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VASOMEDICAL INC
Form 10-Q
January 16, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the quarterly period ended November 30, 2006

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the transition period from _____ to _____

Commission File Number: 0-18105

VASOMEDICAL, INC.

(Exact name of registrant as specified in its charter)

Delaware

11-2871434

(State or other jurisdiction of incorporation or organization)

(IRS Employer Identification Number)

180 Linden Ave., Westbury, New York 11590

(Address of principal executive offices)

Registrant's Telephone Number

(516) 997-4600

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 No

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

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Number of Shares Outstanding of Common Stock, \$.001 Par Value,
at January 16, 2007 65,198,592

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ITEM 1. FINANCIAL STATEMENTS

Vasomedical, Inc. and Subsidiaries
CONSOLIDATED CONDENSED BALANCE SHEETS

| | November 2006 |
|--|--------------------|
| | ----- (Unaudite |
| ASSETS | |
| CURRENT ASSETS | |
| Cash and cash equivalents | \$1,441, |
| Accounts receivable, net of an allowance for doubtful accounts of \$364,809 at November 30, 2006, and \$410,691 at May 31, 2006 | 806, |
| Inventories, net | 2,332, |
| Other current assets | 266, |
| | ----- |
| Total current assets | 4,847, |
| PROPERTY AND EQUIPMENT, net of accumulated depreciation of \$2,708,201 at November 30, 2006, and \$2,613,180 at May 31, 2006 | 1,407, |

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OTHER ASSETS

291,

\$6,546,

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES

| | |
|--|--------|
| Accounts payable and accrued expenses | \$766, |
| Current maturities of long-term debt and notes payable | 161, |
| Sales tax payable | 142, |
| Deferred revenue | 1,500, |
| Accrued director and executive compensation | 85, |
| Accrued warranty and customer support expenses | 26, |
| Accrued professional fees | 70, |
| Accrued commissions | 162, |

Total current liabilities 2,915,

LONG-TERM DEBT

818,

ACCRUED WARRANTY COSTS

DEFERRED REVENUE

551,

COMMITMENTS AND CONTINGENCIES

STOCKHOLDERS' EQUITY

| | |
|---|----------|
| Common stock, \$.001 par value; 110,000,000 shares authorized; 65,198,592 shares at November 30, 2006, and May 31, 2006, issued and outstanding | 65, |
| Additional paid-in capital | 46,152, |
| Accumulated deficit | (43,955, |

Total stockholders' equity 2,261,

\$6,546,

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

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Vasomedical, Inc. and Subsidiaries

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(Unaudited)

| | Six Months Ended | | |
|--------------------------------|------------------|-------------|-------|
| | November 30, | | |
| | 2006 | 2005 | 200 |
| | ----- | ----- | ----- |
| Revenues | | | |
| Equipment sales | \$1,648,148 | \$4,191,318 | \$57 |
| Equipment rentals and services | 1,956,931 | 2,025,237 | 94 |
| Total revenues | 3,605,079 | 6,216,555 | 1,52 |
| Cost of Sales and Services | | | |
| Cost of sales, equipment | 908,829 | 1,857,405 | 29 |

