deficit accumulated during development stage	(4,867,349)

TOTAL STOCKHOLDERS' EQUITY	(457,578)

TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	\$ 160,336
	=====

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

RECOM MANAGED SYSTEMS, INC.
(A DEVELOPMENT STAGE COMPANY)
STATEMENTS OF OPERATIONS
(UNAUDITED)

	Successor Company	Predecessor Company	Successor Company	Predecessor Company	Successor Company
	Three Months Ended September 30, 2003	Period from July 1, 2002 to September 18, 2002	Nine Months Ended September 30, 2003	Period from January 1, 2002 to September 18, 2002	Period From September 19, 2002 to September 30, 2002
Revenue	-	-	-	-	-
Research and Development	90,734	-	166,910	-	-
General and Administrative Expenses	2,680,946	21,790	4,541,165	54,941	-
Net Loss	\$ (2,771,680)	\$ (21,790)	\$ (4,708,075)	\$ (54,941)	\$ -
Basic and Diluted Loss Per Share	\$ (0.09)	**	\$ (0.15)	**	\$ -
Shares Used in Computing Basic and Diluted Loss Per Share	31,923,149	1,429,928	31,583,666	1,429,928	27,689,784

** Per share amounts are not meaningful due to reorganization.

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

4

RECOM MANAGED SYSTEMS, INC.
(A DEVELOPMENT STAGE COMPANY)
STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Successor Company	Predecessor Company	Successor Company	
	----- Nine Months Ended September 30, 2003 -----	----- Period From January 1, 2002 to September 18, 2002 -----	----- Period From September 19, 2002 to September 30, 2002 -----	----- Cumulative For the Period From September 19, 2002 to September 30, 2003 -----
Cash used in operating activities	\$ (696,737)	\$ (42,841)	\$ -	\$ (873,614)
Cash Flows from Investing Activities:				
Purchase of equipment	(50,267)	-	-	(79,308)
Cash Flows from Financing Activities:				
Capital contributions	3,295	-	-	24,695
Issuance of stock	598,000	-	-	805,786
Sale of warrants	-	35,000	125,000	125,000
Net cash provided by financing activities	----- 601,295	----- 35,000	----- 125,000	----- 955,481
Net increase (decrease) in cash	(145,709)	(7,841)	125,000	2,559
Cash at beginning of period	----- 148,689	----- 8,262	----- 421	----- 421
Cash at end of period	\$ 2,980 =====	\$ 421 =====	\$125,421 =====	\$ 2,980 =====

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

5

RECOM MANAGED SYSTEMS, INC.
NOTES TO FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company is in the development stage and has a limited operating history since its reorganization. These factors raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments relating to the classification and recoverability of recorded asset amounts or the amount of liabilities that may be incurred should the Company be unable to continue in existence. Continuation as a going concern is dependent on raising additional capital to fund the Company's planned operations. There is no assurance that the necessary funds will be generated.

The accompanying unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial statements pursuant to Regulation S-B. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (including normal recurring accruals considered necessary for a fair presentation) have been included. Operating results for the nine months ended September 30, 2003 are not necessarily indicative of the results that may be expected for the year ending December 31, 2003. For further information refer to the financial statements and footnotes included in the Form 10-KSB for the year ended December 31, 2002.

NOTE 2 - ACQUISITION OF TECHNOLOGY

On September 19, 2002, the Company acquired from ARC Finance Group LLC ("ARC"), certain know how, trade secrets and other intellectual property described below in exchange for 7,800,000 shares of the Company's common stock. This technology was valued at \$7,800. As a result of this transaction, ARC owned approximately 84.5% of the Company's outstanding shares. This transaction is considered a reverse acquisition and as a capital transaction that results in a capital reorganization. Accordingly, the reorganized Company's assets have been reflected at fair value. In the

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reorganization, the Predecessor Company's intangible asset, Reorganization Value in Excess of Amount Allocated to Identifiable Assets (in the amount of \$76,667) and its accumulated deficit (in the amount of \$164,947) were eliminated against Additional Paid-in Capital. There has been no goodwill or intangible assets recognized for this reorganization in the financial statements.