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| | | | |
|--|--------------|-----------------|--------|
| Cost of equipment rentals and services | 772,389 | 663,608 | 41 |
| | ----- | ----- | ----- |
| Total cost of sales and services | 1,681,218 | 2,521,013 | 71 |
| | ----- | ----- | ----- |
| Gross Profit | 1,923,861 | 3,695,542 | 80 |
| Operating Expenses | | | |
| Selling, general and administrative | 2,357,164 | 4,917,773 | 1,03 |
| Research and development | 469,285 | 1,115,702 | 14 |
| Provision for doubtful accounts | (4,001) | 70,575 | (|
| | ----- | ----- | ----- |
| Total operating expenses | 2,822,448 | 6,104,050 | 1,16 |
| | ----- | ----- | ----- |
| LOSS FROM OPERATIONS | (898,587) | (2,408,508) | (36 |
| Other Income (Expense) | | | |
| Interest and financing costs | (37,329) | (44,953) | (1 |
| Interest and other income, net | 35,824 | 40,790 | 1 |
| | ----- | ----- | ----- |
| Total other income (expense) | (1,505) | (4,163) | (|
| | ----- | ----- | ----- |
| LOSS BEFORE INCOME TAXES | (900,092) | (2,412,671) | (36 |
| Income tax expense, net | (8,300) | (7,112,826) | (|
| | ----- | ----- | ----- |
| NET LOSS | (908,392) | (9,525,497) | (36 |
| Preferred Stock Dividend | -- | (854,536) | |
| | ----- | ----- | ----- |
| NET LOSS ATTRIBUTABLE TO COMMON STOCKHOLDERS | \$ (908,392) | \$ (10,380,033) | \$ (36 |
| | ===== | ===== | ===== |
| Net loss per common share | | | |
| - basic | \$ (0.01) | \$ (0.18) | \$ |
| | ===== | ===== | ===== |
| - diluted | \$ (0.01) | \$ (0.18) | \$ |
| | ===== | ===== | ===== |
| Weighted average common shares outstanding | | | |
| - basic | 65,198,592 | 59,031,491 | 65,19 |
| | ===== | ===== | ===== |
| - diluted | 65,198,592 | 59,031,491 | 65,19 |
| | ===== | ===== | ===== |

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

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Vasomedical, Inc. and Subsidiaries

CONSOLIDATED CONDENSED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(Unaudited)

| | Common Stock | | Additional | |
|------------------------------------|--------------|----------|--------------|-------|
| | Shares | Amount | Paid-in | |
| | ----- | ----- | Capital | ----- |
| Balance at June 1, 2006 | 65,198,592 | \$65,198 | \$46,148,493 | \$ |
| Stock options granted for services | -- | -- | 3,790 | |
| Net loss | -- | -- | -- | |
| | ----- | ----- | ----- | ----- |
| Balance at November 30, 2006 | 65,198,592 | \$65,198 | \$46,152,283 | \$ |

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The accompanying notes are an integral part of this consolidated condensed financial statement.

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Vasomedical, Inc. and Subsidiaries

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

| | 2006 |
|--|--------------|
| Cash flows from operating activities | |
| Net loss | \$ (908,392) |
| Adjustments to reconcile net loss to net cash used in operating activities | |
| Depreciation and amortization | 194,021 |
| Provision for doubtful accounts | (4,001) |
| Reserve for excess and obsolete inventory | -- |
| Deferred income taxes | -- |
| Common stock issued for services | -- |
| Stock options granted for services | 3,790 |
| Changes in operating assets and liabilities | |
| Accounts receivable | 40,512 |
| Inventories | 358,654 |
| Other current assets | 33,792 |
| Other assets | (9,364) |
| Accounts payable, accrued expenses and other current liabilities | (318,219) |
| Other liabilities | (172,041) |
| | 127,144 |
| Net cash used in operating activities | (781,248) |
| Cash flows provided by investing activities | |
| Redemptions of certificates of deposit | -- |
| Net cash provided by investing activities | -- |
| Cash flows provided by (used in) financing activities | |
| Payments on long term debt and notes payable | (162,714) |
| Payments of preferred stock dividends | -- |
| Payments of preferred stock issue costs | -- |
| Proceeds from sale of convertible preferred stock | -- |
| Net cash provided by (used in) financing activities | (162,714) |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (943,962) |

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| | |
|---|-------------|
| Cash and cash equivalents - beginning of period | 2,385,778 |
| | ----- |
| Cash and cash equivalents - end of period | \$1,441,816 |
| | ===== |
| Non-cash investing and financing activities were as follows: | |
| Inventories transferred to (from) property and equipment, attributable to operating leases, net | \$8,517 |
| Issue of note for purchase of insurance policy | \$192,120 |
| Preferred stock dividends | \$-- |
| Preferred stock issue costs | \$-- |
| Supplemental Disclosures | |
| Interest paid | \$37,329 |
| Income taxes paid | \$6,534 |

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

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Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (unaudited)
November 30, 2006

NOTE A - ORGANIZATION AND PLAN OF OPERATIONS

The Company was incorporated in Delaware in July 1987. During fiscal 1996, the Company commenced the commercialization of its EECP(R) external counterpulsation system ("EECP(R)"), a microprocessor-based medical device for the noninvasive, outpatient treatment of patients with cardiovascular disease. EECP(R) is marketed worldwide to hospitals and physician private practices. To date, the Company's revenues have been generated primarily from customers in the United States.

The Company has incurred large declines in revenue and significant operating losses during the last four fiscal years and its ability to continue operating as a going concern is dependent upon achieving profitability or through additional debt or equity financing. Achieving profitability is largely dependent on sufficiently reducing operating costs and halting the current trend of declining revenue. The Company's ability to halt the declines in revenue and restore its revenue base is largely dependent upon increasing the demand in the refractory angina market and operating in a more efficient manner. If the Company is not able to restore its revenue base and sufficiently reduce operating costs to generate an adequate cash inflow, or raise additional capital, it will not be able to continue as a going concern.

In order to reduce the Company's cash usage and bring its cost structure more into alignment with current revenue, the Company initiated a restructuring in January 2006, to reduce personnel and spending on marketing and development projects. Additional cost reductions are continuing. However, revenue has continued to decline and the Company has not achieved its goal of profitability.

Management believes that cash flow from operations together with current cash reserves will be sufficient to fund minimum projected capital requirements through at least May 2007, assuming the current revenue rate.

The Company may seek to raise capital through public or private equity or

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debt financings or by other means. If the Company is unable to raise additional funds when needed, it may need to further scale back operations, research, marketing or sales efforts or obtain funds through arrangements with collaborative partners or others that may require the Company to license or relinquish rights to technologies or products. Future capital funding, if available, may result in dilution to current shareholders, and new investors could have rights superior to existing stockholders.

The accompanying financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

Reclassifications

Certain reclassifications have been made to the prior years' amounts to conform with the current year's presentation.

NOTE B - STOCK-BASED COMPENSATION

In December 2004, the FASB issued Statement of Financial Standards No. 123 (revised 2004), Share-Based Payment ("SFAS No. 123 (R)"), which is a revision of SFAS No. 123. SFAS No. 123 (R) supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and amends FASB Statement No. 95, Statement of Cash Flows. Generally, the approach to accounting for share-based payments in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. Pro forma disclosure of the fair value of share-based payments is no longer an alternative to financial statement recognition.

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Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (unaudited) November 30, 2006

Prior to first quarter of fiscal 2007 the Company accounted for stock-based compensation using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations ("APB No. 25") and adopted the disclosure provisions of Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No. 123." Under APB No. 25, when the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized. Accordingly, no compensation expense has been recognized in the consolidated financial statements in connection with employee stock option grants prior to fiscal 2007.

The following table illustrates the proforma effect on net loss and loss per share had the Company applied the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," to stock-based employee compensation, for the six and three months ended November 30, 2005.

| | ----- Six Months Ended November 30, 2005 ----- | ----- Three Months Ended November 30, 2005 ----- |
|--|---|---|
| Net loss attributable to common stockholders, as reported | \$ (10,380,033) | \$ (8,681,548) |

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| | | |
|---|----------------|---------------|
| Deduct: Total stock-based employee compensation expense determined under fair value-based method for all awards | (433,742) | (221,448) |
| | ----- | ----- |
| Pro forma net loss | \$(10,813,775) | \$(8,902,996) |
| | ===== | ===== |
| Loss per share: | | |
| Basic and diluted - as reported | \$(0.18) | \$(0.15) |
| | ===== | ===== |
| Basic and diluted - pro forma | \$(0.18) | \$(0.15) |
| | ===== | ===== |