The Company's technology relates to certain proprietary methods, processes and ideas concerning devices and services which, if successfully developed, may be capable of:

- * accurately measuring heart functions
- * automatically and remotely evaluating these functions over the telephone, the Internet, or other wireless transmission systems

6

- * providing the patient and the patient's physician(s) with vital heart and other data on a real time basis to provide early warnings about the patient's heart functions.

No assurance can be given that commercial products or services will ever result or that those products or services will be accepted by regulatory agencies, physicians, patients or insurance providers.

NOTE 3 CAPITAL TRANSACTIONS

In March 2003, the Company's Board of Directors approved the issuance of five-year warrants to purchase 900,000 shares (on a post-split basis) of the Company's common stock at \$.50 per share to a firm which was retained to perform various services including: the introduction of the Company to investment banking firms; assistance in the structuring of the Company's private offerings; assistance in capital market transactions, mergers and acquisitions; advisory services; and assistance in developing strategic relationships. The agreement for the above-referenced services was entered into on March 10, 2003. The warrants do not include any registration rights but they do contain a cashless exercise provision. The Company recognized \$708,000 of expense in connection with the issuance of these Warrants (valued using the Black-Scholes Model).

On April 1, 2003, the Company issued 112,812 shares of common stock (on a post split basis) for \$100,000 in cash and \$150,000 in expenses and equipment (valued using the market value of shares issued). On April 15, 2003 the Company split its stock three for one. All share amounts and earnings per share have been presented on a post split basis.

On April 15, 2003, the Company issued to Brookstreet Securities Corporation warrants to purchase 200,000 shares of the Company's common stock pursuant to an investment banking agreement. The warrants were issued in four tranches of 50,000 each with the first tranche of 50,000 fully vested and exercisable at \$1.25 per share. The second tranche will vest in 90 days after the date of the agreement and will have an exercise price of \$2.25 per share. The third tranche will vest in 180 days and will have an exercise price of \$3.25 per share. The fourth tranche will vest in 270 days and will have an exercise price of \$4.25 per share. The Company recognized an expense of \$281,950 in connection with the issuance of these warrants using the Black-

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Scholes Model.

In May 2003, the Company completed the first tranche of its private placement as it sold 82,667 units to three accredited investors at \$3.00 per unit for cash amounting to \$248,000. Each unit consisted of one share of common stock and one warrant. Each warrant is exercisable at \$3.00 until May 14, 2004. Upon exercise of the warrants each investor will receive one share of common stock and an additional warrant to purchase one share of common stock at \$6.00 per share until November 15, 2004.

On July 17, 2003 the Company retained Maxim Group, LLC (Maxim) a New York based investment banking firm to act as its lead investment bank. Maxim will provide, among other services, assistance with the Company's financing efforts as it attempts to secure additional capital for product development as well as to fund the process of gaining approval for the Company's cardiac monitoring device by the FDA. Maxim will also assist the Company with general business strategy and with seeking a listing on a national exchange. Maxim was paid \$50,000 at the inception of the agreement and will be paid \$7,500 per month through June 30, 2004. In addition, Maxim received a total of 100,000 warrants to purchase shares of restricted common stock at \$4.92 per share.

7

The Company recognized expense of \$156,200 in connection with the issuance of these warrants (valued using the Black-Scholes Model).

In July 2003, the Company closed its second tranche of its private placement by selling 75.075 units to four accredited investors for total cash of \$250,000 under terms consistent with the first tranche.

In August 2003, the Company entered into voluntary trading restriction agreements with two shareholders in exchange for warrants to purchase a total of 23,501 shares of the Company's common stock at a price of \$3.29 per share. In September 2003, the Company entered into a voluntary trading restriction agreement with a shareholder in exchange for a warrant to purchase 18,000 shares of the Company's common stock at 85% of the closing price of the common stock on the date of the agreement (\$5.29 at September 23, 2003). The value of the warrants issued using the Black-Scholes Model was \$87,304.