During the six-month period ended November 30, 2006, the Board of Directors granted non-qualified stock options under the 1997 Stock Option/Stock Issuance Plan to one director to purchase an aggregate of 150,000 shares of common stock, at an exercise price of \$.09 per share, and granted non-qualified stock options under the 1999 Stock Option/Stock Issuance Plan to three directors to purchase an aggregate of 450,000 shares of common stock, at an exercise price of \$.09 per share, and granted non-qualified stock options under the 2004 Stock Option/Stock Issuance Plan to one officer to purchase an aggregate of 200,000 shares of common stock, at an exercise price of \$.11 per share, which represented the fair market value of the underlying common stock at the time of the respective grants. These options vest over a two year period, and expire ten years from the date of grant.

Stock-based compensation expense recognized under SFAS 123 (R) for the six months ended November 30, 2006 was \$3,790 which comprised the fair value of the stock options discussed above.

For purposes of estimating the fair value of each option on the date of grant, the Company utilized the Black-Scholes option-pricing model. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

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Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (unaudited)
November 30, 2006

The fair value of the Company's stock-based awards was estimated assuming no expected dividends and the following weighted-average assumptions for the six months ended November 30, 2006:

| | |
|-------------------------|---------|
| Expected life (years) | 5 |
| Expected volatility | 114.09% |
| Risk-free interest rate | 4.76% |
| Expected dividend yield | 0.00% |

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Equity instruments issued to non-employees in exchange for goods, fees and services are accounted for under the fair value-based method of SFAS No. 123(R).

During the six-month period ended November 30, 2006, options to purchase 1,219,026 shares of common stock at an exercise price of \$.22 - \$3.875 were cancelled.

NOTE C - LOSS PER COMMON SHARE

Basic loss per share is based on the weighted average number of common shares outstanding without consideration of potential common shares. Diluted loss per share is based on the weighted number of common and potential common shares outstanding. The calculation takes into account the shares that may be issued upon the exercise of stock options and warrants, reduced by the shares that may be repurchased with the funds received from the exercise, based on the average price during the period, plus conversion of convertible preferred stock into common shares based upon the most advantageous conversion rate during the period.

The following table sets forth the computation of basic and diluted loss per common share:

| | Six Months Ended November 30, | | Thru |
|--|----------------------------------|-----------------|----------|
| | 2006 | 2005 | 2006 |
| Numerator: | | | |
| Net loss | \$(908,392) | \$(9,525,497) | \$(368, |
| Deemed dividend related to beneficial conversion feature on Series D preferred stock | -- | (786,247) | |
| Series D preferred stock dividends | -- | (68,289) | |
| | \$ (908,392) | \$ (10,380,033) | \$ (368, |
| Denominator: | | | |
| Basic - weighted average common shares | 65,198,592 | 59,031,491 | 65,198, |
| Stock options | -- | -- | |
| Warrants | -- | -- | |
| Convertible preferred stock | -- | -- | |
| | 65,198,592 | 59,031,491 | 65,198, |
| Diluted - weighted average common shares | 65,198,592 | 59,031,491 | 65,198, |
| | \$ (0.01) | \$ (0.18) | \$ (0. |
| Basic and diluted loss per common share | \$ (0.01) | \$ (0.18) | \$ (0. |

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Options, warrants, and convertible preferred stock, in accordance with the following table, were excluded from the computation of diluted loss per share for the six and three months ended November 30, 2006 and 2005, respectively, because the effect of their inclusion would be antidilutive.

| | Six and three months November 30, | |
|-----------------------------------|--------------------------------------|------|
| | 2006 | |
| Options to purchase common stock | 7,593,049 | 7,3 |
| Warrants to purchase common stock | 2,254,538 | 2,4 |
| Convertible preferred stock | -- | 5,1 |
| | 9,847,587 | 14,9 |

NOTE D - INVENTORIES, NET

Inventories, net consist of the following:

| | November 30, 2006 | Ma 2 |
|-----------------|----------------------|---------|
| Raw materials | \$720,063 | \$8 |
| Work in process | 1,017,413 | 1,2 |
| Finished goods | 595,026 | 5 |
| | \$2,332,502 | \$2,6 |

At November 30, 2006 and May 31, 2006, the Company has recorded reserves for excess and obsolete inventory of \$677,166.

NOTE E - PROPERTY AND EQUIPMENT

Property and equipment is summarized as follows:

| | November 30, 2006 | May 3 2006 |
|---|----------------------|---------------|
| Land | \$ 200,000 | \$ 200, |
| Building and improvements | 1,383,976 | 1,383, |
| Office, laboratory and other equipment | 1,436,362 | 1,444, |
| EECP(R) systems under operating leases or under loan for clinical trials | 815,143 | 874, |
| Furniture and fixtures | 162,068 | 162, |
| Leasehold improvements | 117,803 | 117, |
| | 4,115,352 | 4,182, |
| Less: accumulated depreciation and amortization | (2,708,201) | (2,613, |
| | \$1,407,151 | \$1,569, |

NOTE F - NOTES PAYABLE

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The Company financed the purchase of Director's and Officer's Liability Insurance through the issuance of a note with a principal value of \$192,120. The note, which bears interest at 8.15%, is payable in ten monthly installments consisting of principal and interest, and expires in April 2007. The balance outstanding at November 30, 2006, of \$97,685 is presented on the consolidated condensed balance sheet in current maturities of long-term debt and notes payable.

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Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (unaudited)
November 30, 2006

NOTE G - LONG-TERM DEBT

The following table sets forth the computation of long-term debt:

| | November 30, 2006 | May 31, 2006 | |
|-----------------------|----------------------|---------------------|--|
| | ----- | ----- | |
| Facility loans (a) | \$ 882,219 | \$ 914,528 | |
| Term loans (b) | - | 35,970 | |
| | ----- | ----- | |
| Less: current portion | 882,219 (63,515) | 950,498 (97,309) | |
| | ----- | ----- | |
| | \$ 818,704 | \$ 853,189 | |
| | ===== | ===== | |

(a) The Company purchased its headquarters and warehouse facility and secured notes of \$641,667 and \$500,000, respectively, under two programs sponsored by New York State. These notes, which bear interest at 7.8% and 6%, respectively, are payable in monthly installments consisting of principal and interest payments over fifteen-year terms, expiring in September 2016 and January 2017, respectively, and are secured by the building.

(b) In fiscal years 2003 and 2004, the Company financed the cost and implementation of a management information system and secured several notes, aggregating approximately \$305,219. The notes, which bear interest at rates ranging from 7.5% through 12.5%, were payable in monthly installments consisting of principal and interest payments over four-year terms, and expired at various times between August and October 2006. As of November 30, 2006 the loans have been paid in full.

NOTE H - DEFERRED REVENUES

The changes in the Company's deferred revenues are as follows:

| | Six Months Ended November 30, | | Thru |
|--|----------------------------------|-------|-------|
| | ----- | ----- | ----- |
| | 2006 | 2005 | 2006 |
| | ----- | ----- | ----- |