In September 2003, the Company issued a consultant a warrant to purchase 25,000 shares of the Company's common stock at an exercise price of \$3.29 per share. The value of the warrants using the Black-Scholes Model was \$46,050.

In September 2003, the Company issued 305,000 shares of restricted common stock to three persons pursuant to the cashless exercise provisions of common stock purchase warrants held by such persons.

During the three month and nine month periods ended September 30, 2003, the Company issued 169,105 and 327,342 shares of common stock, respectively, for marketing and business services rendered during the period. These services were valued at \$626,539 for the three months ended September 30, 2003, and \$1,073,131 for nine month period ended September 30, 2003, based upon the market value of the shares at the date of issuance.

NOTE 4 - STOCK-BASED COMPENSATION PLANS

The table below summarizes the transactions in the Company's Employee 2002 stock option plan as of September 30, 2003:

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Option outstanding at January 1, 2003	-
Granted	1,960,000
Exercised	-
Purchased	-
Canceled	-

Options outstanding at September 30, 2003 (weighted average exercise price of \$1.04 as of September 30,2003)	1,960,000
	=====
 Exercisable as of September 30, 2003	 981,000

The table below summarizes options and warrants issued to non-employees as of September 30, 2003:

Options and warrants outstanding at January 1, 2003	825,000
Granted	1,269,501
Exercised	-
Cancelled	-

8

Options outstanding at September 30, 2003 (weighted average exercise price of \$0.87 as of September 30, 2003)	2,094,501
	=====
 Exercisable as of September 30, 2003	 1,994,501
	=====

The fair value of each option and warrant grant to non-employees was estimated on the date of grant using the Black-Scholes option pricing model, the form of the option agreement and the option price along with the following assumptions:

Risk free interest rate	4.4%
Dividend yield	0.0%
Expected volatility	43.0%

The Company recognized total expenses of \$684,639 and \$1,392,639 related to options and warrants granted to non-employees for the three months and nine months ended September 30, 2003, respectively.

NOTE 5 - AHT SETTLEMENT

During October 2002, the Company entered into a Loanout Agreement with Dr. Budimir Drakulic pursuant to which he agreed to serve as our Chief Technology Officer. In this agreement, we agreed on his behalf, to fulfill certain obligations in connection with a settlement agreement, which Dr. Drakulic entered into with the minority shareholders of AHT. Dr. Drakulic's settlement agreement is complex, but it generally requires that if the Company completes a financing of more than \$2,000,000, up to 4% of the proceeds are to be paid to certain AHT shareholders, up to a total amount of \$480,100.

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As discussed in Note 7, the Company completed a financing in October 2003 in excess of \$2,000,000. The Company has recorded a liability of \$480,100 at September 30, 2003, as a result of the financing. However, such payment is subject to compliance with the provisions of the settlement agreement and the Company believes that it has evidence that several of the representations, warranties and covenants have been violated. The Company is currently investigating the violations and does not intend to pay any amounts until the investigation is completed and a final determination is made of amounts due, if any, pursuant to the settlement agreement.

NOTE 6 - ACCOUNTING PRONOUNCEMENTS

a. Accounting for Certain Financial Instruments with Both Liabilities and Equity

In May 2003, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity, SFAS No. 150 clarifies the accounting for certain financial instruments with characteristics of both liabilities and equity and requires that those instruments be classified as liabilities. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Company does not have any obligations to be settled in either cash or common stock that are classified as a liability. It does not have any immediate plans to enter into other financial instruments

9

subject to the accounting requirements of SFAS No. 150. The adoption of SFAS No. 150 does not have an impact on the Company's financial statements.

b. Accounting for Derivative Instruments and Hedging Activities

In April 2003, the FASB issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. SFAS No. 149 clarifies financial accounting and reporting requirements for derivative instruments and hedging activities as set forth under SFAS No. 133. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships entered into after June 30, 2003. The adoption of SFAS No. 149 does not have an impact on the Company's financial statements.

c. Consolidations of Variable Interest Entities

In January 2003, the FASB Interpretation ("FIN") No. 36, Consolidation of Variable Interest Entities, requiring that companies consolidate variable interest entities if they are the primary beneficiaries, as defined under FIN No. 46, of the activities of the variable interest entities. Companies are required to apply FIN No. 46 immediately for all variable interest entities created after January 31, 2003, and as of the beginning of the first interim period beginning after June 15, 2003, for all other variable interest entities. The Company does not have any variable interest entities.