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| | | | |
|---|-------------|-------------|---------|
| Deferred Revenue at the beginning of the period | \$2,322,588 | \$2,551,532 | \$2,066 |
| ADDITIONS | | | |
| Deferred extended service contracts | 1,049,461 | 1,177,310 | 658 |
| Deferred in-service and training | 25,000 | 85,000 | 7 |
| Deferred service arrangements | 75,000 | 265,000 | 22 |
| RECOGNIZED AS REVENUE | | | |
| Deferred extended service contracts | (1,241,476) | (1,143,855) | (635) |
| Deferred in-service and training | (25,000) | (85,000) | (5) |
| Deferred service arrangements | (154,375) | (288,957) | (63) |
| Deferred revenue at end of period | 2,051,198 | 2,561,030 | 2,051 |
| Less: current portion | (1,500,038) | (1,718,581) | (1,500) |
| Long-term deferred revenue at end of period | \$551,160 | \$842,449 | \$551 |

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Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (unaudited)
November 30, 2006

NOTE I - WARRANTY COSTS

The changes in the Company's product warranty liability are as follows:

| | Six Months Ended November 30, | | Three |
|---|----------------------------------|-----------|-------|
| | 2006 | 2005 | 2006 |
| Warranty liability at the beginning of the period | \$32,000 | \$118,333 | \$30, |
| Expense for new warranties issued | 30,000 | 15,000 | 9, |
| Warranty amortization | (35,500) | (68,333) | (12, |
| Warranty liability at end of period | 26,500 | 65,000 | 26, |
| Less: current portion | (26,500) | (62,000) | (26, |
| Long-term warranty liability at end of period | \$ -- | \$3,000 | \$ |

NOTE J - INCOME TAXES

During the six-months ended November 30, 2006 and 2005, we recorded a provision for state income taxes of \$8,300 and \$20,000, respectively.

As of November 30, 2006, the recorded deferred tax assets were \$19,865,489, reflecting an increase of \$306,031 during the six months ended November 30, 2006, which was offset by the valuation allowance of the same amount.

Ultimate realization of any or all of the deferred tax assets is not assured, due to significant uncertainties and material assumptions associated with estimates of future taxable income during the carryforward period. In February 2006, we concluded that, based upon the weight of available evidence, it was "more likely than not" that the net deferred tax asset would not be realized and increased the valuation allowance to bring the net deferred tax

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asset carrying value to zero.

NOTE K - COMMITMENTS AND CONTINGENCIES

Employment Agreements

The approximate aggregate minimum compensation obligation under active employment agreements at November 30, 2006 is summarized as follows:

| Twelve months ended November 30, ----- | Amount ----- |
|---|-----------------------------|
| 2007 | \$260,000 |
| 2008 | 210,167 |
| Total | ----- \$470,167 ===== |

Litigation

The Company is currently, and has in the past been, a party to various routine legal proceedings incident to the ordinary course of business. The Company believes that the outcome of all such pending legal proceedings in the aggregate is unlikely to have a material adverse effect on the business or consolidated financial condition of the Company.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Except for historical information contained in this report, the matters discussed are forward-looking statements that involve risks and uncertainties. When used in this report, words such as "anticipated", "believes", "could", "estimates", "expects", "may", "plans", "potential" and "intends" and similar expressions, as they relate to the Company or its management, identify forward-looking statements. Such forward-looking statements are based on the beliefs of the Company's management, as well as assumptions made by and information currently available to the Company's management. Among the factors that could cause actual results to differ materially are the following: the effect of business and economic conditions; the effect of the dramatic changes taking place in the healthcare environment; the impact of competitive procedures and products and their pricing; medical insurance reimbursement policies; unexpected manufacturing or supplier problems; unforeseen difficulties and delays in the conduct of clinical trials and other product development programs; the actions of regulatory authorities and third-party payers in the United States and overseas; uncertainties about the acceptance of a novel therapeutic modality by the medical community; and the risk factors reported from time to time in the Company's SEC reports, including the ability of the Company to continue as a going concern. The Company undertakes no obligation to update forward-looking statements as a result of future events or developments.