NOTE 7 - SUBSEQUENT EVENTS

During October 2003, the Company sold 53,2875 units with each unit consisting of 33,334 shares of Series A Convertible Preferred Stock (Convertible Preferred Stock) and 16,667 Class C Common Stock Purchase Warrants (Warrants) at a price of \$100,000 per unit. The proceeds to the Company, net of expenses, was approximately \$4,645,000.

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The Convertible Preferred Stock will pay dividends of 8% annually, to be paid quarterly either in cash or in the form of Convertible Preferred Stock at the Company's discretion. The Convertible Preferred Stock will be valued at \$3.00 per share when it is issued as a dividend. Each Holder of the Convertible Preferred Stock will have the option at any time to convert all or any portion of the Convertible Preferred Stock held by such Holder into shares of Common Stock. The Convertible Preferred Stock shall have a liquidation value equal to \$3.00 per share and shall be convertible into Common Stock on a one-for-one basis (the "Conversion Price"). The Convertible Preferred Stock shall be senior to all other shares of capital stock now existing or hereinafter created of the Company as to dividend and liquidation rights and shall have voting rights as if converted into Common Stock.

The Company can force conversion of the Convertible Preferred Stock into Common Shares upon 45 days written notice to the holders of the Preferred Stock, if (1) the closing price of the Common Stock is at least \$7.50 for 30 consecutive trading days; (2) the Common Stock is listed on a qualified exchange (NASDAQ, AMEX or NYSE); and (3) the Common Stock underlying the conversion is subject to an effective registration statement filed with the SEC pursuant to the Securities Act of 1933, as amended.

Each Warrant entitles the holder to purchase one share of common stock at an exercise price of \$3.75 per share. The Warrants are exercisable anytime during the four year period commencing on the final closing and do not contain provisions for cashless exercise.

The Company will issue the Placement Agent a common stock purchase warrant exercisable for a number of units equal to 10% of the number of units

10

sold in the offering. The Placement Agent warrant will be exercisable at \$3.60 per share and will expire five years following the date of issuance.

The Company is required to file a registration statement with the Securities and Exchange Commission by December 30, 2003, to register the shares of common stock issuable upon conversion of the Series A Convertible Preferred Stock and upon exercise of the Warrants.

Subsequent to September 30, 2003, the Company issued 15,385 shares of common stock to individuals for business services. These shares were valued at \$3.90 based on the market value of the stock at the date of issuance.

ITEM 2. MANAGEMENT'S PLAN OF OPERATION.

FORWARD-LOOKING INFORMATION

This Report on Form 10-QSB contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The statements regarding the Company contained in this report that are not historical in nature, particularly those that utilize terminology such as "may," "will," "should," "likely," "expects," "anticipates," "estimates," "believes" or "plans," or comparable terminology, are forward-looking statements based on current expectations and assumptions, and entail various risks and uncertainties that could cause actual results to differ materially from those expressed in such forward-looking statements. Details about these risks are set forth in the Company's Report on Form 8-K which was filed with the SEC in September 2002.

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PLAN OF OPERATION FOR THE NEXT TWELVE MONTHS

The Company intends to proceed with further development of products and services which employ or otherwise utilize the technology described in Note 2 above. We plan to develop a "belt" that is worn by the patient which will hold both electrodes and the electronics. This development will be accomplished in stages with the first stage housing only the electrodes with the electronics in a separate module. Subsequent development will incorporate the electronics in the belt along with the electrode. We have initiated the study of alternative algorithms for the analysis of ECG's and the Company is also evaluating the advisability of submitting its proof of concept system for hospital institutional review board testing. We are also in discussion with various medical centers regarding beta testing of the low power electronics version of our system. The Company will also work with the inventor of an alternative to standard electrodes (a sensor). The Company plans to develop the sensor technology for possible future incorporation into the "belt." The Company will have an option to acquire the intellectual property rights to the technology if the proof of concept results are as anticipated. The Company estimates it has sufficient cash on hand to fund development and operations for approximately 12 months, because the Company raised approximately \$4,645,000 in net proceeds from the private sale of Series A Convertible Preferred Stock.