General Overview

Vasomedical, Inc. incorporated in Delaware in July 1987, develops, manufactures and markets EEC(R) therapy systems to deliver its proprietary form of enhanced external counterpulsation therapy. EEC(R) therapy is a noninvasive, outpatient therapy used in the treatment of ischemic cardiovascular diseases,

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currently used to manage chronic stable angina and heart failure. The therapy increases blood flow and oxygen supply to the heart muscle and other organs and decreases the heart's workload and need for oxygen, while also improving function of the endothelium, the inner lining of blood vessels throughout the body, lessening resistance to blood flow. We provide hospitals and physician private practices with EECP(R) equipment, treatment guidance, and a staff training and equipment maintenance program designed to provide optimal patient outcomes. EECP(R) is a registered trademark for Vasomedical's enhanced external counterpulsation systems. For more information visit www.vasomedical.com.

We have Food and Drug Administration (FDA) clearance to market our EECP(R) therapy for use in the treatment of stable and unstable angina, congestive heart failure, acute myocardial infarction, and cardiogenic shock, however our current marketing efforts are limited to the treatment of chronic stable angina and congestive heart failure. Medicare and other third-party payers currently reimburse for the treatment of angina or angina equivalent symptoms in patients with moderate to severe symptoms who are refractory to medications and not candidates for invasive procedures, including patients with serious comorbidities, such as heart failure, diabetes, peripheral vascular disease, etc. Patients with primary diagnoses of heart failure, diabetes, peripheral vascular disease, etc. are also reimbursed under the same criteria, provided the primary indication for treatment with EECP(R) therapy is angina or angina equivalent symptoms.

We recently sponsored a pivotal, randomized clinical trial to demonstrate the efficacy of EECP(R) therapy in the most prevalent types of heart failure patients. This trial, known as PEECH (Prospective Evaluation of EECP(R) in Congestive Heart Failure), was intended to provide additional evidence of the safety and efficacy of EECP(R) therapy in the treatment of mild-to-moderate heart failure and to support our application for expansion of the Medicare national reimbursement coverage policy to include mild-to-moderate heart failure as a primary indication. Results of the trial were initially published on line by the Journal of the American College of Cardiology (JACC) on August 25, 2006, and in print in its September 19, 2006 issue. JACC is the official journal of the American College of Cardiology. The PEECH trial was a positive clinical trial, having met the statistical requirement of meeting at least one of its co-primary endpoints, a significant difference in the proportion of patients satisfying a prespecified threshold of improvement in exercise duration. The trial also demonstrated significant improvements in favor of EECP(R) therapy on several important secondary endpoints, including exercise duration and improvement in symptom status and quality of life. Measures of change in peak oxygen consumption were not statistically significant in the overall study

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Vasomedical, Inc. and Subsidiaries

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

population, though a trend favoring EECP(R) therapy was present in early follow-up. Patients in the trial who had an ischemic etiology, i.e. pre-existing coronary artery disease, demonstrated a greater response to EECP(R) therapy than those who had an idiopathic (non-ischemic) etiology.

Very recently, a second report of results from the PEECH trial was published in the November-December 2006 issue of the journal Congestive Heart Failure, focusing on the results of a prespecified subgroup analysis in trial patients age 65 and over. This analysis demonstrated a statistically positive response on both co-primary endpoints of the trial in patients receiving EECP(R)

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therapy versus those who did not, i.e. a significantly larger proportion of patients undergoing EEC(R) therapy met or exceeded prespecified thresholds of improvement in exercise duration and peak oxygen consumption. Moreover, the patients age 65 and older who received EEC(R) therapy demonstrated the greatest differences in exercise duration, peak oxygen consumption and functional class (symptom status) compared with those who did not receive EEC(R) therapy.

The preliminary results of the PEECH trial were presented at the American College of Cardiology scientific sessions in March 2005. On June 20, 2005, the Centers for Medicare and Medicaid Services (CMS) accepted our application for expansion of reimbursement coverage of EEC(R) therapy to include patients with New York Heart Association (NYHA) Class II/III stable heart failure symptoms with an ejection fraction of