The Company plans on using a portion of its funds to develop a sales and marketing infrastructure and a key physician information program. The Company believes it will need to continue to raise funds to finance the full rate production of its ECG System. Additionally, the Company plans to invest in other medical applications of its technology. The first such application being, the monitoring of brain waves to aide in the treatment of neurological diseases.

11

ITEM 3. Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures within 90 days of the filing date of this quarterly report, and, based upon their evaluation, our principal executive officer and principal financial officer have concluded that these controls and procedures are effective. There were no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

Disclosure controls and procedures are our controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings.

None.

ITEM 2. Changes in Securities.

During July 2003, the Company sold 75,075 units to four accredited investors at \$3.00 per unit in cash. Each unit consisted of one share of common stock and one warrant. Each warrant is exercisable at \$3.00 until May 14, 2004. Upon exercise of the warrants each investor will receive one share of common stock and an additional warrant to purchase one share of common stock at \$6.00 per share until November 15, 2004. The Company relied on the exemption provided by Section 4(2) of the Securities Act and Rule 506 of Regulation D thereunder. The investors received a disclosure document and they executed a Subscription Application and a Common Stock Purchase Agreement in which they represented that they were acquiring the units for investment purposes. The certificates for the warrants and the shares contain restrictive legends.

During September 2003, the Company issued 305,000 restricted shares of common stock to three persons pursuant to cashless exercise provisions of common stock purchase warrants held by such persons. The persons who exercised the warrants were accredited investors. The Company relied on

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Section 4(2) of the Securities Act of 1933, as amended. The appropriate restrictive legend was placed on the certificates and stop transfer instructions were issued to the transfer agent.

On July 17, 2003 the Company issued to Maxim Group LLC a warrant to purchase 100,000 restricted shares of the Company's common stock pursuant to an investment banking agreement. The warrants have a five year term and are exercisable at a price of \$4.92 per share. The Company relied on Section 4(2) of the Securities Act of 1933, as amended.

During March 2003, the Company issued to a consultant a warrant to purchase 21,000 shares of the Company's common stock at an exercise price of \$.81 per share as payment for services rendered by the consultant. During August 2003, the Company also issued a total of 23,501 warrants to two shareholders as consideration for their agreement to a partial lockup of shares they own. The warrants have an exercise price of \$3.29. During September 2003, the Company issued to a consultant a warrant to purchase 25,000 shares of the Company's common stock at an exercise price of \$3.19 as payment for services rendered by the consultant. The Company relied on Section 4(2) of the Securities Act of 1933, as amended.

ITEM 3. Defaults Upon Senior Securities.

None.

13

ITEM 4. Submission of Matters to a Vote of Security Holders.

None.

ITEM 5. Other Information.

See Subsequent Event footnote to the financial statements above.

ITEM 6. Exhibits and Reports on Form 8-K.

a. Exhibits.

31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith electronically
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith electronically
32.1	Certification of Chief	Filed herewith

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Executive Officer and electronically
Pursuant to Section 302
of the Sarbanes-Oxley
Act of 2002

32.2 Certification of Chief Financial Officer and
Pursuant to Section 302
of the Sarbanes-Oxley
Act of 2002

Filed herewith
electronically

b. Reports on Form 8-K.

None.

SIGNATURES

Pursuant to the requirements 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.

RECOM MANAGED SYSTEMS, INC.

Date: November 13, 2003

By:/s/Marvin H. Fink
Marvin H. Fink, Chief Executive
Officer

Date: November 13, 2003

By:/s/ Charles E. McGill
Charles E. McGill, Chief Financial
Officer